[2019] UKUT 0246 (TCC)

Appeal number: UT/2018/0053

INCOME TAX – payment of "loyalty bonus" by platform service provider to investors-whether liability to deduct tax from payments-whether payments annual payments-whether payments possessed the quality of recurrence-whether payments represented pure income profit-s 683 ITTOIA 2005

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

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

- and -

HARGREAVES LANSDOWN ASSET MANAGEMENT LIMITED **Respondent**

TRIBUNAL: Judge Timothy Herrington
Judge Nicholas Aleksander

Sitting in public at The Royal Courts of Justice, Strand, London WC2 on 25 and 26 April 2019

Laura Poots, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

John Tallon QC, for the Respondent

DECISION

Introduction

1. The appellants ("HMRC") appeal against the decision by the First-tier Tribunal ("FTT") (Judge Thomas Scott) released on 8 March 2018 ("the Decision"). The FTT allowed an appeal by the respondent ("HL") against assessments issued to HL by HMRC on 14 September 2016 under s 957 of the Income Tax Act 2007. The assessments relate to the 13 quarterly accounting periods between 1 April 2013 and 30 June 2016. The assessments were issued because HMRC contended that HL was required to deduct and account for sums representing income tax on certain payments in respect of "loyalty bonuses" made by HL, an investment platform provider, to individuals who invested in funds through HL's investment platform during those periods. HMRC contend that HL is required to deduct and account for income tax when making payments in respect of loyalty bonuses because the payments were "annual payments" for income tax purposes.

2. The FTT held that the loyalty bonuses were payable under a legal obligation and were recurrent or capable of recurrence. However, the FTT concluded that the payments did not represent pure income profit and consequently that the payments were not annual payments. Accordingly, HL's appeal against the assessments was allowed.

3. Permission to appeal against the Decision on the question as to whether the payments represented pure income profit was given to HMRC by the FTT on 9 May 2018. In its response to HMRC's notice of appeal HL contend that the FTT was wrong to conclude that the loyalty bonus has the quality of being recurrent or capable of recurrence. HL do not dispute the FTT's finding that the loyalty bonuses were payable under a legal obligation.

The Facts

4. Having recorded by way of background at [3] of the Decision that HL is a well-known "platform service provider", meaning that its business is to provide a platform for the distribution to investors of investment products offered by different fund providers, and to provide administration services to investors, the FTT made a number of findings of fact at [19] to [33] of the Decision. The FTT also made some further findings as to HL's terms and conditions and related documents at [57] to [60] of the Decision, and also made findings at [14] to [18] as to various regulatory changes which affected the way that HL was remunerated for its services. The FTT's findings relied to a significant extent on the documentary evidence that was before it, although it did have witness evidence from Mr Ben Lundie, an executive of HL responsible for managing HL's relationships and commercial negotiations with external fund management groups and companies offering products in which HL's clients might invest.

5. The FTT's findings can be summarised as follows. References to numbers in square brackets are to numbered paragraphs of the Decision.

6. HL's primary business is to present and explain a range of investment products offered by investment providers to retail investors and help their clients to invest in their chosen products. It also provides nominee and custodian services, administrative services and financial advice and information. This platform of services is collectively referred to as the "Vantage Service".

7. Although the FTT made no explicit finding to this effect, it is implicit in its decision that "retail investors" do not hold their investments through the "Vantage Service" for the purposes of any trade. Accordingly, any expenses incurred by investors in relation to their investments are generally not deductible in computing their liability to income tax.

8. At [14] the FTT referred to the result of a consultation and review carried out by the Financial Conduct Authority ("FCA") which related, among other things, to the manner in which investment platforms were funded by investment managers as a result of those investment managers agreeing to pay a proportion of their annual management charges (generally known as a "rebate") to the platform service provider who arranged for their clients to invest in those investment managers' funds through the platform. As a result of these arrangements, typically the investor paid no charges himself for the platform service provided to him. The FTT quoted at [15] the following passage from a Policy Statement issued by the FCA in April 2013 which described the key characteristics of platforms as follows:

> "Platforms are internet-based services used by advisers and retail clients to manage and administer investments online, offering a single view of the retail client's invested portfolio. They are normally investment firms and comprise a web based portal which can be accessed by either retail clients or advisers to execute investment transactions. Platforms are seen as a convenient channel through which investments can be arranged and then held in one place (for example to provide a single valuation for an entire portfolio) ….
>
> In the UK, platforms have in the past generally been funded by payments from product providers. These payments, commonly referred to as 'rebates' in the UK, are a proportion of the fund manager's annual management charge (AMC) paid by the retail client. As a result, many platforms…. have been able to market their services at no explicit cost to the retail client. In contrast, some other types of platform charge retail clients a separate fee for their services and any cash rebate is generally paid into the retail client's cash account."

9. At [17] the FTT recorded the FCA's conclusion that this fee structure created risk for investor protection and hindered transparency. Accordingly, it changed its rules from April 2014 with the effect that, subject to certain transitional arrangements, cash rebates by platform providers to investors would only be permitted if (broadly) a rebate received by a platform from a fund manager was passed on in full to the investor in the form of additional units in the relevant fund or, subject to conditions, in cash. Platform providers would no longer be able to retain a share of the annual management charges paid by the investor to the investment provider but would be obliged to charge their clients a direct fee for

their services. These changes were implemented by new rules in the FCA's Conduct of Business Sourcebook (the "New Rules").

10. At [21] the FTT found that prior to the New Rules HL did not charge clients an explicit fee for its services but earned its profit by retaining a share of the annual management charge levied by investment providers and in part "rebated" to HL.

11. At [22] the FTT recorded its understanding as to how an investment manager of a retail investment fund was remunerated through the medium of an annual management charge ("AMC") for its services of managing the fund's assets as follows:

> "… AMCs are monthly fees paid (or more accurately borne) by investors to investment providers in return for managing their investment in a given fund. A typical AMC (subject to what is said at [29]) would be 1.5% of the value of an investor's shares or units in a fund. In the retail market, AMCs are generally collected directly from the relevant fund rather than being paid by an investor as a separate fee."

12. The FTT recorded at [23] HMRC's contention that the AMC was not paid by the investor but by the fund entity to the fund manager.

13. At [24] the FTT found that HL negotiated lower AMCs with investment providers on behalf of HL clients, which was generally implemented by the investment manager "rebating" part of its AMC to HL, rather than providing a new class of share for HL clients which attracted a lower AMC than other classes of share in the fund.

14. At [25] the FTT found that prior to the New Rules coming into force, in order to pass on to investors part of the benefit of any reduced AMC, HL would pay to investors a "loyalty bonus" (the "Loyalty Bonus"), the remainder of the "rebate" paid by the fund manager being retained by HL. At [26] the FTT recorded HMRC's contention that the Loyalty Bonus is properly described as a "trail commission".

15. At [27] the FTT found from the terms of the contracts entered into between HL and the various investment managers that the amount "rebated" to HL was calculated as a percentage of the AMC "paid or borne" by the investors in the relevant fund. In making those findings the FTT was clearly aware of the terms of the contractual arrangements entered into between the various fund managers and HL, samples of which were available in the evidence before the FTT and which we were taken to in some detail. In particular, the samples we saw clearly show that the investment manager paid to HL a sum described as a rebate, expressed as a stated share of the AMC for the relevant fund, that payment being expressed as consideration for HL acting as intermediary between its clients as investors in the relevant fund in relation to transactions in the funds and promoting the funds to its clients.

16. At [28] the FTT found that HL had a complete discretion over the size of the Loyalty Bonus paid to investors in a particular fund.

