Appeal number
FTC/65/2010

Corporation Tax – mistaken payments by taxpayer's customers – whether arising or accruing from trade

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

PERTEMPS RECRUIMENT PARTNERSHIP LIMITED	**Appellant**
- and –	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

Tribunal: The Hon Mr Justice Arnold

Sitting in public in London on 1 and 2 March 2011

Jonathan Schwarz, instructed by Grant Thornton UK LLP, for the Appellant

Elizabeth Wilson, instructed by HMRC Solicitors' Office, for the Respondents

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MR JUSTICE ARNOLD:

Introduction

1. This is an appeal by Pertemps Recruitment Partnership Ltd ("Pertemps") from a decision of Tribunal Judge Nicholas Aleksander and Mr Philip Gillett sitting in the First-Tier Tribunal (Tax Chamber) ("the Tribunal") dated 13 May 2010 [2010] UKFTT 218 (TC) by which the Tribunal dismissed Pertemps' appeal against (a) the refusal by the Respondents ("HMRC") of error and mistake claims made by Pertemps pursuant to Schedule 18, paragraph 51 of the Finance Act 1998 for each of the accounting periods ended 31 December 1999, 2000, 2001 and 2002, and (b) an amendment to Pertemps' corporation tax return for the accounting period ended 31 December 2003 pursuant to Schedule 18, paragraph 34(4) of the Finance Act 1998.

2. The issue raised by the appeal is whether sums paid by Pertemps' customers to Pertemps by mistake form part of the "profits or gains arising or accruing … from [Pertemps'] trade" within section 18(1)(a)(ii) of the Income and Corporation Taxes Act 1988, so as to be subject to corporation tax.

The facts

3. The facts, which were largely agreed, are set out in detail in the Tribunal's decision at [3]-[21]. For the purposes of this appeal they may be summarised as follows.

4. Pertemps carries on business as a recruitment agency providing either temporary or permanent workers to its customers. Pertemps customers are divided into two groups, "contract" customers and "A-Z" customers. Contract customers enter into negotiated long-term contracts with Pertemps for the supply of temporary and/or permanent workers. A-Z customers engage Pertemps to provide workers on its standard terms of business. Relationships with A-Z customers are often "one off" and last for a short period of time.

5. Customers are invoiced on a regular basis. Customers are contacted promptly by Pertemps' credit control department if an invoice is not paid on time. Where there is a disagreement, for example over the rates charged or the hours worked, the customer will normally withhold payment either for the full amount invoiced, or for the disputed amount. Once the disagreement is resolved (and, where appropriate, a credit note issued), the customer will normally pay the amount agreed as due.

6. Payments are received by Pertemps either as cheques in the post, or by direct credit to its bank account by BACS. All payments are made into the same bank account. At the time when payments are received by Pertemps (either when the payment is credited directly into its bank account by BACS, or when a cheque is banked), the payment may not have been reconciled to a particular invoice, as reconciliation is undertaken separately. Unreconciled payments are not segregated into a separate account, but are mixed with other receipts.

Business expenses incurred by Pertemps are paid from the funds in this bank account.

7. The payments are posted to the sales ledger on Pertemps' computerised accounting system on the day of receipt. BACS receipts are reconciled either using the electronic reference used in the BACS record (which would have been provided by the customer to their bank when instructing the bank to make payment) or using the remittance advice sent separately in the post by the customer. Cheque payments are normally accompanied by a remittance advice detailing the invoices to which the payments relate.

8. Although Pertemps endeavours to match the payments with customers' outstanding liabilities, some payments cannot be reconciled. The majority of unreconciled payments are either offset against another liability of the customer in question, or are repaid. In a minority of cases, sums paid are neither offset against another liability nor returned to the customer.

9. Every six months Pertemps reviews unreconciled balances in the sales ledger. Those that are more than six months old are transferred to a balance sheet account. At the end of each financial year, this balance sheet account is released to Pertemps' profit and loss account as part of its year end procedures. This accounting treatment is one which gives a true and fair view and is in accordance with generally accepted accounting practice.

10. Pertemps keeps a full history of all payments received. If a customer can show that it has made an overpayment in error, Pertemps will refund the overpayment, even if the payment has been transferred to a balance sheet account or has been released to the profit and loss account.

11. In the accounting period ended 31 December 2003, Pertemps received 990 payments totalling £486,000 which were released to the profit and loss account under these procedures. Of these, 110 payments were from contract customers and 880 payments were from A-Z customers. Unreconcilable payments are much less common amongst contract customers because Pertemps continuously monitors contract customers' outstanding invoices. Over the five years in issue, the total unreconciled payments amounted to £1,624,000, representing 0.18% of Pertemps' total turnover of £903,026,000.

12. Pertemps do not know why customers make payments in error, but they appear to fall into three categories. First, in some cases customers made payments against invoices in circumstances where the invoice had been reversed by a credit note, but the credit note was ignored. Secondly, in other cases it would appear that some customers paid invoices twice, or perhaps mistook a credit note for an invoice, and paid against both the invoice and the credit note. Thirdly, in one case during the sample period considered by the Tribunal the payment could not be linked in any way to an underlying supply. All of the sample payments examined by the Tribunal were made by persons who had a customer relationship with Pertemps, and in every case the payment was made by reference to a Pertemps invoice (real or – in one case – imagined).

13. The Tribunal found that:

(i) each of the overpayments which are the subject of this appeal was made by a customer under a mistaken belief that it owed money to Pertemps for services Pertemps had supplied to it;

(ii) the payments derived from the business relationship that Pertemps had with its customers;

(iii) the payments were of sums of money to which, on receipt, Pertemps was not entitled;

(iv) Pertemps does not carry on any specific activity which might be said to earn or encourage these payments;

(v) given the scale on which Pertemps operates, it is inevitable that mistakes will occur from time to time, and therefore the receipt of mistaken payments is an unavoidable incident of Pertemps' trade.

<u>The legal status of the mistaken payments</u>

14. The Tribunal considered the legal status of the mistaken payments at [22]-[27]. This analysis is not in dispute, and may be summarised as follows:

(i) Money paid by a customer to Pertemps by mistake is not a debt owing to the customer. This is not affected by the fact that, as a matter of good accounting practice, prior to release of the mistaken payment to its profit and loss account, Pertemps shows the mistaken payment in its sales ledger and balance sheet account as a liability owed to the customer.

(ii) Nor does Pertemps hold the money on trust for the customer or otherwise receive the money in a fiduciary capacity. Thus the customer has no proprietary claim in respect of the money.

(iii) Since the money is paid by the customer under a mistake, the customer has a common law personal claim against Pertemps for restitution of the money. Pertemps may be able to defend itself against such a claim – for example if it has changed its position by the time the claim is made – but in practice it is unlikely that any of the usual defences to a restitutionary claim would apply in these circumstances. It is unlikely that a restitutionary claim by a customer would ever be barred as a result of the Limitation Act 1980. This is because the limitation period only starts to run from when the customer discovers its mistake or ought to have discovered its mistake. In practice, as soon as a customer discovers its mistake, it will make a claim for a repayment.

(iv) As a consequence of (i)-(iii), money paid by mistake to Pertemps by customers belongs to Pertemps unless and until the customer makes a successful claim in restitution against Pertemps, or such a claim is settled by agreement.

