TC02648

Appeal number: TC/2012/04809

Income tax – Appeal against closure notice – "Investment bonus" to be paid to hedge fund managers in connection with the transfer of management of the hedge fund from one company to another – Whether payment a capital sum – In the circumstances, no – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PHILIP MANDUCA **Appellant**

- and -

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

TRIBUNAL: JUDGE CHRISTOPHER STAKER
MS SONIA GABLE

Sitting in public in London on 14 January 2013

Ms J Ellis and Mrs Jassal for the Appellant

Ms K Sukul and Mr J Hillier for the Respondents

DECISION

Introduction

1. This is an appeal against a closure notice issued in respect of the Appellant's 2002-03 self-assessment. That closure notice gave effect to two conclusions by HMRC, only one of which is subject to the present appeal. This conclusion concerned the tax treatment of a payment received by the Appellant from Dexia Banque Internationale à Luxembourg ("Dexia") under the terms of an out of court settlement of High Court litigation brought against Dexia by the Appellant (the "settlement sum"). The Appellant had in his self-assessment returned this payment as subject to capital gains tax. The closure notice gave effect to HMRC's conclusion that the settlement sum was assessable to income tax under Schedule D, Case VI. The Appellant maintains in this appeal that the payment was correctly returned as subject to capital gains tax.

Background

2. Essentially the relevant facts are not in dispute. The following facts have been accepted by HMRC.

3. The Appellant has considerable experience in investment banking and management. In 1999, the Appellant and a Mr de Jerez decided to set up a new hedge fund to be known as the One Europe Fund ("OEF"). They needed to find a company to sponsor the fund, and it was agreed that OEF would "operate under the umbrella" of Tilney Investment Management Ltd ("Tilney"), a UK company. The Appellant and Mr Jerez joined Tilney in April 1999. OEF was launched in October 1999 through a division of Tilney called Tilney Capital Management ("TCM"). Although Tilney or an affiliate were originally supposed to provide some of the seed capital for the OEF, the Appellant and Mr de Jerez ultimately raised all of the initial funding themselves.

4. In January 2001, Tilney decided to leave the hedge fund market. Tilney gave the Appellant and Mr de Jerez a time limit within which they could find a new backer for the OEF, failing which Tilney intended to close the OEF down. Eventually it was agreed that the new backer would be Dexia, an unrelated company, which duly took over management of the OEF. Under the arrangement, the Appellant and Mr de Jerez left their employment with Tilney and took up employment with Dexia.

5. The Appellant's and Mr de Jerez's contracts of employment with Dexia dated 18 April 2001 (the "employment contracts") provided that they would be paid a salary and would be entitled to participate in the performance related bonus for each financial year.

6. In addition to the employment contracts, there was a separate document also dated 18 April 2001 signed by two managing directors of Dexia and addressed to the Appellant and Mr de Jerez (the "Investment Bonus Document"). This document stated that it was "to set out the manner on which we intend to recognise your role in

transferring to [Dexia] the business of the so-called TCM". The Investment Bonus Document relevantly provided as follows. Within 30 days of the Appellant and Mr de Jerez joining Dexia, Dexia would invest a stipulated sum into the OEF (the "First Investment Bonus"), and (subject to certain conditions) that sum plus or minus any return achieved within the OEF would be divided equally between and released to the Appellant and Mr de Jerez six months later. Additionally, subject to certain conditions, one year after the Appellant and Mr de Jerez joined Dexia, Dexia would invest a further stipulated sum into the OEF (the "Second Investment Bonus"), and (subject to certain conditions) that sum would be divided equally between and released to the Appellant and Mr de Jerez one year later.

7. The Appellant and Mr de Jerez commenced employment with Dexia on 30 April 2001. However, thereafter matters did not proceed as planned. Dexia did not pay the First Investment Bonus into the fund until 2 August 2001, with the result that the date on which the sum was to be released to the Appellant and Mr de Jerez was delayed. Then, on 5 November 2001, the Appellant and Mr de Jerez were informed that Dexia was to retire as investment advisor to the OEF and that they were to be made redundant. The OEF was liquidated on 13 November 2001 and the amount which Dexia had paid as the First Investment Bonus was withdrawn.

8. Dexia terminated the employment of the Appellant and Mr de Jerez by reason of redundancy on 19 April 2002. They each received redundancy payments, the tax treatment of which is not in issue in these proceedings.

9. The Appellant and Mr de Jerez then brought proceedings against Dexia in the High Court, relating to Dexia's failure to pay the First Investment Bonus. The matter was settled out of court. Under the settlement, the Appellant received a specified sum from Dexia as compensation for the bank's failure to pay the First Investment Bonus. It is common ground that the correct tax treatment of the settlement sum follows the treatment that would have been appropriate to the First Investment Bonus, if the Appellant had received it.