17. At [29] the FTT set out the two basic criteria that HL applied in deciding whether to pay a Loyalty Bonus. The first was that the client retained the relevant investment at the end of any given calendar month. The second was that the client had paid, or borne, the AMC in respect of that investment. Prior to 1 March 2014 it was also necessary that the investment had been held for a full calendar month, and that the value of the holding was at least £1,000.

18. At [32] the FTT summarised the effect of the New Rules, namely that any rebate of an AMC received by HL from an investment provider had to be passed on in full by HL to its client. The effect of this was that the Loyalty Bonus equalled the entirety of any rebate negotiated by HL. Investors would pay a platform fee to HL, calculated as a small percentage of the value of their funds under management.

19. At [33] the FTT found that the Loyalty Bonus was generally paid by HL crediting cash to the relevant client account, and once that cash had reached £10 reinvesting that cash into shares or units within the investor's portfolio.

20. At [57] and [58] the FTT set out the extracts from the terms and conditions of the Vantage Service which provided at the relevant times for the payment of the Loyalty Bonus as follows:

> "57. The terms and conditions of the Vantage Service for April 2013 (the first of the periods under appeal) included the following statements:
>
> > "A4- Loyalty Bonus
> >
> > [HL] may amend the level and frequency of loyalty bonus payments at any time. The amount of loyalty bonus payable by [HL] on each fund is published on our website and is available on request. The method of calculating loyalty bonuses and the loyalty bonus we pay on each fund is available on request.
> >
> > A7- Amendments
> >
> > We can amend these terms, including our fees and charges, by giving you reasonable notice of the change…
> >
> > We will give you at least 30 days' notice of any change to these terms that may be detrimental to you, unless we are required to make the change sooner (for example, for regulatory reasons) …
> >
> > We may amend or remove the levels of fund discount at any time."
>
> 58. The terms and conditions which took effect from 1 March 2014, and which continued in force for the period after the New Rules, contained similar provisions relating to amendments to terms, and stated as follows:

> "A4- Loyalty Bonus
>
> You may be entitled to a Loyalty Bonus if you invest in certain investments. Loyalty Bonuses are calculated according to the value of the relevant investment as at the end of each month.
>
> The level of Loyalty Bonus payable is available on each investment's factsheets.
>
> For units purchased before 1 April 2014: Loyalty Bonuses are paid in cash into each Account and you may withdraw, invest or use this cash to settle fees. The level of Loyalty Bonus paid on each fund and the frequency of payment is entirely at our discretion and may be amended at any time.
>
> For units purchased, or transferred to us, on or after 1 April 2014: (a) Loyalty Bonuses are paid in units, (b) Loyalty Bonuses will be paid into each Account and will be re-invested on a monthly basis into units in your largest eligible investment (by value) on reaching a cumulative total of at least £50, (c) Where there are restrictions on buying your largest holding, [HL] may choose an alternate holding at its discretion…
>
> A42-Definitions
>
> … "Loyalty Bonus" means a benefit you may be entitled to receive depending on the funds in which you have invested, as explained in Section A4…" "

21. We were taken to the relevant terms and conditions which contain the above extracts. We make the following additional observations on the terms.

22. As regards the pre-April 2014 conditions, in the introductory section, it was made clear that the terms apply to investments which are available through the Vantage Service, namely those investments which HL has contracted with the relevant fund manager to include on the platform and which investors accordingly may invest in through HL. Section A 20, which describes how HL is paid, makes no reference to its receipt of the rebate from the relevant fund managers or the fact that the share of that rebate forms the basis of the Loyalty Bonus.

23. As regards the post-April 2014 terms and conditions, the introductory section states that the terms:

> "will apply to you once you open an Account with us. They set out your rights and responsibilities when you invest through (and our rights and responsibilities when we supply you with) the HL Vantage Service".

24. Section A 21 deals with charges for the service, referring the investor to a separate tariff. Section A 22 refers to the fact that HL may receive payments from the investment managers or other providers with whom it places business for the distribution and administration of their investments. It makes no specific reference to its receipt of the rebate or the fact that, in accordance with the New

Rules, any such rebate had to be passed on to the investor or that the Loyalty Bonus was effectively funded out of the rebates received by HL.

25. At [59] and [60] the FTT referred to the various "Factsheets" prepared for particular funds available on the platform that for regulatory purposes HL had to provide to investors when arranging for them to invest in those funds. The FTT found that for the period before the New Rules the Loyalty Bonus was expressed as a percentage of funds invested and showed it both as a separate percentage and as a reduction to the net AMC for that fund. For the period after the introduction of the New Rules what was shown was the annual charges for a fund and an "ongoing saving from HL" expressed as a percentage. It was stated that "in some cases the ongoing savings are provided by our loyalty bonus."

26. We were also taken to those Factsheets and it is helpful, for the purposes of our discussion later, to show precisely how the AMC and the Loyalty Bonus were shown.

27. In respect of the period before the New Rules, the example we saw showed the following as part of a table setting out the various charges:

Fund manager's annual charge:	1.25%
HL saving on annual charge (loyalty bonus):	0.125%
Net annual charge:	1.13%
HL platform charge:	free

28. In respect of the period after the New Rules, the relevant part of the table of charges contained in the sample we saw showed:

Ongoing charge:	1.32%
Ongoing saving from HL:	0.715%
Net ongoing charge:	0.605%

29. There was no reference to the separate platform fee that HL now had to charge for its services.

The Law

30. The concepts underlying the taxation of "annual payments" have a long history in UK tax law, probably going back to Addington's original income tax legislation. In common with yearly interest, annual payments (when made out of taxable income) were treated as a charge on income, deductible for income tax purposes in the hands of the payer, and liable to income tax in the hands of the recipient.

31. This was achieved by permitting the person making the payment to deduct and retain income tax from the payment. The recipient suffered basic rate income tax on the payment as a result of the withholding and was not further assessed to income tax on the payment. The payer obtained the benefit of relief as a result of retaining the tax withheld.

32. We were referred to s 169 Income Tax Act 1952 which set out these principles. These principles have been considerably amended and modified since, not least to address the introduction of corporation tax in 1965, the abolition of surtax in 1972, and the removal of the schedular system from tax law.

33. The current legislation is to be found in s 683 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") which so far as relevant provides:

> "(1) Income tax is charged under [Chapter 7 of Part 5] on annual payments that are not charged to income tax under or as a result of any other provision of this Act or any other Act
>
> ….
>
> (3) The frequency with which payments are made is ignored in determining whether they are annual payments for the purposes of this Chapter."

34. The obligation to deduct at source is found in s 901 of the Income Tax Act 2007 ("ITA 2007") which so far as relevant provides as follows:

> "(1) This section applies to any payment made in a tax year if-
>
> (a) it is a qualifying annual payment, and
>
> (b) the person who makes it is not an individual.
>
> …
>
> (4) If the person who makes the payment has no modified net income for the tax year the person by or through whom the payment is made must, on making it, deduct from it a sum representing income tax on it at the basic rate in force for the tax year in which the payment is made."

