[2019] UKFTT 554 (TC)

TC07348

Appeal number: **TC/2018/05027**
TC/2018/04621

CAPITAL GAINS TAX – Entrepreneurs' Relief - whether appellants' company was a trading company during the relevant period -whether there were substantial non-trading activities

FIRST-TIER TRIBUNAL
TAX CHAMBER

JACQUELINE POTTER AND NEIL POTTER **Appellants**

- and -

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

TRIBUNAL: JUDGE MARILYN MCKEEVER

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 7 August 2019

Mr Neil Potter in person on his own behalf and as representative for Mrs Jacqueline Potter

Mr Vallis, an Officer of the Respondents, for the Respondents

DECISION

Introduction

1. Mr and Mrs Potter appeal against HMRC's decision that they are not entitled to Entrepreneurs' Relief (ER) in relation to their capital gains tax liability on the disposal occasioned by the voluntary liquidation of their company, Gatebright Limited ("Gatebright") in the tax year 2015-2016.

2. In particular, the matter turns on whether Gatebright was a "trading company" for the purposes of section 165A (3) of the Taxation of Chargeable Gains Act 1992 (TCGA) during either of the qualifying periods discussed below.

3. Statutory references below are to the TCGA unless otherwise specified.

The Law

4. The normal rate of capital gains tax ("CGT") on the disposal of shares in a company was, in the tax year 2015-16, 28%. Where the conditions for ER are satisfied, a reduced rate of 10% applies to the first £10 million of gains realised, in aggregate, by a taxpayer.

5. The conditions for ER are set out in. Part V Chapter III TCGA. Section 169H TCGA provides for the reduced rate of tax on a "material disposal of business assets". This term is defined in section 169I, which, so far as relevant, provided at the time:

> **"[169I Material disposal of business assets]**
>
> [(1) There is a material disposal of business assets where—
> (a) an individual makes a disposal of business assets (see subsection (2)), and
> (b) the disposal of business assets is a material disposal (see subsections (3) to (7)).
> (2) For the purposes of this Chapter a disposal of business assets is—
> (a) a disposal of the whole or part of a business,
> (b) a disposal of (or of interests in) one or more assets in use, at the time at which a business ceases to be carried on, for the purposes of the business, or
> (c) a disposal of one or more assets consisting of (or of interests in) shares in or securities of a company.
> (3) A disposal within paragraph (a) of subsection (2) is a material disposal if the business is owned by the individual throughout the period of 1 year ending with the date of the disposal.
> (4) A disposal within paragraph (b) of that subsection is a material disposal if—
> (a) the business is owned by the individual throughout the period of 1 year ending with the date on which the business ceases to be carried on, and
> (b) that date is within the period of 3 years ending with the date of the disposal.
> (5) A disposal within paragraph (c) of subsection (2) is a material disposal if condition A[, B, C or D] is met.
> (6) Condition A is that, throughout the period of 1 year ending with the date of the disposal—
> (a) the company is the individual's personal company and is either a trading company or the holding company of a trading group, and

(b) the individual is an officer or employee of the company or (if the company is a member of a trading group) of one or more companies which are members of the trading group.
(7) Condition B is that the conditions in paragraphs (a) and (b) of subsection (6) are met throughout the period of 1 year ending with the date on which the company—
(a) ceases to be a trading company without continuing to be or becoming a member of a trading group, or
(b) ceases to be a member of a trading group without continuing to be or becoming a trading company,
and that date is within the period of 3 years ending with the date of the disposal…."

6. The liquidation of a company is a disposal of the shares in the company taking place when the liquidation proceeds are paid. In the present case the disposal occurred on 11 November 2015. The question I have to decide is whether Gatebright was a trading company, either:

   (1) throughout the period of one year ending with 11 November 2015 in accordance with Condition A in section 169I((6); or

   (2) Throughout the period of one year ending with the date the company ceased to be a trading company where that date is within three years ending with the date of the disposal in accordance with Condition B in section 169I(7).

7. In order to satisfy Condition B, the business must not have ceased before 12 November 2012 and the company must have been a trading company for at least one year ending with 12 November 2012 (or any later date before 11 November 2015) which I will call the "relevant date".

8. HMRC accept that the other conditions for ER are satisfied.

9. The expression "trading company" is defined by section 169SA, which refers to schedule 7ZA which in turn incorporates section 165A.