10. In 2003, the Inland Revenue considered the tax treatment of the settlement sum at the request of Dexia. At that time, the Inland Revenue considered that as the Appellant was entitled to receive the First Investment Bonus under the terms of his employment contract, the settlement sum was assessable as emoluments of the employment under Schedule E. Dexia were accordingly advised to deduct tax under PAYE.

11. However, during the enquiry into the Appellant's self-assessment, HMRC took the view that the settlement sum did not fall within Schedule E, but rather fell to be assessed under Schedule D, Case VI. The closure notice against which the Appellant appeals reflects that conclusion.

12. The position of the Appellant is that the settlement sum does not fall within either Schedule D or Schedule E because the First Investment Bonus, had it been paid, was in the nature of a capital sum that is subject to capital gains tax and not income tax.

This was how the settlement sum was returned by the Appellant in his 2002-03 self-assessment.

Evidence of the Appellant

13. The evidence before the Tribunal included various documents relating to the history of the transfer from Tilney to Dexia of management of the OEF, and of the employment of the Appellant and Mr de Jerez, and of the subsequent High Court litigation.

14. At the hearing, the Appellant adopted his witness statement. This stated amongst other matters as follows.

15. A hedge fund is usually structured as an off-shore limited liability company in which the shares are owned by the investors in the fund. Ownership of that company can change monthly as new investors join or existing investors withdraw funds. Neither Tilney nor Dexia nor the Appellant nor Mr de Jerez ever owned any interest in the company underlying the OEF. The limited liability company is assisted by (1) an independent board of directors, who were not replaced when the fund transferred to Dexia, (2) an independent administrator who had no previous or subsequent connection with Tilney or Dexia and who also was not replaced when the fund was transferred to Dexia, (3) a local management company set up by the fund manager, and (4) the fund manager, a company that procures investors, provides investment advice and research, and employs the individuals who provide these services and the premises from which they work. The fund manager must be appropriately regulated and registered, and thus provides the "institutional envelope" or "regulatory umbrella" for the fund. Tilney then Dexia were the fund managers. When the OEF was "transferred" from Tilney to Dexia, what is meant is that the OEF moved from Tilney's "regulatory umbrella" to that of Dexia.

16. The Appellant and Mr de Jerez launched the OEF and put the team together to undertake the research and take the investment management decisions. None of the team members were historically Tilney or Dexia people. From the beginning, the Appellant and Mr de Jerez grew the business.

17. The fund manager is usually paid two fees: an annual fee (a percentage of the value of the fund) and a quarterly performance fee (a percentage of the annual growth in the fund value). The main element of profit was the latter, about half of which would be paid to staff as bonuses and the other half kept by the company providing the regulatory and overhead support. The fund manager would also underwrite the initial set-up costs and later recoup these over a 12 month period. By the time that OEF transferred to Dexia, these had already been recouped by Tilney. Accordingly, when the OEF was transferred to Dexia, they did not acquire any tangible assets. What Dexia acquired was the profit element of the management fee and their share of the performance fee.

18. At the end of January 2001, the Appellant and Mr de Jerez were informed of Tilney's decision to exit the hedge fund sector. The Appellant and Mr de Jerez were

determined to transfer the OEF to a new regulatory corporate umbrella. They agreed with Tilney a cut-off date of 30 April 2001, by which time they had to have transferred the OEF and associated overhead, which they had the right to do without any reference to Tilney. No one at Tilney met anyone at Dexia at the time of the negotiations, and Tilney received no financial remuneration from the deal.

19. The Appellant and Mr de Jerez took steps to attract a new partner. They received 24 notifications of interest. They chose Dexia for various reasons, even though other offers would have brought them more money.

20. The name of the "investment bonuses" is misleading; they were more properly "earn-out" payments. They were not related to meeting performance targets, but were rather based on a successful transfer of OEF to Dexia. The witness statement states at paragraphs 39 and 44 that:

> The rationale behind the payment was that although the OEF had proved attractive to investors and was regulated historically by Tilney, in effect its inherent value was attributable to ... [Mr de Jerez] and me as the key men operating it with a strong supporting track record and industry credibility, together with our team, who transferred to Dexia with us. Without us, the clients would leave the OEF. Its asset base was necessarily somewhat fragile because of the discussions, corporate changes and inherent monthly liquidity. On a change of fund manager, investors in the fund could and would withdraw their funds if they were unhappy with any instability surrounding the fund managers or dissatisfaction with the new legal owner. It was an important part of our role not only to develop and launch successfully the new Japanese/Asian fund, but to "transfer over" the OEF to Dexia and to keep the clients satisfied and remain as investors in the OEF now operated at Dexia. Dexia wanted to avoid us receiving the payment at the inception of our relationship and leaving immediately thereafter, severely de-stabilising the business before it had a chance to settle under its new regulatory and corporate umbrella. ... As the Dexia letter of 18 April 2001 confirms, the sole and exclusive rationale behind these payments was to reward the successful transfer of the OEF fund manager role from TCM to Dexia.

