[2015] UKUT 0666 (TCC)

Appeal number FTC/20/2014

INCOME TAX and NICs – whether monies paid by first respondent to second respondent (and others) in respect of the benefit of client connections was income "from" employment and thus liable to income tax and NICs – yes – appeal allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and –

(1) SMITH & WILLIAMSON CORPORATE SERVICES LIMITED
(2) PATRICK SMILEY

Respondents

Tribunal: The Hon Mr Justice Warren

Sitting in public at The Royal Courts of Justice, Rolls Building, Fetter Lane, London EC4 on 13 and 14 July 2015

Elizabeth Wilson instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Jolyon Maugham QC instructed by the first Respondent, for the first Respondent

James Rivett instructed by Atcha Associates Ltd, for the second Respondent

DECISION

Introduction

1. This is an appeal from a decision of the Tax Chamber (Judge Demack) ("**the Judge**") released on 22 November 2014 ("**the Decision**"). (I will refer to paragraphs of the Decision in the format "Decision [xxx]" or simply "[xxx]".) The Judge allowed appeals by the first Respondent ("**SWCS**") against determinations by the Appellants ("**HMRC**") made under regulation 80 of the PAYE Regulations and notices issued by HMRC under section 8 of the Social Security Contributions (Transfer of Functions, etc) Act 1999 concerning NICs. He also allowed appeals by the second Respondent ("**Mr Smiley**") against two closure notices, one of which eliminated Mr Smiley's liability to capital gains tax under his self-assessment tax return and the other of which determined that Mr Smiley was in receipt of additional remuneration (although for reasons explained in Decision [7(ii)], the closure notice did not require any further tax to be paid by him). SWCS is a company within the NCL Smith & Williamson group ("**the Group**"). Another company within the Group is Smith & Williamson Investment Management Services Ltd ("**SWIM**").

2. In outline, the Group was pursuing a strategy to increase the funds under management of SWIM, its investment management arm. Mr Smiley was employed by SWCS (as were the members of a team who had worked with him at Butterfield Private Bank ("**Butterfield**")) under a contract of employment following acceptance of an offer of employment on 21 August 2005 (for further detail, see paragraph *51ff* below**)**; and, according to the Judge, by a separate contract with SWIM, Mr Smiley and other members of his team agreed to deliver to SWIM his client relationships for what has been described as a "Goodwill Payment" ("**the Payment**"). The central issue is whether Mr Smiley's share of

the Payment was an emolument from his employment. The Judge held that it was not. His determinations on the appeals before him flowed from his decision on that central issue. I should flag at this point, in order to avoid confusion, that there was not, in 2006, a single contract with the entire Team or with Mr Smiley as agent for the whole Team. Rather, there was a letter dated 16 November 2006 addressed to Mr Smiley under which he was to receive a share of the Payment. I believe, although I have not seen them, that similar letters were written to other members of the Team. I shall use the term "**the 2006 Contract**" to refer to the contract with Mr Smiley, although the Judge uses that term in the Decision to refer to a contract with all of the members of the Team mentioned above.

3. A subsidiary issue in Mr Smiley's appeal is, or at least may be, whether the Judge erred in law in accepting the submission made on behalf of Mr Smiley that the Payment was capital consideration for the disposal of an asset for the purposes of the Taxation of Chargeable Gains Act 1992 ("**TCGA92**").

4. A further issue in Mr Smiley's appeal has been raised by HMRC. HMRC argues that, if the source of the Payment was not the Employment Contract, then the Payment was made pursuant to non-trade and non-employment services provided under the 2006 Contract. Whether it is open to HMRC to advance this argument, it not having been raised before the Judge and no permission to appeal on this ground having been granted, is a matter to which I will come in due course.

5. The parties have made detailed submissions about the Decision and what, as matters of fact, it does and does not decide. I consider that I am unable to do any justice to those submissions (or the Decision itself) unless I, too, address the Decision in some detail. Although there is a measure of overlap between different paragraphs of the Decision, I have not found it easy to address the overlapping

paragraphs at the same time. I have therefore decided to review the Decision by addressing the relevant paragraphs and findings *seriatim*. It has led, I am afraid, to a much longer decision on my part than I would have liked. As will be seen, my actual conclusions and reasoning can be expressed quite shortly but were I to restrict myself to that, the parties might justifiably feel that I had failed to address their points.

