TC04003

Appeal number: TC/2013/07216

CAPITAL ALLOWANCES – Limited liability partnership; Annual Investment Allowance; whether an allowable deduction in computing the profits of the partnership; mixed partnership; company; whether Appellant a "qualifying person"; Capital Allowances Act 2001 section 38A; Income Tax Trading and Other Income Act 2005 section 863; Corporation Taxes Act 2009 section 1273 (2)

FIRST-TIER TRIBUNAL
TAX CHAMBER

DRILLING GLOBAL CONSULTANT LLP **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE J GORDON REID QC FCIArb
DR HEIDI POON CA, CTA, PhD

Sitting in public at George House, Edinburgh on 25 June 2014

Bernard Rice ATC, BJ Rice & Associates CTA and Accountants, Maidstone, Kent for the Appellant

Mrs C Cowan, Officer of HMRC, for the Respondents

DECISION

Introduction

1. This appeal raises the question whether a limited liability partnership (whose members are an individual and a limited company) is a *qualifying person* within the meaning of section 38A of the Capital Allowances Act 2001 and thus entitled to Annual Investment Allowance (AIA) rather than the less beneficial ordinary writing down allowance. It is not disputed that the expenditure on the plant or machinery in question was legitimately incurred principally for business purposes.

2. A hearing took place at Edinburgh on 25 June 2014. The Appellant was represented by Bernard Rice, ATC, BJ Rice & Associates, Maidstone, Kent. He led the evidence of Dr J L Thorogood. The Respondents were represented by Mrs Chris Cowan, an officer of HMRC. A bundle of documents was produced, the authenticity of which was not in dispute. Both parties also lodged skeleton arguments.

3. At the outset, Mr Rice proposed that the hearing be postponed on the ground that he had not received HMRC's skeleton argument seven days before the hearing. Mrs Cowan explained that HMRC were obliged to send the documents to Dr Thorogood. An attempt was made to deliver the documents by courier on 18 June 2014; the documents were successfully delivered the following day.

4. Mr Rice also complained about the late intimation of two authorities but this was said to be in response to a new argument which Mr Rice had raised. We decided to refuse the application to postpone the hearing (there being no significant prejudice to the preparation or presentation of the Appellant's appeal), but allowed Mr Rice to amend the grounds of appeal to articulate the proposed new argument. After a half hour adjournment, Mr Rice produced a short manuscript amendment, to which we refer below, and the hearing proceeded.

Statutory Background

Limited Liability Partnerships Act 2000

5. The Limited Liability Partnerships Act 2000 established a new form of legal entity known as a limited liability partnership. A limited liability partnership is a body corporate.[1] It is incorporated by registration. At least two or more persons associated for carrying on business with a view to profit must subscribe their names to an incorporation document which is delivered to the registrar.[2] A certificate of incorporation duly issued by the registrar is conclusive evidence that the statutory

[1] s 1(2)

[2] s 2(1)

requirements have been complied with. There is no dispute about this in the present appeal.

Annual Investment Allowance (AIA)

6. The Capital Allowances Act 2001 provides the general means for giving effect to Capital Allowances. By section 2, allowances and charges are to be given effect for income tax purposes and corporation tax purposes in calculating income or profits for a chargeable period. The claim for Capital Allowance must be made in a return (s3(2)). In the case of a trade, profession, or business carried on by persons in partnership, the claim must be included in a partnership return (TMA s42(6)(a)&(7)(c)). For present purposes, this means the tax return of the Appellant limited liability partnership (see below). In order to qualify, the plant or machinery need not be partnership property. It may be owned by one or more of the partners (s264(1)&(2)).

7. As amended by the Finance Act 2008, the 2001 Act makes, *inter alia*, provision for an annual investment allowance (AIA). The measure was introduced to encourage investment in most types of plant and equipment by taxpayers. It enabled capital expenditure to be deducted against income in the year in which the expenditure was incurred. It is, in effect, a 100% first year allowance for business expenditure on almost all plant and machinery capped at a maximum amount each year. For the year in question, the maximum was £100,000. The allowance is not available unless the expenditure is *qualifying expenditure* by a *qualifying person*. Section 38A (in chapter 3A of Part 2 of the 2001 Act) provides, so far as material, as follows:-

> (2) Expenditure is AIA qualifying expenditure if –
>
> (a) it is incurred by a qualifying person on or after the relevant date, and
>
> (b) it is not excluded by any of the general exclusions in section 38B.
>
> (3) "Qualifying person" means –
>
> (a) an individual,
>
> (b) a partnership of which all the members are individuals, or
>
> (c) a company.