35. Section 899 ITA 2007 sets out the definition of "qualifying annual payment" and so far as relevant provides as follows:

> "(1) In this Chapter "qualifying annual payment" means an annual payment that meets the conditions in subsections (2) to (5).
>
> (2) The payment must arise in the United Kingdom.
>
> (3) If the recipient is a person other than a company, the payment must be-
>
> (a) a payment charged to income tax under-

…

(iv) Chapter 7 of Part 5 of [ITTOIA 2005] (annual payments not otherwise charged)

…"

36. Chapter 15 of Part 15 of ITA 2007 provides for persons who have made "section 946 payments" to make returns of those payments, and to collect income tax in respect of them. Section 946 ITA 2007 so far as relevant provides as follows:

> "The payments within this section are-
>
> …
>
> (b) a payment from which a UK resident company is required to deduct a sum representing income tax under-
>
> … (iv) section 901(4) (annual payments made by persons other than individuals) …"

37. The assessments to which this appeal relates were made under section 957 ITA 2007, which states as follows:

> "(1) This section applies if an officer of Revenue and Customs thinks-
>
> (a) that there is a section 946 payment which should have been included in a return under this Chapter and which has not been so included, or
>
> (b) that a return under this Chapter is otherwise incorrect.
>
> (2) An officer of Revenue and Customs may make an assessment, to the best of the officer's judgment, on the person who made the return, or should have made one."

38. It was common ground in this case that if the payments made by HL in respect of the Loyalty Bonus were annual payments, then they were "qualifying annual payments" and therefore s 946 ITA 2007 would apply to those payments.

39. The term "annual payment" is not further defined in legislation and its meaning is to be found in case law. As correctly held by the FTT at [42] the authorities establish that an annual payment is a payment which has four characteristics, as follows:

(1) It must be payable under a legal obligation.

(2) It must recur or be capable of recurrence, although the obligation to pay may be contingent.

(3) It must constitute income and not capital in the hands of the recipient.

(4) It must represent "pure income profit" to the recipient.

40. It was common ground that the Loyalty Bonus payments constitute income in the hands of investors so that the third of the four characteristics set out above was satisfied. The FTT also held, following its analysis of the Vantage Service terms and conditions, that the Loyalty Bonus payments were paid under a binding legal obligation and there is no appeal against that finding. The dispute in this case centres around the second and fourth of the four characteristics set out above.

41. We deal with the authorities which are relevant to the interpretation of "recurrence" and "pure income profit" when considering the arguments of the parties later in this decision.

The Decision

Capable of recurrence

42. HL argued before the FTT that the necessary feature of recurrence was not satisfied because HL could reduce the amount of a Loyalty Bonus to zero. In those circumstances, it was submitted that if an offer to pay the Loyalty Bonus could be withdrawn at any time, the necessary feature of recurrence was lacking.

43. The FTT rejected those submissions and concluded that the Loyalty Bonus payments were capable of recurrence. Its reasoning was set out at [73] and [74] as follows:

> "73. I find no support in the authorities for the distinction proposed by [Counsel for HL]. Nor do I see any persuasive reason to adopt such a restriction in light of the discernible purpose of the recurrence characteristic as part of the "annual payment" criteria. The authorities identify the characteristic in the context of establishing that a payment is not a "one-off" payment in the nature of capital but has the "quality" of a payment which will or may recur. The approach proposed by [Counsel for HL] would rob the words "capable of" of any substantive meaning and would effectively extend the first characteristic so that it became necessary to establish a continuing binding legal obligation, with the minimum period of such continuance at large.
>
> 74. The Loyalty Bonus payments were not only "capable of recurrence", but they did recur, over many months and for the periods in this appeal. They are not prevented from being recurrent by depending on a contingency, and, per *Smith v Smith*, were not prevented from being annual because they were made monthly provided they might continue beyond a month."

Pure income profit

44. At [77] the FTT explained the rationale for this characteristic as follows:

> "The requirement for the receipt to be pure income profit lies at the heart of what is meant by an "annual payment". It is therefore critical to understand the underlying rationale which led the courts to lay down this principle. It does not focus on the position of the payer, and in particular does not depend on an element of gratuity or bounty on the part of the payer. Rather, it is driven by the application of the deduction at source mechanism to annual payments. Under that mechanism someone other than the taxpayer (namely the payer) must collect and discharge all or part of the taxpayer's liability for the receipt. That mechanism would operate improperly if the payment comprised anything other than a *gross* receipt of the payee. The rather archaic phrase "pure income profit" is no more than shorthand for this principle".

45. At [82] the FTT recorded that the parties did not dissent from the proposition that pure income profit at its most basic was essentially income that is received without the person in receipt of that income having to do anything in return, that is no outgoing or expense has been incurred for receipt of the income.

46. With that principle in mind, at [98] the FTT held that the authorities establish that it is the character or nature of the payment which determines whether it is pure income profit. It went on to say at [99] that in general terms, an AMC would be likely to be understood by a typical investor to be a cost he would have to bear each year in order to invest or remain invested in a particular fund.

47. At [103] the FTT criticised HMRC for offering no evidence to support their understanding that the AMC is taken from or paid by the fund entity and is not paid by the investor. It then went on to consider the other evidence available and said at [109] and [110]:

> "109. Having considered the evidence put forward by the parties, and all the facts and circumstances, I have reached two conclusions. First, although the AMC is not paid as a separate fee by an investor, it is a compulsory charge directly borne by him as a term of investing through HL. Secondly, HL consistently and clearly presented the Loyalty Bonus to investors as a method of reducing or discounting the net cost of investing in a fund through HL.
>
> 110. The mechanism by which an AMC was charged to an investor and the relationships between the different fund flows were far from transparent to an investor. Indeed, that was a large part of the FCA's rationale in imposing the New Rules. However, an investor would or should have understood that the AMC would be charged against his fund investment and would be effectively reduced by the Loyalty Bonus. He would or should have understood that following the New Rules the fund structures and money flows would change, but in net terms he should be no worse off, and might be better off, by remaining invested through HL."

48. At [113] the FTT held that the language used in the documentation relating to the AMC "can only sensibly be read as indicating that the AMC is an annual charge to investors for investing in a fund". It went on to say that the mechanic for collecting that charge (presumably here the FTT was referring to the charge being paid to the manager of the fund) "does not alter the burden and responsibility on

the investor to bear the charge." The FTT relied on a statement in Mr Lundie's witness statement which described AMC's as "monthly fees payable by Investors to Investment Providers in return for managing their investment in a given fund" and the fact that the Vantage Service Terms and Conditions list the AMC under "charges you [the investor] pay" as a charge "taken from the Fund".

49. The FTT then concluded that the Loyalty Bonus payments were not pure income profit. Its reasoning was set out at [116] and [117] as follows:

> "116. In my judgment, the evidence makes it plain that the nature and quality of a Loyalty Bonus payment is that it is not a "profit" to an investor, but a reduction of his net cost. It is quite unlike an annuity payment or interest in respect of which a recipient need do nothing but sit back and receive the payments. The assertion by HMRC that an investor does not need to pay or bear an AMC to receive a Loyalty Bonus and that there is nothing in the contract between HL and investors to impose the AMC ignores the plain terms on which HL offers and permits investment to be made. The terms and conditions, and indeed the marketing material, could scarcely make it plainer that in investing through HL in a particular fund, a schedule of charges will apply. Investment on terms that HL would meet what I have found (and HMRC assert) to be a binding legal obligation to pay the Loyalty Bonus each month, but without the recipient being charged the applicable AMC, is not an option, and would be a commercial nonsense. Yet that in substance is what HMRC say occurs when a Loyalty Bonus is received, because it is "pure income profit".
>
> 117. HMRC's analysis seeks to recharacterize and unpick the various payment flows taking place on a fund investment in order to isolate the Loyalty Bonus and treat it as pure profit. That approach is not the way to establish objectively the nature and quality of the payment; the Loyalty Bonus is a mechanism for reducing net cost, nothing more and nothing less."

