Neutral Citation: [2023] UKFTT 912 (TC)

Case Number: TC08977

FIRST-TIER TRIBUNAL
TAX CHAMBER

Taylor House, London

Appeal reference: TC/2021/00046
TC/2021/00047

INCOME TAX – whether there was a distribution made to the appellants assessable to income tax – appeal allowed

Heard on: 14 and 15 August 2023
Judgment date: 30 October 2023

Before

TRIBUNAL JUDGE AMANDA BROWN KC
JOHN AGABOOLA

Between

MARK ALAN SMITH
ROBERT ANDREW CORBETT

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Patrick Cannon of counsel

For the Respondents: Mx Cleo Lunt litigator of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. These appeals concern discovery assessments (**Assessments**) to income tax issued by HM Revenue & Customs (**HMRC**) to each of Mr Smith and Mr Corbett (together **Appellants**) pursuant to section 29 Taxes Management Act 1970 (**TMA**) for the year ended 5 April 2013 in the amounts of £361,160.43 and £418,744.92 respectively.

2. The Assessments were raised because HMRC consider that Simpsons Independent Financial Advisors Ltd (**SIFA**) made a distribution to the Appellants meeting the definition of section 1000 Corporation Tax Act 2010 (**CTA**) and assessable to income tax pursuant to section 383 Income Tax (Trading and Other Income) Act 2005 (**ITTOIA**). The distribution in question is said to have been in the form of goodwill which was credited to the capital accounts of the Appellants in Simpsons Wealth Management LLP (**SWM**).

BACKGROUND

3. SIFA was incorporated on 29 June 1999. At that time Mr Corbett was appointed as a director. Mr Smith was appointed as a director on 1 January 2006.

4. SWM was founded on 2 June 2011 with five members including SIFA and the Appellants (together with the wives of each of the Appellants).

5. Pursuant to a business transfer agreement (**BTA**) dated 1 July 2012 the business of SIFA was transferred to SWM.

6. Mr Corbett's capital account in SWM was credited with £1,179,000 and Mr Smith's capital account was credited with £1,017,000. Both credits were recorded as "goodwill introduced".

7. On 24 December 2014 HMRC opened enquiries unto SIFA's corporation tax return for the period ended 30 September 2013 and SWMs partnership return for the year ended 5 April 2013. HMRC contend and the Appellants accept that in consequence of information obtained through those enquiries HMRC discovered what is said to be income for each of the Appellants which ought to have been assessed to income tax and, on 19 April 2017 raised the Assessments.

8. On 7 August 2018 HMRC also issued a closure notice to SIFA for the accounting period to 30 September 2013 charging additional tax of £525,886.13 in respect of a capital gain said to have arisen in connection with the crystallisation of a gain in connection with self-generated goodwill. HMRC subsequently conceded that no such charge arose in that tax period. That closure notice is therefore not under appeal but HMRC's position in respect of SIFA is relevant in the context of the appeals before us.

THE ISSUE TO BE DETERMINED

9. There is a single issue which we must determine: whether there was a distribution made by SIFA to the Appellants.

10. For the reasons set out below we find that there was no distribution by SIFA. The appeal therefore succeeds.

THE LAW

11. Section 1000 CTA (**Section 1000**) provides a definition for "distribution". So far as material to this appeal, a distribution includes:

(1) B – a distribution out of assets of the company in respect of the shares in the company except repayment of capital on the shares or where made to a new contribution of capital of equal value; and/or

(2) G – an amount treated as a distribution (pursuant to section 1020 CTA) i.e. the transfer of assets to a member where the value of the benefit exceeds any new contribution.

12. Section 383 ITTOIA brings any distribution into the charge to income tax (**Section 383 Charge**).

13. Section 46 Corporation Tax Act 2009 (**section 46**) provides:

> "The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes."

14. Section 46 has variously been described as encapsulating "the golden rule" when taxing a company. As recently confirmed by the Supreme Court in *HMRC v NCL Investments Limited and another* [2022] UKSC 9 (***NCL***) Section 46 confirms that accounts prepared in accordance with currently accepted accounting principles "are the best guide as to the true and fair view of the profit or loss of the company in the relevant accounting period."

15. There are no statutory provisions determining what constitutes goodwill or how its ownership is to be determined. The parties referred to a number of cases concerning goodwill. These cases were of limited assistance to us as it is it not the nature of the asset in question which is in dispute but who it belonged to before it was contributed to SWM. However, to the extent necessary we address the cases referred to in the outline of submissions and the discussion sections below.