The statutory provisions

15. Section 18 of the Income and Corporation Taxes Act 1988 ("ICTA") provides, so far as relevant to the present case:

"(1) The Schedule referred to as Schedule D is as follows:-

SCHEDULE D

Tax under this Schedule shall be charged in respect of-

(a) the annual profits or gains arising or accruing -

…

(ii) to any person residing in the United Kingdom from any trade, profession or vocation, whether carried on in the United Kingdom or elsewhere,

...

(2) Tax under Schedule D shall be charged under the Cases set out in subsection (3) below, and subject to and in accordance with the provisions of the Tax Acts applicable to those Cases respectively.

(3) The Cases are-

'Case I:

tax in respect of any trade carried on in the United Kingdom or elsewhere but not contained in Schedule A;

…"

16. Section 42(1) of the Finance Act 1998 provided in respect of accounting periods beginning after 6 April 1999 but before 24 July 2002:

"For the purposes of Case I or II of Schedule D the profits of a trade, profession or vocation must be computed on an accounting basis which gives a true and fair view, subject to any adjustment required or authorised by law in computing profits for those purposes."

17. With effect from 24 July 2002, the words "on an accounting basis which gives a true and fair view" in section 42(1) were replaced by the words "in accordance with generally accepted accounting practice" by section 103(5) of the Finance Act 2002.

The Tribunal's decision

18. Before the Tribunal, Pertemps argued in summary that a mistaken payment by a customer was not a trading receipt since the payment was made in error, Pertemps had no legal entitlement to the money on receipt and the money was not paid in return for the provision of any goods or services. In support of this argument Pertemps relied in particular on the decisions of the Court of Appeal in *Morley v Tattersall* (1938) 22 TC 51 and of the Special Commissioners in *Anise Ltd v Hammond* [2003] STC (SCD) 258. The Tribunal did not accept this argument. It distinguished *Morley v Tattersall* and held that *Anise v Hammond* was wrongly decided. It also considered a number of other cases cited by the parties. It expressed its conclusions as follows:

> "45. In our view, the overpayments received by Pertemps arise because of Pertemps' trading activities, and are therefore receipts arising or accruing from its trade. The payments were made by customers in the mistaken belief that they owed money to Pertemps for services Pertemps had supplied to them in the course of Pertemps' trade. Even though Pertemps did not carry on any specific activity which might be said to earn or encourage the receipt of these mistaken payments, their receipt is an inevitable and unavoidable incident of Pertemps' trade. Pertemps did not segregate the mistaken payments from its other receipts, and treated the mistaken payments as its own money, as indeed they were. The fact that the payments were unilateral or that customers may have an entitlement to claim the money back does not prevent the payments from being trading profits.
>
> 46. It is not in dispute that Pertemps' accounts show a true and fair view and are prepared in accordance with generally accepted accounting practice. As we have determined that the overpayments are receipts of Pertemps' trade within Schedule D, Case I, it then follows that the amounts released to the profit and loss account each year fall to be treated as taxable profits."

The appeal

19. Pertemps contends that in reaching its decision the Tribunal erred in law. In short, Pertemps argues that the present case falls squarely within the ratio of *Morley v Tattersall* and that the Tribunal was wrong to regard it as distinguishable. It submits that (i) a receipt is to be judged once and for all at the time of receipt and (ii) a payment cannot be a trading receipt unless the trader has a legal entitlement to receive it at that time, save perhaps in exceptional circumstances which do not apply here.

Morley v Tattersall

20. Since *Morley v Tattersall* is central to Pertemps' submissions, it is necessary to consider it in some detail. Tattersall was the well-known firm of horse auctioneers. They auctioned horses as agent for the vendors. They received the purchase prices paid by the purchasers on behalf of their clients, and deducted their commission and expenses. It was a term of their contracts with their

clients that no money would be paid to the client without a written demand from the client. For various reasons, clients from time to time did not call for payment of their money, and so Tattersall held unclaimed balances to the credit of the clients. Many of those balances remained unclaimed for a considerable number of years. As Sir Wilfrid Greene MR, with whom Scott and Clauson LJJ agreed, observed at 61, however:

> "… the learned Solicitor General quite properly admitted that the vendors in question were entitled to claim payment of their money at any time, unaffected by the Statute of Limitations, which has not yet begun to run owing to any written order as required by the conditions. We are dealing, therefore, with obligations which, as a matter of law, are existing obligations which the firm can be called upon to perform at any moment. That is a matter not without importance in the examination of this case".

21. Tattersall did not include the unclaimed balances in its profit and loss account which was made up each year. Provision was made in the partnership agreement, however, for annual transfers of unclaimed balances to the credit of the partners. As Greene MR pointed out at 63 and 64, that was "merely a private arrangement as to the way in which [the partners'] assets and liabilities would be dealt with" which "had no effect whatsoever on the customers and did not diminish their rights".

22. Despite this, the Crown contended that the unclaimed balances became trading receipts when distributed to the partners. Lawrence J upheld that contention, but the Court of Appeal allowed Tattersall's appeal. In the Court of Appeal the Crown advanced two arguments. Greene MR began with the argument advanced by junior counsel for the Crown at 65-66:

> "It might. I think, be more convenient to deal with Mr Hills', argument first, because that is the one which starts off with this perfectly clear admission, that the money when received from the purchasers was not a trade receipt. That proposition, I should have thought, in any case, was quite incontestable. The money which was received was money which had not got any profit-making quality about it; it was money which, in a business sense, was the client's money and nobody else's. It was money for which they were liable to account to the client, and the fact that they paid it into their own account, as they clearly did, and the fact that it remained among their assets until paid out do not alter that circumstance. It would have been for Income Tax purposes, in my judgment, entirely improper to have brought those receipts into the account at all for the purpose of ascertaining the balance of profits and gains. Indeed, as I have said, the Crown did not suggest that it would have been proper. But what was said was this: Mr Hills' argument was to the effect that, although they were not trading receipts at the moment of receipt, they had at that moment the potentiality of becoming trading receipts. That proposition

> involves a view of income tax law in which I can discover no merit except that of novelty. I invited Mr Hills to point to any authority which in any way supported the proposition that a receipt which at the time of its receipt was not a trading receipt, could by some subsequent operation *ex post facto* be turned into a trading receipt, not, be it observed, as at the date of receipt, but as at the date of the subsequent operation. It seems to me, with all respect to that argument, that it is based on a complete misapprehension of what is meant by a trading receipt in income tax law. No case has been cited to us in which anything like that proposition appears. It seems to me that the quality and nature of a receipt for income tax purposes is fixed once and for all when it is received. What the partners did in this case, as I have said, was to decide among themselves that what they had previously regarded as a liability of the firm they would not, for practical reasons, regard as a liability; but that does not mean that at that moment they received something, nor does it mean that at that moment they imprinted upon some existing asset a quality different from what it had possessed before. There was no existing asset at all at that time. All they did, as I have already pointed out, was to write down a liability item in their balance sheet, and how in the world by effecting that operation you can be said to have converted a sum received years ago into something which it never was is a thing which, with all respect, passes my comprehension."

