[2011] UKFTT 705 (TC)

TC01542

Appeal number TC/2010/01864

Appeal against the disallowance of Entrepeneurs' Relief by HMRC on the sale of part of the Appellant's business – appeal allowed

FIRST-TIER TRIBUNAL

TAX

MR M GILBERT T/A UNITED FOODS **Appellant**

- and -

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

TRIBUNAL: S.M.G.RADFORD (TRIBUNAL JUDGE)
R.THOMAS

Sitting in public at 45 Bedford Square, London WC1 on 30 September 2011

The Appellant in person

Mrs E.Gardiner for the Respondents

DECISION

1. This is an appeal against the decision of HMRC to amend the Appellant's self-assessment for the tax year 2008-09 and to disallow his claim to Entrepeneurs' relief when calculating the chargeable gain arising in respect of the sale of assets used in his business by the Appellant.

2. The Appellant claimed that the sale had been part of a separate and definable business and as such it was entitled to the relief.

Background and facts

3. The Appellant commenced trading as United Foods in 1995. He had worked in the food industry for many years before this.

4. The business provided inexpensive sales representation to manufacturers and suppliers, mainly to UK catering wholesalers, on a commission basis. This saved the supplier expensive sales personnel.

5. The Appellant added 1% extra to the supplier's price on its invoice to the customer and on payment to the supplier by the customer the Appellant would raise an invoice and the supplier would pay it the commission. The Appellant characterised his business as that of a food "broker".

6. The Appellant supplied this service to some nine suppliers and he represented them in relation to about 120 customers.

7. One of these suppliers was Fayrefield Foods Limited ("FFL"). In August 2008 agreement to purchase a business as a going concern was reached with FFL. The sale agreement defined the "Business" sold as that part of the Appellant's business consisting of the sale of FF Ltd products to customers. The agreement stated that the purchase was to include the customer database relating to the Business and the goodwill, the trade marks which the Appellant had registered relating to the Gyma and Diploma brands (which were among the FFL products) and business information together with the benefit and burden of unperformed contracts and the records.

8. After the sale the Appellant could no longer use the trademarks nor have any contact at all with the customers of FFL. The Appellant stated that after the sale his gross commissions were reduced by 55% and his customer base was reduced to 35.

9. The Appellant mentioned that he had subsequently arranged to sell the remainder of the Appellant's business so that he could retire.

10. In his tax return (including a self-assessment) for 2008-09, the Appellant had shown a gain from the disposal of the assets to FFL of £285,000, and a claim to Entrepreneurs' Relief which reduced the amount of the gain by four-ninths, making the relief, in terms of tax at 18%, £22,800.06. HMRC enquired into the return and on 9 February 2011 notified the Appellant of their conclusion, which was that Entrepreneurs' Relief was not due.

Legislation

11. Entrepreneurs' Relief is found in Chapter 3 Part 5 Taxation of Chargeable Gains Act 1992 ("TCGA"). Section 169I TCGA (in that Chapter) states:

> (1)There is a material disposal of business assets where—
>
> (a)an individual makes a disposal of business assets (see subsection (2)), and
>
> (b)the disposal of business assets is a material disposal (see subsections (3) to (7)).
>
> (2)For the purposes of this Chapter a disposal of business assets is—
>
> (a)a disposal of the whole or part of a business,
>
> (b)a disposal of (or of interests in) one or more assets in use, at the time at which a business ceases to be carried on, for the purposes of the business,

12. Section 169L of the TCGA states:

> (1) If a qualifying business disposal is one which does not consist of the disposal of (or of interests in) shares in or securities of a company, entrepreneurs' relief is given only in respect of the disposal of relevant business assets comprised in the qualifying business disposal.
> (2) In this Chapter "relevant business assets" means assets (including goodwill) which are, or are interests in, assets to which subsection (3) applies, other than excluded assets (see subsection (4) below).
> (3) This subsection applies to assets which—
> (a) in the case of a material disposal of business assets, are assets used for the purposes of a business carried on by the individual…

HMRC's Submissions

13. HMRC submitted that for the Appellant to qualify for Entrepreneur's Relief it was not enough for him to make disposals of assets used in the business; there needed to be the disposal of an identifiable part of the business which on its own was separately definable.

14. Whilst the Appellant sold the brands and customer base, in the scheme of how the business itself operated, HMRC did not consider that those disposals amounted to the disposal of a separately definable business. The business carried on after the disposal was the same as that carried on before, albeit on a smaller scale.

15. HMRC contended that even the disposal of substantial assets was not enough to demonstrate that part of the business had been disposed of even if the business was reduced considerably in size after the sale. In order to qualify for the relief there had to be what the cases have recognised as the sale of part of a business.