EVIDENCE AND FINDINGS OF FACT

16. We were provided with a bundle of documents and six witness statements: two from each of the Appellants and one from each of Mr Pink an advisor to SIFA/SWM and Mr Killick the accountant responsible for the preparation of the accounts for SIFA and SWM. All witnesses gave sworn testimony and were subject to cross examination. We found each of them to be straightforward, truthful and competent. In the main, and save as specifically identified below, we accept their evidence.

17. From the evidence we find the following facts:

(1) The Appellants are, and at all material times were, personally registered and regulated as independent financial advisors (**IFAs**) by the Financial Conduct Authority (or its predecessor body) (**FCA**). They are licenced to provide individuals with independent financial advice concerning investments, life policies, pensions etc. In the provision of such advice each of the Appellant's built up personal connections of trust with the individuals to which financial advice was provided.

(2) SIFA and SWM are also entities regulated by the FCA. The firm registration and regulation is separate from the individual registrations.

(3) Individuals requiring independent financial advice, at least from small providers, will form a relationship will a particular regulated individual agnostic to whom the IFA is employed by (if employed at all). This is so despite the contract for the provision of such advice being between the individual requiring advice and, where relevant, the IFA's employer.

(4) The income derived from the provision of advice will accrue to the employer and not the individual. Despite this it was and is the professional "norm" for IFAs who work in small organisations and, in any event for those who worked for Mr Corbett, SIFA and SWM, to consider that their client relationships from which such income is derived "belonged" to the IFA such that when moving between employers (or organisations) it

was expected that the clients would follow the IFA. The contracting entity/employer would not consider there to be an ongoing ability to derive income from those contractually advised by the entity once the advising IFA was no longer employed; however, ultimately it would be a decision for the client whether to switch to another IFA employed by the contracting entity or whether to follow the IFA with whom there was a relationship. Where an IFA retires the relationships can be transferred to another IFA, but it is expected that there will be a full hand over carried out personally by the retiring IFA who will look to ensure that the clients are facilitated to build trusted relationships with the transferee.

(5) The Appellants were known to one another prior to their joining forces in business. In or about 1995 Mr Smith commenced employment for Mr Corbett. At that time Mr Corbett operated as a sole trader under the trading name Simpson Independent Financial Advisors.

(6) There is no written evidence as to the terms of Mr Smith's employment at the time he commenced employment, but we accept the evidence of both Mr Smith and Mr Corbett that his clients "belonged" to him. Whilst employed it was expected that Mr Smith would cultivate and nurture professional relationships with the clients with whom he had historically worked and develop new relationships, usually by word of mouth from existing relationships. The propensity for (initially Mr Corbett and subsequently SIFA) to be able to derive income from those clients was founded in the relationship between the client and Mr Smith and his personal reputation with them and not as a consequence of the reputation of his employer. As such, we find that despite there being no formal written terms of employment for the period from 1995 - 1999 it was accepted and agreed between Mr Corbett and Mr Smith that should Mr Smith cease employment with Mr Corbett his clients would follow him together with the ability to obtain an income from advice provided to them. For the period from 1999, when the business operating under the trading name Simpsons Independent Financial Advisers was incorporated into SIFA, we find that there was a similar understanding/expectation between SIFA and Mr Smith.

(7) On 24 June 2002 Mr Smith's employment arrangements were formalised with SIFA through a written contract. The contract used was a template provided to SIFA by a local firm of solicitors. The template included restrictive covenants precluding: Mr Smith from (a) soliciting business from any person firm or company which had been a client of SIFA in the prior 12 months; (b) offering employment to anyone employed by SIFA in the prior 12 months and (c) a non-compete clause. We were told and accept that the Appellants were agreed that the template was not appropriate as it precluded Mr Smith from continuing to advise his clients if he left SIFA contrary to the agreement between them. The non-solicitation clause was struck out of the agreement and the contract then signed. We find that the parties did not adopt the template the written agreement reflected the oral arrangements which had existed before June 2022 i.e. that he was entitled to continue to provide advice to individuals to whom he had previously provided advice. The non-compete clause remained.

(8) Mr Smith was appointed as a director on 1 January 2006. We infer (though there was no direct evidence) that the terms of Mr Smith's employment which subsisted from 2002 continued whilst he was a director and accordingly, find that the expectation regarding the ability to port clients on a change of employer continued.