23. Greene MR went on to deal with the argument advanced by leading counsel for the Crown, and then with the judgment of Lawrence J. In that context he said at 70:

> "The learned Judge took a different view, as I have said: he took the view that the balances, when distributed to the partners, were trading receipts. The distribution to which I imagine he is referring is the allocation of sums to the partners' account in the balance sheet: but what was distributed to the partners was not an asset item, but a liability item. As I have pointed out, this liability was cut down by a certain sum. That sum was then used to feed the partners' account, but it was a liability not an asset; it is on the left-hand side of the balance sheet, not on the right, and there was no dealing with any balance in the sense of an asset at all. It seems to me quite impossible, with the greatest deference to the learned Judge's view, to treat that accountancy transaction *inter socios*, by which they affected the re-arrangement of the liability side of their balance sheet, as a distribution of trading profits. It was not.
>
> Now the learned Judge further treated the liability as a merely contingent liability which could be disregarded. I have

> difficulty accepting that view, at any rate in the sense in which the learned Judge appears to have used it. This money, of course - using a colloquial and business expression rather than legal expression - was never Messrs. Tattersall's money; it was the customer's money; it remains the customer's money; the customer can call for it at any moment, and the fact that a demand in writing has to be made before the liability to pay accrues, so as to make the Statute of Limitations run, does not make the liability a merely contingent liability in the sense in which the learned Judge appears to regard it. It is an existing liability which can only be enforced when the creditor has made a demand."

Once and for all

24. Counsel for Pertemps submitted that *Morley v Tattersall* was authority for the proposition that the nature of a receipt was fixed once and for all when it was received: receipts either are or are not trading receipts at the time that they are received, and their nature cannot change after receipt. In support of this submission he relied on passage from Greene MR's judgment at 65 which I have quoted in paragraph 22 above.

25. While that passage on its face supports counsel's submission, it turns out to be a classic example of a judicial statement which is broader than was necessary for disposition of the case at hand and subsequently requires qualification. This is demonstrated by the decision of Atkinson J in *Jay's the Jewellers Ltd v Commissioners of Inland Revenue* (1947) 29 TC 274. In that case the taxpayer carried on business as jewellers and pawnbrokers. The Pawnbrokers Act 1872 required a pawnbroker to hold a pledged article for 12 months and 7 days. If it had not been redeemed by then, and the amount of the loan was 10 shillings or less, the article became the property of the pawnbroker. Thus the pawnbroker could sell the article and pocket the proceeds. If the loan exceeded 10 shillings, the pawnbroker could sell the article and deduct the loan, interest and costs of sale out of the proceeds, but the balance belonged to the owner of the article. After three years, however, the owner lost the right to demand payment of the surplus and the money became the property of the pawnbrokers. In the case of loans exceeding 40 shillings, a pawnbroker was allowed to make special contracts, and the taxpayer's contracts specified the same three-year period for loans up to £10. For loans over £10, the normal six-year limitation period applied.

26. There was no dispute that the sale proceeds from articles subject to a loan of 10 shillings or less formed part of the taxpayer's trading receipts. The issue was as to the unclaimed balances from the sale of articles subject to loans of greater value. The Crown contended that the sale proceeds were ordinary trade receipts at the time of sale. The Special Commissioners held that the unclaimed balances became trade receipts at the end of three years or six years as the case might be. Appeals against this conclusion by both the Crown and the taxpayer were dismissed by Atkinson J.

27. He dealt first with the Crown's appeal, saying at 284:

> "I think the answer to the Crown's appeal is that these surpluses are not trading receipts in the year in which they are received. I think that the case is completely governed on this point by *Tattersalls'* case."

Having summarised the facts and quoted part of the passage from Greene MR's judgment at 65 set out in paragraph 22 above, he concluded at 285:

> "That, and the rest of that page, seem completely applicable to this case. As a matter of law, these monies when received were not their monies at all; they belonged to their clients, and if a client came in the next day and demanded his money they have to pay it away."

28. He then turned to the taxpayer's appeal. In relation to this, he said at 286:

> "The true accountancy view would, I think, demand that these sums should be treated as paid into a suspense account, and should so appear in the balance sheet. The surpluses should not be brought into the annual trading account as a receipt at the time they are received. Only time will show what their ultimate fate and character will be. After three years that fate is such, as to one class of surplus, that in so far as the suspense account has not been reduced by payments to clients, that part of it which is remaining becomes by operation of law a receipt of the Company, and ought to be transferred from the suspense account and appear in the profit and loss account for that year as a receipt and profit. That is what it in fact is. In that year Jays become the richer by the amount which automatically becomes theirs, and that asset arises out of an ordinary trade transaction. It seems to me to be the commonsense way of dealing with these matters, and it is the way in which the Special Commissioners have dealt with them. But it is argued that I cannot give effect to that view because of *Tattersalls'* case. Is there anything in *Tattersalls'* case to indicate that that view is wrong? In that case there been no change whatever in the character and nature of the money held. The Statute of Limitations had not commenced to run, and the Court was dealing merely with the effect of a change in the method in which these sums were dealt with in the firm's books."

29. Having quoted another part of the passage in Greene MR's judgment which I have set out in paragraph 22 above, he continued:

> "But here the position is quite different. Here, at the end of three years, the money in question, the three-years-old surplus, did attain a totally different quality; a different quality was imprinted on surpluses three years old. I think there was then a definite trade receipt. At the end of the three years a new asset came into existence, an asset which had arisen out of a trade

> transaction, and it seems to me that what the Master of the Rolls was dealing with in that case was a situation quite different from that which exists here."

He went on to hold that the same was true of the six-year surpluses.

30. As this reasoning demonstrates, there can be circumstances in which money which is not a trading receipt at the time of receipt subsequently becomes a trading receipt because something occurs which changes its character. In the present case, however, this point does not seem to me to be material, for the simple reason that HMRC are not contending that receipts which were not originally trading receipts became trading receipts by virtue of some later event. On the contrary, HMRC contend that the mistaken payments were trading receipts from the moment they were received by Pertemps.

Legal entitlement to receipt

31. Counsel for Pertemps argued that *Morley v Tattersall* was also authority for the proposition that in general a receipt is not a trading receipt unless the trader has a legal entitlement to receive the money, since it is that entitlement which connects the receipt to the trade. In that case, he submitted, the sums received by Tattersall from the purchasers were their clients' money, Tattersall had no legal entitlement to that money and thus the unclaimed balances were not trading receipts. Similarly, he argued, in this case Pertemps had no legal entitlement to the mistaken payments, and therefore the mistaken payments were not connected to Pertemps' trade and were not trading receipts.

32. Before expressing a conclusion on this argument, it is necessary to consider a number of other cases which were cited to me. It is convenient to take these in chronological order.

33. In *Lincolnshire Sugar Co Ltd v Smart* [1937] AC 697 the taxpayer was a manufacturer of beet sugar. In the 1920s and 30s the beet sugar industry was in difficulties. Under the British Sugar (Subsidy) Act 1925 government subsidies were paid to companies such as the taxpayer. In 1931 this was replaced by the British Sugar Industry (Assistance) Act 1931. This provided for "advances" to be paid to companies who accepted the conditions laid down in the Act. The advances were repayable if the market price for sugar exceeded a certain amount. The taxpayer received such advances. The taxpayer challenged the treatment of these advances as trading receipts in its Schedule D assessment, contending they were properly to be characterised as loans. This contention was upheld by the Special Commissioners and Finlay J, but rejected by the Court of Appeal and the House of Lords.

34. In the House of Lords the only speech was given by Lord Macmillan, with whom Lords Atkin, Russell of Killowen, Thankerton and Roche agreed. At 701 he stated:

> "As the question whether the payments received by the Company under the Act of 1931 were or were not trade receipts depends upon the character and incidents of these

> payments, it is necessary to examine the relative provisions of the Act."