Grounds of Appeal and issues to be determined

50. HMRC's grounds of appeal can be summarised as follows:

> (1) On the basis that the investors did not pay the AMC (which is payable out of the fund entity directly to the fund manager), and were not liable to pay the AMC, the FTT erred in finding that an investor had to have "paid, or borne, the AMC" in respect of investment in order to receive the Loyalty Bonus. The fund manager will receive the AMC (from the fund entity) as a result of the continued existence of the investment in the fund, but this did not require any action or payment by the investor in order to receive the Loyalty Bonus. The investor need do nothing more than continue to hold the investment in the fund.
>
> (2) The FTT erred in law by concluding at [116] that the AMC was a compulsory charge as a term of investing through HL because the AMC is charged by the fund manager at the same rate by reference to all investments in the funds whether the investor invests through HL or not.

(3) The FTT erred in law by making findings of facts that were not open to it at [24] and [25], as set out at [13] and [14] above. It was clear from the contractual agreements between HL and the various fund managers that the fund managers agreed to pay amounts to HL and HL was not responsible for paying the AMC so that it was not open to the FTT to find that HL negotiated lower AMCs on behalf of its clients.

(4) On a proper understanding of the facts the only thing that the investors had to do to receive the Loyalty Bonus was to maintain their investment. The investors did not have to pay the AMC because they were never under any obligation to do so, the AMC being collected from, and paid by the fund entities. Consequently, since the investors were not obliged to pay the AMC the Loyalty Bonuses received by the investors were gross receipts from which no deductions were necessary.

51. In its response to HMRC's Notice of Appeal, HL contends that the FTT's reasoning and conclusions in relation to the pure income profit issue are correct, particularly its conclusion at [117] that the Loyalty Bonus is a mechanism for reducing net cost, nothing more nothing less. The payment of the Loyalty Bonus delivered a reduction in cost for investors which achieved the same economic result of there having been a special class of share for those investing through HL as a result of negotiation of a rebate from the fund manager, part of which was paid by HL to investors by way of the Loyalty Bonus pursuant to its bargain with them.

52. HL accepted that there was no direct contractual obligation between the investors and the fund entity or investment manager of the fund entity to make a payment in discharge of AMCs, but it was clearly a term of investing that AMCs would be levied and investors were made fully aware of that by HL.

53. HL contends that the FTT was wrong to conclude at [75] that the Loyalty Bonus has the quality of being recurrent or capable of recurrence on the basis that as the Loyalty Bonus could be reduced to zero at any time the necessary feature of recurrence was lacking.

54. HMRC contend that the FTT was correct in its conclusions at [75]. The fact that HL can bring its ongoing obligation to pay the Loyalty Bonuses each month to an end does not deprive the payments of the quality of recurrence. Where a contract envisages and expressly imposes an indefinite obligation to make a payment each month, that payment is capable of recurrence.

55. It is therefore clear that as far as the pure income profit issue is concerned, the key question that we need to determine is whether the investor received the Loyalty Bonus without having to do anything in return, or whether on the contrary the investor incurred an expense in return for receiving the Loyalty Bonus, namely the fact that he had to bear the AMC so that the payment of the Loyalty Bonus was simply a payment in reduction of an expense that the investor was obliged to bear.

56. As far as the recurrence issue is concerned, the question is whether in circumstances where a contractual obligation to make a recurring payment continues unless and until the party making the payment, in accordance with the terms of the contract, brings its obligation to do so to an end, it can be said that the payments concerned are capable of recurrence.

57. As HMRC is the appellant this appeal, we shall deal with the pure income profit issue first.

The pure income profit issue

The authorities

58. We agree with the FTT's analysis of the concept of "pure income profit" as summarised at [77] of the Decision and set out at [44] above. That analysis is consistent with the authorities.

59. In particular, as was said by Lord Radcliffe in *CIR v Whitworth Park Coal Co Ltd* 38 TC 531 ("*Whitworth Coal*"), the category of annual payments is limited and the reason for the limitation lies in the fact that annual payments have been inseparably associated with payments from which tax is deductible. It has been thought to be inconsistent with the idea of tax being deducted at the source to allow payments that are likely to be gross receipts of the payee and not "pure income profit" to be classed as annual payments: see page 575 of the report.

60. Where the payee is a trader, the concept is easy to grasp in principle. The FTT set out at [79] the much-quoted example given by Scrutton LJ in *Earl Howe v CIR* 7 TC 289 at page 303:

> "It is not all payments made every year from which Income Tax can be deducted. For instance, if a man agrees to pay a motor garage £500 a year for five years for the hire and upkeep of a car, no one suggests the person paying can deduct Income Tax from each yearly payment. So, if he contracted with a butcher for an annual sum to supply all his meat for a year, the annual instalment would not be subject to tax as a whole in the hand of the payee, but only that part of it which was profits."

61. As the FTT recognised at [80], the question becomes more difficult where, as in this appeal, the recipient is not a trader. Mr Tallon relies on what was said by the Court of Appeal in *CIR v National Book League* 37 TC 455, a case concerning covenants entered into by members of the League to pay their subscriptions and whether payments made under those covenants were annual payments. The Crown had contended that the payments were received in consideration of the annual provision of goods and services and were not annual payments. At page 473 Lord Evershed MR placed emphasis on the counter-stipulations on the part of the League to provide membership benefits as follows:

> "The question, therefore, as I see it, turns first upon this: looking at the substance and reality of the matter, can it be said that those who entered into these covenants

> have paid the sums covenanted without conditions or counter stipulations? On the whole I have come to the conclusion that they cannot so say. It seems to me that against the special background of this case, and having regard to the terms of the letter, there was here, in a real sense, a condition or counter stipulation on the part of the League against which the covenant was entered into. Without repeating what I said at the beginning of this judgment, I must guard myself again saying that whenever you find a covenantor in favour of a charity getting aloud to him certain privileges it therefore follows that such a covenant or no longer can say that he has paid without conditions or counter stipulations."

62. However, it is clear that the presence of counter stipulations is only one of the circumstances to be considered. This point was emphasised by the House of Lords in *Campbell v CIR* 45 TC 427 where Lord Donovan said at page 475:

> "The truth is, in my opinion, that one cannot resolve the problem whether a payment is an annual payment… Simply by asking the questions "Must the payee give or do something in return?" or "Did the payer make some counter-stipulation or receive some counter-benefit?" or "Was it pure bounty on his part?" Such questions come more easily to the mind perhaps where, as here, payment to a charity is involved. But there is no warrant in the Income Tax Acts for applying a special test in the case of charities. The test must be applicable to all annual payments; and the problem must continue to be resolved, in my opinion, on the lines laid down by Scrutton LJ in Earl Howe's case. One must determine, in the light of all the relevant facts, whether the payment is a taxable receipt in the hands of the recipient without any deduction for expenses or the like—whether it is, in other words, "pure income" or "pure profit income" in his hands, as those expressions have been used in the decided cases. If so, it will be an annual payment ... If, on the other hand, it is simply gross revenue in the recipient's hands, out of which a taxable income will emerge only after his outgoings have been deducted, then the payment is not such an annual payment…The test makes it necessary to decide each case on its own facts."

63. On the basis of these authorities we find that it is for the tribunal to determine the question as to whether the payments in question amount to pure income profit in the hands of the payee in the light of all the relevant circumstances. That will include an analysis of the various contractual arrangements entered into between the parties. In this case, in particular, it is necessary to examine carefully the contractual arrangements entered into between HL and the fund managers on the one hand and HL and the investors on the other hand as well as the relationship between the investor and the fund and consider the character of the payments in question in the light of those arrangements.

The contractual arrangements

Who pays the AMC?

64. One of HMRC's key criticisms of the Decision is that the FTT based its findings on the premise that the investor had "paid or borne" the AMC.

