[2012] UKUT 274 (TCC)
Appeal number FTC/68/2011

Capital gains tax – claim by Respondent for roll-over relief on basis that gain arising on sale of business was wholly in respect of goodwill - HMRC disallowed part of Respondent's claim on ground that part of consideration for sale was compensation for termination of car dealership – FTT allowed appeal – HMRC appealed on ground that FTT erred in law and reached conclusion not available on facts - appeal allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and –

MERTRUX LIMITED

Respondent

Tribunal: Mr Justice Newey
Judge Sinfield

Sitting in public in London on 30 and 31 May 2012

Akash Nawbatt and Christopher Stone, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Richard Bramwell QC, counsel, instructed by Bates Weston, for the Respondent

DECISION

Introduction

1. This appeal relates to a claim by Mertrux Limited ("Mertrux") for roll-over relief on a payment of £1,705,502 received by Mertrux on the termination of its Mercedes dealership with Daimler-Chrysler (UK) Ltd ("DCUK") and the transfer of that part of its business to Leadley Limited ("Leadley"). Mertrux treated the payment as consideration for the disposal of goodwill on the sale of its business and claimed roll-over relief under section 152 of the Taxation of Chargeable Gains Act 1992 ("TCGA") on the whole amount. HM Revenue and Customs ("HMRC") took the view that only half of the payment was consideration for goodwill and restricted Mertrux's claim for roll-over relief accordingly. Mertrux appealed HMRC's decision to the First-tier Tribunal (Tax) ("the FTT"). In a decision dated 21 June 2011 – [2011] UKFTT 398 (TC) - the FTT allowed Mertrux's appeal against HMRC's decision. HMRC now appeal to the Upper Tribunal.

Facts

2. There was a statement of agreed facts which the FTT reproduced, with minor variations, at [4] – [17] of the decision. In summary, the relevant facts were as follows.

(1) DCUK operated the Mercedes-Benz dealer network in the UK and had agreements with a number of dealers, including Mertrux. The Dealer Agreements contained provisions granting exclusivity to dealers to sell Mercedes cars in certain geographical areas. The Dealer Agreements could be terminated by either party giving the other 24 months' notice. However, DCUK could terminate the Dealer Agreement on 12 months' notice if it were necessary to reorganise the distribution system. In 2000, DCUK decided to reorganise the dealership network. DCUK purported to terminate all the Dealer Agreements on 12 months' notice.

(2) A number of dealers, including Mertrux, began proceedings to challenge the purported termination. The proceedings were settled by agreement. Under

the terms of the settlement, Mertrux's Dealer Agreement was amended by a Deed of Variation and Termination ("DoVT") dated 13 July 2001. Under the DoVT, the earlier notices of termination were cancelled and it was agreed that Mertrux's dealership would end on 30 June 2003 (ie on just less than 24 months' notice) unless Mertrux opted for an earlier termination date. The DoVT provided that the dealership would be taken over either by a dealer nominated by DCUK or by DCUK itself if no other dealer had been found to take over the business by the termination date.

(3) Clause 4 of the DoVT provided that Mertrux was entitled to a Territory Release Payment ("the TRP") calculated in accordance with the terms of Schedule 2 to the DoVT. The TRP would be adjusted depending on the period for which it was payable. By clause 4 of the DoVT, the TRP could be a "12 month TRP", an "18 month TRP" or a "24-month TRP". A 12 month TRP was an amount equal to Mertrux's profit for a prior year, less certain deductions, and was payable if the dealer chose to continue for the full 2 years to 30 June 2003. An 18 month TRP was payable if the dealer elected to terminate on 31 December 2002. A 24 month TRP (ie twice the 12 month TRP) was payable if the dealer elected to terminate on either 30 June 2002 or 1 January 2002. Mertrux elected for a cessation date of 30 June 2002 and thus became entitled to the 24 month TRP.

(4) Clause 5 of the DoVT provided for the maintenance by the dealer of "Revised Core Standards" until termination of the dealership. By clause 5.3, the dealer acknowledged that failure to adhere to the Revised Core Standards was likely to have an adverse effect on the business and might lead to a challenge by DCUK to the amount of the TRP.