10. Section 165A(3) defines a "trading company" and "trade" as follows:

"(3) "Trading company" means a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities.
(4) For the purposes of subsection (3) above "trading activities" means activities carried on by the company—
(a) in the course of, or for the purposes of, a trade being carried on by it
(b) for the purposes of a trade that it is preparing to carry on,
(c) with a view to its acquiring or starting to carry on a trade, or
(d) with a view to its acquiring a significant interest in the share capital of another company that—
(i) is a trading company or the holding company of a trading group, and
(ii) if the acquiring company is a member of a group of companies, is not a member of that group.
(5) Activities do not qualify as trading activities under subsection (4)(c) or (d) above unless the acquisition is made, or the company starts to carry on the trade, as soon as is reasonably practicable in the circumstances.
(14) In this section—
…
"trade" means (subject to section 241(3)) anything which—

(a) is a trade, profession or vocation, within the meaning of the Income Tax Acts, and

(b) is conducted on a commercial basis and with a view to the realisation of profits.]"

11. In order to qualify as a trading company, the company's activities must either be wholly trading activities or trading and other activities, but the other activities must not be a "substantial" part of what the company does.

The facts

12. Mr and Mrs Potter were the directors and equal shareholders of Gatebright. Mr Potter dealt with the trading and Mrs Potter dealt with the administration of the business.

13. HMRC's Statement of Case stated that "The Company sold insurance until 2009…". That was wrong. Gatebright did not sell insurance but was involved in a specialist area of the financial world; the London Metal Exchange ("LME"). At the hearing, Mr Potter gave a detailed account of the company's business and what happened following the financial crash in 2008. I found him to be a straightforward and honest witness and I accept his account of what happened.

14. Mr Potter was an "introducing broker" and also a "dealer" with a physical seat in the "Ring" at the LME within which billions of pounds worth of trades in base metals such as copper took place. Trades were carried out by "open outcry". Advice, orders for trades and instructions were largely carried out on the telephone and the deals themselves were done orally in the open outcry environment.

15. When not actually trading, Mr Potter would advise clients on the markets, prices, price movements, opportunities for arbitrage and so on. This was a high pressure job and he would often be on two phones at once, which led to shoulder problems which ultimately was a factor in Mr and Mrs Potter's decision to close the company.

16. Most of the business was done on the phone or by Yahoo Messenger. They did not tend to use emails and did not have any from the period.

17. Mr Potter was personally registered with the Financial Services Authority, which was, at the time, the relevant regulatory organisation which enabled him to carry out some advisory work. In order to carry out the trading certain market and regulatory memberships and licences were needed and these were provided by the banks with which Brightgate worked.

18. Brightgate's business was to trade in the LME and to broker credit deals to provide the finance to enable clients to engage in the high value trading at the LME. These deals were complex and could take months to negotiate,

19. Gatebright worked with a number of financing banks including well known institutions such as Barclays, J P Morgan and Goldman Sachs. It would only work with one such bank at a time and at the time of the financial crash in 2008-9, the bank was Natixis SA. Natixis and the other banks could nominate "employees"

and he and Gatebright were effectively licensed and regulated under the umbrella of the bank's licence. The conditions and financial requirements of the licences were such that an individual or small company would not be able to obtain them.

20. Gatebright's clients were hedge funds, banks and other institutions who wanted to buy and sell metals.

21. Gatebright's role was to introduce its clients to the financing bank with a view to the bank making credit available to the client. The negotiations for the credit could take many months. When trades were made, using the bank's credit, the bank charged the client a commission and under its agreement with the bank, Gatebright received 50% of that commission for its services as "introducing broker". Trades would be notified on a daily basis and Gatebright issued invoices on a monthly basis.

22. Gatebright was a successful business and had built up reserves of over £1million when the financial crash happened in 2008-9. In order to safeguard the reserves, Gatebright used approximately £800,000 of the reserves to purchase two six year investment bonds which matured in November 2015 (the "bonds"). The capital was locked up during that period, but the bonds paid interest of £35,000 a year and it appears that was distributed by way of dividend. The remaining funds, approximately £200,000 were retained as working capital although this was also distributed as dividends between 2009 and 2015 as it proved not to be needed for the company's business.

23. As a result of the crash, banks withdrew credit lines, little or no credit was available generally and there was little appetite for risk among clients. The volume of trades declined dramatically. During this period, the banks were reluctant even to discuss credit.

