Legal Update

The Northampton Regional Livestock Centre Company Limited v Cowling and Lawrence [2015] EWCA Civ 651, judgment of 30 June 2015

Cowling and Lawrence formed a partnership of property consultants. The appellant company, of which Cowling was the chairman and had a shareholding of 41%, was advised by the partnership on its sale of a former livestock auction site to Earlplace. Lawrence subsequently left the partnership and began to act for Earlplace, and he and Cowling sold the partnership business to Carter Jonas. The company alleged that the partners had been negligent in their advice, and that Lawrence had been guilty of a breach of fiduciary duty for which Cowling was jointly and severally liable.

The Court of Appeal upheld the decision of the trial judge that the marketing of the site had not been conducted negligently. Given the dire financial straits of the company, the sale negotiated was at the best price reasonably obtainable in the circumstances. Cowling's instructions to the partnership on the sale had properly discharged his duties to the company qua director, and the partnership could therefore not be criticised for failing to advise that it would be a sale at an undervalue.

The Court of Appeal also upheld the decision of the trial judge that Lawrence remained a fiduciary after 4 July 2015. Although he sought to resign from the partnership on 4 July 2005, he did not cease to owe a fiduciary duty to the company until 23 September 2005 when the company exchanged contracts with the purchaser for the site. The agreement that Lawrence would leave was contingent on a number of future events including the sale of the partnership business and a formal dissolution of the partnership. Although it was agreed that Lawrence would be free to exploit opportunities in his name and compete with the partnership from 4 July, it was necessarily understood that his doing so would not involve any activity on his part that put him in a position of conflict with the company or the partnership's continuing instruction to market the site. In any event, Lawrence continued to owe a fiduciary duty to the company until the exchange of contracts on the sale of the site to Earlplace on 23 September. The court noted that in normal circumstances an estate agent's duty to his client ceased upon exchange and although Lawrence remained a partner, his duty to the company ceased on exchange since the sale price was then legally fixed.

The court also rejected Lawrence's argument that the company's failure to object when he informed it that he proposed working with Earlplace meant that it was estopped by convention from recovering damages as a consequence of Lawrence so acting. The court held that it was not disputed that Lawrence was entitled to act for the purchaser, but whether he was entitled to do so in a manner which put his duty and his interest in conflict. Estoppel by convention required that it be unjust or unconscionable to permit one of the parties to resile from the convention on the basis of which they had regulated their dealings (*The Vistafjord* [1988] 2 Lloyds Rep 453 per Bingham LJ at 352) and there was no unconscionability in the company seeking to recover from Laurence the benefit which he secured to himself.

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Although the trial judge considered that Lawrence had imparted valuable commercial information to the purchaser, a substantial part of which was confidential to the company or had only come into his possession because he was working for the company and which the company would not have wished to be divulged to the purchasers, it had held that it would have found Lawrence liable for breach of fiduciary irrespective of the communication of information. Lawrence's challenge to the findings that he had misused confidential information could therefore not affect the outcome of the appeal, but the Court of Appeal nonetheless noted for the record that it considered it would not be appropriate to infer that Lawrence's conduct compromised the price achieved by the company and that he acted in breach of duty to the company by imparting information to the purchaser. There was therefore no basis upon which the company could seek from Lawrence a remedy for breach of fiduciary duty going beyond the requirement that he account for the commission he received from the purchaser.

However, the Court of Appeal allowed the company's appeal against the ruling that Cowling was not jointly and severally liable with Lawrence. Section 10 of the Partnership Act 1890 provided that if the wrongful act or omission of a partner acting in the ordinary course of the business of the firm, or with the authority of his co-partners, caused loss or injury to a third party, the firm was liable to the same extent as the partner. Although Cowling had not authorised Lawrence's wrongful act, it was not necessary for authority to be given to do the wrongful act but was sufficient if authority was given to do acts of the kind in question (*Dubai Aluminium Co Limited v Salaam and others* [2003] 2 AC 366). Lawrence was not moonlighting but carrying out the partnership's business, and Cowling was therefore jointly and severally liable with Lawrence to account both for the commission earned from Earlplace through Lawrence's breach of duty and for Lawrence's share of the fee paid by the company to Carter Jonas in respect of the sale of the site.

EAD Solicitors LLP and others v Abrams UKEAT/0054/15/DM, judgment of 5 June 2015

Abrams was a member of an LLP. He set up a limited company, of which he was the sole director, to take his place as a member, and retired from membership. The LLP objected to the company offering Abrams' services once he had reached agreed retirement age of 62. The parties disputed whether the company continued to be a member or had suffered a detriment by reason of Abrams' age but, for the purposes of the judgment in this case, the Employment Appeal Tribunal (EAT) assumed that it had suffered a detriment.