(9) As indicated above Mr Corbett operated as a sole trader prior to the incorporation of SIFA in 1999. Mr Corbett was a director from incorporation. There was no evidence

of the arrangements between SIFA and Mr Corbett i.e. no contract appointing him as a director or a contract of employment. Whilst Mr Corbett was the sole director we infer from the evidence generally that he considered his client relationships/list to be his. We do not have accounts for this period but understand, by reference to the later period accounts that we do have, that, at no point, was any value attributed to Mr Corbett's clients in the SIFA accounts.

(10) Mr Smith became a shareholder of SIFA on 1 October 2006. He paid £15,000 for his 33 shares (one third of the total shareholding). The price of the shares was said to have determined by reference to the net book value of fixtures and fittings of the business premises. At the time of the share purchase we find that no value for goodwill was attributed to Mr Corbett's client relationships and the price paid for the shares represented approximately one third of the net book value of fixtures and fittings.

(11) In the early 1990s the consideration payable for the activities of an IFA was generally an up-front commission paid by the financial product provider to the IFA personally (or the employer of the IFA where appropriate).

(12) This mode of remuneration changed over the 1990s and what is known as "trail commission" was introduced. Trail commission provides for remuneration of the IFA/their employer as appropriate to be paid by the financial product provider over the life of the product, usually by reference to the value held under the product. Under both the up-front and trail commission model there was little inherent value in an ongoing client relationship as the IFA earned the right to receive commission income at the point at which a client was introduced to the financial services provider. Even with trail commission the right to receive the commission did not require that the client had a continuing relationship with the introducing IFA. Commission continued to be paid to the IFA/their employer provided that the client did not cancel the product/move their investment. Nevertheless, we accept that client lists and the potential for new business from existing clients switching financial product thereby generating new commission had value and could be traded. However, due to the more personal nature of the relationship the continuing value of a relationship with the IFA who had nurtured it was greatest.

(13) From 31 December 2012 regulatory change precluded remuneration of IFAs through trail commission on any new financial products sold. Trail commissions can (and continue) to be earned for financial products sold prior to 31 December 2012. From 1 January 2013 IFAs must be remunerated directly by the client. This is usually under an annual retainer, time spent basis or as a percentage of assets in the portfolio. This change had an impact on the intrinsic value of the client to the IFA. From 1 January 2013 the relationship and in particular the propensity to continue to seek advice regarding suitability and performance of investments and financial products is the means by which future income is derived in the form of advisory fees. This enhances the value of the personal relationship from which the income might then be generated.

(14) We were told and accept that Mr Corbett and Mr Smith understood that the market value of their relationships with individuals needing independent financial advice was 2 – 4 times the prior year income derived from such clients.

(15) In the period in which Mr Smith was employed by initially Mr Corbett and subsequently SIFA all income derived from relationships with clients as a consequence of their individual personal relationship accrued initially to Mr Corbett/SIFA as appropriate.

(16) In or about early 2012 the Appellants were advised by Mr Pink that conversion from a limited company to a limited liability partnership would suit the business. The

reason underlying this advice was not clear to us. It was claimed that the underlying rationale was that the corporate structure did not permit fair remuneration for the shareholder/directors through dividends. Rightly, Mx Lunt cross examined all the witnesses on this rationale as remuneration for performance of key personnel need not be restricted to dividends of a single class of shares; it was put to the witnesses that they could have remained as a limited company and paid remuneration through dividends of different share classes, salary, bonuses etc. The witnesses accepted that the remuneration infrastructure could have been altered but, somewhat weakly and without any real supporting rationale, they asserted that they considered that a limited partnership was a better vehicle through which to ensure a fairer remuneration of all. We note that the timing of the restructuring was proximate with the regulatory change to remuneration of services by IFAs and we wonder whether this was a contributory factor. We also note that Mr Pink is a tax advisor and question whether beneficial tax arrangements may also have been a factor. However, no positive case was put to the witnesses as to an alternative rationale and in the end we do not consider the reason for the restructuring is relevant to the matter we have to decide so we make no finding in this regard.

(17) Following formation of SWM, SWM and SIFA entered the **BTA** dated 11 June 2012.

