Appeal number: FTC/97/2010
[2011]UKUT 470 (TCC)

Upfront payment for exclusive supply arrangement – whether capital or income receipt – the Upper Tribunal's role on an appeal

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

COUNTRYWIDE ESTATE AGENTS FS LIMITED

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: THE HONOURABLE MR JUSTICE SALES

Sitting in public at The Royal Courts of Justice on 20/21 October 2011

Mr Stephen Brandon QC & Ms Harriet Brown, instructed by Olswang for the Appellant

Mr Rupert Baldry QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents:

DECISION

1. This is an appeal against the decision of the First-Tier Tribunal ("the Tribunal"), [2010] UKFTT 263 (TC), deciding that the receipt of what was referred to as an "Upfront Payment" of £25 million paid to the Appellant by Friends Provident Life and Pensions Ltd ("Friends Provident" or "FP") under an agreement dated 21 August 2002 ("the FP Distribution Agreement") was in the nature of a receipt of income, and so liable to be taxed under Schedule D to the Income and Corporation Taxes Act 1988 as part of the revenue contributing to the profits of the Appellant. The Appellant contends that Tribunal erred in law and should have found that the Upfront Payment was a capital receipt of the Appellant, and so not liable to be taken into account in calculating the corporation tax due from the Appellant.

2. The issue which arose before the Tribunal was correctly identified by the Tribunal at paras. [2]-[3] of its decision as follows:

> **"The statutory provisions and the issue**
>
> 2. Income and Corporation Taxes Act 1988 Section 70 provides that for the purposes of corporation tax income shall be computed under Schedule D:
>
> "… (o) on the full amounts of the profits or gains or income arising in the period …. without any other deduction than is authorised by the Corporation Tax Acts."
>
> Section 18(1)(a) of that Act provides that tax under Schedule D shall be charged in respect of:
>
> "(t) the annual profits or gains arising or accruing to any person … from any trade .."
>
> 3. The issue arising here is this. The Appellant contends that the £25 million payment did not form part of its profits or gains arising in 2002 or in any other period: the entire payment was capital in nature as having been received in return for the Appellant's grant to FP of the exclusive right to distribute "Life Products" for 15 years, resulting in its giving up the right to exploit its customer base. HMRC say that the £25 million should be included as part of the Appellant's taxable profits; it accrued when the Appellant entered into the FP Distribution Agreement and falls to be taxed as and when recognised by the Appellant as a profit under recognised accounting principles. We therefore have to decide whether, to adopt the expression of Bankes LJ in *British Dyestuffs Corporation*

(1924) 12TC 584 at 596, by entering into the FP Distribution Agreement (see below) the Appellant parted with "part of its property for a purchase price" or was this "a method of trading by which it acquires this particular sum of money (the £25 million) as part of the profits of its trade"."

3. In the course of the hearing before me, Mr Baldry QC for HMRC also made reference to section 42 of the Finance Act 1998, which provides that for the purposes of Schedule D the profits of a trade "must be computed in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in computing profits for those purposes." This did not carry the debate forward. Although the profits of the Appellant, as stated in accordance with generally accepted accounting practice, reflected the Upfront Payment, it was common ground that if the proper characterisation of that payment in law was as a capital receipt of the Appellant, the consequence would be that it would have to be left out of account for the purposes of computing the taxable profits of the Appellant.

4. The Tribunal gave an admirably succinct and accurate account of the factual background and relevant terms of the FP Distribution Agreement at paras. [5]-[29] of its decision, which I gratefully adopt, as follows:

"Background

5. The Appellant is within the "financial services" division of a group of companies, "the Countrywide Group". The Appellant was until 2004 known as Countrywide Assured Financial Services Limited and was a subsidiary of Countrywide Assured Group plc ("CAG"). After the demerger of Countrywide Assured plc, the Appellant changed its name to Countrywide Estate Agents FS Limited.