21. After commencing employment with Dexia, the Appellant's and Mr de Jerez's relationship with Dexia deteriorated for various reasons. In relation to their litigation with Dexia after they were made redundant, the Appellant's statement says:

> Dexia defended the action on the basis that the bonuses were performance-related bonuses which had not been earned. Our case, from the outset, was that this was not a bonus in the usual employment sense, but a payment of consideration for securing a successful transfer over a defined timeframe of our business of running the OEF.

22. The Appellant's statement concludes by stating that:

> Neither [Mr de Jerez] nor I ever owned the OEF itself: this was legally owned by the shareholders (ie clients). We had created the fund and raised the initial seed capital through clients we knew; we had nurtured

> the fund and brought clients to it that were loyal to us and not to Tilney. We felt protective towards it, and to our clients who had invested into it. Fund management fees were paid first to Tilney (through TCM) and then to Dexia, which provided the regulatory umbrella we needed in order to operate, but for all practical purposes, the business of managing the OEF belonged to [Mr de Jerez] and me – as was clearly evidenced by Tilney's lack of involvement in the disposal process and by the payment of – effectively – earn-out payments in respect of the transfer of the fund management business being agreed by Dexia as payable to me and [Mr de Jerez], rather than to Tilney.
>
> It is a fact that no payment was ever sought by Tilney for the OEF and none was proposed to them either by us or by Dexia. Other than to secure the disposal of the business to our preferred bidder and to transfer the business from their regulatory umbrella to that of our preferred bidder, they played no part in the disposal of the OEF.
>
> The value to the potential acquirers of the OEF was in the expected revenue stream, and notably the performance bonuses they expected to secure. This in turn derived from the intangible asset value of our fund management business and the "earn-out" structure we agreed with Dexia for its successful transfer.

23. In cross-examination and re-examination, the Appellant further stated amongst other matters as follows.

24. The Appellant was employed by Tilney to develop a long only business, and the hedge fund business was exclusive to the Appellant and Mr Jerez and had no input from Tilney other than provision of the regulatory umbrella. The transfer of the management of the OEF from Tilney to Dexia was a transfer of his and Mr de Jerez's own business. Although he was an employee of Tilney at the time that he negotiated the transfer, he was not acting as an employee of Tilney when engaging in these negotiations, but was rather selling his own business. No employer would allow an employee to march off with the employer's assets and sell them to a third party without paying the employer anything. The assets in the OEF were achieved parallel to his employment, but not as part of the employment, so the rights did not belong to his employer. However, when he left Dexia, those rights stayed with Dexia. There was no contract or agreement between Dexia and Tilney when the OEF moved to Dexia, although Tilney were brought into the completion meeting to sign off on TUPE.

25. In response to the question why the Appellant needed an employer if it was his own business, he responded that he needed the regulatory umbrella of the employer company. However, he accepted that Dexia did not acquire anything that Tilney did not already have. The Appellant said that he sold Dexia the revenue streams, the client goodwill and his own track record. If Tilney had not consented to the transfer, Tilney would still theoretically have had the contract to run the OEF. However, there would have been no one at Tilney to manage it, and if the directors of the OEF had appointed Dexia to manage the fund, Tilney would have been left with nothing except the redundant offshore vehicle.

Arguments of the Appellant

26. The Appellant puts his appeal on two bases:

a) that the settlement sum was capital in nature, and was properly returned as such (the "capital v revenue argument");

b) that even if this is incorrect, HMRC are now out of time to make an assessment under Schedule D, Case VI, and as the Appellant did not return any sum under Schedule D, Case VI, his return cannot be amended in this respect (the "procedural argument").

27. In relation to the "capital v revenue argument", it was submitted on behalf of the Appellant amongst other matters as follows.