35. Having considered the provisions of the Act, Lord Macmillan observed that, if the nature of the payments were to be determined solely by the language of the statute, there would be much to be said for the view that the payments were loans. He went on, however, at 704:

> "But in my view the question ought not to be decided on merely verbal arguments. What to my mind is decisive is that these payments were made to the company in order that the money might be used in their business. Here I definitely part company from Finlay J. who thought that 'they were not subsidies or grants to assist the company in their business.' We are told in the stated case that it was because of an apprehension that the companies might not be able to pay to the growers of beet the prices they had contracted to pay that this further assistance was given by the Government. It is true that the appellants apparently did not actually require to have recourse to the 'advances' they received, for in their accounts for the relevant years which have been produced the advances are not carried into profit and loss but are entered as liabilities in the balance sheet, and the profit and loss accounts show a balance of trading profit without taking the 'advances' into account. But if the Company had not happened to be able to pay for its raw material otherwise it could properly have used the 'advances' for this purpose. It was with the very object of enabling them to meet their trading obligations that the 'advances' were made; they were intended artificially to supplement their trading receipts so as to enable them to maintain their trading solvency. If the 'advances' had in any year been carried to the credit of the Company's trading account, as might properly have been done, and the trading account had in consequence shown a profit instead of a loss, can it be doubted that the credit balance would rightly have entered into the computation of the Company's profits or gains for tax purposes?"

36. He concluded at 705:

> "… I do not find it necessary to rest my judgment on wisdom after the event. I prefer to rest it on my view of the business nature of the sums in question which the Company received in 1931-32. I think that they were supplementary trade receipts bestowed upon the Company by the Government and proper to be taken into computation in arriving at the balance of the Company's profits and gains for the year in which they were received."

37. Counsel for Pertemps submitted that the basis of this decision was that the taxpayer was legally entitled to receive the advances by virtue of the statute. I

do not accept that analysis. The taxpayer would have been equally legally entitled to receive the advances if their true character had been that of loans, as the taxpayer contended. Lord Macmillan's reasoning was based not on the legal entitlement of the taxpayer to receive the money, but upon the true nature and purpose of the payment.

38. Counsel for HMRC submitted that the decision demonstrated that a payment which was subject to a contingent obligation to repay could be a trading receipt. I accept that submission so far as it goes; but I do not regard that aspect of the case as particularly significant, because on the facts the contingency did not materialise.

39. In *Commissioner of Income Tax* v *Savundranayagam* (1957) 67 TC 239 the taxpayer challenged an income tax assessment. The issue was whether certain sums he had received were profits of a trade. The facts were somewhat complicated, but in essence what had happened was that a company of which the taxpayer and his wife owned 60% of the shares sold some lubricants to a Chinese company. The taxpayer's company bought the lubricants from a French business. The taxpayer had a power of attorney for a partnership between his company and a subsidiary. The Chinese company opened a letter of credit with a Swiss bank. The bank paid the taxpayer on presentation of the requisite documents. After paying the French supplier, the taxpayer deducted his personal commission and paid the balance to his company, which paid dividends to the taxpayer and his wife and director's fees to the taxpayer. It turned out that, unbeknownst to the taxpayer, the documents were forgeries. The Chinese company and the bank both claimed the money from the partnership, but in the event no payments were made to either of them and it was found as a fact that that the money would not be repaid. The taxpayer was assessed for income tax on (i) his personal commission, (ii) the dividends and (iii) the director's fees. Although the taxpayer's challenge to the assessment was upheld by the Supreme Court of Ceylon, it was rejected by the Privy Council.

40. The taxpayer advanced two arguments before the Privy Council. The first was recorded by Lord Somervell of Harrow, giving the opinion of the Privy Council, at 243 as follows:

> "The Respondent submitted and submits that the payment by the bank having been made under a mistake of fact, the money paid to the Respondent still 'belonged' to the bank or to the Chinese company. It could not, therefore, [h]e submitted, be treated as a credit item in his trading account."

41. He rejected this argument at 244, holding the consequence of a payment under a mistake of fact was not that the money continued to belong to the payer, but that "the payee is liable to pay to the payer the same amount which he has received".

42. Lord Somervell recorded the taxpayer's second argument at 244 as follows:

> "He submitted that, in a purchase and sale transaction, no profit arises until the seller becomes entitled to receive the purchase price. In the present case, therefore, there was not even a condition[al] or *prima facie* credit item when the money was paid. If this argument were right, it would seem to follow that, in every case where there is a possibility of an adverse claim, no credit item can be entered until the facts have been ascertained. It would also seem to follow that there is no profit even if no claim is or ever will be made if on the facts the seller was not entitled to the price."

43. Again, he rejected this argument, holding at 244-245:

> "The difference between the amount paid by the bank and the amount paid to [the French supplier] was on the face of it, subject to expenses, the profit of the transaction. It was when received so regarded and, if books were kept, it would so appear in them. There are of course numerous cases in which after the purchase price has been paid there is a claim by the buyer. It may be a claim to reject the goods and recover the purchase price, it may be a claim for damages, the goods being retained. The seller may dispute the claim, successfully. The buyer, though having a claim, may refrain from pressing it to avoid expense and preserve friendly relations. From the aspect of income tax the question is whether money has had to be paid out in respect of the transaction. If it has been it will normally come in on the debit side of the tax account.
>
> If a claim is plainly going to be made, which may equal or exceed the amount of the purchase price, the taxpayer will have a strong case for treating the 'receipt' as conditional only until the final profit of the transaction is settled. This would have special force if the trade was being discontinued and no adjustment was later possible.
>
> In their Lordships' opinion the fact that the 'claim' is under English procedure for money had and received makes no difference. The taxpayer has still to show that the payment he has received as the purchase price has been or will be diminished or extinguished. If a claim having been quantified and admitted the Revenue authorities are satisfied that it will be paid it could, no doubt, be treated as an ordinary book debt.
>
> In the present case, therefore, the Respondent in order to succeed must show that the sums on which the assessment is based have been or will be extinguished or diminished. He does not seek to show that they have been extinguished or diminished. On the question as to whether they will be, it may be sufficient to refer to the finding of fact. It is worth noting the inconsistency of the Respondent's case. If, as he maintains to the Revenue, the money is not his money, why has he not

> repaid it or any part of it to the bank or the Chinese company, or if he was doubtful as to which was entitled to it, into a joint account?"

44. He went on at 245 to distinguish *Morley v Tattersall*:

> "That case dealt with purchase monies received by auctioneers for vendors which had not been claimed by the vendors. It was held that these could not be treated as trading receipts. The basis of the judgment in that case was that these sums were not received as profits or credit items on an account of a trade.
>
> The sum in question here was received as the purchase price of goods sold. It was a profit of a trade and the Respondent has failed to satisfy the tribunal of fact that there are sums to be placed on the other side of the account which would extinguish or diminish it".

45. Counsel for HMRC submitted that this decision established that the fact that a receipt was obtained by a trader in circumstances such that the payer had a claim for restitution of the money (as it was then called, a claim for money had and received) did not prevent it from being a trading receipt. She also submitted that it established that such a case is properly to be distinguished from the situation in *Morley v Tattersall*. Finally, she submitted that the inconsistency identified by the Privy Council in the taxpayer's case was equally true of Pertemps' case on this appeal. I accept each of those submissions.