(5) Clause 8.1 of the DoVT stated that it was assumed that, before the termination of the dealership, an incoming dealer (or DCUK if there was no incoming dealer) would have entered into a transfer agreement ("the Transfer Agreement") by virtue of which it would buy Mertrux's business. Clause 8.1 further provided that, on termination, the incoming dealer (or DCUK if there was no incoming dealer) would pay Mertrux

(a) the TRP;

(b) a contribution to Mertrux's transaction costs;

(c) in certain circumstances, a reimbursement of certain investment costs incurred by Mertrux; and

(d) the price of assets to be transferred pursuant to the Transfer Agreement.

(6) Clause 9.4 of the DoVT provided that the terms of the Transfer Agreement were to be agreed between Mertrux and the incoming dealer (or DCUK, as appropriate). The clause specified that the Transfer Agreement was to provide, among other things, that the incoming dealer (or DCUK) would buy tools and parts from Mertrux. Clause 10 of the DoVT provided for the transfer of staff to the incoming dealer (or DCUK).

(7) By agreement, the termination of Mertrux's dealership was postponed beyond 30 June 2002, without prejudice to its entitlement to the 24 month TRP, because there were difficulties in finding an incoming dealer. On 31 July 2003, Mertrux entered into the Transfer Agreement with Leadley. Clause 3 of the Transfer Agreement set out the purchase consideration for the sale of the business and assets, as defined. That consideration was the aggregate of the values attributed to the assets. Under clause 3, the value attributed to the TRP, which had the same meaning as in the DoVT, was expressed separately from the purchase consideration for the business and assets.

(8) On the transfer, some employees transferred to Leadley but Mertrux retained its premises and the business name. DCUK appointed Leadley as a Mercedes dealer in place of Mertrux. Leadley paid Mertrux £1,752,698. In its corporation tax return for the year ended 31 December 2003, Mertrux treated £1,705,502 of the payment as having been paid entirely on account of goodwill.

(9) HMRC considered that part of the TRP (the "basic" 12 month TRP) was for goodwill and the balance (the "enhanced" TRP ie the amount in addition to the 12 month TRP) was to compensate Mertrux for the early termination of its dealership and did not qualify for roll-over relief. Accordingly, HMRC amended

Mertrux's corporation tax return for the period ended 31 December 2003 to show gross capital gains of £852,751 on which corporation tax was chargeable.

Legislation

3. Section 152 TCGA provides that roll-over relief is available, on a claim being made, where a person carrying on a trade applies the consideration for the disposal of assets used for the purposes of the trade in acquiring new assets that are also so used and the old and new assets are both within specified classes. Section 155 lists the classes and class 4 is goodwill. The other classes are not relevant in this case. Section 152(11) provides that where the consideration is for the disposal of assets, some of which qualify for roll-over relief and some of which do not, the consideration is to be apportioned in a just and reasonable manner.

4. Section 21 TCGA defines assets broadly as all forms of property, including incorporeal property generally and any form of property created by the person disposing of it or otherwise coming to be owned without being acquired.

5. Section 22 TCGA provides that there is a disposal of assets where any capital sum is derived from assets even if no asset is acquired by the person paying the capital sum such as where amounts are received as compensation or for surrender of rights.

The FTT's decision

6. The question for determination by the FTT was whether the whole of the TRP received by Mertrux was consideration for the disposal by Mertrux of the goodwill of the business on its sale to Leadley and qualified for roll-over relief or whether part of the TRP was a payment for Mertrux terminating its Dealer Agreement early ie a surrender of a right which did not qualify for relief. If the consideration related to both qualifying and non-qualifying disposals, there was no dispute about the apportionment as HMRC agreed that half of the TRP related to a disposal of goodwill by Mertrux. The FTT found that the whole of the TRP amount was for the goodwill and, therefore, the whole of the gain was eligible for roll-over relief. The FTT allowed Mertrux's appeal.