6. At the relevant times CAG was the parent company of the Countrywide Group. The activities of the Countrywide Group were divided into several operating divisions including the estate agency, financial services and life assurance divisions each contained in separate companies. All the divisions were wholly owned within the Countrywide Group.

7. The Appellant's business at the relevant time (and now) comprises the provision of a range of financial services which include providing advice in relation to the sale of mortgages, life assurance products and other general insurance products, predominantly through the estate agency chain of businesses operated by the Countrywide Group. The Countrywide Group was formed following the merger of Bairstow Eves and Mann & Co and it subsequently grew through acquisitions. The business of the Appellant is associated with the business interests of the other Countrywide Group companies in that when homes are sold the buyers will be introduced to financial services consultants, employed

within the Group, who will seek to help them pick the required financial products.

8. Once a customer has decided to purchase a life product the relevant information will be transferred electronically to the life insurance provider (which until the execution of the FP Distribution Agreement was Countrywide Assurance). Countrywide Assurance's staff would then deal with the processing of the application for life assurance.

9. The individual branches were (and still are) operated by estate agents in the Countrywide Group. The branch of the Countrywide Estate Agency Network is responsible for the sale of the home. It introduces its customer to the Appellant. This might happen on registration with the estate agency with a view to purchasing a home.

10. The staff of the Appellants will then consult with the customer and assess the customer's needs and resources. A mortgage consultant will typically recommend a suitable mortgage product and suggest the need for life insurance. The Appellant's staff would then introduce the customer to Countrywide Assured's life insurance product.

11. Prior to the FP Distribution Agreement there had been an oral agreement between Countrywide Assured and the Appellant which commenced in October 1998, followed by an agreement reduced to writing on 1 December 2001. The written agreement records Countrywide Assured as having appointed the Appellant as its intermediary and as such the Appellant was permitted, in relation to life insurance products, to introduce Countrywide Assured to potential customers. In return the December 2001 agreements provided that Countrywide Assured was to pay agreed commission on sales to the Appellant.

12. The Appellant had, prior to the FP Distribution Agreement, introduced Countrywide Assured to its customers in accordance with terms set out in the December 2001 agreement. Customers could, however, take any combination of products. In the period 1999 to 2002, for every 100 mortgages sold, 90 life products were sold.

13. The Financial Services Authority, in its paper "FSA 121", announced its proposal to remove "Polarisation". The effect of Polarisation had been that financial intermediaries in the position of the Appellant had to choose between either handling the product of one product provider or being entirely independent and operating as an Independent Financial Adviser. The consequence of removal, as foreseen in the insurance industry, was that intermediaries in the position of the Appellant would no longer be confined to selling the products of a single supplier. Life product providers wishing to protect their long term distribution networks might therefore attempt to secure exclusive distribution agreements with

distributors such as the Appellant. The evidence shows that the Appellant was particularly attractive as a distributor because it was the leading seller in the country of mortgage related products through the Countrywide Estate Agency Network. Some life insurance companies bought interests in brokers or entered into joint venture arrangements with them. Financial intermediaries were thereby in a position to demand a premium in respect of their market positions.

Events leading to the FP Distribution Agreement

14. A decision was taken in 2002 for Countrywide Assured to cease to write new life policies. Countrywide Assured's customer volumes did not warrant the costs of developing and selling new life products. Consequently the Appellant needed to find a new life product provider. For this the Appellant was advised by Lexicon Partners.

15. At that point the Appellant's trading position was, to recapitulate, as follows.

16. The Appellant's business was associated with the business interests of the other companies in the Countrywide Group. Those of its staff whose job it was to introduce customers of the Countrywide Estate Agents to life insurance providers were working from the estate agents' premises for that purpose: there was no plan to displace the Appellant and its staff following the discontinuance by Countrywide Assured of its own life insurance business.

17. The Appellant's source of customers was the estate agents. The Appellant's actual customers were those purchasing properties on the estate agents' books and who needed life insurance cover. On occasions individuals with Countrywide Assured life insurance policies might come direct to the Appellant where, for example, they needed a further policy to provide extra cover. We did not have details of how many such individuals returned, nor what proportion of introductions from returning business bore to the total introductory business of the Appellant. We infer that it was relatively small.

