[2016] UKFTT 0150 (TC)

TC04936

Appeal number: TC/2014/06012

INCOME TAX – Funded Unapproved Retirement Benefit Scheme (FURBS) – trustees of FURBS invested in LLP engaged in trade of property development - whether profits from LLP exempt from rate applicable to trusts under s686(2)(c) ICTA 1988 – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MARTIN RIGDEN, SCOTT RIGDEN, NEIL PIPER, QED TRUSTEES LIMITED, QED TRUSTEES (UK) LIMITED, D A PHILLIPS & CO LIMITED (as trustees of the Blueberry Developments FURB Scheme)	**Appellants**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE SWAMI RAGHAVAN

Sitting in public at the Royal Courts of Justice, London on 4 December 2015

Alan Pink FCA CTA, for the Appellants

David Yates, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appellants are the trustees of a funded unapproved retirement benefit scheme (FURBS) and were members of an LLP which carried on property development activities (Blueberry Homes (Kent) LLP ("the LLP")). The appellants received a profit share of £365,771 for the tax year 2005/6 upon which it is accepted that basic rate tax is payable.

2. The issue in this appeal is whether the appellants are able to rely on section 686(2)(c) of the Income and Corporation Taxes Act 1988 ("ICTA 1988") so that they do not have to pay tax at the trust rate of 40%. The difference this makes to them in terms of their tax liability is agreed to amount to £65,838.78.

3. Section 686(2)(c) provides an exemption in relation to "income from deposits, investments and other property held" and the appellants maintain the profit share received was income from property. HMRC argue the income is trading income and as such cannot fall within s 686(2)(c) and that, contrary to the appellants' position, the FTT is bound by the High Court's ruling on this point (*Clarke (Inspector of Taxes) v British Telecom Pension Scheme Trustees* [1998] STC 1075 (which was not overturned by the subsequent appeal to the Court of Appeal)).

Facts

4. The appellants' case as put by them turned principally on the interpretation of the relevant legal provisions. The evidence put before the tribunal was brief and accordingly the facts may be shortly stated. I heard oral evidence from Martin Rigden who as well as being a trustee of the FURBS was also a member of the LLP. Mr Rigden had provided a one page witness statement, which apart from one point relating to the role the FURBS trustees played in the business, was agreed. He was cross-examined by HMRC. I found Mr Rigden to be a credible witness and set out the following findings of fact from his evidence and the documentary evidence I was referred to.

5. Throughout the tax year 2005/6 the trustees of the FURB were, in addition to Mr Rigden, the appellants named in the heading of this decision. The trustees were appointed collectively as a member of the LLP on or shortly after the formation of the LLP at the end of September 2005. The LLP was formed in order to take over the business of an unincorporated partnership, Blueberry Developments Partnership, whose business concluded on 30 September 2005 when it was incorporated into the LLP. The LLP made up its first accounts for the six month period ended 31 March 2006. Its principal activity was that of property development. The other members of the LLP (in addition to the collective trustees) were Blueberry Developments Limited, and Martin Rigden. As recorded in the accounts of the predecessor partnership the FURBS introduced funds into that partnership amounting to £586,475. In the period

to 30 September 2005 (the date of cessation of the predecessor partnership) the accounts showed a net loss of £1,782. The FURBS did not receive any allocation of profit or loss in this period.

6. In the subsequent period, after the business had been transferred to the LLP, the LLP showed a net profit for the period of £423,769 of which the FURBS did receive a share (£365,771). The profit was self-assessed as trading income.

7. Mr Rigden and Neil Piper had worked together for many years in the business of property development and they were as Mr Rigden put it the "prime movers" behind the business conducted by the LLP. The property development activities took the form of the buying houses and flats, and developing them. This involved carrying out contracts, liaising with surveyors, architects, contractors and estate agents.

8. Mr Rigden did not play any role in the meetings of the LLP which were, as far as he was concerned, held by the accountants in their offices. He could not remember what had happened in the year under assessment– it was a long time ago; he had just got on with the business of developing property and had relied on his accountants for advice and he simply "went with the flow" of that advice.

Law

9. Section 686 sets out what trust income is to be charged with additional rate tax. Section 686(2)(c) makes an exception for:

> "(c) … subject to subsection (6A) below, income from investments, deposits or other property held—
>
> (i) for the purposes of a fund or scheme established for the sole purpose of providing relevant benefits within the meaning of section 612; …"

10. It is not in dispute that the FURBS provided relevant benefits within the meaning of s612 and it is not therefore necessary to set that provision out.