65. It is unfortunate that neither party adduced sufficient evidence or made submissions based on the relevant legislation and regulatory provisions before the FTT that would have enabled the FTT to have made clear findings as to whether it was the fund entity or the investor who was under an obligation to pay the AMC to the fund manager in return for the services of the fund manager. As we have observed at [47] the FTT criticised HMRC for offering no evidence to support their understanding that the AMC is taken from or paid by the fund entity and is not paid by the investor.

66. This is an expert tribunal, and the members of this Tribunal panel are knowledgeable about the regulation and taxation of investment funds and the manner in which investment funds are structured. Based on our own knowledge, we were able to inform the parties at the hearing as to the legal position regarding the payment of AMCs, taking judicial notice of the relevant legal and regulatory provisions governing retail investment funds, that is investment funds established in the UK which are authorised by the FCA so that they can be marketed to the public, or equivalent entities in other member states of the EU which under passporting arrangements can also be marketed to the public in the UK.

67. It was confirmed to us at the hearing that the relevant entities in this case were either open-ended entities established in the UK in the form of unit trusts or open-ended investment companies ("OEICs") or the equivalent of OEICs established in Luxembourg or Ireland.

68. An OEIC is a body corporate. That is clear from Regulation 3 (1) of the Open-Ended Investment Companies Regulations 2001 which provides that if the FCA makes an authorisation order permitting an OEIC to be marketed to the public then immediately upon the coming into effect of the order, the body to which the authorisation order relates is to be incorporated as an open-ended investment company.

69. That part of the FCA's Handbook of rules and regulations known as the Collective Investment Schemes Sourcebook (COLL) sets out, among other things, how an OEIC is to be managed and the manner in which expenses of management can be paid.

70. In particular, COLL 6.5.3 requires an OEIC to appoint an authorised corporate director, that is an entity authorised by the FCA to act as the authorised fund manager of the OEIC. In that capacity the authorised corporate director will have the overall responsibility of managing the OEIC's assets, although it may delegate some or all of those functions to a sub-manager.

71. Typically, therefore, in order to meet this obligation, the OEIC will appoint an authorised corporate director under a contract pursuant to which the authorised corporate director will agree to manage the OEIC, including responsibility for managing its fund. The contract governing the relationship between the OEIC and the authorised corporate director will include provision for payment of an AMC to the authorised corporate director in return for its services. It is therefore

clear from the structure that it is the OEIC which has the responsibility to pay the AMC out of its assets directly to the authorised corporate director. The investor therefore has no legal obligation to pay the AMC.

72. That position is reinforced by the provisions of COLL 3.2.6 which set out the provisions that must be included in the instrument of incorporation establishing the OEIC. Among other things, that rule contains a provision that the investor is not liable to make any further payment after he has paid the price of his units in the fund and no further liability can be imposed on him in respect of the units which he holds. The instrument must also contain a statement setting out the basis on which the authorised corporate director may make a charge and recover expenses out of the property of the OEIC.

73. Our understanding is that similar structures are adopted for the equivalent of OEICs in Luxembourg and Ireland: again, those vehicles are separate legal entities and engage fund managers to whom they are liable to pay AMCs.

74. A UK unit trust is not a body corporate. It is constituted by a trust deed executed by a trustee. The trustee holds the assets of the unit trust on trust for the unit holders according to their respective shares in the assets of the fund and an authorised fund manager has the responsibility for managing the assets of the fund. COLL 6.7.4 authorises payments out of the property of the fund in order to remunerate those operating the fund (that is both the trustee and the authorised fund manager). That clearly includes payments to the authorised fund manager in respect of AMCs.

75. Therefore, it is clear that unit holders do not pay AMCs themselves. The trustee who has custody of the assets, makes the necessary payments to the authorised fund manager out of the fund's assets. The same provisions regarding the contents of the instrument of incorporation referred to at [72] above which apply to OEICs also apply to unit trusts, so the unitholder is not liable to make any further payment after he has paid the price of his units.

76. It is therefore clear that in respect of the funds which are relevant to this appeal, there was no obligation imposed upon investors to pay AMCs to the relevant fund managers.

77. It is again unfortunate that the only direct evidence available to the FTT on that issue was the statement in Mr Lundie's witness statement referred to at [50] above and also the FCA's policy statement referred to at [8] above. The second paragraph of that quoted at [8] above refers to the AMC being "paid by the retail client." It will be apparent from our analysis of the legal position that both those statements were misleading.

78. We note that the FTT did not make any express finding that AMCs were paid by the investor. At [22], as quoted at [11] above, the FTT described AMCs as being borne rather than paid by investors, a formulation which it repeated at [29]. At [109] it said that "although the AMC is not paid as a separate fee by an investor,

it is a compulsory charge directly borne by him as a term of investing through HL." The waters were muddied a little, however, by its statement at [113] that the AMC "is an annual charge to investors for investing in a fund." But it then went on to say that it was the responsibility of investor to "bear the charge", in which context it relied on Mr Lundie's witness statement. On balance, we find that the FTT understood the difference between the investors bearing the charge, in the economic sense, and being liable to pay it, as a matter of legal obligation.

What is meant by "bearing the charge"?

79. In that context, we need to examine the relationship created between the investor and the fund entity as a result of the investor agreeing to invest in the fund. The investor agrees as a matter of contract to acquire shares or units in the fund, upon the terms of the fund documentation, which will include the relevant provisions contained in the constitutional documents regarding the payment of AMCs and their amount. Therefore, as a matter of contract the investor has agreed to invest in the fund on the basis that payments will be made out of the property of the fund to meet the AMCs which are payable according to the terms of the constitutional documents. The effect of payment of AMCs is that the assets of the fund will be diminished by the amount of those payments. As AMCs are normally paid out of the income of the fund, derived from dividends and interest received on the investments in which the fund is invested, the effect of charges is to reduce the income return that would otherwise be provided to the investor through the payment of distributions out of the fund. Alternatively, if the income is insufficient, or it was decided (which is permissible under COLL) as a matter of policy to pay AMCs out of capital, then the value of the investor's units would be diminished through the effect of charges.

80. Regulatory provisions laid down in European Union Regulation 1286/2014 require those who advise on or sell retail investment funds to disclose the effect of charges on the value of an investor's investment in the fund. It is necessary for a key information document to be prepared which, among other things, under a section headed "what are the costs?" requires the promoter to disclose what are the "costs associated" with the product "comprising both direct and indirect costs to be borne by the investor" and to show the compound effect of the total costs and the value of the investment. It is clear that as far as the investor is concerned, the AMC would be regarded as an "indirect cost" for this purpose.

81. That position is the same for any investor in the fund, whether or not he has invested as a result of being introduced through HL. It is clear from that analysis that an investor bears the same level of AMCs regardless of the route through which he made his investment in terms of the impact of charges on the value of the assets of the fund and the distributions that are made out of the property of the fund. Therefore, in our view the fact that the investor has become invested in the fund through arrangements made by HL does not, in our view, affect the level of AMC borne by the investor.

82. The FTT states at [109] of the Decision that the AMC "is a compulsory charge directly borne by him as a term of investing through HL." We find that the AMC is borne by the investor in the sense that payments of the AMC by the fund to the fund manager will reduce either the level of distributions made to the investor or the value of his investment, as described above. However, we find that the AMC is not borne by the investor in the sense that the AMC is paid by him to the fund manager, rather it is paid by the fund to the authorised fund manager.

83. It is clear from the Factsheets that were included in the FTT hearing bundles that HL discloses the cost representing AMCs both as a gross figure and a net figure after the deduction of the Loyalty Bonus. We make no comment as to whether that is the correct method of disclosure for the purposes of the EU Regulation referred to above, but in any event it has no effect on the legal position. We find that the investor bears the gross amount of the AMC as an indirect cost of investing in the fund. We also note that the key information documents prepared by the fund manager in relation to funds promoted by HL and which would have been provided to the investor at the time of them applying for units in the fund disclosed the AMC at the gross rather than net level, as found by the FTT at [105].