18. The customer details required by the provider of the life insurance product to enable it to effect the policy belonged to the provider, i.e. Countrywide Assured. Names and addresses of such customers were, we understand, on the Appellant's records. The Appellant's customer base was the result of, and came to it because of, its position in the market place as fellow occupier with the estate agent of high street premises. Information about existing customers could only be counted as part of that customer base to the extent that it could be used to attract those customers to come back for more Countrywide Assured products. Otherwise, as noted, it belonged exclusively to Countrywide Assurance.

19. The discontinuance of the Polarisation regime meant that the Appellant had, for the future and unless it chose to enter into an agreement with a life product supplier which confined it to introducing product of that supplier, an opportunity to act as financial intermediary in relation to product of more than one other supplier.

20. Countrywide Assured's intended discontinuance of its life insurance business would leave the Appellant with access to potential customers for life insurance cover, through its association with the estate agents in the Countrywide Group, but with no exclusive provider of life insurance.

21. The Appellant opened negotiations with Friends Provident and AXA with a view to entering into an exclusive life insurance distribution agreement. The Appellant announced that it required two elements of consideration from the potential offerors. These were a non-refundable "apportionment payment" and a commission on sales resulting from introductions made by the Appellant. The former explained Mr Buck, was for the right to be the only life insurance provider to whom the Appellant would introduce customers; the latter had to be greater than the commission received under the December 2001 agreement with Countrywide Assured.

22. The negotiations concluded with FP agreeing a payment of £25 million up-front with commission of 325% LAUTRO. On 21 August 2002 the FP Distribution Agreement was signed.

The FP Distribution Agreement

23. Before dealing with the terms of the agreement, we mention that the operating structure which was followed after entering into the FP Distribution Agreement, but which was not contained in that agreement, involved Countrywide Group estate agents finding properties for customers who would then be introduced to the staff of the Appellant. The Appellant would attempt to secure a mortgage and suggest the need for appropriate insurance cover. The applications for insurance would still be dealt with by the same personnel as previously, except that they were now working for FP, from FP's premises.

24. By clause 5.1, FP appointed the Appellant as its distribution agent to effect introductions to FP with a view to customers acquiring a "Life Product". It reads as follows:

> "Friends Provident hereby appoints Countrywide FS as its distribution agent on the terms and conditions of this Agreement on a non-exclusive basis to

(a) effect introductions of its customers to Friends Provident with a view to their acquiring a Life Product;

(b) offer advice to its customers in relation to Life Products;

(c) arrange the Life Products for its customers;

(d) allow its representatives to carry out all or any of the activities referred to in sub-clauses (a), (b), (c) above

through the Countrywide Estate Agency Network in accordance with the terms and conditions of this Agreement. All such activities shall, for the purposes of this Agreement, constitute "distribution" of the Life Products …."

"Life Products" are defined as any of the "Contracts for Long Term Insurance" of FP (referred to in Schedule 1) together with others which may be agreed to fall within this definition. Schedule 1 defines "Life Products" to include, particularly, level term assurance, critical illness benefit, mortgage payment protection and income replacement benefit. An effect of this provision was that while FP would continue to sell its Life Products through other providers, the Appellant could not sell the Life Products of other providers through the estate agents.

25. Clause 2 of the FP Distribution Agreement provided first that £25 million was to be paid to the Appellant as consideration for its exclusive right to distribute the Life Products to the Appellant's customers. It further provided that "Initial Commission" would be paid in respect of each life product sold by the Appellant and that a "Further Commission Element" would be paid. The initial commission was paid on each Life Product that the Appellant sold, subject to an adjustment. The Further Commission Element was calculated in accordance with clause 6.10 and covered the necessary in-house system development working and ongoing running costs to allow the Appellant's "Point of Sale" system to distribute FP's products.