(18) The BTA provided for the transfer and assignment or agreement to transfer or assign with full title and guarantee the ongoing business of SIFA as a going concern and all assets used in the business including "the goodwill and the trade name 'Simpsons Independent Financial Advisers'" and "lists of customers, suppliers, agents and others and all subsisting records lists and information". The effective date of transfer was intended to be 1 July 2012. The consideration for the transfer was agreed to be the fair value of the business which was transferred as a credit to the capital account of SIFA in SWM. The transfer recorded in the BTA was proposed to the shareholders by resolution of the board of SIFA on 11 June 2012 and approved unanimously by the shareholders on the same date. The minutes of the partnership approved the introduction of SIFA's "beneficial interest in the goodwill and assets of the business" as contribution of capital on behalf of SIFA by resolution dated 11 June 2012. The BTA and associated resolutions indicate that the date of transfer was expected to be 1 July 2012 and this was the position confirmed in correspondence between the parties. However, we were told in oral evidence by Mr Corbett that the transfer was delayed as it needed to await regulatory approval. Further, it is recorded in the accounts (by way of a note concerning related party transactions) of both SIFA and SWM that the transfer occurred on 1 October 2012. On the evidence it has not been possible for us to determine precisely when the transfer was made however, we infer that there were two transactions pursuant to which SIFA's membership account with SWM was credited:

(a) The first occurred in the year to 30 September 2012 to the value of £35,032. We determine this by reference to the following evidence:

(i) The balance sheet for SIFA as at 30 September 2012 notes a related party transaction:

> "At the year end the company was owed £35,032 by [SWM]"

(ii) The SWM accounts to 30 September 2012 show net assets of £35,124 made up of other debtors £7,154 and cash £28,211 less current liabilities. This is represented by £92 "other reserves classified as equity" and £35,032 "members capital". No related party transactions are noted.

(b) The second, and the one with which we are principally concerned, occurred on 1 October 2012 in the sum of £76,094.

(19) We reach our conclusion on the second transfer by reference to the following evidence:

(a) The SIFA balance sheet on 30 September 2012 shows net assets of the business as £169,300. This comprised: tangible assets (fixtures, fittings and equipment) £18,450, debtors £66,366 (of which, by reference to the related party transaction, £35,032 was the debt due from SWM) and cash at bank £192,723 less liabilities, and provisions for liabilities of £108,239. No figure is shown for intangible assets.

(b) The accounts for SIFA to 30 September 2013 i.e. the year in which the transfer to SWM had taken place, record:

> "At 1 October 2012 the company transferred all the assets, liabilities and trading activities to [SWM] of which it is a member. The transfer of goodwill was at market value and fixtures and fittings at written down value. This included goodwill from [Feist].
>
> Included in other debtors is £1,052 owing by [SWM] …
>
> The company has made an investment of £175,000 in SWM in the year."

(c) On 30 September 2013 the accounts record net assets of £252,472 including: (1) £32,288 (representing the amortised value of J Peirce's client relationships acquired in that year and valued at £35,876): (2) investments SIFA made in the year are valued at £239,200 being the acquisition the share capital in Feist Hedgethorne Independent Financial Advisers Limited (**Feist**) for £64,000 and the investment of £175,000 made in SWM; (3) the disposal of depreciated tangible fixed assets with a written down value of £18,450.

(d) The corresponding accounts for SWM disclose net assets of £2,107,867 comprising intangible assets of £1,976,400 (the amortised goodwill introduced in respect of the Appellant's client lists), tangible assets of £34,197 (depreciated fixed assets acquired in year of £45,595) current assets of £203,485 less liabilities of £106,215.

(e) The member's interests recorded in SWM show capital introduced in the year totalling £2,272,094 being £1,179,000 by Mr Corbett, £1,017,000 by Mr Smith and £76,094 by SIFA.

(f) The related party transaction note records:

> "On 1 October 2012 all assets, liabilities and trading activities were transferred from [SIFA] to the LLP. A credit equating to the net assets introduced by the member has been entered as equity capital introduced".

(g) The inter-company accounts demonstrates that the assets transferred by SIFA and contributed as capital were limited to £18,450 in respect of fixtures and fittings and £57,644 cash transferred (totalling £76,094).

(h) It was the unchallenged evidence of both Mr Pink and Mr Killick that they considered that there was no goodwill asset to be valued in the accounts for SIFA

associated with the personal client relationships of either of the Appellants capable of or actually transferred to SWM.

