Neutral Citation: [2022] UKFTT 00274 (TC)

Case Number: TC08566

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

By remote video hearing

Appeal reference: TC/2021/01846

*Income tax – loss relief – transfer of a trade – section 86 of Income Tax Act 2007*

**Heard on:** 25 July 2022
**Judgment date:** 15 August 2022

**Before**

**TRIBUNAL JUDGE ABIGAIL MCGREGOR**
**JAMES ROBERTSON**

**Between**

**MR GRAHAM DAVIS**

**Appellant**

**and**

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

**Respondents**

**Representation:**

For the Appellant: Mr James Boyce, of Boyce and Co, instructed by Mr Davis

For the Respondents: Martin Priestly, litigator of HM Revenue and Customs' Solicitor's Office

## DECISION

### INTRODUCTION

1. With the consent of the parties, the form of the hearing was V (video) by Tribunal video hearing system. A face-to-face hearing was not held because it was held to be expedient to conduct the hearing by video. The documents to which we were referred are a document bundle of 362 pages and an authorities bundle of 174 pages.

2. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

### BACKGROUND

3. This case was an appeal against two closure notices issued in respect of tax years 2016/17 and 2017/18 to Mr Graham Davis. HMRC had refused his claims, made in the tax returns for the relevant years, to offset losses made in a sole trade against income derived from a company under section 86 of the Income Tax Act 2007 ("ITA 2007").

### EVIDENCE

4. As noted above, we had before us a bundle of documents.

5. Two witness statements were included in the bundle:

   (1) From Mr Boyce; and

   (2) From Mr Singh, inspector for HMRC who had conducted the enquiry into Mr Davis' tax returns and issued the closure notices.

6. Mr Singh adopted his evidence in chief at the hearing. He was available for cross-examination, but no questions were asked of him. We accept his evidence as fact.

7. The witness statement of Mr Boyce was a curious mix of evidence and submissions, but, by his own admission, Mr Boyce was helped to put the witness statement together by Mr Davis and therefore he appeared to be seeking to give evidence of matters of which he did not have primary knowledge.

8. When questioned about this at the hearing, Mr Boyce said he had been requested to provide a witness statement and so had done so. This was explained in correspondence between the parties and the Tribunal before the hearing:

   (1) Mr Davis had originally provided a witness statement;

   (2) When the hearing had been scheduled, it became apparent that Mr Davis was not intending to attend the hearing;

   (3) HMRC questioned this, stating that they challenged some of the statements in the witness statement and wished to cross examine him;

   (4) Mr Boyce had been listed as attending the hearing as a witness;

   (5) HMRC had said that if he was to attend as a witness, he should provide a witness statement.

   (6) Mr Davis' witness statement was then withdrawn because he did not intend to attend the hearing;

   (7) Mr Boyce then provided a witness statement.

9. Mr Boyce adopted his statement as evidence. HMRC did not cross-examine him on it, submitting that the evidence only had weight as hearsay evidence but that the factual evidence provided in it was not in dispute.

10. As a result, we have given very little weight to the contents of the witness statement of Mr Boyce, preferring to rely on the documentary evidence where it exists.

11. For the record we have not seen the withdrawn witness statement of Mr Davis and it was not referred to at the hearing.

**LAW**

12. Under section 86 ITA 2007 a person who transfers a trade to a company can, provided the conditions are met, set off carried forward trade losses from the original trade against income derived from the company. Since the whole case is predicated on its application, we have reproduced the whole section here:

> 86 Trade transferred to a company
>
> (1) This section applies if—
>
> (*a*) a trade is carried on by an individual otherwise than as a partner in a firm or by individuals in partnership,
>
> (*b*) the trade is transferred to a company,
>
> (*c*) the consideration for the transfer is wholly or mainly the allotment of shares to the individual or individuals, and
>
> (*d*) in the case of any individual to whom, or to whose nominee or nominees, shares are so allotted, the individual's total income for a relevant tax year includes income derived by the individual from the company.
>
> (2) For the purposes of carry-forward trade loss relief, the income so derived is treated as—
>
> (*a*) profits of the trade of the relevant tax year carried on by the individual, or
>
> (*b*) if the trade was carried on by the individual in partnership, profits of the individual's notional trade of the relevant tax year.
>
> (3) The tax year in which the transfer is made is a relevant one if—
>
> (*a*) the individual is the beneficial owner of the shares allotted as mentioned above, and
>
> (*b*) the company carries on the trade,
>
> throughout the period beginning with the date of the transfer and ending with the next 5 April.
>
> (4) Otherwise a tax year is a relevant one if—
>
> (*a*) the individual is the beneficial owner of the shares allotted as mentioned above, and
>
> (*b*) the company carries on the trade,
>
> throughout the tax year.
>
> (5) The income derived from the company may be by way of dividends on the shares or otherwise.
>
> (6) This section applies to businesses which are not trades as it applies to trades.

**PARTIES ARGUMENTS**

13. Mr Boyce submits that:

(1) After operating as a sole trader for a number of years, Mr Davis decided to transfer his trade of financing the sale of second motor cars to a company, USL Securities Limited ("USL");

(2) The trade had been loss making and had no assets and therefore there were no items to transfer physically to the company, nor was there any goodwill;

(3) What was transferred was the right to carry on the business of motor car finance;

(4) It was transferred for a 'peppercorn';

(5) The trade transferred was the same trade as that carried on by USL, with the changes in operating model being driven only by obtaining greater security for his investment following his experiences with the single customer of Mr Davis' sole trade ("Dickinson");

(6) Mr Davis funded USL to enable it to start trading with a large director's loan;

(7) Dickinson did not transfer as a customer from the sole trade to USL because Mr Davis had been advised by solicitors that it would complicate matters because there were already outstanding debts in the trade that needed to be pursued;

(8) Losses were generated in the sole trade as a result of Dickinson's default in their arrangements, ultimately resulting in Mr Davis winning a civil claim against Dickinson, but never receiving any funds because Dickinson was declared bankrupt;

(9) These losses should be available to be offset against Mr Davis' income derived from USL pursuant to ITA 2007, s 86;

(10) The setting off of losses from an earlier sole trade against income from a later incorporated trade fits the purpose of the section 86 loss relief rules perfectly, so he cannot see why relief would be denied.

14. We can summarise HMRC's submissions succinctly, but will come back to more detailed elements of the submissions in the discussion below as relevant:

(1) There was no trade transferred from Mr Davis to USL;

(2) Mr Davis continued to carry on the sole trade for over 2 years after the incorporation of USL;

(3) Even if there had been a transfer of a trade on incorporation, there was no continuity of trade because the two trades were substantially different;

(4) If there had been a transfer of a trade and it was the same trade, loss relief would still not have been available under section 86 ITA 2007 because:

(a) The losses were in fact incurred 2 years after the cessation of trade and therefore were post-cessation losses (which are only available for carry back) rather than carried forward trading losses and section 86 only allows relief for carrying forward trading losses; and/or

(b) Mr Davis did not meet the requirements of s 86(1)(c) because the shares in USL were not allotted to Mr Davis in consideration for the transfer of the trade, because Mr Davis in fact subscribed for them in cash.

**FINDINGS OF FACT**

15. We find the following facts. The majority of the background facts were not in dispute, but there were some areas of contention, which we highlight as we note the findings of fact. Some of the matters under consideration relate to mixed matters of fact and law; we address these in the discussion below.

16. Mr Davis had carried on a sole trade of providing finance for second hand car sales from July 2002.

17. The only customer of this sole trade was Dickinson.

18. The sole trade operated by Mr Davis providing funds to Dickinson, who acquired second-hand cars, either for cash or in part exchange. When the car was subsequently sold, Dickinson repaid the loan for buying the car and shared the profit on sale with Mr Davis.

19. USL was incorporated in September 2005 and started trading in October 2005.

20. The trade carried on by USL also related to the purchase and sale of second-hand cars, but the structure was different in that USL bought the cars directly. The cars were then sold on to consumers by a range of third-party garages (not including Dickinson). When the car was sold, USL received the original purchase price of the car and a share of the profit made on the sale.