26. Clause 2.4 provides that the FP Distribution Agreement is automatically terminated on 15th anniversary of the Commencement Date.

27. By Clause 5.5 the Appellant undertakes, during the life of the Agreement, that it will not distribute through any office which forms part of the Countrywide Estate Agency Network (as defined) any contracts of long term insurance which are an integral part of a mortgage or property related transaction other than those under written by FP.

28. Clause 10 provides:

"10.1 Subject to clauses 10.5 and 19, customer information relating to persons who take out Life Products pursuant to this Agreement which is provided to Friends Provident either directly or through the Countrywide FS shall in respect of the Life Products, belong to Friends Provident and Friends Provident shall subject to all applicable law and regulation (but without prejudice to its obligations to pay any Additional Initial Commission ….), be entitled to utilise that information as it sees fit throughout the Term and after termination (for whatever reason) of this Agreement.

10.2 Customer information relating to persons who are provided with any product or service by or through Countrywide FS which is not a Life Product shall belong to Countrywide FS ….

10.3 For the avoidance of doubt, customer information relating to persons who seek and/or are provided with any product or service from any member of the Countrywide Group shall belong to both that member of the Countrywide Group and Friends Provident where such persons also become a Policy holder."

Accounts for the years 2001-2003

29. The Appellant's annual turnover for the year ending 31 December 2001 was £35.2 million. Annual turnover in the year ending 31 December 2002 was £42.2 million and in the year ending 31 December 2003 was £51.8 million."

5. The legal analysis adopted by the Tribunal was clearly set out at paras. [30]-[38] of the decision, which also deserve to be set out at length:

"Conclusions

30. The Appellant's case for claiming the £25 million payment to be of a capital nature is that, in return for the payment, the Appellant parted with the exclusive use of its goodwill for 15 years. The goodwill, it was said, consisted of its customer base (present and future) that rested on its name and association with the estate agents in the Countrywide Group, on its reputation and on its geographical spread. The Appellant, it was argued, parted with the goodwill through its agreement that FP was to be the only Life Product provider to whom it (the Appellant) would introduce customers, whether new customers or returning customers. The Appellant was thereby precluded from adapting to the removal of Polarisation and negotiating any multi-tie with other suppliers. The result, it was contended, was for the Appellant to have presented FP, in return for the one-off £25 million payment, was a significant part of its business, namely that which had formerly been part of its goodwill. The situation was no different in principle from that found in *British Salmson Aero*

Engines Limited v *IRC* 22CC 29, *Murray* v *Imperial Chemical Industries Limited* 44TC 175 and *Wolf Electric Tools Limited* v *Wilson* 45TC 326. So regarded, the £25 million was, as to its entirety, a payment of a capital nature.

31. In common with HMRC we do not accept the Appellant's contention.

32. The central question for us is one of fact. For what was the £25 million consideration? The payment was made to the Appellant as an intermediary. As such, it did not own any rights to distribute Life Products; those belonged to Countrywide Assured (and subsequently to FP) who alone had the product to sell. Was the payment made in return for the Appellant ceding part of its goodwill to FP by giving up the right to exploit its customer base in respect of the Life Products for 15 years?

33. The findings of fact show that the Appellant's goodwill as a financial intermediary has at all times depended on its position in the market. The name "Countrywide Estate Agents FS Limited", and its association with and presence in the Countrywide Estate Agents' premises are continuing features of its goodwill. Those are the features that have given it access to customers. The effect of the FP Distribution Agreement therefore was to give FP access, through the Appellant, to those customers. On that basis we cannot see that the Appellant parted with any significant element of its goodwill to FP.

