



TC00557

Appeal number: SC/3068/2009

Corporation Tax – Capital or income – lump sum receipt – taxpayer a financial intermediary – taxpayer enters into exclusivity agreement with life insurance provider – life insurance provider agrees to pay lump sum in advance plus commission on sales following successful introductions from taxpayer – whether lump sum of capital nature – no – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

COUNTRYWIDE ESTATE AGENTS FS LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: SIR STEPHEN OLIVER QC
MIKE BELL ACA CTA**

Sitting in public in London on 26 April to 28 April 2010

Stephen Brandon QC and Harriet Brown, counsel, instructed by KPMG LLP, for the Appellant

Rupert Baldry QC, instructed by the General Counsel and Solicitor for the Commissioners of HM Revenue & Customs, for the Respondents

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DECISION

1. Countrywide Estate Agents Financial Services Limited (“Appellant”) appeals against a Notice of Amendment to its corporation tax return for the year ended 31 December 2002. The amendment has the effect of bringing the sum of £25 million into the amount of profits chargeable for the year. The question for determination is whether the sum of £25 million, paid to the Appellant by Friends Provident Life and Pensions Limited (“FP”) in accordance with an agreement of 21 August 2002 (“the FP Distribution Agreement”), falls to be treated as a revenue or capital receipt for tax purposes.

The statutory provisions and the issue

2. Income and Corporation Taxes Act 1988 Section 70 provides that for the purposes of corporation tax income shall be computed under Schedule D:

“... (o) on the full amounts of the profits or gains or income arising in the period without any other deduction than is authorised by the Corporation Tax Acts.”

Section 18(1)(a) of that Act provides that tax under Schedule D shall be charged in respect of:

“(t) the annual profits or gains arising or accruing to any person ... from any trade ..”

3. The issue arising here is this. The Appellant contends that the £25 million payment did not form part of its profits or gains arising in 2002 or in any other period: the entire payment was capital in nature as having been received in return for the Appellant’s grant to FP of the exclusive right to distribute “Life Products” for 15 years, resulting in its giving up the right to exploit its customer base. HMRC say that the £25 million should be included as part of the Appellant’s taxable profits; it accrued when the Appellant entered into the FP Distribution Agreement and falls to be taxed as and when recognised by the Appellant as a profit under recognised accounting principles. We therefore have to decide whether, to adopt the expression of Bankes LJ in *British Dyestuffs Corporation* (1924) 12TC 584 at 596, by entering into the FP Distribution Agreement (see below) the Appellant parted with “part of its property for a purchase price” or was this “a method of trading by which it acquires this particular sum of money (the £25 million) as part of the profits of its trade”.

4. The factual background is drawn from a statement of agreed facts supported by witness evidence of:

- (i) Harry Hill, Chairman of the Countrywide Group.
- 5 (ii) MDJ Buck, a partner in Lexicon Partners (engaged to provide advice on the transactions leading to the FP Distribution Agreement).
- (iii) Michael Nower former Group Finance Director of the Countrywide Assured Group plc.
- 10 (iv) Glen McGregor, Finance Director of the Countrywide Group.

Background

15 5. The Appellant is within the “financial services” division of a group of companies, “the Countrywide Group”. The Appellant was until 2004 known as Countrywide Assured Financial Services Limited and was a subsidiary of Countrywide Assured Group plc (“CAG”). After the demerger of Countrywide Assured plc, the Appellant changed its name to Countrywide Estate Agents FS Limited.

20 6. At the relevant times CAG was the parent company of the Countrywide Group. The activities of the Countrywide Group were divided into several operating divisions including the estate agency, financial services and life assurance divisions each contained in separate companies. All the divisions were wholly owned within the
25 Countrywide Group.

30 7. The Appellant’s business at the relevant time (and now) comprises the provision of a range of financial services which include providing advice in relation to the sale of mortgages, life assurance products and other general insurance products, predominantly through the estate agency chain of businesses operated by the Countrywide Group. The Countrywide Group was formed following the merger of Bairstow Eves and Mann & Co and
35 it subsequently grew through acquisitions. The business of the Appellant is associated with the business interests of the other Countrywide Group companies in that when homes are sold the buyers will be introduced to financial services consultants, employed within the Group, who will seek to help them pick the required financial products.

40 8. Once a customer has decided to purchase a life product the relevant information will be transferred electronically to the life insurance provider (which until the execution of the FP Distribution Agreement was Countrywide Assurance). Countrywide Assurance’s staff would then deal with the processing of the application for life assurance.