11. Section 686(6A), which is a carve-out to the above exception, applies to property held as a member of a "property investment LLP". This term is defined in s842B of ICTA 1988 (now s1004 Income Tax Act 2007) as an LLP business which consists wholly or mainly in the making of investments in land and the principal part of whose income is derived from investments in land. While it is agreed the LLP in this appeal was not a "property investment LLP", as s6A was referred to in the discussion which took place on statutory interpretation at the hearing it is useful to set it out:

> "(6A) The exemptions provided for by subsection (2)(c) above in relation to income from investments, deposits or other property held as mentioned in sub-paragraph (i) or (ii) of that paragraph do not apply to income derived from investments, deposits or other property held as a member of a property investment LLP."

12. Section 863(1) of Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") makes provision in relation to LLPs. It provides:

> "863 Limited liability partnerships
>
> (1)For income tax purposes, if a limited liability partnership carries on a trade, profession or business with a view to profit—
>
> (a) all the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),
>
> (b) anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and
>
> (c) the property of the limited liability partnership is treated as held by the members as partnership property.
>
> References in this subsection to the activities of the limited liability partnership are to anything that it does, whether or not in the course of carrying on a trade, profession or business with a view to profit."

13. The interpretation of the exception in s686(2)(c) ICTA 1988 fell to be considered in *British Telecom Pension Scheme Trustees.* While HMRC argue the High Court's decision in respect of s 686(2)(c) is binding, this is disputed by the appellants. In order to appreciate the parties' submissions it is necessary to set out briefly what issues were appealed to respectively the Special Commissioners, the High Court, and the Court of Appeal and how they were disposed of. *British Telecom Pension Scheme Trustees* concerned the treatment of commissions paid to the appellant trustees for the sub-underwriting of share issues. The sub-underwriter was in essence, being paid a commission, for taking on the risk of buying unsubscribed for shares (in the context e.g. of an IPO or rights issue), which might or might not materialise depending on the proportion of shares unsubscribed for, or unrealisable economically by a primary underwriter. The Special Commissioners found in favour of the appellants on the basis that the commissions were not receipts of a trade within Case I, that they were chargeable under Case VI and therefore exempt under s592(3)(c) ICTA 1988 (the "trade issue"), but they held they would have found in favour of the Inland Revenue on the question of whether (if the commissions had not been exempt) the trustees would have been liable to the additional trust rate ("the additional rate issue"). (There was a third issue relating to whether the sub-underwriting transactions were options contracts which is not relevant for present purposes). Having lost on the trade issue the Revenue appealed to the High Court. The trustees cross-appealed on the additional rate issue. Before the High Court (Lightman J), the Revenue was successful on the trade issue. It therefore became relevant to consider the additional rate issue, and on that Lightman J dismissed the trustees' cross-appeal.

14. In the High Court [1998] STC 1075, Lightman J held at paragraph 32:

> "32. The language of s 686(2)(c) is in my view, as in the view of the commissioners, quite inappropriate to catch or include income arising

> from the trade of sub-underwriting and from entering into sub-underwriting contracts in the course of such trade. The exemption is limited to income of 'investments, deposits and other property'. Though the word 'property' can have a very wide meaning, in this context the word is to be construed ejusdem generis with the words it follows, namely 'investments' and 'deposits'; it connotes some asset held by the trustees which (like investments and deposits) produces income. The draftsman plainly had in mind assets such as real estate producing rentals or intellectual property rights producing licence fees. The language of the exemption is not designed to include any income of the trustees but only income of the designated character. It restricts the exemption to the fruits of ownership: it does not extend to the fruits of activities, whether trades or businesses, carried on by trustees or the sums payable to them under contracts entered into in the course of such activities. This approach is entirely in accordance with the scheme of s 18 of the 1988 Act. For Sch D draws the same distinction between the annual profits arising 'from any kind of property' and arising 'from any trade' (see and compare Sch D(1)(a)(i) and (ii) and D(3) Case I and Case V).
>
> I accordingly uphold the decision of the commissioners that, if (as I have held) the sub-underwriting commissions are chargeable to tax under Case I of Sch D, the trustees are also liable to the additional rate of tax applicable to trusts."