34. The same goes for such customer information as belonged to the Appellant. We have already noted that the detailed information relating to the contracts of life insurance belonged to Countrywide Assured as to the past transactions, and would belong to FP as to the future transactions. At most the Appellant had the prospect of ex-customers returning and kept its own list of names and addresses of those who had sought introductions from the Appellant. Our conclusion is that the Appellant was not, as regards this customer information, disposing of anything in the nature of a capital asset. It was using its access to customers by giving FP the right to be introduced to them. FP's £25 million payment was the consideration for the Appellant's undertaking to give FP access to the Appellant's position in the market and its enhanced ability to introduce FP product to customers of the Countrywide Estate Agents.

35. Did the Appellant, by foregoing the opportunity presented by the ending of Polarisation, part with a capital asset by entering into an exclusive trading agreement with FP? We do not think so. It had never been any part of the Appellant's business activities to act as a financial intermediary for more than one life insurance provider. At most the FP Distribution Agreement meant that the Appellant lost the chance to be financial intermediary for other providers. That was a possibility, not an

asset. As Nicholls LJ (as he then was) observed in *Kirby* v *Thorn EMI* [1987] STC 621 at 627, the freedom to trade is not an asset.

36. Turning to the authorities relied upon by the Appellant, we recognise that there is no single test to determine whether a receipt is of a capital or income nature. The cases show that sums paid for giving up or modifying a capital asset held by the recipient will be of a capital nature, as will sums paid for the cancellation of contractual arrangements that effectively destroys or cripples the whole structure of the recipient's profit-making apparatus. Here, the Appellant neither parted with a capital asset nor was its profit-making apparatus depleted or destroyed. Unlike *British Salmson Aero Engines*, where a third company held rights to manufacture and sell aero engines world wide and granted the tax payer an exclusive right to use such rights for 10 years in a defined territory in return for a lump sum (held to be capital), the Appellant as financial intermediary parted with no property. In *British Salmson* manufacturing and selling aero engines was the business of the recipient. Here the Appellant never provided and sold life insurance products and FP did not become a financial intermediary in relation to customers derived from Countrywide Estate Agents.

37. Unlike *Wolf Electric Tools*, where shares received as part of the arrangements whereby Wolf Electric gave up selling its manufactured goods to India (and such shares were held to be capital receipts), the Appellant has neither parted with any asset to FP nor by undertaking to introduce customers exclusively to FP product has it depleted the capital structure of its business. *IRC* v *Coia* (1959) 38 TC 334 concerned an agreement between a garage proprietor and an oil company under which the proprietor entered into an exclusivity agreement with the garage proprietor for sums of money. Those sums, held to be capital, were contributions to the capital costs of extending the garage building and premises to meet the standards required by the oil company. That was not the position in the present case.

38. We revert finally to the test expressed in the *British Dyestuffs Corporation* case, supra. The Appellant has used its goodwill and turned it to account through the FP Distribution Agreement as its "method of trading"; it has not parted with part of its property for a purchase price. On that basis the £25 million is income in nature and that amount will therefore be taxed as it is recognised for the UK GAAP in the Appellant's accounts."

6. An appeal lies to the Upper Tribunal on a point of law. In deciding on an appeal in a case of this kind whether the Tribunal at first instance has erred in law in characterising the nature of the receipt in question, the Tribunal may be accorded what might be termed (to adopt language from another context) a margin of appreciation in making its assessment. This is the familiar approach, set out in many decisions, where an overall evaluative judgment is called for

when deciding how a particular legal rule or legal concept falls to be applied in the particular circumstances of a specific case: see e.g. *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14, in particular at 34-36 per Lord Radcliffe. As Lord Diplock observed in his classic judgment in *Council for Civil Service Unions v Minister for the Civil Service* [1985] AC 374, at 410F-411A, the concept foreshadowed by Lord Radcliffe and now to be used is that of "irrationality" on the part of the decision-maker in arriving at the relevant decision or conclusion. Recent authority makes clear that this approach is applicable where the question that has to be addressed is whether a particular receipt or expenditure is to be regarded as being capital or income: *Able (UK) Ltd v Revenue and Customs Commissioners* [2007] EWCA Civ 1207; [2008] STC 136 at [20]-[22] per Collins LJ (in particular at [22], where he says, "… once as a matter of law a receipt or an expenditure is capable of being regarded as capital or income (as the case may be), then the Commissioners' decision should be capable of review only on *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14, 36 TC 207 principles") and [23] and [28] per Buxton LJ. Indeed, Viscount Simonds affirmed that it was appropriate to apply the approach in *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14 in the context of decisions whether a particular receipt is in the nature of capital or income long ago in *Jeffrey (H.M. Inspector of Taxes) v Rolls-Royce Ltd* (1962) 40 TC 443 at 490.