46. Counsel for Pertemps pointed out that in that case the payment was not made merely by mistake, but as a result of the documents being forged. In my judgment that is not a material distinction from the present case, because it was found as a fact that the taxpayer had presented the documents believing them to be genuine and unaware of the fraud which had been perpetrated by a director of the French supplier. This is why the claims by the Chinese company and the bank were described by the Privy Council as claims for money had and received. In any event, as I shall discuss below, it would not have made any difference if the taxpayer had been party to the fraud.

47. More pertinently, counsel for Pertemps submitted that that case differed from the present case because in that case the money was paid as the purchase price under a sale which was indisputably a trading transaction, whereas in the present case there was no contract which required payment of the mistaken payments. That is true, but it does not detract from the points I have referred to in paragraph 45 above.

48. In *Elson v Prices Tailors Ltd* [1963] 1 WLR 287 the taxpayer carried on business as bespoke and ready-to-wear tailors. When taking an order for made-to-measure garments, the taxpayer recorded the customer's measurements on an order form. The customer would then be asked for a "deposit". After the customer had paid the deposit, its amount was recorded on the order form, from which a slip was detached and given to the customer.

This slip showed the price, and the balance due, the difference being the amount of the deposit. If, subsequently, the customer declined to take the garment, the taxpayer refunded his deposit. Where, as often happened, neither garment, nor deposit was claimed after several reminders, the taxpayer transferred the sums to an unclaimed deposits account, from which it made refunds in the event of later claims. The taxpayer was assessed to income tax in respect of unclaimed deposits as trading receipts of their business in the year in which they were paid.

49. The taxpayer's challenge to the assessment was upheld by the Special Commissions, but rejected by Ungoed-Thomas J. He held that the "deposits" were true deposits (i.e. were irrecoverable by a purchaser in default), and not mere part-payments. Accordingly, the deposits were the property of the taxpayer from the moment of receipt, though subject to certain contingencies. Thus each deposit was a trading receipt in the year in which it was received by the taxpayer.

50. Ungoed-Thomas J held at 293 that it was immaterial that in practice the taxpayer would refund any deposit which was claimed by the customer:

> "But the deposits became the company's property on payment, and it was only those whose return was requested by the customers which were paid to them: and then not on account of any right of the customer to what was the company's property, nor on account of any obligation under the contract, but because it was decided by the company of its own volition, as a separate matter of policy, that it would be helpful to the company's goodwill. I understand that there is no difficulty about allowing such payments by the company as trading expenses properly incurred. Such treatment would reflect its true nature as the outcome of a separate, independent decision of the company."

51. He distinguished *Morley v Tattersall* and *Jay's v IRC*:

> "In *Morley v Tattersall*, the vendors' unclaimed balances, in the hands of a firm of auctioneers, of proceeds of sale of horses were held not to be trading receipts; and in *Jay's - The Jewellers Ltd v Commissioners of Inland Revenue*, a pawner's unclaimed balance in the hands of a pawnbroker of the proceeds of sale of an unredeemed pledge, after satisfying the amounts due under the pledge, was held not to be a trading receipt until the pawner's claim was statute-barred. In these cases, the balances in the traders' hands were not theirs at all but were held for others, and this fact is fundamental to the decisions. The traders had no beneficial interest in them at the relevant time, and, although it was because they were traders that they received them, they were not receipts of their trade at all. Counsel for the taxpayers suggested that nevertheless the decisive feature in these cases was the existence of an obligation on the part of the trader to repay the unclaimed

> balances. But that was an unqualified obligation to repay absolutely, and is only another way of saying that the balances were not the property of the traders but of their clients or customers. Both the ownership of the deposit and the absence of any comparable obligation to repay put this case completely outside the essential facts in the *Morley* and *Jay's* cases, and I do not consider that those decisions assist in the decision of this case."

52. He went on to consider the *Lincolnshire Sugar* case and *J.P. Hall & Co Ltd v Commissioners of Inland Revenue* (1921) 12 TC 382, and concluded at 294:

> "The *J P Hall* case does not, to my mind, establish that a receipt in the course of trade which must at some time enter into the computation of profits or gains of a trade in a particular year should not do so in the year of its receipt, but only when the contract under which it is paid has been completely executed. The *Lincolnshire Sugar Co* case, in my view, indicates the contrary. The deposit becomes the taxpayers' property on receipt. It is a trading receipt in the year in which it is received, and not the less so because there might or might not have to be debited items with which I am not concerned on this appeal."

53. Counsel for HMRC submitted that Ungoed-Thomas J had correctly identified the true basis of the decision in *Morley v Tattersall* as being the fact that the unclaimed balances were not the property of the auctioneers, but of their clients. I accept that submission. I will return to this point below.

54. In *Simpson v John Reynolds & Co (Insurances) Ltd* [1975] 1 WLR 617 the taxpayer, which carried on business as an insurance broker, had for many years acted as adviser to a particular client on all its insurance matters. In 1965 a large company acquired a major shareholding in the client, and required the latter to place all its insurances with another insurance company. The client informed the taxpayer that its services would no longer be required. Subsequently, the client wrote to the taxpayer volunteering to pay the latter £1,000 per annum for a period of five years commencing in March 1966. The letter stated that the payment was in recognition of the taxpayer's past services as insurance broker and was calculated on the basis that in the past the annual earnings of the taxpayer by way of commission in respect of the client's business had been in the order of £2,000. The taxpayer was assessed to corporation tax on the basis that the annual instalment of £1,000 received by the taxpayer from the client was a trading receipt liable to tax under Case I of Schedule D. The taxpayer's challenge to the assessment was upheld by the Special Commissioners, Pennycuick V-C and the Court of Appeal.

55. Russell LJ held at 619 that the money was not within the meaning of the phrase "annual profits or gains arising or accruing to the taxpayer from its trade" for the following reasons:

> “First, this was a wholly unexpected and unsolicited gift. Secondly, it was made after the business connection had ceased. Thirdly, the gift was in recognition of past services rendered to the client company over a long period, though not because those past services were considered to have been inadequately remunerated. Fourthly, the gift was made as a consolation for the fact that those remunerative services were no longer to be performed by the taxpayer for the donor; and, fifthly, there is no suggestion that at a future date the business connection might be renewed.”

56. At 619-620 Russell LJ dealt with the Crown’s argument to the contrary, and said:

> “For the Crown it was contended that the fact that a payment is made without legal obligation does not per se elude the fiscal grasp. This is true. Gifts made or promised during the relevant connection may well be caught. It was also pointed out that the fact that payments are made after the connection has ceased does not per se elude the fiscal grasp. This also is true: for it may be part of the connection that such payments after its determination are to be expected. But that does not in my view lead to the suggested conclusion that when both of those circumstances are present—that is to say, where the gift is wholly voluntary and made unexpectedly after the business connection has come to an end—the payment is within the statutory language.”

57. Stamp LJ and Walton J both concurred. Stamp LJ said at 620-621:

> “They were not made to satisfy any legal liability, real or imagined, to which the customer was or believed itself to be subject. The payments were not made by way of additional reward for any particular service rendered by the brokers or for their services generally. They were not made pursuant to the terms of a trading contract or as compensation for the breach of any such contract. The brokers were not entitled to and indeed did not expect to receive them. Then, out of the blue came the promise, unenforceable as it was, to make them. By the time they were promised to be made, the trading relationship was, as I have said, terminated. The payments were voluntary payments, and I find wholly satisfactory the description of them as made by way of recognition of past services or by way of consolation for the rupture of a business relationship.”