28. The settlement sum is capital in nature, and subject to business asset taper relief, because the First Investment Bonus, had it been paid, related to the disposal of assets owned by the Appellant and Mr de Jerez. Strictly speaking, the owners of the OEF were the shareholders of the company which held the investments, and not Tilney or Dexia. What Tilney owned was an entitlement to receive management fees and performance fees as provider of fund manager services to the OEF. Tilney's ability to provide those services arose because of the skills, contacts, business reputation and investment track record of the Appellant and Mr de Jerez, and the teams which they had assembled from people with no connection to Tilney or Dexia. Without the Appellant or Mr de Jerez, there simply was no business. In recognition of this, they were given complete freedom by Tilney to find a new sponsor for the OEF; Tilney was only minimally involved in the sale process, and Tilney sought no payment from Dexia. Tilney did not seek a fee from Dexia for the transfer of this entitlement to Dexia.

29. What Dexia acquired was a team of people transferred under the TUPE Regulations, and an ongoing commitment to provide fund management services to the OEF in exchange for the fees previously paid to Tilney. In order to deliver this, Tilney needed the skills, contacts, business reputation and investment track record of the Appellant and Mr de Jerez. Dexia acquired the following separate and distinct assets, all of which were intangible: the personal services, experience and expertise of the Appellant and Mr de Jerez, customer relationships "owned" by the Appellant and Mr de Jerez personally, an established hedge fund vehicle model in which other Dexia clients might be interested, and the right to charge fees to the OEF. The existence of these intangible assets is demonstrated by the personal reputations of the Appellant and Mr de Jerez in the hedge fund marketplace, their ability to build up the OEF from a standing start, and by Dexia's agreement to pay them for the intangible value acquired when "their" business was successfully transferred to Dexia.

30. It is common ground between the parties that Case VI of Schedule D and capital gains tax are mutually exclusive. The labelling of a payment does not affect its nature for tax purposes, so it is not relevant that the First Investment Bonus was called a "bonus". The First Investment Bonus was a payment to the Appellant and Mr de Jerez for the successful transfer to Dexia of "their" business. It was not earnings as

employees (for which they were receiving a salary) or for investment performance of the OEF itself (for which they would receive a share of the bonus pool). It was additional to this, for the transfer of the goodwill and intangible assets that they had built up over a number of years and the benefit of which they were now selling to Dexia. The HMRC 7 March 2012 review decision acknowledges that "as far as the bank was concerned, the First Investment Bonus was to be a payment of a capital nature -- part of the cost of acquiring an asset (the One Europe Fund)".

31. The present case is analogous to *Hose v Warwick* (1943-1947) 27 TC 459.

32. The payments to be received under the First Investment Bonus and the Second Investment Bonus are comparable to an earn-out structure. It is common for the sale price of certain types of business to be based on a specified future criterion such as turnover or profit targets. The First Investment Bonus was in reality a contingent earn-out payment for the intangible assets which the Appellant and Mr de Jerez transferred to Dexia.

33. The Appellant and Mr de Jerez provided no facilities, services or work to require the investment bonuses to be paid. Had the OEF performed in accordance with expectations, the whole amount would have been contractually due without any effort expended by the Appellant or Mr de Jerez at all. Any services provided were pursuant to the separate contract of employment. There was no direct correlation between the size of the settlement sum and the endeavours of the Appellant and Mr de Jerez. It is not at all unusual for someone to sell their business for a capital payment structured as an "earn-out" and be employed by the purchaser on a market-rate salary and bonus arrangement, with the earn-out payment routinely accepted as being capital. Reference was made to the HMRC manuals at CG17937.

34. The settlement sum is therefore properly characterised as a payment for intangible business assets, which had been owned by the Appellant for a number of years and in respect of which entitlement to full business asset taper relief had accrued.

35. In relation to the "procedural argument" referred to in paragraph 26 above, it was submitted on behalf of the Appellant amongst other matters as follows.

36. A closure notice under section 28 TMA must make "amendments" to any "return". The usual meaning of "amendment" is "change" or "operation". The examples given in the HMRC manuals at EM3851 all deal with cases where the taxpayer puts a number in a box in their tax return which after investigation is shown to be incorrect so that the sum originally self-assessed in that specific box is amended, changed or altered to a different figure in the same box. That is consistent with the usual meaning of the word "amend". That is not what HMRC are seeking to do here. There was no original self-assessment of any figure within Case VI of Schedule D. HMRC are therefore not seeking to amend or change an existing figure for an amount included in the return under Case VI of Schedule D, but rather are seeking to create a new entry in the Appellant's tax return.

37. HMRC has powers to make an assessment under TMA ss 29, 38, 34 and 36, but it is now too late for HMRC to raise such an assessment. There has been no recent "discovery" in connection with the payment from Dexia as full disclosure of the receipt in question had been made on the return. Correspondence on the matter has now been ongoing for nine years, and the time limit for raising an assessment under Case VI of Schedule D has passed. This is not a case of loss of tax brought about carelessly or deliberately, within the meaning of s 36 TMA. A long-standing technical debate with HMRC about a fully disclosed payment is not remotely comparable to the examples given in the HMRC manuals of "deliberate behaviour" or "careless behaviour".