7. Depending on the nature of the particular issue which arises for decision by the Tribunal, the margin of appreciation available to it may be wide or narrow (or non-existent, if there is only one possible correct answer which can be given in applying the relevant legal rule to the facts of the case). I consider that the present case was located around the mid-way point in the spectrum. The issue calling for decision (whether the Upfront Payment should be characterised as a capital or an income receipt) was one which was reasonably capable of being resolved either way by the specialist decision-maker, the Tribunal – provided it had directed itself correctly as to the test to be applied - without its decision being open to criticism as irrational.

8. There was no misdirection of law by the Tribunal. Its reference to the test in the *British Dyestuffs Corporation* case was apposite. That was the test for deciding whether a receipt is in the nature of capital or income applied and approved in *Jeffrey (H.M. Inspector of Taxes) v Rolls-Royce Ltd* (1962) 40 TC 443 (see in particular at 491 per Viscount Simonds).

9. It follows from this analysis that there was no error of law by the Tribunal. It was entitled to assess the features of the FP Distribution Agreement and the general circumstances of the case in the way that it did and to arrive at the conclusion that the Upfront Payment was a receipt in the nature of income. Despite the extensive citation of authority on the appeal, in my judgment the answer to be given to the appeal is as short and simple as that.

10. Indeed, I would go further. I respectfully agree with the conclusion arrived at by the Tribunal and the reasons it gave. In particular, I agree with para. [35] of the Tribunal's decision. The Appellant did not give up a capital asset to Friends Provident in return for a payment by it. By entering into the FP Distribution Agreement the Appellant was making use of its goodwill (constituted by its relationship with other companies in the Countrywide Group, which gave it the opportunity to place its sales personnel in their estate agent offices, and also such goodwill as it had with customers who entered those offices or were referred to it or chose to trade with it because of its connection with the Countrywide name) to earn money, both in the form of commission payments and in the form of the Upfront Payment. The Upfront Payment was in my view, on proper characterisation, income earned by the Appellant from use of its goodwill, not a capital sum received by it in return for giving up any part of its goodwill to Friends Provident. In that regard, there is a relevant analogy to be drawn with the characterisation of the lump sum upfront payment in *Jeffrey (H.M. Inspector of Taxes) v Rolls-Royce Ltd* (1962) 40 TC 443 as a receipt in the nature of income (see in particular at 494-495 per Lord Radcliffe). Therefore, if this was an issue which called for me to make a judgment without regard to the decision of the Tribunal, I would have given the same answer as the Tribunal.

11. In making that observation I should make it clear that I specifically reject the submission of Mr Brandon for the Appellant that, in order to characterise a receipt as in the nature of a capital receipt in consideration for disposal of (part of) the goodwill of a company, it is sufficient for the taxpayer to show that the transaction under which payment was received had a significant impact on the goodwill of the taxpayer. In my judgment that is far too imprecise as a test, and would cover many payments which clearly are in the nature of trading income from the point of view of the taxpayer (it would be a test which could even, if taken to its full natural extension, cover every sale of an item by a trader, since each time an item of property is sold by a trader to one customer, there is an impact on its goodwill in that it can no longer sell that property to another customer).

12. Of the authorities cited to me, I think it is only necessary for me to refer in further detail to one, *Commissioners of Inland Revenue v Coia* (1959) 38 TC 334 (Court of Session), both because it represented the high point of the argument on the authorities presented by Mr Brandon QC for the Appellant and because the Tribunal's treatment of it at para. [37] of the decision was brief and (while it was in my view correct) a fuller explanation should be given on the appeal to set out in detail why the Tribunal's view of the case and why its assessment that it did not require the receipt here to be characterised as a capital receipt cannot be criticised.