24. The last invoice issued by Gatebright was in March 2009.

25. Also in 2009, Mr Potter was ill with pneumonia and was unable to work for three or four months. When he went back to work and sought to pick up the business, the bank he was working with ended its agreement with Gatebright because it was not giving credit and clients were not trading. This meant that Mr Potter no longer had the regulatory licences to trade. Having been in the business for 30 years, Mr Potter had many contacts among banks and clients and he got in touch with them with a view to starting new negotiations and continuing to trade. Mr Potter gave evidence that there was no intention to stop trading and that he was constantly in touch with the "metal family" to try and arrange credit deals. He had clients and tried to introduce them to banks to obtain credit, but the credit was simply not available.

26. Before the crash, Mr Potter had travelled a great deal. After the crash, he had visited New York and also France, to seek deals, but he did not really travel much after the crash as there was little business to be had.

27. Mr Potter was not able to produce any documentary evidence of these activities. He stated that the contacts were made on the telephone or at lunches or other

informal meetings. There were no emails, and phone calls were not routinely recorded at the time.

28. In correspondence with HMRC, Mr Potter stated that during the relevant period "we were still actively attempting to continue the company's usual business trading…the company was actively seeking trading income right up to June 2014…". In their letter of 17 November 2017, HMRC asked how the business was sought and also asked for evidence such as "the number of contracts sought, who the customers were, where the attempted business was performed eg website, telephone, shop premises." These last references indicate, as noted above, that HMRC did not have a good understanding of the nature of the Appellant's business.

29. Mr Potter responded I his letter of 4 December 2017:

> "…we would make contact via telephone and informal personal meetings to try to secure old and new trading relations with parties that would execute trading transactions, that would subsequently provide income. Gatebrigjht Limited was not able to underwrite these high worth transactions, and would require banks or financial institutions to provide the credit, market and regulatory memberships and licences. Many organisations were considered and included Barclays Plc, Natixis SA, Touradji Capital Management, Citrine Capital, JP Morgan, Man Financial, Macqarie Securities, AMC Group, Glencore, Goldman Sachs to name but a few.
>
> Unfortunately, as previously detailed, the medical and other circumstances meant that these were approaches (sic) were fractured and ultimately unable to proceed to a formal level as they could take several months to crystallise."

30. As noted, Gatebright needed to have an agreement with a bank regarding the provision of credit to clients and commission, to provide income, and, crucially, to "piggy back" on the bank's regulatory licences.

31. The reference to "medical and other circumstances" relate to events in 2011 onwards which are discussed below.

32. Mr Potter stated that following the turmoil and lack of credit generally in 2008-9, the markets began to settle in in 2010 and he continued his efforts to find credit for clients.

33. By 2011, negotiations had started to come through. As mentioned, these negotiations could take several months to come to fruition.

34. Just as things were beginning to pick up, Mr Potter suffered several medical issues and other personal misfortunes starting in 2011. In May 2011, the Potters' house was invaded by a gang of local youths, ransacked and burgled and his son was subsequently assaulted by one of the gang who was on bail. It took a long time for the case to come to court and issues arising from this meant Mr Potter could not get out as much as he wanted to go to meetings and so on.

35. In 2014 Mr Potter was admitted to hospital for a perforated bowel.

36. In a letter to HMRC dated 26 October 2017, Mr and Mrs Potter stated (after informing HMRC about the break in and assault)

37. "This meant that we could not continue the intensity in closing deals to generate the trading income, but we were still actively seeking to execute trading business, right through until June 2014 when Mr Potter was admitted again to hospital, …

It was at this time that we slowed our attempts to seek business, and when in June 2015 Mr Potter had double shoulder surgery, we decided we would close the company via the MVL [Members' Voluntary Liquidation]."

38. As a result of these problems, there were gaps, when Mr Potter was not able to work and this meant that the negotiations he was carrying out were fragmented and he had to start again each time a new issue arose.

Burden of Proof

39. The burden of proving that they are entitled to ER is on the Appellants and they must prove this to the normal civil standard of the balance of probabilities. That is to say, they must show that it is more likely than not that they qualify for the relief.

The Appellant's submissions

40. The Appellants submit that Gatebright continued to be a trading company right up to June 2014 and that, as this was less than three years from the liquidation and the other conditions are satisfied, they are entitled to ER.