21. Dickinson was never a customer of USL.

22. Dickinson defaulted on the contractual arrangements with Mr Davis on a number of occasions going back to 2002, whereby they would not pay Mr Davis either the capital or profit, or would only pay partially. To understand the scale of these defaults, there were:

(1) 1 default in 2002;

(2) 3 defaults in 2003;

(3) 1 default in 2004;

(4) No defaults in 2005;

(5) 8 defaults in 2006; and

(6) 10 defaults in 2007.

For comparison purposes, there were between 30 and 70 transactions each year.

23. Mr Davis ultimately pursued Dickinson for these defaults. Mr Boyce asserted that this pursuit had been ongoing at the time of incorporation of USL and that legal advice to keep the relationship in Mr Davis' sole name had been a contributing factor in doing so. There is no evidence provided to that effect.

24. The first evidence of pursuit of Dickinson for lost funds is an invoice from Mr Davis to Dickinson dated 31 October 2008 in which capital outstanding is recorded. There is then evidence of instructing solicitors and discussing the issuing of a particulars of claim in December 2010.

25. While we accept that Dickinson had made occasional defaults by the time of the incorporation of USL in 2005, we do not accept that Mr Davis had started to conduct legal proceedings against Dickinson at that time, nor that it was in contemplation at that time.

26. We find that the final conclusion of that dispute was in tax year 2010/11, when a decision was made in Mr Davis' favour in the amount of approximately £145,925, which was not paid because Dickinson had become insolvent.

27. The final transactions in Mr Davis' sole trade were with Dickinson in November 2007.

28. Mr Davis recorded profits from his sole trade in the self-assessment tax returns for each of the tax years from 2002/03 to 2007/08 as follows:

| Basis period to | Sales | Net profit | Net profit (for tax) |
|---|---|---|---|
| 31/03/2003 | £13,225 | £11,335 | £10,535 |
| 05/04/2004 | £29,445 | £23,285 | £23,285 |
| 05/04/2005 | £28,475 | £22,610 | £22,610 |
| 05/04/2006 | £31,738 | £16,689 | £16,689 |
| 05/04/2007 | £18,900 | £12,500 | £12,500 |
| 05/04/2008 | £11,105 | £6,555 | £6,555 |

29. There was some variation between earlier statements and the submissions made by Mr Boyce at the hearing, but we find that Mr Davis subscribed for 100 shares at £1 per share, paid in cash, at the incorporation of USL. The shares were not issued to Mr Davis in consideration for the transfer of a trade to USL.

30. At the time of incorporation, no physical assets were transferred from Mr Davis to USL.

31. Mr Davis received £80,000 in 2016/17 and £42,250 in 2017/18 from USL as payment for his services to the company.

**DISCUSSION**

32. It was not in dispute that a "trade is carried on by an individual" and that therefore the condition for loss relief in ITA 2007, s 86(1)(a) was met in the relevant year.

33. Secondly, we must consider whether a trade was transferred from Mr Davis to USL. We find that it was not. The factors that pointed towards this conclusion were that:

34. As noted above in our finding of facts, no physical assets transferred from Mr Davis to USL at or around the time of incorporation.

35. When pressed, Mr Boyce urged us to consider that what had transferred from Mr Davis to USL was "the right to carry on the business". With respect to Mr Boyce, we do not find that this is supported by the facts or evidence and, even if it were, we are not convinced that on its own the transfer of such a right without more, such as a customer list or right to use a trading name, could be treated as a transfer of a trade. There aren't legal restrictions on carrying on this kind of trade: any person has a right to carry on a second-hand car financing business if they so wish and have the necessary skill, there is no valuable asset in the right to carry on this particular business that is being transferred from Mr Davis to USL.

36. When asked what the consideration for the transfer was, Mr Boyce submitted that it was a 'peppercorn' because it was recognised that there was no value in the trade being transferred. He also submitted that this peppercorn was not recorded anywhere because Mr Davis was the sole owner of the company and therefore there was no need.

37. HMRC pointed out that Mr Davis had been recording profits in the business for several years and therefore to transfer the business for no value at all would not have been correct. HMRC also noted that no goodwill was recorded in the accounts of USL.