13. In *Coia* the taxpayer was the proprietor of a garage selling petrol. During the Second World War and for a few years afterwards dealers who sold petrol to the public were required to purchase all their supplies from the Petroleum Board. As these arrangements were in the course of being wound up, dealers began to look to other suppliers, who competed to become exclusive suppliers to particular garages. The taxpayer had discussions with a petrol company, Esso, which offered him financial assistance to extend and improve his business premises in return for him agreeing to purchase all his petrol requirements from Esso. An agreement was entered into under which, in consideration of Esso agreeing to assist the taxpayer in making certain improvements to his premises, he undertook to take all his requirements of petrol from Esso. In accordance with this agreement, in October 1951 the taxpayer received a sum of about £422 from Esso in reimbursement of the cost of the purchase of ground at the rear of the premises and in December 1951 he received a further sum of about £462 to reimburse him part of the cost of extending the garage premises. The taxpayer treated these receipts as additions to his capital account in the relevant year. The General Commissioners held that they were correctly so treated. The Revenue appealed to the Court of Session. The appeal was dismissed.

14. In my view, on a proper reading of the judgments in the Court of Session, the whole circumstances in which the sums paid were required under the contract with Esso to be spent by the taxpayer on capital assets (additional land and improved premises) were critical to the result arrived at and the reasoning of each of the three judges. At p. 338 the Lord President said, "It is plain that the expenditure in buying the additional ground and the expenditure of extending the garage premises were capital outlays … The nature of the expenditure in the present case … would indicate that the sums paid by [Esso] to reimburse the [taxpayer] for this expenditure were also of a capital nature." At pp. 338-339 the Lord President added a further reason, as follows:

> "But the matter does not end there. These payments were made as the consideration for and in return for an onerous obligation entered into by the [taxpayer] that he would confine his petroleum purchases to [Esso] as his sole suppliers for a period of ten years. In so doing he gave up his unrestricted freedom to trade as he wished, to buy petrol from any of the various suppliers in the market, and to sell other brands of petrol to his customers at this garage. This restraint in his trading was the return which he gave for the money which he received from [Esso]. It was argued that there was no finding in the Case of the extent to which this restriction on his business did in fact reduce its goodwill, and it was said that for aught that appears the goodwill might indeed be enhanced by this restraint. But it would be astonishing if the object of this contract was that not only would the [taxpayer] get a payment from [Esso] to improve his own garage, but in consideration of that payment that he should give an undertaking which was to enhance his business goodwill as well. It is clear that he never understood that the contract was of such a character,

> and it is difficult to believe that [Esso] would ever have entered into so one-sided an agreement. From the language of the agreement it appears to me quite clear that the [taxpayer] got a money payment for a capital expenditure by him as the consideration for his giving up his freedom of trading and changing the structure of this part of his business so as to make it in effect an agency for the sale of [Esso's] fuels. [Esso] were willing to pay £1,100 for the securing of this benefit over a period of ten years. That in itself would in the circumstances of this particular agreement be enough to lead to the inference that the moneys paid to reimburse this capital expenditure were of a capital nature."

15. Mr Brandon emphasised this passage, in order to suggest that the Lord President held that the taxpayer's giving up of his general freedom to seek suppliers other than Esso (a transaction with some similarity to that under the FP Distribution Agreement) involved a sufficient impact upon or reduction in the taxpayer's goodwill as in itself to mean that the payments received by him should be characterised as being in the nature of capital receipts. In my judgment, however, on a fair reading of the whole judgment (where the Lord President had already made the point about the linkage between the reimbursement payments and the capital outlays by the taxpayer and where, at the end of the passage just cited, he emphasised that he was making observations "in the circumstances of this particular agreement") a number of factors were relevant to be taken into account in arriving at the conclusion he did. I agree with the Tribunal that the linkage between the capital outlays by the taxpayer and the reimbursement payments by Esso were important factors which were critical to the outcome of the case. If the Lord President had intended something different from this, with a more profound impact on the approach to the way in which receipts are to be characterised, I consider that he would have engaged in a far more detailed and elaborate discussion of the far from straightforward issues which would then have arisen.