45 9. The individual branches were (and still are) operated by estate agents in the Countrywide Group. The branch of the Countrywide Estate Agency Network is responsible for the sale of the home. It introduces its customer to the Appellant. This

might happen on registration with the estate agency with a view to purchasing a home.

10. The staff of the Appellants will then consult with the customer and assess the customer's needs and resources. A mortgage consultant will typically recommend a suitable mortgage product and suggest the need for life insurance. The Appellant's staff would then introduce the customer to Countrywide Assured's life insurance product.

11. Prior to the FP Distribution Agreement there had been an oral agreement between Countrywide Assured and the Appellant which commenced in October 1998, followed by an agreement reduced to writing on 1 December 2001. The written agreement records Countrywide Assured as having appointed the Appellant as its intermediary and as such the Appellant was permitted, in relation to life insurance products, to introduce Countrywide Assured to potential customers. In return the December 2001 agreements provided that Countrywide Assured was to pay agreed commission on sales to the Appellant.

12. The Appellant had, prior to the FP Distribution Agreement, introduced Countrywide Assured to its customers in accordance with terms set out in the December 2001 agreement. Customers could, however, take any combination of products. In the period 1999 to 2002, for every 100 mortgages sold, 90 life products were sold.

13. The Financial Services Authority, in its paper "FSA 121", announced its proposal to remove "Polarisation". The effect of Polarisation had been that financial intermediaries in the position of the Appellant had to choose between either handling the product of one product provider or being entirely independent and operating as an Independent Financial Adviser. The consequence of removal, as foreseen in the insurance industry, was that intermediaries in the position of the Appellant would no longer be confined to selling the products of a single supplier. Life product providers wishing to protect their long term distribution networks might therefore attempt to secure exclusive distribution agreements with distributors such as the Appellant. The evidence shows that the Appellant was particularly attractive as a distributor because it was the leading seller in the country of mortgage related products through the Countrywide Estate Agency Network. Some life insurance companies bought interests in brokers or entered into joint venture arrangements with them. Financial intermediaries were thereby in a position to demand a premium in respect of their market positions.

Events leading to the FP Distribution Agreement

14. A decision was taken in 2002 for Countrywide Assured to cease to write new life policies. Countrywide Assured's customer volumes did not warrant the costs of developing and selling new life products. Consequently the Appellant needed to find a new life product provider. For this the Appellant was advised by Lexicon Partners.

15. At that point the Appellant's trading position was, to recapitulate, as follows.

16. The Appellant's business was associated with the business interests of the other companies in the Countrywide Group. Those of its staff whose job it was to introduce customers of the Countrywide Estate Agents to life insurance providers were working from the estate agents' premises for that purpose: there was no plan to displace the Appellant and its staff following the discontinuance by Countrywide Assured of its own life insurance business.

17. The Appellant's source of customers was the estate agents. The Appellant's actual customers were those purchasing properties on the estate agents' books and who needed life insurance cover. On occasions individuals with Countrywide Assured life insurance policies might come direct to the Appellant where, for example, they needed a further policy to provide extra cover. We did not have details of how many such individuals returned, nor what proportion of introductions from returning business bore to the total introductory business of the Appellant. We infer that it was relatively small.

18. The customer details required by the provider of the life insurance product to enable it to effect the policy belonged to the provider, i.e. Countrywide Assured. Names and addresses of such customers were, we understand, on the Appellant's records. The Appellant's customer base was the result of, and came to it because of, its position in the market place as fellow occupier with the estate agent of high street premises. Information about existing customers could only be counted as part of that customer base to the extent that it could be used to attract those customers to come back for more Countrywide Assured products. Otherwise, as noted, it belonged exclusively to Countrywide Assurance.

19. The discontinuance of the Polarisation regime meant that the Appellant had, for the future and unless it chose to enter into an agreement with a life product supplier which confined it to introducing product of that supplier, an opportunity to act as financial intermediary in relation to product of more than one other supplier.

20. Countrywide Assured's intended discontinuance of its life insurance business would leave the Appellant with access to potential customers for life insurance cover, through its association with the estate agents in the Countrywide Group, but with no exclusive provider of life insurance.

21. The Appellant opened negotiations with Friends Provident and AXA with a view to entering into an exclusive life insurance distribution agreement. The Appellant announced that it required two elements of consideration from the potential offerors. These were a non-refundable "apportionment payment" and a commission on sales resulting from introductions made by the Appellant. The former explained Mr Buck, was for the right to be the only life insurance provider to whom the Appellant would introduce customers; the latter had to be greater than the commission received under the December 2001 agreement with Countrywide Assured.

22. The negotiations concluded with FP agreeing a payment of £25 million up-front with commission of 325% LAUTRO. On 21 August 2002 the FP Distribution Agreement was signed.