The company and Abrams argued that this was a breach of the Equality Act 2010. Section 45 of the Equality Act provides that an LLP must not discriminate against a member as to the terms of his membership, by expelling him or by subjecting him to any other detriment. Section 13 provides that a person discriminates against another if, because of a protected characteristic (which included age), the former treats the latter less favourably than he treats other persons. The Interpretation Act 1978 provides that the word 'person' included a body of persons corporate or unincorporate unless the contrary intention appears. The LLP argued that a company could not have a protected characteristic and could therefore not claim the protection of the Equality Act.

The EAT noted that the Equality Act did not deal with individuals on the basis of their protected characteristics, but instead identified discrimination as being detrimental treatment to any person, whether natural or legal, caused by the protected characteristic or related to it. In cases prior to the Equality Act the courts had recognised that a person who had suffered a detriment could claim compensation even though they did not have the protected characteristic where, for example, they had been told by their employers to discriminate against others on grounds of their race.

The EAT contrasted the provisions of the Equality Act with the wording of the Disability Discrimination Act 1995 which defined discrimination by reference to less favourable treatment of the disabled person rather than any person. The Equality Act only required that the discrimination be 'because of a protected characteristic', and not that the protected characteristic be that of the person subjected to the detrimental treatment.

The EAT considered that this interpretation was supported by the fact that certain provisions of the Equality Act expressly required that the person subject to the detriment be an individual, as these references would not be required unless the references to the word 'person' elsewhere in the Act were capable of including a corporation.

The EAT therefore rejected the argument that a corporation could not complain of discrimination. It also refuted the claim that argument that this created a whole new class of discrimination and noted that it still had to be linked to the protected characteristic of an individual.

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Huitson v Commissioners for HMRC [2015] UKFTT 0448 (TC)

Huitson entered into a tax avoidance scheme in 2001 under which he was the settlor of, and had an interest in possession in, an Isle of Man trust which became a partner in an Isle of Man partnership. Huitson then contracted with the partnership to provide his services as an engineering consultant. The intended effect was that Huitson's income from the trust would be treated as being of the same nature as the underlying trust income, namely a share in the partnership profits; but that, because he would not be a partner, s858(4) of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2995) would not apply. Section 858(1) and (2) provided that a partner, defined in s858(4) as including 'any person entitled to a share of income of the firm', would be liable to income tax despite the existence of the double taxation arrangements which would otherwise allow tax relief, such as those with the Isle of Man. HMRC took the view that s858 applied.

Huitson's application for judicial review, on the ground that the retrospective effect of s858(4), which was inserted by the Finance Act 2008, was incompatible with his right to peaceful enjoyment of his property under Article 1 of Protocol 1 to the ECHR, was dismissed by the Court of Appeal on the ground that any interference struck a fair balance between his rights and the public interest in securing the payment of taxes. His application to the European Court of Human Rights was declared inadmissible on similar grounds.

Huitson also appealed against the decision of HMRC. The tribunal held that although he had sought to amend his appeal to encompass Art 56 EC (now Art 63 TFEU) on the free movement of capital, a breach of which had been alleged by claimants in similar judicial review proceedings to his, which had taken place at a similar time, there was no reason why he could not have amended his judicial review claim to encompass this, and the application was simply a delaying tactic. As to s858(4), that the reference to 'income of the firm' was intended to mean a share in the profits of the firm, and not to a share in the gross income. This interpretation reflected the fact that s858 was clearly an anti avoidance provision aimed initially at schemes involving a share of profits (as in *Padmore v Commissioners of Inland Revenue* [1987] STC 36) and must be given a purposive approach (*Berry v HMRC* [2011] STC 1057). It was also consistent with the context of the provision, whereby the trading profits of a partnership were taxed in the hands of individual partners according to their share of those profits (s852 IPPOIA 2005) and the requirement for partners to make a tax return explicitly referred to income (s s8(1B) of the Taxes Management Act 1970 (TMA 1970)). Huitson was therefore to be treated as a partner in the relevant tax years because he was entitled to a share of the partnership's income.

Commissioners for HMRC v Vaines [2016] UKUT 2 (TCC)

Vaines was a partner in a law firm which was an LLP. He had previously worked for a different firm which had ceased to trade owing considerable sums to a bank. Vaines agreed to pay the bank a sum to release him from all claims, and he then sought to deduct that sum for tax purposes. HMRC rejected that claim but the First Tier Tribunal allowed it on the basis that the payment was incurred, wholly and exclusively for the purposes of the trade that Vaines was carrying on and that it was revenue not capital.