16. The other judgments in *Coia* support this interpretation. The other judges took themselves to be agreeing with the Lord President, and expressed themselves in a way which involved taking a cumulative view of all the aspects of the facts in that case, including very importantly the fact that the payments made by Esso were specifically to reimburse the taxpayer for his capital outlay. Lord Patrick said:

> "Considering the agreement between [Esso] and the [taxpayer] in this case – and the construction of that agreement is a matter for this Court – it appears to me that its object and its effect was to enable the [taxpayer] to increase his capital assets by acquiring a piece of freehold ground at the rear of his premises, and by acquiring a lubrication bay and some brick extensions to his garage and workshops. In return he parted with what I regard as a valuable asset of a capital nature, the right to obtain the supplies of fuel oils which were his stock-in-trade from such sources as he might consider most suited to the varying nature of the demands made by

his customers, and the right to obtain these fuels in the cheapest market. For ten years he must buy his supplies of motor fuels Esso], and he must buy them at such prices as [Esso] chose to exact. It seems to me that a sum of money which a trader receives to enable him to obtain valuable assets of a capital nature, a sum which he can only obtain if he does so add to his capital assets, and in return for which he parts with a valuable asset of a capital nature, cannot properly be described as a trading profit. I should have thought that such a transaction should be properly entered in a capital account and not an account of the annual profits, gains and losses of the trader."

Lord Mackintosh said:

"…These payments, therefore, unlike the payments for sales promotion and advertising contracted to be made to the garage proprietor by the petrol marketing company in the very recent case if *Evans v Wheatley* to which we were referred by Crown Counsel, were payments essentially of a capital and not of a revenue nature. They were made to reimburse [the taxpayer] for capital expenditure which it was part of his agreement with [Esso] that he would lay out on the improvement and extension of his garage premises. The reimbursement was to be made only on production by him to [Esso] of receipted accounts showing that this improvement expenditure had been incurred. But sub-paragraph (7) [of the statement of facts by the General Commissioners] does not set out the whole reason why the said payments were made. The contract, which forms part of the Case, shows that the reimbursement of [the taxpayer's] capital expenditure on the enlargement and improvement of his premises was made in consideration of his agreeing to take all his requirements of motor fuels exclusively from [Esso] for a period of ten years. That requirement of the contract, whether it was likely to depreciate the value of the goodwill of the garage proprietor's business or not – a matter upon which there was no finding in fact in the Case and about which it is illegitimate to speculate – plainly in my opinion affected the overall structure of [the taxpayer's] garage business. He became henceforth for a ten-year period tied to [Esso] for all his supplies instead of being at liberty from 1953 onwards to buy and sell all the particular brands of motor fuel which were then on the market. Money received by a garage proprietor (*a*) to reimburse him for capital expenditure on his premises, and (*b*) to regulate the conditions under which he was to carry on his trade, and to do so in a way which required a fundamental reorganisation of his trading activities, cannot, in my opinion, be regarded as an income receipt in the garage proprietor's hands. In this connection I would refer to the case of *Van den Berghs, Ltd. v Clark*, [1935] A.C. 431, and especially to the passage in the speech of Lord Macmillan at the foot of page 442. I agree therefore with your Lordships that the question of law should be answered in the affirmative."

17. I therefore consider that *Coia* is not an authority which can bear the weight which Mr Brandon sought to place on it in his argument.

18. For the reasons given above, I dismiss this appeal.

TRIBUNAL JUDGE:

THE HONOURABLE MR JUSTICE SALES

RELEASE DATE: 1 December 2011