Section 38B, which provides for general exclusions, is not relevant for present purposes.

Income Tax (Trading and Other Income) Act 2005

8. Section 849 provides *inter alia* that:-

> (1) If-
>
> (a) a firm carries on a trade and

(b) any partner in the firm is chargeable to income tax, the profits or losses of the trade are calculated on the basis set out in subsection (2) or (3), as the case may require.

(2) For any period of account which the partner is a UK resident individual, the profits or losses of the trade are calculated as if the firm were a UK resident individual.

(3) …….(relates to non-residents)

9. Section 863 provides *inter alia* as follows: –

(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.

(2) For all purposes, except as otherwise provided, in the Income Tax Acts –

(a) references to a firm or partnership include a limited liability partnership in relation to which subsection (1) applies,

(b) references to members of the partners of a firm or partnership include members of such a limited liability partnership,

(c) references to a company do not include such a limited liability partnership, and

(d) references to members of a company do not include members of such a limited liability partnership.

Corporation Tax Act 2009

10. The same provisions as those in s863 of the 2005 Act have been enacted in s1273 of the Corporation Tax Act 2009 for corporation tax purposes (see below).

11. Section 1257(1) of the 2009 Act provides that persons carrying on a trade in partnership are referred to collectively in the Act as a *firm*.

12. Section 1259 of the 2009 Act provides, *inter-alia*, as follows:-

(1) This section applies if a firm carries on a trade and any partner in the firm ("the partner") is a company within the charge to Corporation tax.

(2) For any accounting periods of the firm the amount of the profits of the trade ("the amount of the firm's profits") is taken to be the amount determined, in relation to the partner, in accordance with subsections (3) or (4).

(3) If a partner is a UK resident

(a) determine what would be the amount of the profit of the trade chargeable to corporation tax for that period if a UK resident company carried on the trade, and

(b) take that to be the amount of the firm's profit.

13. Section 1262 requires the profits so defined to be shared amongst the partners.

14. Section 1273 provides *inter alia* as follows:-

(1) For corporation tax purposes, if a limited liability partnership carries a trade 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 order 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,……

(2) For all purposes, except as otherwise provided, in the Corporation Tax Acts-

(a) references to a firm include a limited liability partnership in relation to which subsection (1) applies,

(b) references to members of a firm include members of such a limited liability partnership,

(c) references to a company do not include such a limited liability partnership.

15. The Interpretation Act 1978 provides that the word *Person* includes a body of persons corporate or unincorporated.

Grounds of Appeal

16. The Appellant contends that it should be regarded as a company for the purposes of determining its profits chargeable to tax and is therefore a *qualifying person* within the meaning of s38A(3)(c) of the 2001 Act. This is said to follow from the deeming provisions contained in section 1259 and elsewhere of the Corporation Tax Act 2009. The deeming provision applies across the Taxes Acts as a whole. On that basis, the Appellant is entitled to the AIA. Having regard to the purpose of AIA, it is contended that it would be hard if mixed partnerships or partnerships comprising only of companies should be denied relief given to promote the investment in plant and equipment by small and medium-sized enterprises.

17. The amendment to the grounds of appeal was in the following terms:-

"That the appeal be amended to permit the argument that for the year in question, any partnerships relationship was suspended or did not exist, within the meaning of section 1 of the Partnership Act.

None of the indicators in section 2 of the 1890 Partnership Act exist in the year in question.

The aeroplane is an asset owned by Dr JL Thorogood and, with his permission, used by the LLP for business purposes".

Facts

18. The Appellant is a limited liability partnership. It was incorporated in June 2007. The Appellant is also registered for the purposes of VAT. The partners are Dr J L Thorogood and Thorogood Consultants Ltd (TCL), an unlimited company. Dr Thorogood and his wife are the directors of TCL. TCL does not trade as such. It has no customers. It makes commercial loans from time to time to a distillery and a ski company in which Dr Thorogood has a financial interest. Dr Thorogood's professional work is carried out through the medium of the Appellant.