84. The arrangements negotiated by HL which resulted in a rebate of part of the AMC to HL did not have the effect of reducing the AMC which the fund paid and the investor bore as a result of him becoming an investor in the fund.

85. Although the Loyalty Bonus is expressed in HL's factsheets as reducing the AMC, it might have been better (and more accurately) presented to investors on the basis that the effect of HL agreeing to pass on part (before the New Rules) or all (after the New Rules) of the rebate by means of the Loyalty Bonus was to increase the return received by the investor from the fund.

The arrangements between HL and the fund manager

86. In our view, the contracts entered into between HL and the various fund managers, sub-managers, or other related entities (for convenience, we refer to all of these entities as "fund managers") are properly characterised as creating purely bilateral obligations between HL and the relevant fund manager pursuant to which the fund manager pays HL cash consideration in return for HL agreeing to place the fund manager's funds on its platform and to make investment in those funds available to HL's clients. The payments in question are calculated by reference to the amount of the AMC and operate in practice so as to give HL a share of the AMC payable by the relevant fund to the fund manager.

87. As a matter of contract, those arrangements were purely for the benefit of the contracting parties to the arrangements and nothing is said about whether the payments which are made to HL are to be passed on for the benefit of its clients. The fund manager has no contractual right to determine what HL must to do with those payments when it receives them. It is a matter of choice for HL, subject to its regulatory obligations, whether to retain those payments entirely for itself or whether to pass on all or any part of the payments to its clients. The fund manager

had no right or obligation to ensure that all any part of the sums received by HL were passed on to its clients.

88. We agree with HMRC that the payments concerned might properly be described as a form of commission, commonly called a trail commission, since the payments are made by reference to the value of the funds invested by HL's clients, the payments continuing so long as the relevant investor remains invested in the fund.

89. Prior to the New Rules, bearing in mind that the terms and conditions of the Vantage Service make it clear that the amount of the Loyalty Bonus is discretionary, it was entirely a matter for HL as to the extent to which it chose to share the payments it received from the fund manager with its clients.

90. As we have set out above, the position following the New Rules was different because if HL did receive a rebate, the New Rules required it to use the sums received in purchasing additional units in the relevant fund for the investor or paying it to the investor in cash. However, as the terms of the contractual arrangements between HL and the fund manager did not change following the introduction of the New Rules, our analysis of the contractual arrangements as set out above continued and continues to hold good.

91. As there is no contractual link between the payment of the Loyalty Bonus and the amount of the AMC, we find that the payment of the Loyalty Bonus does not result in a reduction in the amount of the AMC payable by the fund. As Ms Poots submitted, the fund managers did not actually offer lower AMCs to HL investors or to the fund entities in respect of investments made by HL investors.

92. Because there is no contractual link relating to the Loyalty Bonus between the investor and the fund, the payment of the Loyalty Bonus does not directly reduce the cost to the investor of investing in the fund. Consequently, there is nothing in the Loyalty Bonus arrangements that supports the FTT's conclusion that the payment of the rebate by the fund manager to HL reduced the net cost to the investor of investing in the fund.

The Terms and Conditions of the Vantage Service

93. It is apparent from the terms and conditions, as we observed at [24] above, that there is no specific reference to the terms on which HL receives a rebate from the fund managers, or any suggestion that all or any part of it was received on behalf of the investor.

94. As the FTT found at [57] the detailed conditions regarding the amount of the Loyalty Bonus to be paid were to be found on HL's website. At [29] the FTT found that there were two basic criteria that a client had to satisfy in order to receive a Loyalty Bonus. Those criteria are not specifically stated in the terms and conditions we saw, except that the post-New Rules version does state that the Loyalty Bonus is calculated according to the value of the relevant investment as at the end of each month. Therefore, by implication, if the investment had been

disposed of by the investor before the end of the month, he would not be entitled to a Loyalty Bonus in respect of that investment. As HMRC did not challenge the existence of that criteria in respect of the position prior to the New Rules, we assume that the condition was set out elsewhere, possibly on the website.

95. However, HMRC do challenge the finding that it was a condition that the investor had paid or borne the AMC in respect of that investment. In our view, HMRC are correct in their submission that there is nothing in the contractual terms which places a requirement on the investors to bear the AMC in order to receive the Loyalty Bonus. Even if there was such an express obligation, we do not see how it could be of any significance, bearing in mind our analysis that the investor only bears the cost of the AMC in the sense of it affecting the value of his investment in the fund simply by virtue of his agreeing to invest in the fund and remaining so invested. As Ms Poots submitted, and as we have found, there is no contractual link between the payment of the Loyalty Bonus to the investor and the obligation on the part of the fund entity to pay the AMC to the fund manager. Therefore, we agree with Ms Poots that the only relevant contractual condition is that the investor holds the investment at the end of the month.

96. Mr Tallon expressed the conditions for payment of the Loyalty Bonus differently. He submits that the promise by HL to pay the Loyalty Bonus was made under the terms of a unilateral contract if certain conditions were satisfied, relying on the well-known case of *Carlill v Carbolic Smoke Ball Company* [1893] 1 QB 256. That case shows that performance of the conditions under a unilateral contract is both acceptance of the offer to pay or to do (or forbear from doing) a particular act and also the time at which a binding contract comes into existence.

97. Mr Tallon submits that the conditions for payment of the Loyalty Bonus under the offer by HL to make such a payment were (i) maintaining the investment and (ii) paying or bearing the cost of AMCs which were in fact payable monthly. He submits that satisfaction of each condition provided the necessary consideration by the investor. In the case of retention or forbearance from selling, the investor gave up the opportunity to realise his investment for cash to use as he pleased. In the case of paying or bearing the cost of AMCs the investor clearly provided consideration to HL whose commission (represented by the rebate) would increase accordingly, the substantial point being that this was the bargain as presented to investors by HL and as understood by investors from the terms of, inter-alia, the fund Factsheets.

98. We reject that analysis. In our view there is no scope for the existence of a series of unilateral contracts in this case. The contract between HL and the investor was constituted by a bilateral contract as set out in the terms and conditions. Those Terms and Conditions make it clear that they apply on an ongoing basis to all the transactions entered into pursuant to the terms of the service, so there is no room for a series of separate unilateral contracts. The position is different from that in *Carlill* where the relevant party will not know if he is bound until somebody performs a specified act. In this case, the contractual terms simply say that if the investor holds his investment at the end of the month, he will receive a Loyalty

Bonus, subject to the terms set out on the website or elsewhere. In our view, the terms of the Factsheets do not cast any doubt on that analysis.

99. We asked Mr Tallon whether the Loyalty Bonus might be characterised as a rebate of, or reduction in, the platform fees otherwise payable by the investor to HL. But Mr Tallon told us (having taken express instructions from his clients) that this was not the case.

100. We can therefore summarise our conclusions on the various contractual arrangements as follows:

(1) It is the fund entity (which has legal existence which is separate from the investor) and not the investor which has the liability to pay the AMC.

(2) An investor introduced to a fund by HL pursuant to the terms of the Vantage Service bears the economic impact of the AMC regardless of whether any rebate in respect of that AMC has been negotiated between HL and the fund manager, but only in the sense that in common with all other investors in the relevant fund, the value of his investment and/or the amount of his distributions from the fund is reduced as a result of the payment of the AMC.

(3) The rebate paid by the fund manager to HL is in substance a commission payable by the fund manager in return for HL agreeing to place the fund manager's funds on its platform and promote them to its clients. The payment of that rebate does not result in a reduction of the AMC borne by the investor as a consequence of him being an investor in the fund.