The Respondent's submissions

41. Mr Vallis submits that no invoices were issued after March 2009 and as a result of the crash, the company ceased to trade and so ceased to be a trading company outside the three year period in condition B in section 165I TCGA. Accordingly, ER is not due

42. Even if there were some trading activities, following the investment of the reserves in the bonds, the activities of the company became substantially investment activities. ER is not therefore due because the company was not a trading company as it could not be said that its "activities do not include to a substantial extent activities other than trading activities".

Discussion

43. The critical question is whether Gatebright was a trading company at any time after March 2009 when it issued its final invoice. If it was, the question becomes whether it was a trading company in the one year period leading up to 12 November 2012 or a later relevant date. If it was, that is sufficient to satisfy Condition B and it is immaterial that the business ceased at some time after that.

44. The first part of the definition of "trading company" in section 165A (3) requires the company to carry on "trading activities". "Trading activities" are defined by section 165A (4) as "…*activities* carried on by the company-

(a) in the course of, or *for the purposes of, a trade being carried on by it*,

(b) For the *purposes of a trade that it is preparing to carry on*,

(c) With a view to its acquiring or starting to carry on a trade…" (emphasis added)

45. The focus is on what the company is actually doing; its activities. In addition, those activities must be done for the purposes either of a trade that is actively being carried on or that the company is preparing to carry on. The legislation draws a distinction between preparing to carry on a trade and acquiring or starting to carry on a trade and I will return to this.

46. What was the company doing in the one year period from November 2011 to November 2012?

47. The evidence is largely derived from Mr Potter's witness evidence and the company accounts. As mentioned, I accept Mr Potter's account of what happened. No documentary evidence was produced either before or at the hearing. Mr Potter's explanation was that the activities were largely carried out in person on the telephone or in informal meetings. As no contracts resulted, there was no subsequent documentation and in his letter to HMRC of 4 December 2017 Mr Potter said "we don't have specific documented records of theses calls or meetings in the same way that a shopkeeper cannot produce a bill of sale if a customer does not make a purchase." One might have expected there to be diary entries or perhaps notes of the people Mr Potter spoke to, but we are looking at a period which began nearly ten years before the enquiry was opened in July 2017 and the enquiry began nearly two years after the company was liquidated. It is hardly surprising that such informal records, if there were any, are no longer available.

48. Mr Potter's evidence at the hearing was consistent with his statements to HMRC in correspondence in the course of the enquiry. His statements are also corroborated, to some extent, by the accounts. The earliest accounts which I had for Gatebright were the 2011 accounts, but these had the comparative figures for 2010. The accounts give a breakdown of the general administrative expenses. In each year. The accounts were drawn up to 31 August each year, except for the final, 2015 accounts, which covered the period 1 September 2014-31 October 2015. For the years from 2010 until the final set of accounts in 2015, the relevant expenses (in pounds) are set out below:

	2010	2011	2012	2013	2014	2015

Telephone and fax	2,221	2,196	1531	1170	571	710
Stationery/printing	384	129	8	0	0	133
Computer consumables	0	2436	185	515	0	1457
Travel and subsistence	0	530	310	89	0	0

49. These figures and the pattern of them are consistent with Mr Potter's account of what happened. He stated that most of the contacts and attempts to negotiate business were by way of telephone conversations although there were some face to face meetings and that following the burglary in 2011 he could not get out to meetings so much. The October 2017 letter indicated that the intensity of the activity reduced after the break in, but that there were still active attempts to do deals until June 2014. There are substantial telephone and fax expenses up to and including 2012, which taper off in 2013 and fall substantially in 2014. Presumably the increase in 2015 was in connection with the liquidation. There were some, though reducing, stationery and printing costs and modest and reducing amounts spent on travel. The computer expenses do not show a consistent pattern.

50. The overall impression is that the company was active at least until 2013 when the level of activity began to tail off and it significantly decreased in 2014.

51. I am mindful of the burden of proof and the lack of documentary evidence. This case is finely balanced but, having taken account of the oral evidence, the information in the accounts, the correspondence with HMRC and all the circumstances of the case, I find that it is more likely than not that Gatebright was carrying on trading activities at least up to November 2012.

52. The next question is whether those activities were being carried on for the purposes of a trade that Gatebright was carrying on or which it was preparing to carry on.

53. Mr Vallis seemed to accept that Gatebright was carrying on a trade up to March 2009 but, in his view, it ceased to trade at that point because no more deals were in fact done.