The facts

6. The Judge made a number of findings of fact, the detail of which I will need to examine in due course. A summary of his findings appears in the Decision itself at [159]. I think that it is worth setting out, at this early stage of my decision, the whole of that paragraph with the addition of my own numbering (i) to (vii) for ease of reference to each sentence and proposition.

> "[159] (i) To sum up, Mr Smiley's contract of employment and the 2006 Contract were two separate and independent contracts, the former being made some time before the latter. (ii) The negotiations for his contract of employment and those for the Payment were conducted independently. (iii) The sums payable under the contract of employment and the 2006 Contract were market rate sums calculated by the parties thereto at arm's length and on arm's length terms, and it follows, I infer, that the sums payable under the former represent full payment to Mr Smiley for the services that he had agreed to and would in the future provide to SWIM. (iv) The Payment was calculated by reference to the client connections and nothing else; and the qualifying funds were only those transferred with the Team. (v) Further, the 2006 Contract was made with SWIM, and not the employer SWCS; the levels of the payments due under the contracts of employment were similar to those of existing employees of the Group; and the Team's rewards for introducing new business to SWIM were to be found in their entirety in the contracts of employment in the form of pensions, share options and bonuses. (vi) Taking those matters in combination I regard them as firmly establishing that the effect of the 2006 Contract was that Mr Smiley and the Team made over to SWIM a capital asset and the Payment represented full payment therefore. (vii) That, in my judgment, was the intention of the parties to the two contracts, and I see no reason to conclude otherwise."

7. And so the Judge concluded in Decision [160] that the Payment was not from the Team's employment and held the Payment to have been a capital receipt in the

hands of the Team in general, and Mr Smiley in particular, and not a payment from his employment liable to income tax.

The Law

8. With that brief summary of the facts, I propose to consider the relevant legal principles before examining the application of those principles to the facts as found by the Judge.

9. The statutory provisions relevant to the potential tax charges on Mr Smiley and SWCS are set out in Decision [53] to [65]. The present appeal so far as concerns income tax turns, essentially, on section 9(1), (2) Income Tax (Earnings and Pensions) Act 2003 ("**ITEPA**"):

> "(1) The amount of employment income which is charged to tax under this Part for a particular tax year is as follows:
> (2) In the case of general earnings, the amount charged is the net taxable earnings from an employment in that year."

10. The issue on this appeal is whether the Payment constitutes "earnings from an employment". If the Payment is subject to income tax under that provision, it is not contended that it is not also subject to NICs.

11. The starting point on the issue of law is the decision of the House of Lords in *Shilton v Wilmshurst* [1991] STC 88 ("***Shilton***"). The facts are well-known to those familiar with this area of the law and hardly need rehearsing save to repeat that the case concerned the taxability of a payment to Mr Shilton (the well-known footballer) of £75,000 by his employer, Nottingham Forest Football Club, to agree to his transfer to Southampton Football Club. That case establishes that under the provisions then in force (relevantly section 181 Income and Corporation Taxes Act 1970 which provided for tax to be charged "in respect of any office or employment on emoluments therefrom"), the charge was not confined to emoluments from **the employer** but embraced all emoluments from **the**

employment and could therefore include emoluments provided by a third party. Emoluments from employment meant emoluments from being or becoming an employee. At p 91e-f, Lord Templeman drew the distinction which needs to be drawn

> "between an emolument which is derived 'from being or becoming an employee' on the one hand, and an emolument which is attributable to something else, on the other hand…. If an emolument is not paid as a reward for past services or as an inducement to enter into employment and provide future services but is paid for some other reason, then the emolument is not received 'from the employment'. The task of determining whether an emolument was paid for being or becoming an employee or was paid for another reason, is frequently difficult and gives rise to fine distinctions…….. If the provider of the emolument is the employer who has an interest in the performance of the contract, the court may find difficulty in accepting that the emolument was not 'from the employment' but from something else. The difficulty is not so great where a person who is not the employer provides an emolument because such a person may well be activated by motives other than desire to see that the employee enters into or continues in the employment of another."