38. We also find that the existing trade of Mr Davis, being the second-hand car financing activities with Dickinson, continued to be operated by Mr Davis for 2 years after USL was incorporated.

39. If the existing trade carried on on a sole trade basis, HMRC suggested that we should consider whether a part of the trade transferred, pointing us to authorities regarding whether the transfer of a part of a trade could be sufficient (in the context of other provisions). We do not feel that we need to consider this legal issue since there was no evidence before us of a part of a trade having transferred. We find that the entirety of the existing sole trade remained being carried on by Mr Davis.

40. HMRC sought to argue that the trade carried on by USL was sufficiently different to be treated as a different trade. We do not agree with HMRC on this point and find that (if the trade had in fact transferred) the change in security structure would not have been sufficient to make it a different trade. The trade was providing finance relating to second hand motor cars, which were ultimately sold by third parties on their forecourts.

41. On the condition in section 86(1)(c), Mr Boyce conceded that the shares were subscribed for in cash by Mr Davis and were not issued in consideration for the transfer of the trade (as noted in our finding of fact above). With respect to Mr Boyce, we do not think that he understood the fundamental importance of this point – it is a necessary condition for the use of the losses and on its own prevents the losses being used even if we had found that a trade had transferred.

42. On the condition in section 86(1)(d), it was not in dispute that the income derived from the company in question. Therefore this condition would have been met.

43. HMRC also encouraged us to find, in the alternative, that the losses in question were not in fact carried forward losses but post-cessation losses and that therefore section 86 would not have been available. We were not provided with sufficient evidence or submissions on either side on this point to reach a conclusion. Given its relevance is so remote in this case (because our decisions on the other points prevent the application of section 86 in any event) we do not need to decide the point.

44. We therefore find that Mr Davis does not meet the conditions to obtain loss relief under section 86 of ITA 2007.

45. On final point to consider is Mr Boyce's submission that reaching that conclusion would be unfair to Mr Davis, who simply made a commercial decision to protect himself better through the use of a limited company and altered security arrangements but left his existing relationship with Dickinson outside the company for practical ease of administration.

46. He submitted that true life commercial decisions are made "on the hoof" and that Mr Davis did his best in the circumstances.

47. Mr Boyce urged us to compare Mr Davis' position with what would have been the case if he had carried on in sole trade with the new customers and changed arrangements. He argued that in those circumstances, Mr Davis would have been able to set off the losses and that the situation should be comparable when a trade is incorporated.

48. On this issue, HMRC submitted that a literal interpretation of the law is required and that, in any event, the spirit of the law would not suggest the use of losses should be available in these circumstances.

49. Although Mr Boyce did not articulate this point as a legal submission, encouraging us rather to take a "common sense point of view", we consider whether there is anything in the obligations, derived from the line of cases often referred to as the "*Ramsay doctrine*", which

would require us to take a purposive approach to interpretation and whether that would make any difference in this context.

50. Lord Nicholls in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1 at [32] said:

> 'The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description'.

51. There have been a great many cases on the application of these principles and the limitations thereof, including, in particular, that the more prescriptive the statutory language, the less room there is for an appeal to a purpose which does not match the literal meaning of the words of the statute.

52. In our view, the purpose of section 86 of ITA 2007 is to allow losses generated in a sole trade (or partnership) to be available, in limited prescribed circumstances, where the trade has been transferred into a company. The restrictions on when this relief is and is not available are very clear and unambiguous. The facts that we have found do not match up with this purpose or the prescriptive statutory provisions because no trade was transferred.

53. Although Mr Boyce may be correct to say that the losses would have been available if Mr Davis had carried on in sole trade, these are not the facts we are dealing with, and the losses would not have been available under section 86 which is dealing specifically with relief following incorporation. Therefore we do not think that this submission changes the decision.

**DISPOSITION**

54. For the reasons set out above, we find that loss relief under section 86 of ITA 2007 is not available for Mr Davis to set off against his income from USL in 2016/17 or 2017/18.

**RIGHT TO APPLY FOR PERMISSION TO APPEAL**

55. 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.

**ABIGAIL MCGREGOR**
**TRIBUNAL JUDGE**

**Release date: 15 AUGUST 2022**