(i) Taking the entries in the accounts in the round we consider that it is plain that SIFA had not ascribed any value to goodwill prior to 30 September 2013. In the year to 30 September 2013 it acquired goodwill from J Pierce which was capitalised and amortised but not transferred to SWM.

(j) In the accounting period to 30 September 2013 SIFA acquired the share capital of Feist. The shares were not transferred and although, at least notionally, the Feist goodwill was transferred its market value was nil by reference to the accounts of either SIFA or SWM. This valuation of the Feist goodwill was not challenged by HMRC.

(k) Mr Pink's unchallenged evidence was that no value had been ascribed to goodwill transferred under the BTA (including the Feist goodwill).

(20) The accounts for SIFA were prepared by Mr Killick. It was accepted by HMRC that he prepared them on the understanding and belief that he was doing so in accordance with generally accepted accounting principles (**GAAP**). HMRC did not put to Mr Killick that the accounts were not in fact prepared in accordance with GAAP. They considered that as he was not an expert he was in no position to give an opinion to that effect. HMRC did not call any evidence of their own that the accounts failed to comply with GAAP and it was, at least implied, that the Tribunal did not need to and should not make a finding as to GAAP compliance. However, for the reasons addressed below at paragraphs 24 - 30 we consider that it is important to consider the question of GAAP compliance. Having considered the evidence we determine whether that it is no reasonable basis for concluding that the accounts either do not give a true and fair view and/or are not GAAP compliant. We do so for the following reasons:

(a) It was unchallenged that Mr Killick believed that he had prepared the accounts in accordance with GAAP. He also considered that they represented a true and fair view.

(b) For each year ended 30 September 2012 and 2013 the statement of director's responsibility in the accounts for SIFA states:

> "Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial states in accordance with United Kingdon Generally Accepted Accounting Practice (UK Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period."

(c) When approving the accounts for 2012 the board acknowledged "their responsibilities for ensuring that the company keeps accounting records which comply with section 286 of the Act and for preparing financial statements which give a true and fair view of the state of affairs of the company as at the end of the financial year and of its profit or loss for the financial year." In 2013 the acknowledgement was in a shorter form recognising their responsibilities under the Companies Act 2006 as regards the accounts and confirming "These financial statements have been prepared in accordance with the provisions applicable to

companies subject to the small companies' regime and the Financial Reporting Standards for Smaller Entities".

(d) Mr Killick's evidence, which we accept, is that were SIFA to have had a goodwill asset valued at approximately £2.2m which was subsequently distributed to the Appellants the accounts produced would have been materially inaccurate. Further, SIFA would have been technically insolvent having distributed the full value of the asserted asset without taking account of a capital gains deferred tax charge which would have arisen.

(21) The Limited Liability Partnership Agreement (**Partnership Agreement**) for SWM was signed on 1 July 2012. It provided that each equity member (Mr & Mrs Smith, Mr & Mrs Corbett and SIFA) "shall acquire … a Member's Share equal to the amount or value of any Contribution made by him". Contribution is defined for the purposes of the Partnership Agreement as "money or assets paid into the account of or transferred into the ownership of the LLP by a Member …". Members's Share is defined as the Equity Member's share of the interest in the Capital which itself is defined as the net capital of the LLP as should in any balance sheet prepared in accordance with the provisions of the Partnership Agreement as belonging to the Members and being the excess of assets of the LLP over its liabilities.

(22) On 1 October 2012 each of the Appellant's introduced as capital what is recorded in the SWM accounts as goodwill. Mr Corbett is recorded as contributing £1,179,000 and Mr Smith £1,017,000. On the evidence before us such contributions represented the market value (being 3x the prior year's income derived for the benefit of SIFA from their respective personal relationships) of the personal relationships with individuals requiring independent financial advice. The contributions were made by the Appellant's personally, the underlying asset so contributed not having been the property of SIFA.

SUBMISSION OF THE PARTIES

18. We are grateful to the parties for their skeleton arguments and clear and careful oral submissions. We mean no disrespect to the parties in the short summaries below of the arguments they presented. However, as this appeal is substantially determined on the facts we consider the summaries to adequately frame our analysis and decision.

Appellant's submissions

19. The Appellant's primary submission centred on the supremacy of the accounts. The Appellant contended by reference to section 46 (as confirmed in *NCL*) that as HMRC did not directly contest that the accounts were GAAP compliant there was no basis on which to conclude that there had been a distribution by SIFA to the Appellants and therefore nothing to which the Section 383 Charge would apply.