12. The same approach obviously applies to section 9(2) ITEPA.

13. Lord Templeman reviewed a number of the authorities. One of them was *Hochstrasser v Mayes* [1960] AC 376 ("***Hochstrasser***"). In that case, a company scheme for the benefit of certain grades of employee provided for an interest-free loan to the employee for the purchase of a new home on his transfer from one location to another. The scheme also provided compensation for any capital loss suffered as a result of the move. The taxpayer was transferred to another location and in accordance with the scheme received £350 compensation for a loss suffered on the sale of his house. It was held that, although the employment was a *causa sine qua non* it was not the *causa causans* of the payment and that the payment did not, therefore, arise from the employment.

14. In the course of his speech, Viscount Simonds approved what Upjohn J had said at first instance:

> "Indeed, in my judgment, the authorities show that to be a profit arising from the employment the payment must be made in reference to the services the employee renders by virtue of his office, and it must be something of a reward for services, past, present or future."

15. That passage was also cited approvingly by Lord Reid in *Laidler v Perry* [1966] A.C. 16 at p 30 ("***Laidler***") after having provided these cautionary words:

> "There is a wealth of authority on this matter, and various glosses on or paraphrases of the words in the Act appear in judicial opinions, including speeches in this House. No doubt they were helpful in the circumstances of the case in which they were used, but in the end we must always return to the words in the Statute and answer the question – did this profit arise from employment? The answer will be no if it arose from something else."

16. Lord Templeman, in his speech in *Shilton*, cites at some length from Lord Radcliffe's speech in *Hochstrasser*. It is worth repeating two short passages. The first (see p 391) is where Lord Radcliffe, in referring to the various ways in which the test had been put by different judges, said this:

> "But it is perhaps worth observing that they [the various glosses] do not displace those words [the statutory words]. For my part, I think that their meaning is adequately conveyed by saying that, while it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee, it is assessable if it has been paid to him in return for acting as or being an employee."

17. The second passage (see p 392) is this:

> "The essential point is that what was paid to him was paid in respect of his personal situation as a house owner, who had taken advantage of the housing scheme and had obtained a claim to an indemnity accordingly. In my opinion, such a payment is no more taxable as a profit from his employment than would be a payment out of a provident or distress fund set up by an employer for the benefit of employees whose personal circumstances might justify assistance."

18. Reliance has also been placed by one or other of the parties on authorities before and after *Shilton*. I mention some of them in the following paragraphs.

19. In *Mudd v Collins* 9 TC 297, the taxpayer, an accountant, was the secretary and director of a company and received a salary as such. He negotiated the sale of a

branch of the company's business and was granted by the company the sum of £1,000 "as commission for his services in negotiating the sale". His appeal against an assessment under Schedule E was dismissed. He had argued that the negotiation of the sale was not part of his duties as secretary and director and that the payment was a voluntary gift which did not constitute a profit for income tax purposes. It was held that the £1,000 was part of the profit of this office and thus assessable to income tax under Schedule E. Rowlatt J said this at p 300 :

> "…the whole point made by [counsel for the taxpayer] …. was that, as this [the payment] could not be said to be in respect of a duty involved in his secretaryship and directorship, offices which received their own salary for the performance of those duties, therefore it could not be a profit of his office. Now I do not think that is so. It seems to me that if an officer is willing to do something outside the duties of his office, to do more than he is called upon to do by the letter of his bond, and his employer gives him something in that respect, that it is a profit; it becomes a profit of his office, which is enlarged a little so as to receive it."

20. Later, at p 301, he said this:

> "But where a man does a business operation of this kind which he could not be called upon to do, but it is a business operation and would have to be paid for handsomely if done by somebody else, and it is said "One of our directors did it for us and he ought to have something besides his fees as director because of this" that seems to me to be paying him for his services…"

21. The next case is *Hose v Warwick* 27 TC 459. It is heavily relied on by SWCS and Mr Smiley and I must deal with it in a little detail. It is not altogether easy to extract the relevant principles from the judgment because the findings of fact are not entirely clear.