5 The FP Distribution Agreement

23. Before dealing with the terms of the agreement, we mention that the operating structure which was followed after entering into the FP Distribution Agreement, but which was not contained in that agreement, involved Countrywide Group estate agents finding properties for customers who would then be introduced to the staff of the Appellant. The Appellant would attempt to secure a mortgage and suggest the need for appropriate insurance cover. The applications for insurance would still be dealt with by the same personnel as previously, except that they were now working for FP, from FP's premises.

24. By clause 5.1, FP appointed the Appellant as its distribution agent to effect introductions to FP with a view to customers acquiring a "Life Product". It reads as follows:

"Friends Provident hereby appoints Countrywide FS as its distribution agent on the terms and conditions of this Agreement on a non-exclusive basis to

(a) effect introductions of its customers to Friends Provident with a view to their acquiring a Life Product;

(b) offer advice to its customers in relation to Life Products;

(c) arrange the Life Products for its customers;

(d) allow its representatives to carry out all or any of the activities referred to in sub-clauses (a), (b), (c) above

through the Countrywide Estate Agency Network in accordance with the terms and conditions of this Agreement. All such activities shall, for the purposes of this Agreement, constitute "distribution" of the Life Products"

"Life Products" are defined as any of the "Contracts for Long Term Insurance" of FP (referred to in Schedule 1) together with others which may be agreed to fall within this definition. Schedule 1 defines "Life Products" to include, particularly, level term assurance, critical illness benefit, mortgage payment protection and income replacement benefit. An effect of this provision was that while FP would continue to sell its Life Products through other providers, the Appellant could not sell the Life Products of other providers through the estate agents.

25. Clause 2 of the FP Distribution Agreement provided first that £25 million was to be paid to the Appellant as consideration for its exclusive right to distribute the Life Products to the Appellant's customers. It further provided that "Initial Commission"

would be paid in respect of each life product sold by the Appellant and that a “Further Commission Element” would be paid. The initial commission was paid on each Life Product that the Appellant sold, subject to an adjustment. The Further Commission Element was calculated in accordance with clause 6.10 and covered the necessary in-house system development working and ongoing running costs to allow the Appellant’s “Point of Sale” system to distribute FP’s products.

26. Clause 2.4 provides that the FP Distribution Agreement is automatically terminated on 15th anniversary of the Commencement Date.

27. By Clause 5.5 the Appellant undertakes, during the life of the Agreement, that it will not distribute through any office which forms part of the Countrywide Estate Agency Network (as defined) any contracts of long term insurance which are an integral part of a mortgage or property related transaction other than those under written by FP.

28. Clause 10 provides:

“10.1 Subject to clauses 10.5 and 19, customer information relating to persons who take out Life Products pursuant to this Agreement which is provided to Friends Provident either directly or through the Countrywide FS shall in respect of the Life Products, belong to Friends Provident and Friends Provident shall subject to all applicable law and regulation (but without prejudice to its obligations to pay any Additional Initial Commission), be entitled to utilise that information as it sees fit throughout the Term and after termination (for whatever reason) of this Agreement.

10.2 Customer information relating to persons who are provided with any product or service by or through Countrywide FS which is not a Life Product shall belong to Countrywide FS

10.3 For the avoidance of doubt, customer information relating to persons who seek and/or are provided with any product or service from any member of the Countrywide Group shall belong to both that member of the Countrywide Group and Friends Provident where such persons also become a Policy holder.”

Accounts for the years 2001-2003

29. The Appellant’s annual turnover for the year ending 31 December 2001 was £35.2 million. Annual turnover in the year ending 31 December 2002 was £42.2 million and in the year ending 31 December 2003 was £51.8 million.

Conclusions

30. The Appellant's case for claiming the £25 million payment to be of a capital nature is that, in return for the payment, the Appellant parted with the exclusive use of its goodwill for 15 years. The goodwill, it was said, consisted of its customer base (present and future) that rested on its name and association with the estate agents in the Countrywide Group, on its reputation and on its geographical spread. The Appellant, it was argued, parted with the goodwill through its agreement that FP was to be the only Life Product provider to whom it (the Appellant) would introduce customers, whether new customers or returning customers. The Appellant was thereby precluded from adapting to the removal of Polarisation and negotiating any multi-tie with other suppliers. The result, it was contended, was for the Appellant to have presented FP, in return for the one-off £25 million payment, was a significant part of its business, namely that which had formerly been part of its goodwill. The situation was no different in principle from that found in *British Salmson Aero Engines Limited v IRC* 22CC 29, *Murray v Imperial Chemical Industries Limited* 44TC 175 and *Wolf Electric Tools Limited v Wilson* 45TC 326. So regarded, the £25 million was, as to its entirety, a payment of a capital nature.