Arguments of HMRC

38. The following arguments were presented on behalf of HMRC.

39. The Appellant and Mr de Jerez never owned OEF or any of its assets. If there had been a sale of OEF, any payments would have been payable to Tilney. Tilney wished to sell the OEF, but in the absence of a buyout were prepared to dispose of it for no consideration to meet the deadline of withdrawing from the OEF by 30 April 2001. The Investment Bonus Agreement anticipated payments being made to the Appellant and Mr de Jerez in recognition of services provided to Dexia to secure the transfer of OEF. The settlement sum was in respect of those services rendered and falls to be taxed under Case VI of Schedule D.

40. The settlement sum did not constitute a capital gain as no asset passed from the Appellant to Dexia. The evidence indicates that the Investment Bonus Document recognised services rendered, not assets acquired. While HMRC originally considered the payment to be taxable under Case IV of Schedule D, they changed their position when the Appellant provided more and better evidence. Since then, HMRC have consistently held the view that the payment is taxable under Case VI.

41. HMRC did not make an assessment in this case. They closed an open enquiry. There is no deadline for closing an enquiry. The deadlines applicable to assessments are irrelevant.

Findings

a) The capital v revenue argument

42. The Tribunal accepts, as it is common ground between the parties, that the appropriate tax treatment of the settlement sum is the tax treatment that would have applied to the First Investment Bonus, had it been paid.

43. The Appellant contends that the First Investment Bonus (together with the envisaged Second Investment Bonus) was in effect the purchase price paid by Dexia to the Appellant and Mr Jerez for the sale of "their" business to Dexia. Alternatively, it is said that the investment bonuses were in effect the purchase price paid by Dexia for certain intangible assets transferred by the Appellant and Mr de Jerez to Dexia.

44. Paragraph 2.22 of the Appellant's skeleton argument identifies the assets said to have been transferred to Dexia by the Appellant and Mr de Jerez as (1) the personal services, experience and expertise of the Appellant and Mr de Jerez as individuals, (2) customer relationships "owned" by the Appellant and Mr de Jerez personally having been built up by them over a number of years, (3) an established hedge fund vehicle model in which other Dexia clients might be interested, and (4) the right to charge fees to the OEF.

45. The Tribunal considers the following to be clear from the evidence. Tilney did not own the OEF or the funds invested in it. What Tilney had was a contractual right to receive payments from the OEF in return for fund manager services to the OEF (item 4 in the previous paragraph). This right of Tilney ended and a corresponding right was acquired by Dexia. There is no suggestion that the Appellant or Mr de Jerez personally had such rights. Rather, they were employed by Tilney, and then by Dexia. They were remunerated for their services by their employers. Thus, while they may have *arranged* for the transfer of the OEF fund management business from Tilney to Dexia, they could not in their own right sell the business to Dexia, since the business was not theirs to sell.

46. A second intangible asset which the Appellant claims that he and Mr de Jerez sold to Dexia is "the personal services, experience and expertise of [the Appellant] and Mr de Jerez as individuals, and the rest of the team transferred from TCM, for which the consideration was their employment contracts and entitlement to share in the bonus pool" (item 1 in paragraph 44 above). However, the provision of personal services does not amount to the sale of an asset, and remuneration for personal services is obviously not a capital sum. The experience and expertise of the Appellant and Mr de Jerez were brought to bear in the provision of their personal services to Dexia. The value of their experience and expertise in the services they provided was reflected in the amount that they were paid for those services pursuant to their employment contracts. On the evidence, the Tribunal does not see how it can be said that their experience and expertise as individuals was sold to Dexia as a capital item that was separate from the personal services that they were providing.

47. Another intangible asset which the Appellant claims that he and Mr de Jerez sold to Dexia was "an established hedge fund vehicle model in which other Dexia clients might be interested" (item 3 in paragraph 44 above). On its consideration of the evidence as a whole, the Tribunal is not persuaded that the Appellant has established that any hedge fund vehicle model was in the circumstances of this case capable of being characterised as a legal intangible or competitive intangible (as paragraphs 2.25 and 2.26 of the Appellant's skeleton argument suggest). In any event, the Tribunal finds that the Appellant has not established on the evidence that the First Investment Bonus or Second Investment Bonus were intended by the parties to be the purchase price of a particular hedge fund vehicle model or any other identifiable competitive intangible.