19. Dr Thorogood is a professional drilling engineer engaged in oil exploration production activities in various parts of the world. He has an international reputation and was formerly employed by BP. Following his retirement he set up his own business and carries on the business of the Appellant. That business is the provision of consultancy services to the oil industry. The Appellant enters contracts, renders invoices, and collects payment. Dr Thorogood's business card refers to the Appellant.

20. He owns a four seater Piper Apache twin engine aeroplane ("the Aircraft"). He has held a pilot's licence since 1969. The Aircraft is kept at an airfield in the Aberdeen area. He uses it partly for business purposes to travel to other parts of the United Kingdom and some parts of mainland Europe. The Aircraft's navigation system was limited and did not enable him to undertake long flights, flights in bad weather or to land at some large modern airports.

21. Accordingly, at some point in the tax year to 5 April 2011, the Aircraft's navigation system was upgraded to bring it into line with modern commercial systems. This enabled Dr Thorogood to fly further afield on business and in bad weather, and land at most large airports in much the same way as a commercial aeroplane does using its sophisticated instrumentation. This new instrumentation is used principally for flights undertaken in connection with the business of the Appellant.

22. The cost of the upgrade was paid for by the Appellant.

23. Dr Thorogood has always recognised that the Aircraft was being used partly for business purposes and partly for private use. He attributed 80% of its use and related costs to business use and 20% to private use. There appears to be no dispute about that allocation or apportionment of use.

24. In evidence, Dr Thorogood said, and we accept, that all the profits of the Appellant go to TCL. TCL invest the profits. The Aircraft is in effect hired out to the Appellant rent free. According to Mr Rice's unwritten statement, which we have no reason to doubt on this aspect of the background, there was initially to be a partnership between Dr Thorogood and TCL from year to year. Each year in about March the profit sharing arrangements were to be agreed prior to the commencement of the ensuing period of account. This arrangement was in place during the financial

year ending 31 March 2011. Such *agreement* would be between Dr Thorogood acting in two capacities, and is, in effect, his decision from time to time.

25. The Appellant was formed on the advice of Mr Rice. Mr Rice has acted for Dr Thorogood and TCL for many years. They have communicated almost exclusively by telephone and email, and, curiously, only met face-to-face for the first time shortly before the hearing in this appeal. The underlying purpose of setting up the limited liability partnership was to limit the extent of any professional liability as a result of services provided through Dr Thorogood and to safeguard the assets built up over the years in the event of the limited partnership being wound up. It was not intended to be part of a tax avoidance scheme. Dr Thorogood did not need the income from the business which was to be invested elsewhere.

26. On 4 October 2012, HMRC opened an enquiry, under section 12AC TMA 1970, into the partnership return of the Appellant for the tax year ended 5 April 2011. HMRC intimated that the claim in the return for 100% AIA on the upgrade to the Aircraft's navigation system would not be accepted. Correspondence and discussion ensued but no agreement was reached.

27. Accordingly, by letter dated 19 July 2013 to Mr Thorogood, HMRC issued a closure notice under section 28B(1) & (2) TMA 1970 and intimated an amendment to the Appellant's tax return. The Capital Allowance claim was amended by removing the 100% £85,242 AIA and by substituting Writing down Allowance at the normal rate of 20%, namely £17,049. As a consequence the figure for partnership profit was increased from £135,800 to £203,993 ie by £68,193, all allocated to TCL.

28. On 26 July 2013, the Appellant requested an internal review. By letter dated 25 September 2013, the review upheld the decision. A Notice of Appeal was lodged on 18 October 2013.

Submissions

29. Mr Rice emphasised the underlying purpose of AIA; there was no good reason to exclude mixed partnerships from its benefits. The profits of the Appellant are, by virtue of section 1259 of the 2009 Act to be determined as if a UK resident company carried on the trade. This is a deeming provision which requires mixed partnerships such as the Appellant to be regarded for the purposes of calculating corporation tax as if it was a company resident in the UK carrying on the trade. The predecessor of section 1259, namely section 114 ICTA 1988 was even clearer on this point. Section 849 of the 2005 Act is another deeming provision; profits of the firm are liable to be taxed as if the firm was a UK resident individual. Accordingly when calculating the profits of the Appellant, a mixed partnership, it is to be regarded as an individual and a company respectively. Here, as no individual is entitled to any profits, we are concerned only with corporation tax. The deemed individual or deemed company falls within s38A. Profits of the Appellant fall to be determined as if it were a company. These fall to be adjusted by reference to Capital Allowances. They are

then reported in the tax return. Claims for Capital Allowance have to be made in a tax return.[3] The tax return was submitted by a company.[4]

30. Mr Rice also developed an argument to show that there was no partnership within the meaning of the Partnership Act 1890 between Dr Thorogood and TCL. He submitted that none of the factors in section 2 for the 1890 Act were present. Dr Thorogood has never enjoyed any profits of the limited partnership as they are all enjoyed by TCL. There is no joint tenancy or joint or common property. It cannot therefore be said that Dr Thorogood and TCL were partners. He urged us to consider s5 of the 2000 Act.