HMRC appealed on the grounds that a trade was not carried on by an LLP member as an individual, but by the LLP, and that even if this were wrong, the payment had not been made wholly and exclusively for the purposes of Vaines' trade (and was thus denied by s34) of the Income Tax (Trading and Other Income Act 2005 (ITTOIA)) and the payment was capital in nature (and thus denied by s33 of ITTOIA).

The Upper Tribunal allowed the appeal. It ITTOIA, in particular s863, specifically envisaged that it was the LLP that was carrying on the trade, although its activities were to be treated as carried on in partnership by its members rather than by the LLP. The profits of that single trade were computed and charged, and s850 made the members chargeable according to the LLP's profit sharing arrangements for the period. The change to self assessment had not affected this; it was the profits of the trade carried on collectively that had always been recognised as the subject matter of computation and charge, and it was therefore in the context of the LLP trade conducted collectively that Vaines had to justify the deduction of this payment.

This conclusion inevitably led the Tribunal to conclude that the payment had not been made wholly and exclusively for the purposes of the LLP's trade. The liability had arisen from Vaines' previous engagement with another firm and had nothing to do

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with the LLP's business. The LLP had not made the payment and Vaines' decision to pay it had not been discussed with the LLP's management or members. Indeed, the fact that the payment was initially funded by a loan to Vaines from the LLP indicated that the LLP declined to take any responsibility for the payment. Even if the LLP had assumed responsibility for part of the payment, it might not have been deductible by it. The Tribunal noted that although there was a distinction between the purpose and the effect of particular expenditure, the effect achieved might be so inevitable or inextricable from the payment that it represented an unspoken or subconsious purpose (*MacKinlay v Arthur Young McClelland Moores & Co* (1986) 62 TC 704 per Lord Oliver at 757; *Vodafone Cellular Ltd v Shaw* (1997) 69 TC 376 per Millett LJ at 436-437), and that the primary enquiry was to ascertain the particular objective of the taxpayer in making the payment, and not whether he intended to obtain a trade or a personal advantage (*Vodafone Cellular Ltd v Shaw* (1997) 69 TC 376 per Millett LJ at 436-437). Although Vaines had made the payment to preserve his professional career or trade, its inevitable and necessary objective was the wider one of avoiding protracted litigation and the risk of bankruptcy.

Given the Tribunal's rejection of Vaines' appeal on these two grounds, it held that it was unnecessary for it to decide where the payment was capital or a revenue expense. However, it noted that payments designed to protect or preserve a person's trade or profession could be deductible as revenue expenditure and were not necessarily to be disallowed as capital (*Morgan v Tate & Lyle Ltd* [1955] AC 21). Had Vaines succeeded on the first two grounds, he might well have succeeded on this third ground.

R (on the application of De Silva and another) v Commissioners for HMRC [2016] EWCA Civ 40, judgment of 2 February 2016.

This was an appeal against a decision of the Upper Tax Tribunal which was noted in 'A Propos Partnership' Issue 41 (July 2014).

A number of film partnerships, in which the appellants were limited partners, lodged tax returns in which they claimed loss relief for losses in three tax years. The relevant legislation enabled a limited partner to set off his allocated share of the losses of a film partnership in its early years of trading against his general income for that year or any of the three previous years by 'carrying back' those losses. HMRC challenged the partnerships' claims and they were ultimately compromised by an agreement between HMRC and each of the partnerships. HMRC informed the partners that their individual claims for carry-back relief would be amended as a consequence and the appellants sought to quash these decisions.

The Court of Appeal disagreed with the conclusion of the Tribunal that the appellants were not parties to the settlement agreement. Section 6 of the Partnership Act 1890 provided that 'An act or instrument relating to the business of the firm done or executed in the firm-name, or in any other manner showing an intention to bind the firm, by any person thereto authorised, whether a partner or not, is binding on the firm and all the partners'. The settlement agreement related to the business of the firm, was done or executed in the firm name, showed an intention to bind the firm, and was executed by the general partner who was clearly authorised to do so. It expressly conferred benefits on the partners individually by providing for the quantum of reliefs that they could claim and providing that they were not to have penalties levied against them. It was therefore contractually binding on the appellants.

The Court of Appeal rejected the appellants' claim that HMRC was precluded from relying on the settlement because it had failed to open an enquiry under Sch 1A, para 5(1) of the Taxes Management Act 1970 (TMA) into their standalone claims for tax relief. First, it was not mandatory to make a standalone claim for carry-back losses since the disapplication by Sch 1B, para 2(2) TMA of the rule that a claim which could be made in a return must be so made simply meant that a claim could be made either in a return or as standalone claim. Second, regardless of how the claim had been 'made', it must be included in the return for the year in which the losses were actually made. The Court agreed with the Tribunal that the appellants' inclusion in their returns of the claims to carry back partnership losses did not make them standalone claims. Third, even if they were, HMRC was not obliged to conduct an enquiry into them pursuant to Sch 1A, para 5(1) TMA and, if it did not do so within the prescribed time, was not precluded from bringing a further enquiry.