(4) Pursuant to the terms and conditions of the Vantage Service, the investor is entitled to a Loyalty Bonus if he holds the relevant investment at the end of the month and there are no other requirements he needs to meet in order to receive the payment.

(5) The Loyalty Bonus is paid to the investor by HL, and not by the fund or the fund manager.

101. It is therefore clear from this analysis that the right to receive the Loyalty Bonus operates independently of the contractual arrangements which result from the investor contracting to acquire units in the fund and the contractual arrangements agreed between HL and the fund manager for the payment of a rebate. Therefore, the arrangements are not to be construed as a composite transaction pursuant to which it could be said that the payment of the Loyalty Bonus amounts to a reduction in the cost the investor has to bear in respect of the AMC as a result of his investment in the fund.

102. In the light of those conclusions, we need to consider whether how the overall arrangements would have been understood by the investors and the other relevant parties affects the analysis.

The overall impression of the entirety of the commercial arrangements

103. The FTT did not carry out a contractual analysis of the nature that we have set out above. It appears to us, as submitted by Ms Poots, that the FTT looked instead at the overall picture from the perspective of the investor: see its findings at [99] referred to at [46] above, its findings at [109] and [110] set out at [47] above and its conclusions at [116] set out at [49] above. As regards its key finding that the investors had to bear the AMC in order to receive the Loyalty Bonus, that conclusion was reached at as a matter of overall impression of the entirety of the commercial arrangements between the various parties. It appears from the passages from the Decision that we have referred to, that the FTT was heavily influenced by the way that the matter was presented to investors in the marketing material prepared by HL.

104. Mr Tallon submitted that it is necessary to consider all the prevailing commercial background when identifying, and seeking to apply, the principles to be drawn from the case law. He also submitted that whether or not the investor actually paid the AMCs or simply bore the cost by a reduction in value of his investment, the industry at large regarded investors as paying.

105. We reject Mr Tallon's submissions. We accept that the prevailing factual background, commonly called the factual matrix, is a relevant factor in construing the contractual documents: see *Wood v Capita Insurance Services Limited* [2017] AC 1173 at [10] to [15]. However, it does not appear that the FTT analysed the contractual documents, and we received no submissions to the effect that the matters referred to by the FTT as regards the marketing material and other commercial circumstances had a bearing on the proper construction of the contractual terms. It follows from our analysis, as set out above, that we do not regard those matters as being relevant in this case to the proper construction of the contracts.

106. Mr Tallon's submission that the industry at large largely regarded the investors as paying the AMC is without evidential foundation, and that assertion certainly does not form any part of the findings of the FTT. In our view, the way the arrangements were presented to the investors was, as we have said, simply the way in which HL chose to market the arrangements. They are not determinative of the substance of the arrangements, which is to be determined by reference to the proper construction of the contractual documents. Likewise, there was no evidential foundation for the FTT's conclusion at [110] that an investor would or should have understood that the AMC would be effectively reduced by the Loyalty Bonus.

Conclusion

107. It follows from the discussion set out above that the FTT erred in its approach to the issue by not basing its decision on the terms of the contractual arrangements. In our view, that was an error of law and as it was material to the FTT's decision on the pure income profit issue, we should set aside that decision.

108. We can proceed to remake the Decision in relation to this issue on the basis of the findings of fact made by the FTT and our own contractual analysis.

109. As we have set out above, the authorities demonstrate that the question as to whether the payment in question amounts to pure income profit in the hands of the recipient should be determined, in the light of the relevant facts, by establishing whether the payment is a taxable receipt in the hands of the recipient without any deduction for expenses or the like.

110. In this case, the relevant facts are the contractual arrangements entered into between the relevant parties. Those arrangements establish that the investor does not pay the AMC and the payment of the rebate is entirely a matter negotiated between HL and the relevant fund manager. HL alone is the party entitled to that rebate. The fact that the investor has to bear the AMC (in the sense that it reduces the distribution of income or the value of his investment in the fund) does not give rise to an expense which is deductible in computing the amount of tax payable on the Loyalty Bonus. The Loyalty Bonus is paid on the single condition, as set out in the terms and conditions, that the investor holds the relevant investment at the end of the month. Following his decision to invest in the fund and pay for his units, the investor does not have to do anything else in return for receiving the payment of the Loyalty Bonus other than remain invested in the fund. In particular, the investor does not need to incur any expense to receive the Loyalty Bonus.

111. Although, as we have described above, HL chose to market the arrangements on the basis that the payment of a Loyalty Bonus reduced the AMC, in our view the correct characterisation of the arrangements is that the investor receives a further income distribution in respect of his investment in the fund as a result of his continuing investment in the fund. The term Loyalty Bonus is therefore a correct description; the payment does what it says on the tin – it rewards loyalty. We therefore conclude that the Loyalty Bonus is pure income profit.

112. Although the existence of anomalies cannot in themselves limit the meaning to be attached to clear language in the statute, we are reinforced in our conclusion by the tax treatment that would result were the FTT's conclusion to be accepted. As Ms Poots submitted, that analysis results in a difference of tax treatment between two alternative mechanisms for reducing the impact of the AMC, namely payment of a rebate and loyalty bonus, and the issue of unbundled shares, that is a separate class of shares or units with lower AMCs.

113. We take the example of a fund which has two share classes, one (Class A) with a standard AMC of 1.5% which is open to all investors and one (Class B) which is created especially for clients of one particular platform service provider, where the AMC is 1%. Let us assume for simplicity that each class only has one investor. One investor (X) has an investment to the value of £1000 in Class A and another investor (Y), who has been introduced by the platform service provider into Class B also has an investment to the value of £1000. Investor X's financial adviser has negotiated a rebate, part of which is paid to Investor X as a loyalty bonus.

114. It is assumed that the fund has received income of £100, £50 of which is attributable to Class A shares and £50 to Class B Shares.

115. An AMC to the value of £15 is paid to the fund manager in respect of the Class A shares, reducing the total distributable income of the fund attributable to the A shares to £35 and Investor X will ultimately be liable for tax on that sum. The fund manager pays a rebate of £5 to Investor X's financial adviser who passes that on to Investor X as a loyalty bonus. On the FTT's analysis, Investor X is not taxable on that £5.

116. An AMC to the value of £10 is paid to the fund manager in respect of the Class B shares, reducing the total distributable income of the fund attributable to the B shares to £40 and Investor Y will ultimately be liable for tax on that sum, meaning that he will be paying more tax than Investor X despite receiving the same level of income as Investor X has in total received from the fund through combination of the distributable income and the loyalty bonus.

117. As Ms Poots submitted, the FTT's analysis effectively results in the same amount being available for deduction twice in the case of Investor X: the AMC is deducted by the fund entity in calculating the amount of distributable income and Investor X is also treated as incurring the AMC as an expense which can be deducted against the loyalty bonus so that it is not viewed as pure income profit. However, in the case of Investor Y the only deduction made against the income distributed to him is the amount of the AMC.

118. On the basis of our contractual analysis, the AMC is only taken into account once, as a deduction against the distributable income of the fund and on the basis of our example the AMC is not taken into account as a deduction for either investor, because he does not pay any part of it and does not reimburse the fund entity for any part of the AMC. That appears to us to be the appropriate tax treatment.

119. We therefore remake the Decision on the pure income profit issue by determining that issue in favour of HMRC.

The recurrence issue

The authorities

120. In *Whitworth Coal* at first instance, in reviewing the authorities on what was meant by an annual payment, Harman J observed at page 549 that the payment in

question must possess the essential quality of recurrence implied by the description "annual". He went on to say that the description has been given a broad interpretation in the authorities, referring to *Smith v Smith* where it was said that the fact that a payment is to be made weekly does not prevent it being annual provided the weekly payments may continue beyond the year.