48. Finally, the Appellant contends that he and Mr de Jerez sold to Dexia an intangible asset consisting of customer relationships "owned" by the Appellant and

Mr de Jerez personally having been built up by them over a number of years (item 2 in paragraph 44 above).

49. The Appellant relies on the case of *Hose v Warwick*. That case concerned an insurance broker who had built up "a considerable personal connection". He commenced employment with a company "bringing his personal connection with him". The original terms of his employment were described by Atkinson J as follows:

> He was to receive a salary of £750 a year and 50 per cent. of the commissions earned through the connection which he brought with him. He had his own office, and part of his staff consisted of individuals who had worked under him in his previous business. He devoted all his time to the same activities as theretofore, that is to say, attending to the requirements of his own particular clients. .... He did very well. His connection grew. By 1937 his share of the commissions earned from his own connection amounted to about £10,000. His clients were; and remained, his personal clients. Two of the staff who had come with him, Mr. Pratt and Mr. Hose's brother, were paid in part by the company and in part by Mr. Hose. The agreements under which he worked were oral. There was no fixed term. It is quite clear that if he left the company his connection would go with him.

50. Subsequently, Mr Hose took over the post of managing director of the company. The effect of this move was described by Atkinson J as follows:

> It is important to understand what this change involved. ... It meant giving up everything that he had got out of it. It meant that he would not retain his connection, as he would have to manage the whole concern. Of this connection the Commissioners say, "he was possessed of his business connection, which had a sale value, and which he could have taken away" if he had left the service of the company. Gradually but surely his personal clients would become the clients of the company. The change meant that the goodwill of his personal connection, worth in 1937 £20,000 a year in commission - his half was £10,000 but the whole commission would be £20,000 - went to the company. That fact was thoroughly appreciated by the negotiators. The price to be paid for this connection and for giving up his post was the subject of much negotiation.

51. In return for taking up the post of managing director, it was agreed that Mr Hose would be paid, in addition to his remuneration as managing director, a lump sum of £30,000. Atkinson J concluded that "to my mind it is plain that the £30,000 was in no sense a remuneration or reward for the services to be rendered as managing director, but was a sum paid to him for abandoning to the company his personal connection". In the course of judgment, it was noted amongst other matters that:

> [The Commissioners] accepted Mr. Hose's evidence that, throughout the negotiations, he had required a lump sum for his connection, so as to make sure that it should not pass to the company without any benefit to his estate.

> When the terms were arrived at the company sent a circular to its shareholders stating that the company had acquired the business of Mr. S. J. Hose, and that he was acting as sole managing director of the company as from 1st April, 1939. ...
>
> I am perfectly certain that, if either party had been asked before signing that agreement what it was intended to do, both would have answered in the same way: "It is intended to pay you, Mr. Hose, for your business connection that we are getting, and it is intended to fix your remuneration as our managing director." ...
>
> ... it is perfectly plain, if one gives words their natural meaning, that the £30,000 was to be paid for giving up something. There is no reference there to anything in the future; it was the giving up, the wiping out, of something then and there. ...
>
> Then come some rather important words [in the agreement]: "Mr. Hose shall in particular use his utmost endeavours to secure that the Company shall retain all business and business connections introduced by Mr. Hose, Mr. L. H. Pratt or Mr. R. A. Hose to the Company and that Mr. L. H. Pratt and Mr. R. A. Hose shall continue to give their whole time and services to the Company under separate agreements". ...
>
> ..., it is quite clear that clause 1 in terms describes the £30,000 as a payment for giving up something. ...
>
> Under this document he gave up ... the position, the source of his past profits. He gave up working on and developing his personal connection and he gave up that connection to the company. ...
>
> That seems to me to be very like this case, except that this case is stronger. Mr. Hose lost an office which brought him up to £10,000 a year. He also in fact made over to the company a valuable connection which was a capital asset. I can see no conceivable reason for not giving effect to what everybody must have known was the plain intention of the parties, and I think this appeal must be allowed.

52. The essence of the decision in *Hose v Warwick* was thus that Mr Hose had given up something valuable to the company and that the £30,000 payment was compensation or payment for what had been lost or given up by Mr Hose. Thus, the quotes above also refer to Mr Hose's personal connection as having been "wiped out" and "abandoned" to the company.