16. HMRC accepted that if the changes to the business caused by the sale of the assets could lead to the conclusion that the position after the sale is wholly different from the position before the sale then it might be reasonable to say that the business after the sale was not the same as the one before so that part of the business must have been sold. However HMRC did not consider that this had happened. HMRC contended that the operation of the business did not appear to have changed wholly or even noticeably after the disposal of the brands/customer base.

17. HMRC submitted that on the facts the same business was being carried on after the sale as before. The scaling down of activities was not enough to show that assets disposed constituted the disposal of part of the business, so in HMRC's view the disposal did not constitute a material disposal within the meaning of the legislation, so the Entrepreneurs' Relief was not available.

18. Referring to Section 169L TCGA HMRC submitted that whilst it was not in dispute that the assets sold were relevant business assets the disposal needed to be of an identifiable part of the business which on its own was separately definable.

19. HMRC contended that it was necessary to identify the full range of activities comprised within that business and the range of activities was the same after the Appellant had made the sale. The operation of the business did not appear to have changed wholly or even noticeably after the disposal.

20. HMRC cited the cases of *Barrett (HMIT) v Powell* 70 TC 432; *Graham v Green (HMIT)* 9TC 309; *McGregor (HMIT) v Adcock* 51 TC 692; *Atkinson (HMIT) v Dancer* STC 758, *Mannion v Johnson* 61 TC 598 and *Purves (HMIT) v Harrison* 73 TC 390.

21. HMRC pointed out that in *McGregor v Adcock* Fox J had drawn a distinction between the business and the individual assets used in the business. The sale of part of the business was not necessarily the disposal of part of the business merely a factor to be taken into account in deciding whether there had been such a disposal.

22. Further in *McGregor v Adcock* Fox J quoted from Justice Rowlatt in *Graham v Green* where he stated that:

> "Really a different conception arises, a conception of a trade or vocation which differs in its nature from the individual acts which go to build it up, just as a bundle differs from odd sticks. You may say, I think, without perhaps an abuse of language, there is something organic about the whole which does not exist in its separate parts.

23. Although the Appellant had initially intended to sell the business as one entity and had since taken steps to sell the remainder the intention was not enough. Despite the Appellant's intention to sell the remainder of its business this still did not demonstrate that the part of the business disposed of was a separately definable part of the business.

24. HMRC cited Gibson J's words in *Atkinson v Dancer*:

> "Unless there be some evidence to enable two disposals to be treated as one, such as evidence that they were part of the same transaction, they must be treated separately"

Appellant's Submissions

25. The Appellant contended that effectively there were nine separate businesses.

26. He submitted that the sale was of a definably separate part of its business. He no longer had the trademarks of Gyma and Diploma and could no longer approach the customers of FFL. A non-compete clause in the sale agreement ensured that the Appellant complied.

27. The sale was of all the business connected to FFL and the Gyma and Diploma brands. This was clearly a separate and definable part of the business.

28. The Appellant could no longer offer any of the FFL brands to its customers which meant a considerable loss of several distinct products including the products sold under the Gyma and Diploma brands.

29. All activities with FFL ceased. FFL bought the database containing the list of customers with whom the Appellant had previously dealt together with the goodwill attaching thereto. The Appellant's sub-agents who had worked with the Business left.

30. The Appellant cited the case of *Maco Door and Window Hardware (UK) Ltd v HMRC Commissioners* 79 TC 287 ("*Maco* Door") in which Lord Walker stated that:

> "The second half of section 18 (2) (of the CAA 1990) which refers to the case where part only of a trade or undertaking complies with the conditions set out in subsection (1) suggests that the part must be something that has the same characteristics as the trade as a whole -- what Patten J called an activity in the nature of trade."

Findings

31. Since HMRC accepted that the assets sold by the Appellant under the agreement with FF Ltd were "relevant business assets" (s. 169L(2)), the only question for us was whether there had been a "disposal of …..part of a business".

32. We found that the agreement for the sale of the business described it as the sale of a business as a going concern. It included the customer database, the goodwill, the trade marks and business information together with the benefit and burden of unperformed contracts and the records.

33. Section 169I(2) of the TCGA provides (somewhat confusingly) that to qualify for the relief a "disposal of business assets" requires the disposal of all or part of a business. This is more than a disposal of assets used in a business, but how much more is the crucial question. We found that there were a number of pointers showing that it is sufficient if there is a disposal of all or part of a business as a going concern.

34. They are:

(a) Paragraph 64015 of HMRC's Capital Gains Manual (included in the bundle of authorities provided to us) makes it clear that the sale of a business as a going concern is a disposal of the business, and we could see no reason not to apply that to a part of a business.