Dutia v Geldof and others [2016] EWHC 547 (Ch), judgment of 16 March 2016

The claimant alleged that he and the first four defendants, together with a company, had agreed to carry on a private equity business in common with a view of profit and had thereby agreed entered into a partnership governed by the Partnership Act 1890. He appealed against summary judgment in favour of the first four defendants. The court rejected the appeal, holding that the claim had no reasonable prospect of success and therefore not only did the court have the power to grant summary judgment, it should in general exercise that power (*Swain v Hillman* [2001] 1 All ER 91). Although the onus was on the defendants to prove that the claim was fanciful, the legal threshold for a partnership agreement by inference was not easy to surmount, and it was so unlikely that the claimant would succeed at trial that the prospects of success must be regarded as fanciful.

The court noted that partnership was grounded in contract and therefore, in order for there to be a partnership, there had to be a concluded contract. It expressly declined to decide whether the test for the implication of a contract was, as a considerable body of Court of Appeal caselaw suggested, necessity in the sense that a contract would only be inferred if the parties' behaviour was incapable of an alternative explanation, or to give business efficacy to what the parties were doing. The same result would be reached by either route; there was no legal gap requiring a partnership agreement to be inferred, and all the evidence pointed against a partnership coming into being.

The court also noted that it was necessary for the putative partners to carry on business themselves; an agreement that they should have an economic interest in a business to be carried on by some other entity was insufficient, as acknowledged by s1(2) of the Partnership Act which provided that companies were not partnerships. Since a company was a separate legal entity to its members, a business carried on by it was not carried on by its members.

The evidence suggested that the parties had agreed to own an LLP which would carry on the business, that the company would provide the necessary funding to the LLP, and that the individuals would work for the business carried on by the LLP. Indeed an LLP (the fifth defendant) was subsequently incorporated in which at various times the first four defendants and the company were members. The evidence was that the consultancy arrangements with the first four defendants would mature into LLP membership, and although it was not clear whether these arrangements were contractually binding, there was in any event no evidence that they agreed to carry on business together; at most they agreed to own an entity which would carry on a business; work done by the individuals to establish a corporate body to carry on business could not be treated as the equivalent of the carrying on of business by the individuals themselves. Although there was some evidence that the claimant had been encouraged to start work under a consultancy agreement by assurances that he would be a partner, it was made clear that this was subject to the development of legal documents which had not yet been finalised, and thus that there had been no specific formal partnership which was being offered or could be accepted. The use of the words 'partner' and 'partnership' by the parties did not signify that the requirements of the Partnership Act had been complied with, and the court noted 'specifically that in the context of an LLP, "partner" is commonly used to mean "member"'. The fact that the claimant agreed to provide limited services to the LLP, and then provided substantially greater services, did not necessarily leads to the conclusion that there was an agreement to create a partnership which did not include the LLP, which was the entity with which he had contracted. Indeed, the reference to a back-up transaction fee to compensate the claimant for his additional work was inconsistent with a contract giving rise to partnership.

The court noted that claimant was subsequently offered the opportunity to join the LLP which would carry on the business of managing the fund, and that the principals would serve on committees of the LLP and the profits would be distributed to them in accordance with the different number of units allocated to each of them. It held that this was wholly inconsistent with any offer to him to participate in a business to be run by himself and the other principals directly with the profits being shared equally.

The court accepted that a partnership could come into being during a 'twilight period' during which the legal relationships to be entered into the future were being determined. Thus if the parties intended to operate their business through a corporate entity but commenced trading before incorporation, a partnership might be inferred. However where they had already incorporated the principal trading vehicle it was less likely that a partnership could be inferred pending the date on which the full structure was set up. It distinguished *Khan v Miah* [2000] 1 WLR 2123 which concerned individuals who intended to go into business together and the date on which such a partnership started. The

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question here was not about whether the parties' work in establishing the fund was merely preparatory or amounted to embarking upon the business in question, but about whether there was any real prospect of showing that the work was referable to agreement to carry on business together themselves rather than to the setting up of a business to be carried on by the LLP.

Finally, the court noted that the claimant had alleged a partnership between himself, the first four defendants and the company which provided the funding, but had failed to provide evidence of the company becoming a partner. An allegation that there was a partnership between six parties required proof that all six had become partners; it was a different allegation from one of partnership between five parties. While the court should be slow to grant summary judgment against a claimant if a viable amendment could be made which would save the case, this might be different where the claimant had been specifically asked in the Further Information to address the question whether his case was still that the company was a partner and had failed to suggest that he had an alternative case. However, even without this point the claim stood no real prospect of success.