20. Supporting that conclusion the Appellant, in any event, contended that the goodwill contributed by the Appellants had never belonged to SIFA and could not therefore have been contributed by it on their behalf so as to represent a distribution meeting the terms of Section 1000.

21. Countering the position adopted by HMRC in correspondence (and maintained before us) that all goodwill associated with the provision of independent financial advice by SIFA must belong to SIFA as goodwill cannot inherently be held or exist separately from the business to which it relates the Appellant contended that it was perfectly possible for valuable goodwill to attach the strength and identity of the proprietor of a small business such as SIFA. On the facts it was contended that the Appellants each had their own reputation and strong relationships with clients loyal to them personally.

HMRC's submissions

22. HMRC contended that the goodwill shown as having been contributed by the Appellants and standing to their credit in their respective capital account in SWM was goodwill that must have belonged to SIFA. They contended that in order for the Appellant's capital contributions to have been made in SWM the goodwill must have been the subject of a distribution to them by SIFA. This was on the basis that, by reference to the authority in *IRC v Muller & Co Margerine Limited* [1901] AC 217 (**Muller**), goodwill was inseparable from the business to which it adds value.

23. HMRC referred to the terms of the BTA which provided for the transfer of goodwill by SIFA to SWM at market value. They contended that as the only value attributed to goodwill in SWM's accounts was referable to the goodwill said to have been contributed by the Appellants there was a necessary inference that such goodwill had passed from SIFA to the Appellants consequent on the BTA thereby representing a distribution meeting the terms of either section 1000(1)(B) or (G).

DISCUSSION

Relevance and application of Section 46

24. We start with the provisions of section 46 and the clear direction of the Supreme Court in *NCL*.

25. Section 46 provides that the profits of a trade must be calculated in accordance with GAAP compliant accounts which underpin a conclusion that the accounts provide a true and fair view of the company's financial position.

26. This case does not concern SIFA's profits such that we consider that Section 46 cannot directly apply. However, that does not render the provision irrelevant as GAAP accounts provide a true and fair view not only of the profits derived in a particular financial accounting period and on which tax is then charged but also of the financial status and security of the company at the balance sheet date.

27. As set out above we consider there is no basis on which to conclude that the accounts of both SIFA and SWW are anything other than GAAP compliant and accordingly provide a true and fair view of each entity. Those accounts show that in the period prior to 1 October 2012 SIFA was not the owner of any asset associated with the personal relationships of each of the Appellants with individuals requiring independent financial advice. Had it been otherwise we would have expected some valuation of the goodwill at the point at which Mr Smith became a shareholder. The valuation of the SIFA business at that time was limited to fixed assets.

28. Further, the SIFA accounts have attributed value to the retained goodwill acquired from J Pierce thus reflecting that the relevant GAAPs relating to intangible assets has been considered and applied.

29. To conclude, as HMRC invite us to do, that in excess of £2.2m of value had been omitted from the accounts over a number of years (certainly post 2006) would be to invite us to conclude that the balance sheet valuation of the company was so materially inaccurate in each year that the accounts could not have represented a true and fair view. We are unwilling to so conclude on the evidence.

30. On the basis of the accounts therefore we conclude that the goodwill which is said to have been distributed to the Appellants cannot have been an asset of SIFA and cannot therefore have been distributed by SIFA such that the Section 383 Charge cannot arise.

Nature of goodwill

31. In view of our conclusion at paragraph 30 above it is unnecessary to consider the arguments of the parties as to the nature of goodwill more generally. However, given the detailed submissions made we briefly set out our analysis and conclusions.

32. We start in this regard with *Muller*. The case concerned whether an agreement for the sale of goodwill was subject to a charge to stamp duty under Stamp Act 1891. The House of Lords expressed the view that goodwill was an inherent part of an ongoing business. A point reiterated by the Privy Council in *Star Industrial Company Ltd v Yap Kwee Kor* (1976) FSR 256. HMRC would seek us to conclude therefore that goodwill can only ever belong to the entity which carried on the business to which the goodwill (the reputation and propensity to generate future income) relates.

33. However, we consider that the position is more complex than HMRC contend. Plainly, goodwill is associated with the operation of a business but that is not the same as concluding that the goodwill so associated can only vest or be owned by the company.