31. In his unsigned statement, he argues that it cannot be said that the relationship Dr Thorogood has with TCL is that of carrying on a business in common with a view of profit, profit being his participation in profit. Mr Rice posed the question whether TCL was permitted to claim annual investment allowance. Mr Rice addressed us at some length on whether there was some form of common law partnership between Dr Thorogood and TCL. This seems to relate to the amendment to the grounds of appeal. The argument seemed to be that there was no common law partnership and accordingly the business was being conducted by TCL. Ultimately, Mr Rice appeared to accept that neither s 38A(3)(a) or (b) applied, and submitted that if there was no common law partnership between Dr Thorogood and TCL, then the person carrying on the business could only be TCL. We have to confess that we had some difficulty in following this and certain other arguments presented by Mr Rice. TCL is not the Appellant and did not submit the tax return, the amendment of which is the subject of the present appeal.

32. Mrs Cowan, on behalf of HMRC, submitted that *qualifying person*, as defined, did not include mixed partnerships. As not all members of the partnership are individuals, it is in effect a mixed partnership and so cannot be a *qualifying person* in terms of letter s38A(3). The legislation is clear and unambiguous. The Appellant has not discharged the onus of proof which lies on it.

33. Mrs Cowan pointed out that trusts are in the same position; they do not fall within the definition of *qualifying person.* Both trusts and mixed partnerships were excluded from first year allowances for SMEs under earlier Capital Allowance legislation. She drew attention to the observation of the Financial Secretary to the Treasury to the relevant Standing Committee debating the proposed legislation in 1997, that "incredibly complex rules would be required to bring them (trusts and mixed partnerships) in, which would open possible abuses of tax-driven options that the hon. Gentlemen would deprecate". She did not, however, at the end of the day, rely on that statement as an aid to construction.

34. The *qualifying activity* was carried out by the partnership. The claim has been made by the partnership as it incurred the expenditure. The deeming provisions of CTA 2009 and ITTOIA 2005 do not apply or carry over to the CAA 2001 Act. A

[3] 2001 Act s3(2)

[4] 1259(3)(a)

limited liability partnership is a corporate body but it is not the company for income and corporation tax purposes (2005 Act s 863(2)(c), and s1273(2) CTA 2009).

35. In the course of the hearing, we were referred to *Jackson v Laser's Home Furnishers Ltd*,[5] and *Tiffin v Aldridge LLP*.[6] At paragraphs 9, 17, 20, 21, 25 and 29 and to the Joint Law Commission Report on Partnership (Nos 283 & 192, November 2003).

Decision

36. The question we have to determine is whether the Appellant, a limited liability partnership, whose members are an individual and an unlimited company, is a *qualifying person* for the purposes of s38A(3) of the Capital Allowances Act 2001, as amended.

37. That provision defines *qualifying person* as meaning an individual, a partnership of which all the members are individuals, or a company. The facts established that the Appellant is not an individual. Nor is it a company. For the purposes of the Income Tax and Corporation Tax Acts, a limited liability partnership is in general treated as a partnership although under the Limited Liability Partnership Act 2000, it is a body corporate.

38. If the Appellant is treated as a partnership, its members must be regarded as the partners of that partnership. The members, and on this basis, the partners, are an individual, namely Dr Thorogood, and a company, namely TCL. Not all the members of the partnership are individuals. One of the two partners is a company. The Appellant does not, therefore, fall within any branch of the meaning of *qualifying person* in s38A(3).

39. The claim was made in a tax return submitted by the limited liability partnership Appellant. Any claim for Capital Allowance must be made in a tax return (TMA s42(6)). Neither Dr Thorogood nor TCL submitted a tax return in which they made any such claim. Neither can be entitled to the allowance.