54. He drew my attention to the High Court case of *Marriott v Lane (HM Inspector of Taxes)* [1996] BTC 297 where the court held:

> "In my judgement, if a trade is closed down on a basis intended to be only temporary but that becomes in the event permanent, the date for section 69 purposes, when the trade ceased to be carried on is the date on which the trade was closed down."

55. That was a case on capital gains tax retirement relief, but Mr Vallis though it helpful in establishing when a business had "ceased to be carried on". The context of that case was that the business consisted of an aircraft museum which was closed to the public in October 1988. The directors actively decided to close the business, but at that time had not taken a decision as to whether to close the business permanently or cease trading. It was clear by the time of the hearing before the Commissioners that the closure would be permanent. The taxpayer in that case argued that the business had ceased to be carried on in October 1988 as, only on that basis, was he entitled to the relief. The High Court went on to say:

> "When the claim for s 69 relief was dealt with by the commissioners, there was no longer any intention or possibility that the museum business might be recommenced elsewhere. The commissioners held that the directors of Torbay Aviation Ltd had 'neither decided nor intended that the company should cease trading prior to 28 September 1989'. The directors had, however, decided and intended that the Torbay Aviation Museum should close in October 1988; they intended that the cessation of business brought about by that closure should be temporary only; and they intended that in due course the company would reopen the museum elsewhere. It was only in that sense that the directors 'neither decided nor intended that the company should cease trading'. The commissioners then concluded: 'Accordingly the company's trade had not ceased at that time.' In drawing that conclusion the commissioners, in my opinion, fell into an error of law. By the time they determined the appeal it had become apparent that the closure of the company's business that had taken place in October 1988 was a permanent one and that the directors' intention that the cessation of business should be temporary had not been and would not be achieved. That being so, the appellant was, in my judgment, entitled to relief under s 69."

56. Marriott can be distinguished from the present case as there was never any decision to close Gatebright's business down, temporarily or otherwise, until at least 2014. On the contrary, the directors' intention all along was to continue the business. There was no trade to be done because of the economic situation, but Mr Potter continued to take steps to seek business and anticipated that he would be able to make new deals when the financial situation improved.

57. Further, the test for eligibility for ER is different from the test for retirement relief, and this test is set out in paragraph 58 below.

58. Up until the financial crisis, it would appear that Gatebright had had a successful business and was clearly carrying on a trade. A trade does not automatically come to an end because there is a gap in deals actually being done. In the present case, the deals "fell off a cliff" in the financial crash. In the event, there was not merely

a gap in deals being done; despite Mr Potter's best efforts, no actual business was done after March 2009. In these circumstances it might be said that Gatebright was not *carrying on* a trade within paragraph (a) of section 165A(4) during the relevant period, but in my view it was carrying out activities for the purposes of a trade it was *preparing* to carry on within paragraph (b). I consider this is the applicable test, although it might also be said that the activities were carried on for the purposes of *starting* to carry on a trade within paragraph (c). Paragraph (c) refers to "acquiring or starting" a trade and is aimed at new trades. Relief is only available where the taxpayer begins to carry on the trade "as soon as reasonably practicable in the circumstances". So even in this situation there is a period of grace and had a company set up a new business in the period similar to that of Gatebright, one might expect there to have been a substantial delay before it was "practicable in the circumstances" for the company to begin to trade. This extra condition does not apply to paragraph (b) which in my view is the applicable test. Gatebright was not a new venture. The activities were carried out in the context of a trade which might be said to have paused as a result of the economic conditions. The whole purpose of the activities was to seek new business and prepare the ground for the continuance of the trade once market conditions improved.

59. I have concluded that Gatebright was carrying on the trading activities identified above for the purposes, at the very least, of preparing to carry on its old trade once the economic environment permitted it. The Appellants' skeleton argument put it this way:

> "If the shop is open, but nobody buys anything, it does not change its business classification."

60. That is true up to a point. If there comes a time when it is clear that there is no realistic possibility of the efforts to drum up new business leading to future trading transactions, it can no longer be said that the trading activities are being carried out for the purposes of a trade, or for the purposes of a trade that the company is preparing to carry on. At that point, the company must cease to be a trading company.

61. Applying these principles to the present case, I am of the view that in November 2012, matters had not reached that point. It was still reasonable for the Appellants to believe that their continued efforts would ultimately result in new business. They could not have known of the future health problems which would further disrupt the continuity of the negotiations for deals and ultimately cause them to cease their efforts and dissolve the company.