58. Counsel for HMRC submitted that the judgments of Russell and Stamp LJJ were inconsistent with it being a requirement of a trading receipt that the money was paid because of a legal entitlement on the part of the recipient. I accept that submission. Counsel for Pertemps emphasised that the Court of

Appeal's conclusion was that the money was a pure gift, but in my judgment that does not detract from the point made by counsel for HMRC.

59. In *Inland Revenue Commissioners v Falkirk Ice Rink Ltd* [1975] STC 434 the taxpayer owned and operated an ice rink. It provided facilities for curling to members of the public on payment of certain charges. The charges, however, were not sufficient to cover the costs incurred in provision of these facilities. Among the customers of the taxpayer who regularly used its curling facilities was a club. Under an agreement made between the taxpayer and the club, the members of the club had a preferential rate for admission to the ice rink. Under the rules of the club, the club's management committee had power to enter into an agreement with the taxpayer company for the use of its rink for curling "for such period and upon such terms and conditions as may from time to time be agreed". The club's management committee became aware of the loss the taxpayer was incurring in providing curling facilities at its ice rink. Anxious to ensure the continuation of those facilities, the committee agreed to donate a sum of £1,500 to the taxpayer company to cover the additional cost of curling for the season 1968–69. The Crown claimed that the payment constituted a trading receipt chargeable to tax under Case I of Schedule D. The taxpayer appealed, contending that the payment was purely and simply a gift, and not a trading receipt. The appeal was upheld by the General Commissioners, but rejected by the Inner House of the Court of Session.

60. The leading judgment was given by the Lord President, Lord Emslie. He stated the correct approach to the determination of the issue at 439 as follows:

> "In the words of Lord Reid in *Inland Revenue Comrs v City of London Corpn* (*as Conservators of Epping Forest* [1953] 1 All ER 1075 at 1087, [1953] 1 WLR 652 at 667, 34 Tax Cas 293 at 327) 'Trading receipts are generally received in return for something done or provided by the recipient for the payer ...' This is, of course, a statement of the general position but it is plain that the question of consideration or conditions or counter stipulation is not conclusive of the matter (*British Commonwealth International Newsfilm Agency Ltd v Mahany*—in the speech of Lord Cohen [1963] 1 All ER at 93, [1963] 1 WLR at 77, 40 Tax Cas at 582). For a payment to be a trading receipt the recipient must in the first instance be a trader. Not every receipt by a trader in the course of his business is a trading receipt in the income tax sense and whether a particular payment to a trader is to be regarded as a trading receipt is one which must be answered in each case in which the question arises in light of all the relevant circumstances. As Evershed MR said in *British Commonwealth Newsfilm Agency Ltd* [1962] 2 All ER at 144, [1962] 1 WLR at 567, 40 Tax Cas at 574, 574:
>
> 'In my opinion the question for the court is whether in reality, after regarding the whole of the relevant facts, the sum in question is a business payment, part of the trading receipts in this case of an admittedly trading company.'

> Upjohn LJ spoke to the same effect as did Pennycuick J in *Walker* (*Inspector of Taxes*) *v Carnaby, Harrower, Barham & Pykett.* Since this is the correct approach to the solution of the problem the decisions to which we were referred afford no more than useful illustrations and indications of considerations which may relevantly be borne in mind."

61. He categorised *Simpson v Reynolds* at 440 as a case dealing with a wholly unsolicited and unexpected gift to a trading company by former clients after the cessation of the business connection, and concluded at 441 that the instant case was different for the following reasons:

> "The fact that the payment was voluntary is neutral. The findings in fact plainly imply that the club or its members or both were customers and potential customers of the taxpayer company for the purpose of curling on its ice, and that the payment was because of the club's apprehension that in the absence of a donation the taxpayer company might not be able to continue to provide facilities for curling in the course of its trade. It is found that the charges made for curling space did not cover the cost of providing ice of the requisite quality and that curling was unprofitable in view of the high cost of providing facilities to the requisite standard. It is also found that the payment was made 'to cover the additional cost of curling' for the season in question and that the donation was made in the belief that it was in the interests of the members of the club and of the club itself. In spite of the fact that there was no agreement between the taxpayer company and the club requiring the club to make any such payment to the taxpayer company and that the payment was not in respect of services rendered by the taxpayer company to the club in the past and that the taxpayer company gave no undertaking in return for the donation, I am of opinion that the payment was made in order that the taxpayer company might use it in its business, and that in substance and in form it was a payment made to a trading company artificially to supplement its trading revenue from curling and in order, in the interests of the club and its members, to preserve the taxpayer company's ability to continue to provide curling facilities in the future. In its quality and nature this payment was of a business nature. It was accordingly a trading receipt in the hands of the taxpayer company and the question of law should be answered in the negative."

62. Lord Cameron concurred, saying at 443:

> "The phrase 'trading receipts' is not one which has received statutory definition, but obviously it implies that there is a trader carrying on a trade or profession and that the payment is received in the course of his trade or profession. There is nothing in the words themselves which by implication requires

> that the payment should be made by one who is, at the time of the payment, in the course of trading with the trader or that the payment should have to be made in respect of or return for the provision of any particular service or article of commerce. On the other hand, it is obviously more easy to determine that a receipt is a 'trading receipt' if the payment is received for such service or article. As was observed by Rowlatt J in *Chibbett* (*Inspector of Taxes*) *v Joseph Robinson* (1924) 9 Tax Cas 48 at 60, it is a question of looking at the 'point of view' of the person who receives and not at the 'point of view' of the payer.
>
> That the existence of a trading relationship between payer and recipient is not necessary in order to stamp a payment as a 'trading receipt' is made clear by the decision in the *Lincolnshire Sugar Co* case."

63. At 444-445 Lord Cameron said:

> "The voluntary character of the payment is not in my opinion a major—far less a conclusive—element on the issue in this case whether it is a taxable profit in the hands of the recipient. No doubt where there is no commercial or professional link or association subsisting at the time of the payment and no suggestion can be made that it is in any sense either remuneration for past services, compensation for loss of office or breaking of trade or professional connection or association, then the voluntary character of the gift may well be conclusive in a particular case as to the tax liability of the recipient in respect of the actual payment received, but, as the *Lincolnshire Sugar Co's* case demonstrates, a payment may be both voluntary and stem from no trading relationship, yet be such that the payment is stamped with a character of a trading receipt. Whether the payment is voluntary or made in pursuance of an enforceable obligation may be one of the considerations to be taken into account and given such weight as the circumstances of the particular case may require but it is not in any sense the decisive factor."

64. Lord Johnston agreed with both Lord Emslie and Lord Cameron, and Lord Avonside concurred.

65. Counsel for HMRC emphasised Lord Emslie's statement that the fact that the payment was voluntary was neutral and Lord Cameron's statement that this was a factor to be taken into account, but not a major factor. She submitted that this again showed that it was not necessary for a receipt to be a trading receipt that the recipient was legally entitled to it. I agree.