31. In common with HMRC we do not accept the Appellant's contention.

32. The central question for us is one of fact. For what was the £25 million consideration? The payment was made to the Appellant as an intermediary. As such, it did not own any rights to distribute Life Products; those belonged to Countrywide Assured (and subsequently to FP) who alone had the product to sell. Was the payment made in return for the Appellant ceding part of its goodwill to FP by giving up the right to exploit its customer base in respect of the Life Products for 15 years?

33. The findings of fact show that the Appellant's goodwill as a financial intermediary has at all times depended on its position in the market. The name "Countrywide Estate Agents FS Limited", and its association with and presence in the Countrywide Estate Agents' premises are continuing features of its goodwill. Those are the features that have given it access to customers. The effect of the FP Distribution Agreement therefore was to give FP access, through the Appellant, to those customers. On that basis we cannot see that the Appellant parted with any significant element of its goodwill to FP.

34. The same goes for such customer information as belonged to the Appellant. We have already noted that the detailed information relating to the contracts of life insurance belonged to Countrywide Assured as to the past transactions, and would belong to FP as to the future transactions. At most the Appellant had the prospect of ex-customers returning and kept its own list of names and addresses of those who had sought introductions from the Appellant. Our conclusion is that the Appellant was not, as regards this customer information, disposing of anything in the nature of a capital asset. It was using its access to customers by giving FP the right to be introduced to them. FP's £25 million payment was the consideration for the Appellant's undertaking to give FP access to the Appellant's position in the market

and its enhanced ability to introduce FP product to customers of the Countrywide Estate Agents.

35. Did the Appellant, by foregoing the opportunity presented by the ending of
5 Polarisation, part with a capital asset by entering into an exclusive trading agreement
with FP? We do not think so. It had never been any part of the Appellant's business
activities to act as a financial intermediary for more than one life insurance provider.
At most the FP Distribution Agreement meant that the Appellant lost the chance to be
financial intermediary for other providers. That was a possibility, not an asset. As
10 Nicholls LJ (as he then was) observed in *Kirby v Thorn EMI* [1987] STC 621 at 627,
the freedom to trade is not an asset.

36. Turning to the authorities relied upon by the Appellant, we recognise that there
is no single test to determine whether a receipt is of a capital or income nature. The
15 cases show that sums paid for giving up or modifying a capital asset held by the
recipient will be of a capital nature, as will sums paid for the cancellation of
contractual arrangements that effectively destroys or cripples the whole structure of
the recipient's profit-making apparatus. Here, the Appellant neither parted with a
capital asset nor was its profit-making apparatus depleted or destroyed. Unlike
20 *British Salmson Aero Engines*, where a third company held rights to manufacture and
sell aero engines world wide and granted the tax payer an exclusive right to use such
rights for 10 years in a defined territory in return for a lump sum (held to be capital),
the Appellant as financial intermediary parted with no property. In *British Salmson*
manufacturing and selling aero engines was the business of the recipient. Here the
25 Appellant never provided and sold life insurance product and FP did not become a
financial intermediary in relation to customers derived from Countrywide Estate
Agents.

37. Unlike *Wolf Electric Tools*, where shares received as part of the arrangements
30 whereby Wolf Electric gave up selling its manufactured goods to India (and such
shares were held to be capital receipts), the Appellant has neither parted with any
asset to FP nor by undertaking to introduce customers exclusively to FP product has it
depleted the capital structure of its business. *IRC v Coia* (1959) 38TC 334 concerned
an agreement between a garage proprietor and an oil company under which the
35 proprietor entered into an exclusivity agreement with the garage proprietor for sums
of money. Those sums, held to be capital, were contributions to the capital costs of
extending the garage building and premises to meet the standards required by the oil
company. That was not the position in the present case.

40 38. We revert finally to the test expressed in the *British Dyestuffs Corporation* case,
supra. The Appellant has used its goodwill and turned it to account through the FP
Distribution Agreement as its "method of trading"; it has not parted with part of its
property for a purchase price. On that basis the £25 million is income in nature and
that amount will therefore be taxed as it is recognised for the UK GAAP in the
45 Appellant's accounts.

39. We dismiss the appeal. HMRC did not ask for costs.

40. This is a full reasoned decision. The Appellant has the opportunity to seek permission to appeal to the Upper Tribunal.

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SIR STEPHEN OLIVER QC
TRIBUNAL JUDGE
RELEASE DATE: 11 June 2010

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