7. The FTT's decision, having set out the facts and legislation, recorded the submissions of the parties at length. The key point for determination was a short one, namely: what was the £1.7m received by Mertrux consideration for? The FTT's findings in respect of this point are set out at [74] - [80] as follows:

> "74. We found that the DoVT was a global compromise agreement negotiated by a number of dealers. It could not therefore be expected to produce a coherent result in every case. There was nothing in the DoVT which specified any right to compensation for the dealers.
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> 75. HMRC contended that it was inherently unlikely that it was the intention of the dealers in signing up to the DoVT that they would receive half the true value of the goodwill in the business if they terminated a year later because of a risk that their actions would impair goodwill. We found however that by virtue of the fact that the agreement was a compromise negotiated by a number of dealers it would be pure speculation to make any attempt to determine their intention.
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> 76. Leadleys were offered the chance to buy the business as a going concern at a certain price. The price paid exceeded the value of the tangible assets and therefore the natural conclusion is that the balance of the payment was for the goodwill absent some extrinsic evidence that it was for some other asset. We found nothing to displace the fact that the excess was for the goodwill.
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> 77. We found that HMRC were unable to show that the Transfer Agreement between Leadleys and the Appellant referred to an apportionment of the payment between the payment for the business and compensation for the loss of the dealership.
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> 78. We found that Leadleys were solely concerned with acquiring the business at the agreed price and that price was paid for the business and nothing else. Leadleys had no reason to pay compensation for the loss of the dealership.

79. We found that the whole of the goodwill was founded on the dealer agreement. A Mercedes dealer has goodwill with its customers because it has the Mercedes franchise.

80. Over time the Appellant had built up a volume of goodwill with its customers, all of whom had Mercedes cars. We found that the Appellant did have goodwill but could only exploit it through someone who held the Mercedes franchise."

8. The FTT stated its conclusion at [84] as follows:

"84. We found therefore that the whole amount, by which the price received by the Appellant from Leadleys for its business exceeded the value of the tangible assets, was in respect of the goodwill and that the whole of the consequential gain is therefore eligible for rollover relief."

The appeal to the Upper Tribunal

9. HMRC appeal on the grounds that the FTT erred in law and reached a conclusion which it was not entitled to reach on the facts which were largely agreed. HMRC ask this Tribunal to reverse the decision of the FTT. Mr Richard Bramwell QC, for Mertrux, submitted that the FTT was entitled to conclude on the facts that there was no element of compensation in the payment made by Leadley. He further contended, correctly, that this Tribunal cannot interfere with a finding of fact by the FTT unless the only reasonable conclusion was other than the one reached by the FTT.

10. The authorities on the nature of an appeal to the Upper Tribunal and the approach that the Tribunal should take to an appeal such as this were conveniently set out by Arnold J in *Smith v Revenue and Customs Comrs* [2011] UKUT 270 (TCC); [2011] STC 1724, at [46] – [50]. From those authorities, it is clear that we can only allow the appeal if we are satisfied that there was an error of law by the FTT. Error of law in this context is not only a failure to apply the relevant legislation or authorities in arriving at the relevant decision but also includes making a finding of fact which

was not supported by the evidence, as described by Lord Radcliffe in *Edwards v Bairstow* [1956] AC 14 at 36. As Lord Diplock observed in his speech in *Council for Civil Service Unions v Minister for the Civil Service* [1985] AC 374, at 410F - 411A, a better term for this ground for challenging a decision might be "irrationality". In approaching the question of whether the FTT was entitled to make a finding we should exercise an appropriate degree of caution and we should not interfere simply because we might have reached a different conclusion but only where we are satisfied that the FTT has reached a conclusion that is, to use Lord Diplock's word, irrational. Under section 12(2) of the Tribunals, Courts and Enforcement Act 2007, the Upper Tribunal, if it allows the appeal, must either remit the matter to the FTT for a fresh hearing or substitute its own decision for that of the FTT.