66. Counsel for Pertemps submitted that the decisive factor in that case was the purpose of the payment. That is true, but it does not alter the fact that the taxpayer was not legally entitled to the money and yet it was held to be a trading receipt. Counsel for Pertemps emphasised the rather unusual facts of

the case, and in particular the very close relationship between the club and the taxpayer, suggesting as I understand it that it was an exceptional case. In my judgment those particular factual circumstances are immaterial to the present issue.

67. In *Deeny v Gooda Walker Ltd* [1996] 1 WLR 426 the plaintiffs, who were underwriting members at Lloyd's ("names"), brought actions against the defendant underwriting agents, who were members' agents, managing agents or combined agents. The names alleged negligence on the defendants' part in their conduct of the names' underwriting affairs and breach of agency agreements. The defendants pleaded that, if they were held to be liable to the names in damages, then each name could only recover his or her actual loss, and that in calculating such loss credit had to be given for any tax relief, allowances or recoveries which accrued to that name out of the alleged losses. The names denied this, alleging that any damages awarded to them would themselves be subject to tax in their hands under Schedule D, Case I (or, in the case of names who had ceased trading, Schedule D, Case VI, or Case I depending on when the cessation occurred). The trial judge decided that the managing agents were liable in damages to the names, but left the question of taxation to be tried separately. The Revenue was joined for the purpose of determining the issue of the taxability of the damages, and supported the names. The House of Lords held that damages paid to the names constituted a taxable receipt in their hands.

68. Lord Hoffmann, with whom Lords Goff of Chieveley, Browne-Wilkinson, Mustill and Nicholls of Birkenhead agreed, said at 432:

> "… the question is simply whether the damages are a receipt of [the names' underwriting] business.
>
> My Lords, if it were not for the dissenting judgment of Saville L.J. I would have thought that the question admitted only one answer. If a trader sells goods, the price of what he sells is a receipt of his trade. If the buyer has to be sued for the price, the money recovered is a receipt of the trade and the irrecoverable costs are an expense. If the buyer does not accept the goods and the trader recovers damages for non-acceptance (being the difference between the price and the value of the goods left on his hands) the damages are a receipt of the trade. What is true of goods is also true of services. If a trader employs someone to perform services for the purposes of his trade, the money which he realises from the performance of those services is a receipt of the trade. If the employee in breach of his legal duty fails to perform the services, or performs them badly, so that the trader realises less money than he would have done if they had been performed properly, he will be liable in damages and the damages will be a receipt of the trade. In each case the receipt arises out of the trade."

69. Lord Hoffmann went on to explain why a case relied upon by the defendants and by Saville LJ in the Court of Appeal did not lead to a different conclusion.

He then dealt with a wider argument advanced by the names, the starting point of which he recorded at 436 as follows:

> "In order that a receipt should arise out of a trade, it need not become payable by virtue of some pre-existing trade relationship. There need have been no previous contractual relationship between the parties at all."

Although Lord Hoffmann accepted the names' wider argument, the other members of the House expressly reserved their opinion in respect of it. Accordingly, it seems to me that this decision is essentially neutral so far as the present issue is concerned.

70. In *Anise v Hammond* (cited above) the taxpayers published and circulated brochures and booklets containing advertising for which they were paid by the advertisers. Their methods of securing payment for the advertisements involved using a deposit and two banker's orders a year apart. They received excess payments under some standing orders which might have been due to the error of the customer or of the customer's bank. The companies did not engage in activities that would cause or facilitate these errors. When overpayments were received, the companies accounted for the sums as creditors on the basis that they were repayable to the bank or the paying agent. If an overpayment was claimed back, it was repaid subject to an administration charge. After six years, unclaimed overpayments were written to the profit and loss account, and as such included in taxable profits. In 1993, however, the companies changed their views about the overpayments. They decided that they were not trading receipts, and therefore were not taxable receipts. The also decided that they should be transferred to profit and loss account after two years rather than after six years. The Revenue issued assessments on the basis that the overpayments fell to be treated as taxable receipts at the time when they were transferred to profit and loss account. The Special Commissioners (Stephen Oliver QC and Dr David Williams) allowed the taxpayers' appeals.

71. It may be noted that: (i) the inspector represented the Revenue; (ii) although the inspector argued that the overpayments were trading receipts at the time of receipt, he accepted that they fell to be taxed at the time they were taken to the profit and loss account; (iii) although *Commissioner v Savundranayagam* and *IRC v Falkirk* were cited, they are not discussed in the decision; and (iv) *Lincolnshire Sugar*, *Elson v Prices* and *Simpson v Reynolds* were not cited.

72. The Special Commissioners' reasons for concluding that the overpayments were not trading receipts at the date of receipt are set out in their decision at [30]:

> "We agree with [counsel for the taxpayers] that the relevant principle here is that laid down in *Tattersall.* It must be determined whether these overpayments were, or were not, trading receipts at the time they were received. We find as fact that they were not received as part of the trading activities of the member companies of the trading group. That brings the

> overpayments fully within the principle laid down in *Tattersall,* and distinguishes them from the approach taken in *Jay's the Jewellers,* where it was accepted that the surpluses did arise directly from the trading activities of the taxpayer. In this connection the reason for the overpayment was not irrelevant. We have placed reliance on the fact that seeking the overpayments was not a trading activity of the taxpayers. That again distinguishes the present case from *Jay's the Jewellers,* where the retention of the surpluses was the most profitable part of the business and was fully authorised by law. On that basis, we reject the submission of the inspector that the sums were received as trading receipts."

73. The Special Commissioners went on to hold that the transfer of the sums to the profit and loss account made no difference, because that was an internal action within the taxpayers which did not create a trading asset.

74. With respect to the Special Commissioners in that case, I agree with counsel for HMRC and the Tribunal in the present case that *Anise v Hammond* was wrongly decided. The Special Commissioners held that *Morley v Tattersall* was applicable, but the case should have been distinguished from *Morley v Tattersall* on the ground that the overpayments were the property of the taxpayers subject to any claim by their customers for restitution, whereas the unclaimed balances in *Morley v Tattersall* belonged to the clients.

75. In *Forbes v Director of Assets Recovery Agency* [2007] STC (SCD) 1 the taxpayer was arrested and investigated by police in 1998 on suspicion of obtaining money by deception. It emerged from the investigation that between June 1995 and December 1996 nine individuals lost a total of £127,250 "invested" with the taxpayer. They were led to believe their money was to be invested in a US Bank. Many of them received falsified interest certificates. The money was paid into a Jersey account. The taxpayer withdrew it all to meet his own living expenses. Due to the death of a witness and the unreliability of another, the Crown Prosecution Service took no further action. The case was referred to the Assets Recovery Agency in July 2004. The Agency was satisfied that there were reasonable grounds to believe the taxpayer had been engaged in fraudulent activities giving rise to trading income and it raised nine assessments to tax and National Insurance Contributions for the years 1995–96 to 2003–04 pursuant to section 317 of the Proceeds of Crime Act 2002. The taxpayer put in no returns for 1995–96 and 1996–97. Assessments of £75,000 and £60,000 were made for those years in respect of "trading income" under Schedule D, Case I. The assessments were based on information from the police investigation, which established that at least £71,250 and £57,000 had been received from the nine investors, and drawn down by the taxpayer for his living expenses. The taxpayer's appeals to the Special Commissioner (Stephen Oliver QC) against the assessments for 1995-96 and 1996-97 were dismissed, although his appeals against the other assessments were allowed.

76. It may be noted that the taxpayer did not appear, and that no authorities are referred to in the decision or appear to have been cited.