22. Mr Hose was an insurance broker. Up to the end of 1919, he was with a City firm (it is not clear whether he was employed or not). He had worked up a considerable personal connection. Mr Hose was, to use my word, head-hunted and went to work for a company called Lambert Brothers (Insurance) Ltd ("**Lambert**"). He entered into Lambert's service in November 1919 bringing with

him what the directors described as his business connection, that is to say, as the Judge put it, bringing his personal connection with him. He was to receive (under oral agreements with no fixed duration) a fixed salary of £750 pa and a half share of the commissions earned by the connections which he brought with him. He was also a director of the company but devoted all his time to his connections. The connection remained personal to him and he could have taken it with him if he had left the company's service. It seems that he was entitled to receive the same commission in respect of any new business which he generated since the Judge describes him as having done very well and that his connection grew, resulting in his share of commission amounting, by 1937, to about £10,000. His clients were, and remained, his personal clients. As the Judge observed, "It is quite clear that if he left the company his connection would go with him". Mr Hose took two of the staff at the City firm with him to Lambert, Mr Pratt and Mr Hose's brother.

23. In 1939, following prolonged negotiations, Mr Hose took over the post of managing director. This change was significant. As the Judge noted:

> "It meant giving up his post as what I have called departmental manager. It meant giving up everything that he had got out of that role. It meant that he would not retain his connection, as he would have to manage the whole concern. Of this connection, the Commissioners say, "he was possessed of his business connection which had a sale value, and which he could have taken away" if he had left the service of the company. Gradually but surely his personal clients would become clients of the company. The change meant that the goodwill of his personal connection, worth in 1937 £20,000 a year in commission…..went to the company…….
>
> When the terms were arrived at the company sent a circular to its shareholders stating that the company had acquired the business of Mr S.J. Hose, and that he was acting as sole managing director of the company as from 1st April 1939."

24. It is then worth noting what the agreement between Mr Hose and Lambert provided, as the Judge sets out at p 470. Importantly, in consideration of the

£30,000 payment, Mr Hose confirmed that "he has relinquished and abandoned all and every claim to receive any salary commission or other remuneration" under his subsisting agreements and declared that the sum "is accepted by him in full satisfaction of all his rights under [those agreements] which as from the said date are terminated". The Judge regarded the natural meaning of that to be that the £30,000 was to be paid for giving up something – "the giving up, the wiping out, of something then and there". Importantly also Mr Hose was to "use his utmost endeavours to secure that the Company shall retain all business and business connections introduced by Mr Hose, Mr L H Pratt or Mr R A Hose to the Company".

25. In the paragraph at the foot of page 471, the Judge examined the agreements under which Mr Hose had served Lambert, because it was only by an examination of those agreements that one could ascertain what Mr Hose was giving up. The agreements were not in writing and one could only get at them from the facts found:

> "But, at least, the agreements gave him a position in which, by their terms, he was entitled to work and develop a personal business connection, growing more and more valuable, as it turned out, as time went on…..Under the agreement clearly his business connection was to remain with him. There was no term to restrain him carrying on his business if he left the company. Under this document he gave up all that. He gave up the position, the source of his past profits. He gave up working on and developing his personal connection and he gave up that connection to the company."

26. Then, at the top of p 472, the Judge said this:

> "There are two ways in which you can part with a connection. You can assign it, or you can covenant not to solicit and deal with the customers. That is the method which, in fact, was adopted. I have referred to clause 5, which says that he is to use his best endeavours to secure that the company shall retain all the business connections introduced by Mr Hose. I have referred to the last two covenants restraining him completely from competing in any way if his agreement is terminated.

> To my mind it is perfectly clear that the £30,000 had nothing whatever to do with his remuneration as managing director….. When one knows the background, and knows what the giving up of his own position meant, or, as the board put it in their circular, the change by which the company would acquire the business of Mr Hose, to my mind it is plain that the £30,000 was in no sense a remuneration or reward for the services to be rendered as managing director, but was a sum paid to him for abandoning to the company his personal connection, and securing their hold on it by the covenants in clauses 19 and 20."

27. The next case I wish to refer to is *Kuehne + Nagel Drinks Logistics Ltd v HMRC* [2012] EWCA Civ 34 ("***Kuehne***"). This was an appeal from the decision of Newey J (sitting in the Upper Tribunal) dismissing an appeal from Judge Hellier sitting in the First-tier Tribunal. The judgments of Mummery and Patten LLJJ repay reading. I do not propose to go through them in detail but I note the following passages first from Mummery LJ and then from Patten LJ.