40. On the face of matters, the person claiming the allowance is not a *qualifying person* and HMRC's amendment to the tax return in the closure notice is sound and cannot be successfully challenged.

41. It would seem to us extraordinary if the clear and unambiguous provisions of s38A(3) of the 2001 Act were to be turned on their head by deeming a partnership, whose partners were not all individuals, nevertheless eligible for AIA. This would make no sense if such deeming were to be applied to a common law partnership whose partners consist of individuals and limited companies. And it makes no sense to do so with a limited liability partnership whose membership is mixed.

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[5] [1957] 1 WLR 69; 37 TC 69

[6] [2012] EWCA Civ 35

42. What is important is the identification of the entity submitting the return and making the claim. The question is whether the entity submitting the claim is a *qualifying person.* A limited liability partnership is not expressly mentioned in the definition. However, it appears to be common ground that the Income and Corporation Taxes Acts in general, at least, intend references to a partnership to include a limited liability partnership (see s863 of the 2005 Act and s1273 of the 2009 Act). If that were not so, there could be no possibility whatsoever of a limited liability partnership being entitled to claim AIA.

43. The question therefore focuses on whether the phrase *of which all the members are individuals* can be given anything other than its ordinary and obvious meaning. Mr Rice, in effect, suggests that either the phrase should be ignored, or that *all* means *one* or *some*. We cannot identify any principle of statutory construction which would enable us to do that on that phrase a meaning which it simply will not bear.

44. The only other category is *company* but that is excluded by s863(2)(c) of the 2005 Act and 1273(2)(c) of the 2009 Act. While it is true that the calculation of profits of certain entities, whose members are both individuals, partnerships and/or corporate bodies, is to be made by deeming or treating the activity to have been carried out by one and not the other, that does not change the meaning of the clear words of s38A. If Parliament had intended that a return submitted by or on behalf of a limited liability partnership was to be treated as a claim for Capital Allowance by a company, it could readily have said so. It has not done so expressly or by implication. Section 863(2)(c) of the 2005 Act and 1273(2)(c) of the 2009 Act suggest the very opposite.

45. As for the argument about the existence or non-existence of a common law partnership, this does not seem to us to assist the Appellant. The argument was, as we understood it, that there was no common law partnership between TCL and Dr Thorogood. TCL was conducting the business and was therefore entitled to claim the Capital Allowance, being a company. This submission, if we have understood it correctly, seems to be fatal to the appeal, as TCL did not submit a tax return, did not make a claim for Capital Allowances and is not the Appellant in these proceedings.

46. Reliance on s5 of the 2000 Act does not assist in determining whether the Appellant is a *qualifying person.* That section simply specifies how the mutual rights and duties of members of a limited liability partnership are to be governed.

47. The authorities to which we were referred in the course of the hearing do not assist the Appellant. *Tiffin* concerned the question whether a solicitor was a member or an employee of a limited liability partnership for the purposes of an unfair dismissal claim before an employment tribunal. The Court of Appeal endorsed the proposition set forth in earlier cases that it was not a necessary condition of partnership that each partner must be entitled to participate in the profits generated by

the business (paragraphs 20, 22, 60 and 66). *Rowlands v Hodson*[7] at paragraph 37 is to the same effect.

48. Although the 2000 Act was considered, the principal discussion in *Tiffin* was related to the question whether a member of the limited liability partnership should be regarded as an employee. That turned on the question whether, if the business of the limited liability partnership had been carried on in partnership, the particular member whose status was an issue would be regarded as a partner or as a person employed by the limited liability partnership. The discussion on that matter in paragraphs 30 to 34 is not relevant for present purposes.

49. The extract from the Law Commissions' Report simply gives a very brief summary of the ingredients of a partnership and must be considered along with page 31 where the Commission notes that while the definition of partnership in the Partnership Act 1890 requires the partners to carry on a business for profit, it does not make the division of the profits a necessary part of the definition. *Tiffin* contains a much more detailed analysis but is consistent with the view expressed at page 31. *Jackson* was not of assistance. Nor do we need to consider the Financial Secretary's (Dawn Primarolo) parliamentary statement.

Result

50. The appeal is dismissed.

51. 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 off 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.

J GORDON REID QC FCIArb
TRIBUNAL JUDGE

RELEASE DATE: 11 September 2014

[7] [2009] EWCA Civ 1042