11. As stated above, the key point for determination by the FTT was what was the TRP consideration for? HMRC accepted that half of the TRP was obtained by Mertrux for a disposal of goodwill. The issue was whether the balance of the TRP was consideration for goodwill or something else. Mr Akash Nawbatt, who appeared with Mr Christopher Stone for HMRC, criticised the FTT's reasoning and conclusions on several grounds but the main thrust was that the FTT failed to recognise that Mertrux had a right to continue as a Mercedes car dealer for 24 months under the DoVT, and that was an asset separate from Mertrux's goodwill. Mr Nawbatt submitted that the FTT misinterpreted the relevant agreements and reached a conclusion that was inconsistent with the facts.

12. Mr Nawbatt relied on *O'Brien (Inspector of Taxes) v Benson's Hosiery (Holdings)* Ltd 53 TC 241; [1980] AC 562 as authority for the proposition that contractual rights can be assets for capital gains tax purposes. In that case, the company entered into an employment contract for a fixed duration of seven years with no termination provisions. After two years, the company agreed to release the individual from his obligations on payment of £50,000. There was no dispute that the payment was a capital sum. The issue was whether the sum was received in return for the surrender of the company's rights under the employment contract. Lord Russell said, at 269, that he found it difficult to see why the rights under the contract would not be an asset of the company. He maintained that view, at 270, even where the

company's ability to realise value from the asset was limited by its nature if, as in that case, the company was able to obtain a substantial sum for the release from the contract.

13. Mr Nawbatt submitted that there is a clear correlation between the facts of *O'Brien* and of this case. In both cases, there was a contract and an agreement to terminate it early. The other party had a right to a notice period or to enforce a period under the contract. That right was an asset which the owner was able to sell. In this case, Mertrux had the right to 24 months' notice of termination of the Dealer Agreement except when it was necessary to reorganise the network when DCUK could give 12 months' notice. DCUK wanted to terminate the Dealer Agreement on 12 months' notice but that was challenged by the dealers. The 12 months' notice was withdrawn and replaced by the provisions of the DoVT which reflected the 24 months' notice period in the Dealer Agreement and provided that the dealership would terminate on 30 June 2003. When Mertrux agreed to an earlier termination in return for an enhanced payment that was a separate deemed disposal for CGT purposes. The FTT said that there can only be a supply of goodwill because there were no other assets (see [76]). Mr Nawbatt submitted that could not be right because it would mean the right to carry on the dealership for a further 12 months until the end of the 24 month period was worth nothing.

14. Mr Bramwell, who appeared for Mertrux, submitted that everything turned on the meaning of goodwill. If goodwill included the Dealer Agreement then everything paid by Leadley was paid for goodwill. The only way to describe the payment for the termination of the Dealership agreement was as a payment for goodwill. Mr Bramwell said that the goodwill was not just the Dealer Agreement but that there was no goodwill without it. It would, he submitted, be artificial to exclude the Dealer Agreement from the goodwill of the dealer because the agreement was of such fundamental importance. Without the Dealer Agreement, the dealer could not carry on its business (though it might be able to change to sell other cars if it could obtain another dealership). The FTT did not conflate the goodwill of Mertrux with the goodwill of Mercedes but recognised that they were distinct while finding that Mertrux had the right under the Dealer Agreement to exploit the Mercedes brand.

15. Mr Bramwell relied on the description of goodwill in *Balloon Promotions Limited v Wilson (Inspector of Taxes)* [2006] STC (SCD) 167. At [163], the Special Commissioner stated that

> "Goodwill should be looked at as a whole and includes whatever adds value to a business by reason of situation, name and reputation, connection, introduction to old customers and absence from competition. The precise composition of goodwill will vary in different trades and in different businesses in the same trade."

That observation reflects what was said by Lord Lindley in *IRC v Muller & Co.'s Margarine Limited* [1901] AC 217 at 235.