77. The Special Commissioner's reasons for dismissing the appeals against assessments for 1995-96 and 1996-97 are set out in his decision at [13]:

> "The assessments for those periods must, I think, be upheld. There was evidently a trading source, ie the systematic fraudulent activity of obtaining deposits. The full amount deposited by the investors was appropriated by Mr Forbes to his own use. In this connection I know nothing of the steps, if any, taken by the investors to recover the money lost by them. He may one day have to disgorge the proceeds of his criminal activities to the investors; but that feature does not prevent the full amount of the payments by the investors from ranking, prima facie, as taxable trading receipts."

78. I agree with counsel for HMRC and the Tribunal in the present case that (i) the decision in *Forbes v ARA* is inconsistent with the earlier decision in *Anise v Hammond* and (ii) briefly expressed though the Special Commissioner's reasons in *Forbes v ARA* are, they correctly recognise that the fact that the taxpayer was liable to repay the investors did not prevent the sums received by him from being trading receipts. Counsel for Pertemps sought to explain the decision on the basis that the taxpayer's trade was a trade in defrauding people. That is true, but it does not affect either of the foregoing points.

79. Returning to Pertemps' argument summarised in paragraph 31 above, I do not accept it for the following reasons. First, as counsel for HMRC pointed out, there is no requirement in section 18(1)(a)(ii) of ICTA that the trader be legally entitled to the receipts making up the profits. Secondly, Greene MR did not say that there was such a requirement in *Morley v Tattersall*. It is true that he held that the money was the client's money, and that it follows from this that Tattersall was not legally entitled to it; but it does not follow that legal entitlement is a *sine qua non* for a trading receipt. Thirdly, I consider that the review of the authorities above, and in particular *Commissioner v Savundranayagam*, *Simpson v Reynolds* and *IRC v Falkirk*, shows that legal entitlement is not a prerequisite. Fourthly and most fundamentally, the fact that a payment is made in circumstances such that the payer has a restitutionary claim to repayment of that sum does not mean that the recipient is not legally entitled to receive it. On the contrary, the recipient is legally entitled to receive and keep the money unless and until a claim for repayment is made. That is why no-one suggests that Pertemps has done anything wrong in keeping the money mistakenly paid by its customers.

Clients' money in a business sense

80. In addition to the "legal entitlement to receive" argument, counsel for Pertemps also advanced what to my mind is a somewhat contradictory argument, namely that *Morley v Tattersall* was based on the Court of Appeal's conclusion that the money belonged to the clients in a business sense, rather than in a legal sense. Similarly, he argued, in this case the mistaken payments belonged to Pertemps' clients in a business sense, albeit not in a legal sense, and thus were not trading receipts of Pertemps.

81. In support of this argument, he pointed out that the development of the law of restitution in recent years meant that the remedies available in respect of a common law restitutionary claim were converging with those which were available in respect of a proprietary claim, as illustrated by the decision of the House of Lords in *Sempra Metals Ltd v Inland Revenue Commissioners* [2007] UKHL 34, [2008] 1 AC 561 that the court has jurisdiction to award compound interest where a claim was made for restitution of the time value of money paid under a mistake. He acknowledged, however, that certain differences remained, and in particular that, in the circumstances of the present case, no tracing remedy would be available to the customers.

82. This argument does appear to be supported by the language used by Greene MR in the passage quoted in paragraph 22, and even more so in the passage quoted in paragraph 23 above. Nevertheless I cannot accept it. It is not clear to me precisely what Greene MR meant when he said that the money was the customer's money "using a colloquial and business expression rather than a legal expression". Perhaps he simply regarded it as unnecessary to analyse the precise legal status of the money. Be that as it may, it seems to me that its legal status was clear and determinative. Tattersall were auctioneers. Accordingly, they never had title to the horses they sold as agent for their clients. Thus they received the purchase money in a fiduciary capacity and held it on trust for the clients. Beneficially, therefore, the money did indeed belong to the clients. As Ungoed-Thomas J said in *Elson v Prices*, "the balances were not the property of the traders but of their clients". Accordingly, they could not be trading receipts of Tattersall.

83. By contrast, as I have said, in the present case the mistaken payments are the property of Pertemps, albeit that the customers have a claim for restitution.

The purpose of the payments

84. Finally, counsel for Pertemps argued that the purpose of the mistaken payments in the present case was not such as to make them trading receipts, in contrast with the payments in cases such as *IRC v Falkirk*. I disagree. On the facts found by the Tribunal, the mistaken payments derived from the business relationship between Pertemps and its customers, were made by the customers in the belief that they owed money to Pertemps for services supplied by Pertemps and were an unavoidable incident of Pertemps' trade. Having regard not only to the nature of the payments (money which upon receipt became Pertemps'), but also their purpose (money paid for the reasons I have just stated), the Tribunal was entitled to conclude that they were trading receipts.

Ascertaining profits

85. Although the foregoing is sufficient to dispose of the appeal, counsel for HMRC raised a further point which I should mention. She submitted that the best guide to the true profits or losses of a trader is to apply the accepted principles of commercial accountancy. In support of this she relied upon what was said by Sir Thomas Bingham MR (as he then was), with whom Nolan LJ (as he was then) and Sir Christopher Slade agreed, in *Gallagher v Jones* [1993] STC 537 at 555:

> "… the central issue is at root a very short one. The object is to determine, as accurately as possible, the profits or losses of the taxpayers' businesses for the accounting periods in question. Subject to any express or implied statutory rule, of which there is none here, the ordinary way in which to ascertain the profits or losses of a business is to apply accepted principles of commercial accountancy."

86. On this basis, she argued that, since Pertemps' profits as stated in its accounts included the mistaken payments, and those accounts gave a true and fair view and were in accordance with generally accepted accounting principles, the mistaken payments were properly to be regarded as trading receipts.

87. Counsel for Pertemps argued that this point was not open to HMRC since it was contrary to the decision of the Tribunal and HMRC had served no respondents' notice. In support of this, he relied on what the Tribunal said in its decision at [32]:

> "We note that s42 FA 1988 applies for the purposes of Schedule D, Case I to compute the amount of profits. However the first step is to determine the nature of the receipt – does it fall within Case I in the first place? Only if it does, is s42 brought into action to determine the amount that is brought into account as profits."

88. Counsel for Pertemps submitted that this correctly recognised the difference between the threshold question of whether the receipt was a trading receipt and the subsequent question of how the profits were to be computed if it was.

89. The Tribunal went on, however, to say at [33] (emphasis added):

> "It is common ground that the accounts of Pertemps show a true and fair view and are prepared in accordance with generally accepted accounting practice for the purposes of s42. So if the overpayment is a receipt of Pertemps' trade within Schedule D, Case I, it then follows that the amounts released to the profit and loss account each year fall to be treated as taxable profits. *The sole issue therefore before us is whether the overpayments are profits arising or accruing from Pertemps' trade*."

90. In the light of this and [46] (quoted in paragraph 18 above), I do not think that it is clear that the Tribunal made a decision adverse to HMRC on this issue such as to require the service of a respondents' notice. If it did, I would give HMRC permission to serve a respondents' notice out of time.

91. As to the merits of the argument, it seems to me that this point lends additional support to the Tribunal's decision, but is not conclusive on its own.

<u>Conclusion</u>

92. The appeal is dismissed.

Mr Justice Arnold

Release Date: 11 March 2011