53. Two cases based on a similar rationale are referred to in HMRC document SE007010, which has been included in the bundle before the Tribunal. For instance, in *Jarrold v Boustead* [1964] 3 All ER 76, a signing-on fee paid to a professional rugby player was held to be consideration for relinquishing his amateur status for life, rather than part of the remuneration for his services. Lord Denning MR at 80-81 said that:

> In the course of the argument an illustration was taken by counsel on both sides. Suppose there was a man who was an expert organist but was very fond of playing golf on Sundays. He is asked to become the organist of the parish church for the ensuing seven months at a salary

> of £10 a month. It is expressly stipulated by this strange parish council that, if he takes up the post, he is to give up Sunday golf for the rest of his life. Thereupon he says that, if he is to give up golf, he wants an extra £500; and they agree to pay it. In such a case the £500 is not a payment for his services as an organist for seven months. It is a payment for relinquishing what he considered to be an advantage to him. So, here, it seems to me in the cases of these three footballers, each was an amateur, playing Rugby Union football with all the advantages that attached to amateur status, such as the prospect of gaining an international cap. Each gave up all the advantages of being an amateur for the rest of his life: and in return he got this payment of the lump sum at the beginning. It seems to me that the commissioners were quite entitled to find that it was a capital sum in compensation for what was a permanent asset in his hands. The remuneration for services (of so much a match) was an entirely different thing. It was remuneration for services, whereas the signing-on fee was for giving up a permanent advantage.

54. On the basis of the evidence, the Tribunal accepts that the success of the OEF fund management business depended on the continuing involvement of the Appellant and Mr de Jerez. The Tribunal is prepared to accept that if the Appellant and Mr de Jerez had left Tilney without Tilney agreeing to transfer the business, the OEF and its investors would not have stayed with Tilney, but would instead have either followed the Appellant and Mr de Jerez to a new fund management company, or would have taken their investments elsewhere.

55. However, that in itself does not mean that this case is comparable to *Hose v Warwick*. Mr Hose brought his personal connection with him when he first joined the company. However, the £30,000 was paid to him only later, when he subsequently became managing director of the company. There is no suggestion that the tax treatment of the £30,000 would have been the same if it had been paid to Mr Hose when he first joined the company, on the basis that it was the purchase price of the clientele that he would be bringing with him to the company's business. On the contrary, the court found that for the whole time that Mr Hose worked for the company until he became managing director, "His clients were, and remained, his personal clients", and "if he left the company his connection would go with him". It was rather at the subsequent point when his clients ceased to be his own personal clients and became instead clients of the company that it was said that the payment was compensation for the abandonment or wiping out of his personal connection.

56. On the evidence, it appears that following the transfer of OEF from Tilney to Dexia, the position of Dexia was materially the same as that of Tilney prior to the transfer, and the role of the Appellant and Mr de Jerez, and their relationship to the fund manager, was materially the same as it had been before. The only material difference was that the fund manager was now Dexia rather than Tilney. The Appellant has not established the existence of any material difference. The evidence is that the OEF and its investors followed the Appellant and Mr de Jerez when they left Tilney to go to Dexia, and that Tilney could not have kept the OEF management business once the Appellant and Mr de Jerez had left. The Tribunal does not find it to be established on the evidence that the subsequent position of Dexia was any

different. The Tribunal takes into account that there was a six-month non-competition clause in the employment contracts with Dexia, which would have prevented the Appellant and Mr de Jerez from simply leaving Dexia at any point and taking the OEF business to a new employer. However, if the Appellant and Mr de Jerez had left Dexia (and assuming that the OEF had continued successfully rather than being closed down), the evidence does not suggest that Dexia's OEF business would have simply carried on, on the basis that the clients' connection was now to Dexia rather than to the Appellant and Mr de Jerez personally. Furthermore, the six month non-competition clause was in the employment contracts rather than in the Investment Bonus Document, so that the First Investment Bonus cannot be characterised as compensation for giving up the right to compete with Dexia for six months after termination of employment with Dexia.

57. Ultimately, the nature of the First Investment Bonus must be ascertained from the particular facts and circumstances of the case, including the wording of the 18 April 2001 letter providing for the terms on which it would be paid.

58. There is in evidence a document from Dexia dated 9 March 2001 which refers to TCM being 100% owned by the Appellant and Mr de Jerez "following a management buyout by these two individuals last month". This appears not to have been correct. Paragraph 9 of the witness statement of the Appellant dated 4 September 2002 (prepared in connection with the subsequent High Court litigation) says that "The Information Memorandum refers to the ownership of TCM by Leon and me. This had arisen simply as a consequence of the agreement Leon and I had reached with Tilney".

59. Subsequent documents make clear that the business of TCM was being acquired by Dexia from Tilney. In particular, a Dexia document dated 29 March 2001 states that "Tilney ... has expressed its wish to transfer the TCM business to a third party by April 30th failing which it would be closed down", and that "the current owner of the business ... is prepared to transfer the business without payment".