16. The Special Commissioner in *Balloon Promotions* went on to hold that the excess consideration paid for a business over and above the true and fair value of the tangible assets was the value of the goodwill. Mr Bramwell said that, while the parallels between *Balloon Promotions* and Mertrux were not exact (the taxpayers in *Balloon Promotions* traded as Pizza Express under franchise agreements while Mertrux traded under its own name), the statements of principle were of equal application. As, however, Mr Nawbatt pointed out, Balloon Promotions differed from the present case in important respects. Pizza Express was already entitled to open other restaurants near the taxpayers' restaurants (see [277]); customers resorted to the taxpayers' restaurants principally because of the good service provided by the taxpayers (see [238]); and Pizza Express took over the taxpayers' businesses, including their premises, as going concerns (see [4] and [80]). In the circumstances, it is not surprising that the Special Commissioner concluded, on the facts, that the value of the franchise agreements was nominal (see [273]). While we find the description of goodwill in *Balloon Promotions* helpful, the case does not assist in answering the question that arises in this case, namely what was the consideration obtained or received for?

17. Mr Bramwell also relied on *Sabine (Inspector of Taxes) v Lookers Limited* 38 TC 120. This is a decision of the Court of Appeal from 1958 and, accordingly, pre-

dating the introduction of capital gains tax. Lookers was a distributor of Austin cars for many years. In 1953, Austin made changes to the distributorship agreement and paid a sum to Lookers as compensation for any loss caused by the changes. The issue was whether the sum was a revenue or capital receipt. At 133, Jenkins LJ, who gave the only judgment, accepted the submission on behalf of Lookers that the distributor agreements governed Lookers' whole trade and held that the compensation was a capital receipt. Mr Bramwell cited the case as authority that it is correct to regard the Dealer Agreement as a component of Mertrux's goodwill because the Court in Lookers accepted the submissions of the taxpayer and one was that the agreements constituted a connection with Austin on which the entire goodwill of the business was founded.

18. In our view, *Sabine v Lookers* is not authority for the proposition that the dealer's goodwill cannot be separated from the Dealer Agreement. The issue in *Sabine v Lookers* was not whether the payment by Austin was for goodwill but whether it was a capital or revenue receipt. We note that goodwill is not mentioned at all in the report of the appeal before the High Court. The case stated records that the only mention of goodwill before the Special Commissioners was Lookers' submission that the existence of the series of distributorship agreements, in their original form, was the basis on which Lookers had expended money on "buildings, stores and goodwill". Lookers was not submitting that the distributor agreement was goodwill or that a payment of compensation for a variation in the agreement was a payment for goodwill. Lookers submitted that its goodwill was founded on the existence of the agreements but not that it disposed of any part of its goodwill in return for the payment by Austin.

19. Turning to the FTT's decision, the FTT, having correctly found in [74] that the DoVT was a global compromise agreement, stated that there was nothing in the DoVT which specified any right to compensation for the dealers. HMRC submitted that that there was nothing in the DoVT referring to goodwill either but that does not seem to us to take matters very far. HMRC submitted that the name "Territory Release Payment" makes it clear that the parties had designated the payment as consideration for Mertrux releasing DCUK from its obligation to allow the dealer

exclusive rights to sell Mercedes cars in the territory. We consider that the name chosen for a payment is not necessarily a reliable indicator of its true character. Better indicators are the provisions of the contracts pursuant to which the payment was made and the context in which the obligation to make the payment arose.

20. The DoVT was entered into as part of the settlement of the proceedings brought by some dealers when DCUK tried to terminate their Dealer Agreements on 12 months' notice. The DoVT provided for the dealer to receive a TRP the level of which was to depend on the cessation date chosen: the sooner the termination of the dealership, the higher the TRP. The minimum TRP was calculated by reference to a 12 month period and was payable even if the dealer elected to continue the dealership for the full 24 months under the DoVT. In addition, however, the DoVT provided that, if the dealer agreed to the Dealer Agreement being terminated before the expiry of the 24 months' notice period, the incoming dealer or, if there were no incoming dealer, DCUK would pay an additional amount. Under the DoVT, the maximum TRP was for a 24 month period and was payable if the dealer, as Mertrux did, opted to terminate within 12 months. There was also an intermediate 18 month TRP. In our view, there was a clear link between when Mertrux agreed to terminate the dealership and the payment of the additional TRP. The natural inference is that the additional TRP represented consideration for Mertrux's agreement to terminate the dealership earlier than the 24 months provided in the DoVT: Mertrux was being paid to forgo the opportunity to continue to earn profits as a dealer, as it was entitled to under the Dealer Agreement, as varied by the DoVT. It is noteworthy in this context that, if Mertrux agreed to the Dealer Agreement being terminated a year earlier than the longstop date, its TRP was to be enhanced by an amount calculated by reference to a year’s profits.