62. The conditions in paragraphs (a) and (b) of sub-section (6) of section 169I must be satisfied "throughout" the period of 1 year ending with the relevant date. One of those requirements is that the company must be a trading company. The period from November 2011 to November 2012 would have included the period following the burglary. It is not clear whether there were any periods when Mr Potter was unable to work because of ill health in that time. Even if there was, it does not seem to me that a company would stop and start being a trading company in a period simply because trading activities are temporarily suspended for some

reason. Carried to a logical extreme, if this is wrong, a company would cease to be a trading company every weekend and become one again every Monday morning. If, overall, the company is carrying out trading activities during a period but there are temporary gaps in the activities, in my view it can be said that the company is a trading company "throughout" the period.

63. I therefore find that, subject to the "substantial non-trading activities" point discussed below, Gatebright was a trading company at least up to November 2012 and so was a trading company up to the relevant date.

64. I now turn to consider whether Gatebright was disqualified as a trading company because its activities included, to a substantial extent, activities which were not trading activities. In particular, was Gatebright carrying out substantial investment activities?

65. Mr Vallis' approach was that, even if the company was carrying out trading activities (which he denied), from the time when the company made its investment into the bonds, most of the assets of the company and all of the income (apart from trivial sums of bank interest in 2010 and 2011) were derived from the bonds. This was an investment activity and was substantial and therefore Gatebright could not be a trading company.

66. Mr Vallis also placed weight on the statements in the company accounts from 2011 to 2014 that "The company's principal activity during the year continued to be trading investments".

67. Mr Vallis acknowledged that there was no statutory definition of "substantial" but that given the amount of cash invested in the bond and the fact that the company's only income was derived from the bonds, it was difficult to say that this was anything other than substantial.

68. Mr Potter submitted that the company was not carrying on an investment business in the relevant period. The purchase of the bonds was a one off transaction carried out, not because, they wanted to "sit back and live off the income", but in order to safeguard the company's accumulated profits at a time when no bank or financial institution seemed a safe place to deposit money.

69. Mr Potter commented that the company had always put money on deposit and had received income from it. There was no intention to change the nature of the company to an investment company and they were not carrying on "investment activities". There was a single transaction entered into to protect the company's funds in the prevailing economic circumstances. There was no further activity after the investment was made. The bonds could not be liquidated for six years and it was only when this period expired in 2015 that the cash was distributed in the liquidation.

70. Although a substantial part of the company's funds were tied up in the bonds (Mr Vallis put it at 73.57% of the company's cash reserves) a significant amount- approximately £200,000 was retained as working capital in the expectation that it would be needed in carrying out the trading activities and facilitating future

deals. In fact, most of this money was not needed and over the period was distributed as dividends.

71. Mr Vallis did not refer to HMRC's own guidance on when a company will be regarded as having substantial non-trading activities. The guidance is to be found at CG53116 in the Capital Gains Manual and states as follows:

> "A common consideration in deciding whether a company, group or subgroup counts as trading is whether the extent of the entity's non-trading activities is 'substantial'.
> …
> Most companies groups and subgroups will have some activities that are not trading activities. The legislation provides that such companies and groups still count as trading if their activities "… do not include to a substantial extent activities other than trading activities".
> The phrase "substantial extent" is used in various parts of the TCGA 1992 to provide some flexibility in interpreting a provision without opening the door to widespread abuse. In this context 'substantial' means more than 20%.
> A company, group or subgroup whose non-trading activities amount to more than 20% of its total activities (excluding intra- group or intra-subgroup activities) does not meet the trading requirement. Some or all of the following are among the indicators that might be taken into account in reviewing a particular company, group or subgroup's status.
> - The level of turnover received from non-trading activities (CG53116a).
> - Whether the value of non-trading assets was substantial in relation to the value of all assets (CG53116b).
> - The expenditure incurred or time spent by officers and employees on non-trading activities (CG53116c).
> - The company's history (CG53116d).
>
> **Balance of indicators**
> These indicators should not be regarded as individual definitive tests to which a 20% "limit" applies. They are factors, or indicators, that may be useful in establishing whether there is substantial overall non-trading activity. It may be that some indicators point in one direction and others the opposite way. You should weigh up the relevance of each in the context of the individual case and judge the matter "in the round" (see approach of the Special Commissioner in the IHT case of Farmer and another (exors of Farmer dec'd) v IRC SpC 216)."