121. He also referred to the case in the House of Lords of *Moss Empires Ltd v CIR* 21 TC 264 where the payment in question fell to be made under a guarantee by the appellants of the payment of a fixed preferential dividend at a specified rate on the ordinary shares of another company and were therefore in their nature contingent. At page 298 Lord Macmillan stated that the fact that the payments were contingent and variable in amount does not affect the character of the payments as annual payments.

122. Both parties placed some reliance on the recent Supreme Court judgment in *HMRC v Joint Administrators of Lehman Brothers International (Europe) (In Administration)* [2019] UKSC 12 which interpreted the term "yearly interest". Section 874 of the Income Tax Act 2007 requires a debtor in specific circumstances to deduct income tax from payments of "yearly interest" arising in the United Kingdom. That case is relevant as historically "yearly interest" was another type of charge on income: see s 169 Income Tax Act 1952. The question for the Supreme Court was whether the statutory interest that the administrators were obliged to pay on the surplus distributable to shareholders following the completion of the administration was "yearly interest".

123. At [21] to [22] Lord Briggs referred to some old authorities which indicated that yearly interest meant interest at a yearly rate, and which may have to be paid from year to year such as interest payable during a period of delayed completion of a property purchase or mortgage interest. He observed that the reference to mortgage money was intelligible when it is understood that the drafting practice of the time was typically to make mortgage loans repayable, with interest, on a fixed date, usually less than a year after the making of the advance, even if the parties' expectation was that the mortgage would endure for much longer, before redemption, with interest being payable periodically in the meantime. He then said:

> "Thus it was the propensity, rather than the intention or inevitability, for interest payable during a period of delayed completion to run on for more than a year which made it yearly interest, even though in many cases the delay in the completion of the purchase might well be much shorter."

124. He also observed at [23] that the question whether the interest is "yearly" depends on a business-like rather than dry legal assessment of its likely duration.

125. At [33] Lord Briggs considered that the tests laid down by Lord Anderson in the Inner House of the Court of Session in *IRC v Hay* 8 TC 636 at 646 (the so-called "*Hay* tests") remain the best convenient summary of the jurisprudence about the meaning of yearly interest, in the context of interest which accrues due over time. Lord Anderson said:

> "Now the authorities referred to by Crown Counsel seem to me to establish these propositions, five in number: - (First), that interest payable in respect of a short loan is not yearly interest (*Goslings* …). … (Second) that in order that interest payable may be held to be yearly interest in the sense of the Income Tax Acts, the loan in respect of which interest is paid must have a measure of permanence. (Third), that the loan must be of the nature - and this is pretty well expressing the second proposition in another form - that the loan must be of the nature of an investment (*Garston Overseers)*. (Fourth), That the loan must not be one repayable on demand (*Gateshead Corpn* …). And (fifth) that the loan must have a 'tract of future time' (per Lord Johnston in *Scottish North American Trust Ltd*, 1910 Session Cases 966, 973). These propositions are perhaps one proposition expressed in different forms, but they are the result of the authorities."

Discussion

126. Mr Tallon's submissions can be summarised as follows:

(1) Given the obligation to deduct, a payer must be certain that a legal obligation will endure beyond at least a year (and that is the only "minimum period" necessary). For instance, if in this case HL decided after 10 months not to pay the Loyalty Bonus in the future, it would be absurd to say that it should have deducted income tax on making payments in that first 10 months, merely because it might be said that, until cancellation of payment of the Loyalty Bonus, those payments were "capable of recurrence" when made.

(2) The only way that a payer can be certain of whether his first payment must be subject to the obligation to deduct is if there is a binding legal obligation which extends beyond a year. The concept of "capable of" is specifically to deal with the possibility that, under the terms of the legal obligation, there are no payments (or the payments are variable) so that the feature of "recurrence" is not present, because, pursuant to the continuing legal obligation, payment is contingent either on the satisfaction of a condition or in amount because of a formula.

(3) It is not sufficient to say with the benefit of hindsight that, merely because payments did recur, such payments are necessarily annual payments.

(4) In this case, given HL's ability to cancel the payment of Loyalty Bonuses in the future at any time, each payment can only be regarded on each occasion as a one-off payment.

(5) One of the "*Hay* tests" is that the loan must not be repayable on demand. In a current account, since the depositor can reduce his account to zero at any time, the loan to the bank is necessarily repayable on demand and accordingly the interest paid by the bank is not yearly interest.

(6) The payment of the Loyalty Bonus on each occasion is a one-off payment precisely because (i) HL must not revoke its promise to pay and (ii) the investor must satisfy the necessary conditions for payment at each successive month. Any binding contract which comes into existence on satisfaction of the necessary conditions at a month-end is a separate contract each time with each and every person who invests through HL.

127. We reject those submissions. The Loyalty Bonuses were paid on a monthly basis, under a binding contractual obligation. As we have previously said, the terms and conditions which set out that provision, apply on a continuing basis to all the transactions which are effected under the arrangements. Under those terms, the Loyalty Bonuses were contingent only on the investment being held at the end of the month, and inevitably they will vary in accordance with the value of the investment held. We therefore reject the analysis that a separate contract comes into existence at the end of each month with the payment of a Loyalty Bonus. The Loyalty Bonuses were paid under contractual arrangements which were agreed by the investor's acceptance of the terms and conditions at the outset of the relationship.

128. In common with the FTT, we find no support from the authorities to HL's proposition that the necessary quality of recurrence was not present because HL can reduce the amount of a Loyalty Bonus to zero.

129. We do not think that the analogy of the current account drawn by Mr Tallon is correct. We find that the better analogy to be drawn by reference to the distinction between yearly interest and short interest is found in Lord Briggs's judgement at [22] of *Lehmans,* where he placed emphasis on the propensity, rather than the intention or inevitability, for interest payable to run on for more than a year. This is at odds with Mr Tallon's contention that a payment can only be regarded as capable of recurrence if the contractual period for its payment is at least one year. It is also inconsistent with the authorities referred to by Harman J in *Whitworth Coal*, which established that the fact that a payment may or may not continue beyond the year does not prevent it being an annual payment. The fact that the obligation might be terminated in the future does not undermine the proposition that the payment is capable of recurrence.

130. Furthermore, as Lord Briggs said, whether the payment is "yearly" (or by analogy annual) depends on a business-like rather than a dry legal assessment of its likely duration. For commercial reasons, whilst it was able to terminate its obligation to pay a Loyalty Bonus, HL was unlikely to do that without adequate notice. As the kind of investments which were acquired by HL pursuant to the terms of the Vantage Service were likely to be marketed on the basis that they were long-term investments, it was also unlikely that most investors would dispose of their investments and therefore cease to be entitled to the Loyalty Bonus within a short time horizon.

131. There is no need for the application of hindsight to establish whether a payment is capable of recurrence or not. As Ms Poots submitted, it is necessary to look at the features of the arrangements, in this case primarily the terms and conditions for the Vantage Service and the commercial background against which they were entered into.

132. Therefore, and in full agreement with the reasoning of the FTT set out at [73] and [74] of the Decision, we conclude that the Loyalty Bonus payments were capable of recurrence.

133. We therefore determine the recurrence issue in favour of HMRC.

Disposition

134. The appeal is allowed.

JUDGE TIMOTHY HERRINGTON JUDGE NICHOLAS ALEKSANDER

UPPER TRIBUNAL JUDGES

RELEASE DATE: 9 August 2019