60. Subsequent documents indicate that the First Investment Bonus was intended to be payment for the Appellant's and Mr de Jerez's role in facilitating the transfer of Tilney's fund management business to Dexia.

> Dexia places no value on TCM's business as it currently exists in the hands of Tilney, but is prepared to give incentives to the Management Group to facilitate transfer of the business and subsequently manage and develop it as follows [draft Preliminary Agreement, clause 2.1 (following which clauses 2.2 to 2.7 deal with the investment bonuses)].
>
> This is not a conventional acquisition via capital investment, as it consists of introductory bonus payments to two key staff members ... [Dexia minute dated 29 March 2001].
>
> This letter is to set out the manner in which we intend to recognise your role in transferring to [Dexia] the business of the so-called TCM [Investment Bonus Agreement].

> You shall co-operate to the fullest extent in bringing about the transfer to [Dexia] of the OEF agreements ... and to the transfer to [Dexia] of key staff within the TCM division].
>
> There is no question in my mind that [Dexia] always regarded the First Investment Bonus as a financial reward due to [Mr de Jerez] and me for our role in transferring the TCM business to [Dexia] and not a performance related bonus as such [witness statement of the Appellant, 4 September 2002, para 24].

61. The Appellant places reliance on a statement in the 7 March 2012 HMRC review decision, which states that:

> It seems clear that, as far as [Dexia] was concerned, the First Investment Bonus was to be a payment of a capital nature—part of the cost of acquiring an asset (the One Europe Fund). This does not necessarily make the payment a capital sum in the hands of the recipient, however. ... [T]he OEF was the property of Tilney ... Any consideration for disposal of the asset would, therefore, have been received by Tilney ... or its owners, as only they were entitled to sell it. It follows that the payments made to Mr de Jerez and yourself were not a consideration for the asset itself, but a reward for the part you played in enabling the bank to acquire the asset.

62. In view of the statements in the documents quoted in paragraph 60 above, the Tribunal would not agree that Dexia considered the First Investment Bonus to be a capital payment. The Tribunal also notes that the Investment Bonus Agreement includes a clause which states:

> We refer to a letter dated 20 March 2001 from Tilney ... to [the Appellant] which sets out the terms on which the hedge fund business ... may be transferred to another party. On provision of such letter provides that if the business is sold on or before 30 April 2002, Tilney will be entitled to 35% of the full consideration paid ... It is agreed between us that any subsequent claim by Tilney ... that the First and Second Investment Bonuses constitute payment for purchase of the TCM Division, of which Tilney may be entitled to a share, shall be your joint and several responsibility to deal with and satisfy as the case may be.

The 20 March 2001 letter referred to was not in evidence before the Tribunal. However, the Tribunal draws the following inferences from this reference to it in the Investment Bonus Agreement. Tilney did not regard the business as belonging to the Appellant and Mr de Jerez to dispose of as they wished. Although Tilney for its own reasons was prepared to transfer the business without cost, it did so subject to conditions, including a condition that Tilney would receive payment if the business was subsequently sold on before a specified date. Furthermore, neither Dexia, nor the Appellant or Mr de Jerez, considered that the First and Second Investment Bonuses constituted "payment for purchase of the TCM Division" or a selling on of the business, but Dexia was concerned that Tilney might claim that it was. There is no evidence that Tilney did ever make such a claim. The conclusion is therefore that ultimately neither Dexia nor the Appellant or Mr de Jerez nor Tilney regarded the

First and Second Investment Bonuses as "payment for purchase of the TCM Division".

63. The Tribunal finds on its consideration of the evidence as a whole that the First Investment Bonus was a reward for the part played by the Appellant in enabling Dexia to acquire the OEF business from Tilney. It was not a capital sum. The conclusion of HMRC in this respect was correct. It follows that the "capital v revenue argument" fails.

b) The procedural argument

64. The Tribunal rejects this argument. TMA s 9A provides for an enquiry into a "return", and s 28A provides for a closure notice to make amendments to a "return" to give effect to the conclusions of the enquiry. The expression "return" has to be understood in the context of the references to that expression in s 8. The Tribunal considers it to be quite clear that the expression "return" means the self-assessment tax return as a whole, rather than an individual box or item in a return. It is an amendment to the return as a whole for a closure notice to give effect to a conclusion that a particular sum should be included in box B of the return rather than box A. In any event, this would also be an amendment both to box A (which would be changed from a positive figure to zero) and to box B (which would be changed from zero to a positive figure). It follows that the procedural argument fails.

Conclusion

65. For the reasons above, the Tribunal dismisses the appeal.

66. 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.

DR CHRISTOPHER STAKER
TRIBUNAL JUDGE

RELEASE DATE: 17 April 2013