72. The guidance is, of course, just that. It is not legislation.

73. HMRC regard "substantial" in this context as meaning 20%. The question is, 20% of what?

74. As ever, I must start from the legislation. Section 165A(3) focusses on "activities". The company's activities must not "include to a substantial extent *activities* other than trading activities". In other words I need to consider what the company actually does.

75. I do not consider that the statements in the accounts as to the principal activities of Gatebright takes us much further. In every year from 2011 to 2014, the accounts stated that the company was "trading investments". Whatever else it was doing, it does not appear to have been trading investments. The 2015 accounts which covered the period from 1 September 2014 to 31 October 2015 stated that the company's principal activity was "receipt of bank interest from the company's savings accounts". This too is not quite accurate as the interest on the bonds is

not, strictly, bank interest from savings accounts. However, by this stage, the company was in liquidation and it was an acknowledgement that the company was no longer carrying on trading activities and was simply passively receiving interest.

76. The case of *Farmer v IRC* SpC 216, mentioned in the Capital Gains Manual was an inheritance tax case and was not looking at quite the same test as we are considering here, but it does offer an approach to determine whether a company is a trading or investment company. (For inheritance tax purposes the question was whether the business of the company consisted "wholly or mainly of… the making or holding of investments". If it did, the company was not eligible for business property relief.)

77. The Court in that case said:

> "52. … the principle can be derived that it is necessary to look at the business and its activities in the round and to consider all the relevant factors, which, in that appeal, included not only the net profits but also the work undertaken by the owner and his employees.
> 53. Applying the principles derived from the authorities to the facts of the present appeal the following factors can be identified as relevant to a decision of what the business consists, namely: the overall context of the business; the capital employed; the time spent by the employees; the turnover; and the profit. When these factors have been considered it will then be necessary to stand back and consider in the round whether the business consisted mainly of making or holding investments."

78. Clearly, most of Brightgate's assets and virtually all of its income during the period in question came from the bonds, which, on the above test points towards non-trading activities. However, I note Mr Potter's evidence that the company had always had money on deposit, so there had not actually been a change in what the company did although the absence of trading income had highlighted the existence of these funds.

79. The expenditure incurred and the time spent by the officers/employees of the company on non-trading activities were nil. Many of the inheritance tax cases on the trading/investment issue have concerned the letting of land where there is a lot of work to be done in maintaining the investment. Or if the business is that of managing or holding investments, one might expect the managers to keep the investments under review and consider whether to keep or change them.

80. That was not the case here. Once the company had put its money into the bonds it did not, and indeed could not, do anything else in relation to them for six years until they matured. There were no investment *activities*. The company was locked into the bonds during their term and the directors did not *do* anything in relation to them.

81. In HMRC's view (CG53116C) "If a substantial proportion of the expenses of a company were to be incurred on non-trading activities then, on this measure, the company would not be a trading company. Or a company may devote a substantial amount of its staff resources, by time or costs incurred, to non-trading activities." That is no doubt correct, but in this case neither expenses nor time were spent on non-trading activities.

82. There are therefore factors pointing both ways.

83. In the inheritance tax cases, the focus is on the "business" and the extent to which it consisted of "making or holding investments". For ER purposes, the focus is on "activities" and whether the activities of the company included "to a substantial extent activities which were not trading activities". Although the tests are different, I find the general approach set out in *Farmer*, of considering the factors and then standing back and considering in the round the nature of the business, to be helpful.

84. The asset and income position of the company are factors against trading activities. The expenses incurred and time spent by the directors/employees are factors pointing to trading activities. When one stands back and looks at the activities of the company as a whole and asks "what is this company actually doing?" the answer is that the activities of the company are entirely trading activities directed at reviving the company's trade and putting it in a position to take advantage of the gradual improvement in global financial conditions.

85. Having carefully considered all the evidence and circumstances I find that the activities of the company did not, to a substantial extent, include activities other than trading activities.

86. It follows that the requirements of Condition B in section 169I were satisfied throughout the year ending with the relevant date and so ER is due.

Decision

87. For the reasons set out above, I have concluded that the Appellants were entitled to Entrepreneurs' Relief on their disposal of their respective shares in Gatebright on its liquidation.

88. I therefore allow the appeal.

89. 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.

MARILYN MCKEEVER
TRIBUNAL JUDGE

RELEASE DATE: 29 AUGUST 2019