(b) The Notes on Clauses for Schedule 3 to the Finance Bill 2008 say of section 169I(2)(a):

> "Subsection (2) explains what is meant by "a disposal of business assets". This can be one of three disposals:
>
> a disposal of the whole or part of a business (this is more than a disposal of assets used in a business; it requires the disposal of all or part of a business as a going concern);"

(c) In *Pepper v Daffurn* 66 TC 88 (not cited to us by either party) Jonathan Parker J said:

> "At first sight one might have been excused for thinking that para (a) [*of the retirement relief equivalent of section 169I(2) TCGA*] was intended to relate to disposals of a business or part of it as a going concern whereas para (b) was intended to deal with the break-up of a business following cessation, but neither counsel was disposed to accept such a construction. Moreover, I recognise the force of the point that had Parliament intended para (a) to relate to disposals of going concerns it could easily have said so in terms. Accordingly, I am content to proceed on the footing that para (a) is not limited to the sale of a business or part of it as a going concern."

In other words sale as a going concern is a sufficient but not necessary condition for the relief to be available.

(d) In *Atkinson v Dancer* & *Mannion v Johnston* 61 TC 598 Peter Gibson J said:

> "I do not see how they could have reached the conclusion that the mere sale of nine out of 89 acres, with no livestock or equipment or other stock or goodwill or anything else included in the sale, amounted to a sale of part of the business."

35. We found that the Appellant did dispose of the business as a going concern. What characterises a sale as a going concern is a sale of goodwill where it exists and he sold goodwill. He also sold his customer database, a crucial asset in distinguishing a sale of a going concern from a mere sale of assets.

36. In our view such a finding is sufficient to dispose of the case in the Appellant's favour, but since that was not the way HMRC put its case (and neither for that matter did the Appellant who was not represented) we also considered HMRC's "identifiable part of the business which on its own was separately definable" test set out in paragraphs 13 to 19 ("the HMRC test").

37. But first we considered the Appellant's submissions on this test. In the case of *Maco Door* (cited by the Appellant) it was found that to come within section 18(2) of the Capital Allowances Act 1990:

> "a part of a trade must not simply be one of the activities carried out in the course of a trade but a viable section of a composite trade which would still be recognisable as a trade if separated from the composite whole."

38. We accept that the provisions relating to Industrial Buildings Allowance ("IBA") are relevant primarily to composite businesses such as vertically integrated trades where successive activities are carried on (e.g. manufacture and wholesale) or those where very different activities are carried on simultaneously (e.g. car repairs and petrol sales) and would not be relevant in a case like this where essentially the same activities are carried on and a proportion of those activities is disposed of. However we see no reason to think that had it been relevant the same test would not have applied to a single trade – can a viable section of the whole business be recognised as a business if separated from the whole? We found that the business sold was a viable section of the business recognisable as a business even when separated from the whole.

39. We should add here that it was when reading *Maco Door* that we realised where the HMRC test came from. It is in *Bestway Holdings Ltd v Luff* (HMIT) 70 TC 512 ("*Bestway*"), another Industrial Buidings Allowance (IBA) case, where Lightman J describes the submission of the Inland Revenue's counsel:

> "What is needed is (using the language of Rowlatt J.) a bundle of sticks or activities which constitute a significant separate and identifiable "part" of the building user's trade".

Since the paragraph in HMRC's Capital Gains Manual on retirement relief which currently refers to this test did not refer to it in 1998 when *Bestway* was decided, we assume that the Manual was amended to read as it currently does as a result of *Bestway*. But although the test was regarded as crucial in that case, it has been queried by the High Court in *Maco Door* and substantially weakened by the House of Lords judgment in that case which instead propounds the "viable section" test.

40. The "viable section" test in *Maco Door* is strongly reminiscent of the VAT rules for transfers of a going concern. Article 5 of the Value Added Tax (Special Provisions) Order 1995 (SI 1995/1268) states:

> (1) Subject to paragraph (2) below, there shall be treated as neither a supply of goods nor a supply of services the following supplies by a person of assets of his business—
>
> (b) their supply to a person to whom he transfers part of his business as a going concern where—
>
> (i) that part is capable of separate operation,"

We noted that in the sale agreement in this case the Appellant was to seek to obtain relief under the Order.

41. Article 5 SI 1995/1268 derives from the 6th VAT Directive. In a case (*Zita Modes Sàrl v Administration de l'Enregistrement et des Domaines* C497/01) on the relevant article of that directive, the Court of Justice of the European Communities said:

> "Having regard to this purpose, the concept of a transfer, whether for consideration or not or as a contribution to a company, of a totality of assets or part thereof must be interpreted as meaning that it covers the transfer of a business or an independent part of an undertaking including tangible elements and, as the case may be, intangible elements which, together, constitute an undertaking or a part of an undertaking capable of carrying on an independent economic activity, but that it does not cover the simple transfer of assets, such as the sale of a stock of products."