21. The FTT seems to have had such an analysis in mind and rejected it in [75]-[78] on the basis that it would be "pure speculation" to try to determine the dealers' intention in entering into the DoVT and the payment was not made by DCUK under the DoVT but by Leadley under the Transfer Agreement. At [76], the FTT concluded (reflecting the language of *Balloon Promotions*) that the amount by which the price paid by Leadley exceeded the value of the tangible assets must be consideration for

goodwill. The FTT found in [78] that Leadley was solely concerned with acquiring the business of Mertrux and that it paid the price, including the TRP, for the business and nothing else.

22. We disagree with that analysis for the following reasons.

(1) Section 152 TCGA refers to consideration that a person obtains for a disposal and section 22 TCGA refers to sums received. Those provisions show that the standpoint of Mertrux must be important in determining what the TRP was consideration for.

(2) Mertrux's standpoint can be inferred from the contractual documents and surrounding circumstances. As already mentioned, it seems to us that the natural inference is that Mertrux received the additional TRP in return for agreeing to early termination of the Dealer Agreement, as varied by the DoVT.

(3) While the TRP was *paid* under the Transfer Agreement, its amount was calculated in accordance with the provisions of the DoVT, to which Leadley was not even a party. The amount of the TRP was, moreover, fixed when Mertrux notified DCUK of its chosen cessation date, which was before Leadley had even been identified as the incoming dealer.

(4) In any case, it is inherently unlikely that Leadley paid the whole of the TRP for goodwill of Mertrux. The reality is surely that it paid the TRP because DCUK required it to as a condition of becoming a dealer. From Leadley's point of view, the TRP will have been the price of obtaining a dealership *from DCUK*.

(5) Clause 3 of the Transfer Agreement shows that the amounts paid in satisfaction of the TRP were separate from the purchase consideration for the sale of the business and the assets. Only the values attributed to the assets were consideration for the business and assets. It follows that the TRP must have been consideration for something else.

Our view is that the FTT was wrong to conclude that Leadley paid the purchase consideration under the Transfer Agreement for the business and nothing else. In any event, that does not determine what the TRP was obtained or received for by Mertrux.

23. The FTT's finding that the amount paid by Leadley in excess of the value of the tangible assets must have been for goodwill suggests that the FTT had failed to appreciate that Mertrux had rights under the Dealer Agreement and DoVT which could give rise to a disposal even if no asset was acquired by Leadley in return for its payment (or by DCUK). Further, the FTT's finding in [80] that Mertrux had goodwill but could only exploit it through someone (Leadley) who held a Mercedes dealership and, in [81], that Leadley acquired the goodwill from Mertrux along with the Mercedes dealership shows that the FTT had failed to distinguish between the goodwill of Mertrux in relation to its own business (name, location of premises, knowledge, customer relations and reputation, etc) and the goodwill of DCUK in relation to the Mercedes brand.

24. In disregarding the provisions of the DoVT and finding that the *whole* payment was consideration for goodwill, the FTT erred in law. In our view, the only possible finding is that the additional TRP obtained by Mertrux under the DoVT and Transfer Agreement was consideration for Mertrux agreeing to the early termination of the Dealer Agreement. That was a disposal of an asset and the asset was a contractual right and not goodwill.

Decision

25. For the reasons set out above, we allow this appeal. We conclude that the decision of the FTT should be set aside. Our decision is that Mertrux was liable to corporation tax on a capital gain of £852,751 for the year ended 31 December 2003.

Mr Justice Newey
Judge of the Upper Tribunal

Greg Sinfield
Judge of the Upper Tribunal

Release date: 30 July 2012