34. This view is confirmed by judgment of the Court of Appeal in *Kirby v Thorn EMI plc* [1987] BTC 462 (***Thorn***). That case concerned the nature of a payment made to Thorn following the sale of a business carried on by three trading entities within the Thorn group but in respect of which Thorn had agreed to a non-compete covenant. Thorn claimed that the payment made to it could not be in respect of a goodwill asset because the goodwill was that of the trading entities i.e. it was not carrying on the business and as, by reference to *Muller* goodwill could not belong to an entity other than that carrying on the business it could not be the owner of any goodwill to which the payment could relate. Lord Nicholls determined that the freedom to trade enjoyed by everyone is not a form of property but simply a general right. However, as regards the non-compete covenant it was stated:

> "The covenant is the means by which, amongst other matters, the vendor, for the benefit of the purchaser, precludes himself from exploiting the reputation he has regarding the trade in question. That reputation, as already mentioned, is a form of goodwill. It is not something possessed by everyone."

35. HMRC contend that to construe *Thorn* as permitting a conclusion that goodwill could be an asset of a party not carrying on the business is inapposite, when considered in light of the Upper Tribunal judgment in *HMRC v (1) Smith & Williamson Corporate Services Limited and (2) Patrick Smiley* [2015] UKUT 666 (TC) (***Smiley***). *Smiley* concerned whether certain payments made by Smith and Williamson (**S&W**) to Mr Smiley (an employee of S&W) were income from employment (as HMRC contended) or capital payments (as contended by S&W and Mr Smiley). The payments were not made pursuant to Mr Smiley's employment contract but under a contract incentivising him to leverage his relationships with former clients of his former employer to become clients of S&W. The First-tier Tribunal had determined that the payments were capital in nature.

36. Warren J undertakes a thorough analysis of the arrangements between the parties and the relevant case law on goodwill, including *Thorn*. He notes that whilst Mr Smiley had personal relationships with individuals and organisations who had appointed his former employer as fund managers the funds in question were clients of the previous employer. Whilst the nature of the personal relationship between Mr Smiley and the funds was crucial in those clients agreeing to transfer the responsibilities of fund management to the relevant trading entity within S&W Mr Smiley had no property in the clients such that when facilitating the transfer he was carrying out a service associated with his employment obligations. At paragraph 108 Warran J finds that the earn out criteria justifying the payment was not capable of creating or "conjuring up from thin air" an asset. The working relationships that Mr Smiley

had with the clients was not to be equated with the goodwill associated with the provision of fund management services and the associated income generated from such services which belonged to the previous employer. The relevant factual situation was identified (at paragraph 111) as:

> "(i) there were a number of investors (ii) being investors who were clients of [the previous employer] (iii) who were serviced by the Team as employees of [the previous employer] and (iv) who, through their personal connection with the Team as a result of (ii) and (iii), had formed relationships which the Team might be able to turn to their own advantage."

37. A distinction was thereby drawn between the asset of having a client base from which income could be derived on an ongoing basis (classic goodwill) and a personal relationship which may be leveraged to bring new business. Those personal relationships were considered to be broadly similar to the general freedom or right to trade which did not (by reference to the judgment in *Thorn*) represent a capital asset. The ability to derive income from the funds in question passed from the previous employer to S&W facilitated by Mr Smiley but the payment was not for the goodwill and was not made to the owner of the goodwill.

38. We consider, on the facts we have found that the position in the present appeal is distinguishable from *Smiley*. We have found that the relationships themselves represent a valuable asset. Whilst in employment those relationships provided SIFA the opportunity to generate income but the underlying relationship was one which vested with each of the Appellants and which could (subject to the a decision of a client to transfer that relationship to another advisor within SIFA) be taken from SIFA without restriction. We do not consider that these were personal relationships of the type considered in *Smiley* but rather are closer to the broader reputational value considered to be an asset in *Thorn*.

39. Therefore, even were we to have declined to take a view on the GAAP compliance of the accounts and the consequences that follow, on the facts we consider that the asset (however is it labelled) of the reputation and relationships of the Appellants with individuals belonged to them and not to SIFA.

DISTRIBUTION

40. On the basis that we have concluded that the relationships were assets of the individual Appellants and were never assets of SIFA capable of transfer the question of there being a distribution does not arise.

DISPOSITION

41. For the reasons given we allow the appeal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

42. 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.

AMANDA BROWN KC
TRIBUNAL JUDGE

Release date: 30th OCTOBER 2023