This too strongly resembles the "viable section "test in *Maco Door*. We considered that here there was such a transfer as described in *Zita Modes*.

42. The test is also reminiscent of a provision rather closer to Chapter 3 Part 5 TCGA. In Chapter 2 Part 4 TCGA section 140A(1) provides for relief where:

> "*(a*) a company resident in one member State (the transferor) transfers the whole or part of a trade carried on by it in the United Kingdom to a company resident in another member State (the transferee),"

This section (and others following it) represent the transposition into UK law of **C**ouncil Directives 90/434/EC and 2009/133/EC (the Mergers Directives). In the Directives "part of a trade" is described as a "transfer of assets" but this is less confusingly qualified to mean a transfer of a "branch of activity", itself defined as:

> "all the assets and liabilities of a division of a company which from an organisational point of view constitute an independent business, that is to say an entity capable of functioning by its own means"

43. All of these tests seemed to the Tribunal to be variations of Lord Walker's *Maco Door* "viable section" formulation. We think that this test, rather than HMRC's formulation of its test ("an identifiable part of the business which on its own was separately definable") in its submissions in this case or the rather more elegant "separate, distinct and clearly identifiable part of the trade" borrowed indirectly from *Bestway*, is the one that should be used.

44. One way of testing whether there is a viable section in Lord Walker's terms is to consider what would be the case if the transferee was an empty shell until the transfer. Would the activities of the transferee using only the assets and liabilities transferred be capable of constituting a trade or business? In this case we think they would. The transferee would be able to use the customer database and the existing contracts and to exploit the goodwill to make sales and profits – sales were clearly contemplated by the provisions in the sale agreement which amended the purchase price if sales fell below certain levels. So it is for this reason that we found that there was here a transfer of a viable section of the business recognisable as a business even when separated from the whole. We think that the *Maco Door* case cited by the Appellant gives as appropriate a test for "part of a business" in section 169I(2) TCGA as for "part of a trade" in IBA.

45. We then considered whether there was anything in the cases cited by HMRC that would suggest that the test we have used is not the correct one and that the HMRC test is the correct one. The cases cited by HMRC in relation to parts of a trade all

related to farmers and that in all of them the asset sold was "mere" land that is without buildings and structures on it. It was therefore not surprising that in *McGregor v Adcock* Fox J stated that:

> "Really a different conception arises, a conception of a trade or vocation which differs in its nature from the individual acts which go to build it up, just as a bundle differs from odd sticks. You may say, I think, without perhaps an abuse of language, there is something organic about the whole which does not exist in its separate parts.
>
> Prima facie it seems to me wrong to assert that the mere sale of farmland is a disposal of part of the farm business. The true position, I think, is that the sale *[of land]* is merely a factor which the Court has to consider in deciding whether there has been such a disposal. There are cases in which it might be the determining factor. Thus, if a man is farming 200 acres and sells off 190 of those acres, it may very well be that the nature and extent of the man's activities after the sale would be so wholly different from what they were before the sale that the inevitable conclusion would be that there had been a disposal of part or even the whole of the farming business."

But we do not read Fox J there as laying down any test of general application, making it a necessary condition of there being a sale of part of a business that both the nature and extent of the activities must be wholly different from what they were before the sale. He was making a point specifically about farmers and a "mere" sale of farmland.

46. Similarly in *Atkinson v Dancer & Mannion v Johnston* Peter Gibson J said that:

> "What the Commissioners must do if applying Fox J.'s test is to look at the position before the sale and the position after the sale and ask the question whether the sale caused any changes in the activities and assets. If the changes caused by the sale lead to the conclusion that the position is wholly different from the position before the sale, then in Fox J.'s words "it may very well be" (and I stress that he was using the language of possibility, not certainty, even in a case relating to the disposal of 95 per cent. of the land on a farm) that an inference will be drawn of the sale of a business or part of a business."

47. We note that Peter Gibson J here talks about "if applying Fox J's test". He was doubtful whether the test was wholly appropriate, as was Jonathan Parker J in *Pepper (HMIT) v Daffurn* 66 TC 68 (not cited by either party). It is noticeable that in describing Fox J's test he referred only to "changes in the activities and assets", not to the nature and scale of the changes, And in *Jarmin (HMIT) v Rawlings* 67 TC 130 (also not cited) Knox J refers only to a change in the scale (i.e. extent) of the activities. In this case we found that after the sale the Appellant's business was significantly different, certainly in extent and to some extent in its nature.

48. We found that what was sold was (in Rowlatt J's terms) a bundle rather than odd sticks and constituted a significant and identifiable part of the Appellant's business. Thus even if we had accepted that HMRC's test was the correct one, the Appellant still succeeds.

Decision

49. The appeal is allowed.

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

TRIBUNAL JUDGE
RELEASE DATE: 3 November 2011