15. Having lost on both the trade issue and the additional rate issue before the High Court the trustees appealed to the Court of Appeal. They were successful in their appeal on the trade issue but the additional rate issue (described as the secondary issue below) was the subject of comment in the Court of Appeal [2000] STC 222 by Robert Walker LJ at 235:

> "The secondary issue does not therefore need to be decided and I can deal with it very shortly. On this point the commissioners and the judge were in agreement, and so is this court (as became apparent when we did not call on the Solicitor General to address us on it). Although the word 'property' is an expression capable of a very wide meaning, it also has a fairly wide range of meanings, and the commissioners and the judge were right to conclude that its meaning, in the context of s 686(2)(c) of the 1988 Act, is not as wide as Mr Flesch contended. For my part I would reach that conclusion not by the rather blunt instrument of the ejusdem generis ('of the same kind') rule but from a combination of contextual indications."

16. There is nothing recorded in the Court of Appeal's decision or indeed in the High Court's decision as to the wide meaning Mr Flesch sought but in the Special Commissioners' decision (which is contained in the High Court's report) he is reported as having argued (at [117] of the High Court report) that:

> "'Property' was a word of very wide meaning and could include an underwriting contract or a trade in underwriting…"

17. Mr Yates, for HMRC, accepts that the comments of Robert Walker LJ above are obiter but submits that they are nonetheless extremely persuasive. In any case he says

that to the extent the ratio in the High Court's decision adjudicated on a proposition of law, it is binding on this tribunal.

18. The appellants disagree the decision is binding and submit there is no black and white contrast between the fruits of active involvement and the fruits of investment and do not consider that the categories of trading income and property income are mutually exclusive. In order to come within s 686(2)(c) it is, they say, only necessary to be able to answer "yes" to the question: "does the income derive to any extent from property?" In any event the appellants argue that the trustees were entirely passive and the income was not from the fruits of activity. Mr Pink, for the appellants, helpfully clarified that the scope of the question was as to the nature of what the appellants received from their interest in the LLP ("what they got for investing money it") as opposed to any argument related to the fact that the LLP's income derived from property and therefore that the income came from property held by the LLP.

19. The issues to determine are therefore:

(1) What does "property" in s 686(2) refer to as a matter of legal interpretation? To answer this I need to consider whether the High Court's decision is binding on that point and even if it is not what principles are to be taken from the High Court's and the Court of Appeal's statements on the matter given those will be highly persuasive anyway. The real debate is not about whether trading and property are mutually exclusive but whether there is a binding decision on the meaning of "property". The appellants do not appear to me to argue that the *British Telecom Pension Scheme Trustees* decision is wrong rather that it may be distinguished on its facts.

(2) Was the interest the appellants had in the LLP, "property" from which the income in question could be regarded as being from?

Whether British Telecom Pension Scheme Trustees decision binding?

20. The appellants' first argument, which is that the Court of Appeal expressly disclaimed the status of *British Telecom* as a test case (this refers to the passage of that court's decision at pg235f onwards) can be dealt with briefly. The point being made by the Court of Appeal, as highlighted by Mr Yates' submissions for HMRC, was that the appeal was not a "test case" because the particular treatment of sub-underwriting activities by other pension schemes under the relevant tax provisions and the issue of whether those amounted to the carrying on of a trade would depend on the particular facts of those other pension schemes. In any case, as stated above, HMRC accept the Court of Appeal decision was obiter on the additional income issue, so this point would have no bearing on whether the High Court's decision was binding.

21. As to the appellants' second argument for questioning the binding effect of the High Court's decision this may be summarised along the lines that the decision turned on the particular circumstances of sub-underwriting being a form of insurance / "gambling". Given that, it would hardly be surprising that the court would not be inclined to hold the income fell within the exemption as income from property. There

is however no basis in the decision, in my view, to depict the court's decision in those terms. The ratio of the decision, in essence, was that "property" did not have the broad meaning contended for. In particular the term did not extend to income from trade (being fruits of activities). Commissions from the trade of sub-underwriting were not therefore within the scope of the exemption. There is nothing to suggest from the decision that there was something special about the particular nature of sub-underwriting or the way it was carried out by the appellant trustees that led to the decision the commissions received from it were to be denied exemption. Lightman J's decision was clearly based on a point of principle which was not restricted to the facts of the trade of sub underwriting but to trade activities more generally.

22. The decision stands for the proposition that income from trade activities of trustees will not fall under the exemption in s 686(2)(c). It was made in the context of the High Court having to determine the trustees' cross-appeal on the additional rate issue. That remained a live issue which required a resolution, in that case one which went against the trustees. My conclusion therefore is that the High Court's decision on the meaning of "property" in s 686(2)(c) is one which is binding on this tribunal. The question of whether the correct approach is, as Mr Pink suggests, to ask whether the "preponderant character" of income is from property, does not arise. It also means those of the appellants' arguments which effectively seek to unpick the point made by the judge, which formed part of the ratio, that there was within the scheme of the legislation a clear demarcation between income from trading and income from property, will not assist them before this tribunal.

23. There was some discussion on the purpose behind the s 686(2)(c) (HMRC point to Special Commissioners' views in *British Telecom*), but the appellants disagree with those. They point to various inconsistencies between the purpose as set out by the Special Commissioners with the fact that there are other areas where trading income is treated more favourably e.g. inheritance tax, business tax, entrepreneur's relief, rollover relief). Given the High Court's binding pronouncement on the provision there is no scope for this tribunal to reach a different view and I accordingly do not consider those points further.

Was the interest the appellants had in the LLP, "property" from which the income in question could be regarded as being from?

24. The appellants argue the trustees received their income not for working in the business but because of their interest in the partnership which was a capital interest involving a substantial sum. HMRC say the appeal must fail because the income is not income from the trustees' investment but under s863 ITTOIA it is attributed to them under the statutory fiction as trade income. Income from trade is out of the scope of s 686(2)(c). (There was no dispute between the parties that the LLP was carrying on a trade or business for a profit.)

25. The appellants' answer to this is to say that the asset is not the underlying property (to which s863 would apply) but the "higher tier" asset, as Mr Pink put it. The income from this higher tier asset was not caught by the deeming provision.

26. In my judgment the appellants' argument cannot be right. Before getting to the question of whether as a matter of fact the appellant can demonstrate that the income derived from the "higher tier" asset (a requirement which HMRC say has not been met) the appellants would need to be clear what exactly it was that was being put forward as the relevant "property". While Mr Pink correctly acknowledged the difficult issues in the legal characterisation of such an asset or interest, the tribunal was not equipped with any sufficiently precise articulation of what it was that was being suggested as the "higher tier" asset or interest, or evidence or legal submissions on the particular form that it took in relation to the facts of this appeal.

27. But, even putting such difficulties to one side, and assuming that the appellants prima facie received income from a bundle of rights in the LLP that amounted to property, I do not accept that income from the trading activity of the LLP (which activity is treated for income tax purposes as carried on in partnership by its members), can for the purposes of s 686(2)(c), nevertheless be viewed as income from property as opposed to income from trade. Applying the terminology used in the ratio of *British Telecom* the income is plainly for income tax purposes the fruit of activity rather than the fruit of ownership.

28. Further support for this conclusion can be gained from the presence of subsection 6A (set out above at [11]) which excludes certain income from the benefit of the exemption to the additional rate. As HMRC pointed out, the draftsman, when enacting ss6A, must have assumed the "statutory look-through" i.e. the attribution of the LLP's activities for income tax purposes to its members carrying on a partnership. (I note this is supported by the fact that Section 863 ITTOIA which derived from s 118ZA(1) ICTA 1988 was introduced by s75 Finance Act 2001. Section 76 of that Act also introduced ss6A and the consequential amendment to ss 2 into s686 ICTA 1988). If the appellant was correct and one had to look at what was derived from the trustees' share or investment in the LLP that would frustrate the operation of the section. Income from real estate (something clearly within the purview of the exemption in s 686(2)(c) as indicated by Lightman J in *British Telecom*) which was received by trustees as members of an LLP the business of which was investment in real estate, would continue to be exempt from the additional rate on the basis the income derived from the trustees' interest or share and not from the real estate. It is difficult then to see what purpose the amendment brought about by ss 6A would serve.

29. While the appellants' arguments made reference to the particular role they played as trustees and the issue of whether they were active or passive (meaning whether they worked in the business as opposed to sitting back and waiting for a return on investment) and this was a matter contested by HMRC who disagreed with the appellants' position that the trustees were passive, this issue is not relevant. Under s863 ITTOIA the trustees were deemed to be carrying out the LLP's property development activities for income tax purposes.

30. The appellants' profit share did not fall within the exemption in s 686(2)(c) and they were accordingly liable at the additional rate of tax. Their appeals are dismissed.

31. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 2 MARCH 2016