28. Mummery LJ:

    a. [33]:

    > "All I need to say at this point is that the use of "from" in the idea expressed in the statutory expression "earnings from an employment" and "earnings derived from an employment" in a fiscal concept indicates, as a matter of plain English usage, that there must, in actual fact, be a relevant connection or a link between the payments to the employees and their employment."

    b. At [42], he approves, again, the words of Upjohn J in *Hochstrasser* at first instance (see paragraph 13 above) saying that it is "unwise to read too much into differences of judicial language on matters of statutory construction".

    c. At [44], he refers to certain relevant findings made by Judge Hellier namely that the payments were made to avoid industrial action, that the threat of strike action was 'a substantial cause of the payment', that the payments were in reference to the services of the employees rendered and in the nature of a reward, inducement or incentive to work willingly in the

future. Those facts were "sufficient to establish the necessary relevant connection or link between the payments and the recipients' employment and to justify the finding of Judge Hellier that the payments were emoluments from the employment".

29. Patten LJ:

a. At [50], he repeats that the task of the court is to apply the statutory test to the facts found and not to apply some other test based on a gloss. And then, in [50] to [53] he says this:

> "[50] ……But some gloss is inevitable because it is accepted that it is not enough merely to show that a payment was received as an employee and would not have been received if the individual had not been an employee. Something more must be established. This has been expressed in terms of the difference between *causa sine qua non* and *causa causans* but it does, on any view, require a sufficient causal link to be established between the payment and the employment.
>
> [51] The ways in which that necessary link has been described and analysed in the earlier cases does, I think, have to be respected even though the ultimate question is whether the "from" question can be answered in the affirmative. Neill LJ in *Hamblett v Godfrey* [1986] 59 TC 694 at p 726 G-H describes those explanations as valuable and authoritative. And what the cases, I think, show is that the question of taxability involves one being able to characterise the payment as one "from employment" if it derives "from being or becoming an employee" and is not attributable to something else such as a mark of esteem or a desire to relieve distress. I take this formulation from Lord Templeman in [*Shilton*] at pa 105 G-I because this is how the words "from employment" were construed and that decision is, I believe, binding on us in that respect. The same test was adopted by Lord Reid in [*Laidler*] at p 363 and by Lord Kilbrandon in *Brumby v Milner* [1975] 51 TC 483 at p 614.
>
> [52] It must follow from this that, in order to satisfy the s.9 test, one must be able to say that the payment is from employment rather than from a non-employment source. This has certainly been the approach of the courts in most of the decided cases, examples of which are
> …….
>
> (iii) Lord Diplock in *Tyrer v Smart* [1979] STC 34 at p 36 c-d: "determination of what constitutes his dominant purpose"; and

> (iv) Carnwath J in *Wilcock v Eve* [1994] 67 TC 233 at 232A [*sic*]: where there is more than one operative cause 'there is an element of value judgment in deciding on which side of the statutory line the payment falls'.
>
> [53] This process of evaluation requires the fact-finding judge to make findings of primary fact based on the evidence as to the reasons and background to the payment and then to apply a judgment as to whether the payment was from the employment rather than from something else. To this extent, I agree with the appellants so far as they submit that having determined the causes of the payment that process of characterisation must then follow. The interpretation of the words "from employment" by the House of Lords in the cases referred to makes that an inevitable step in answering the statutory question. Although this is the only question (see Russell LJ in *Brumby v Milner* at p 608), it still has to be answered."

b. HMRC had argued that a contributing cause which is more than marginal but which is an employment-based cause can bring the payment into charge even if there are other substantial non-employment causes. At [56], he stated that he did not accept that as a correct statement of the law, although it did not arise on a proper reading of Judge Hellier's decision.

30. The next case is *Manduca v HMRC* [2013] UKFTT 234 (TC) and on appeal to the [2015] UKUT 0262 (UTTC) (the Chamber President, Rose J). The real dispute in that case was whether a payment of £310,000 to the appellant, Mr Manduca, was capital (subject to capital gains tax) or income. Originally, HMRC's position had been that the payment was received by Mr Manduca under the terms of his employment contract and so was taxable under Schedule E. The closure notice, following an enquiry, reflected their final view that the payment was assessable to income tax under Schedule D Case VI. That is the basis on which the appeal to the Upper Tribunal progressed: Mr Manduca was not permitted to raise a new point on appeal which he had not raised before the First-tier Tribunal that, if assessable at all, the payment fell within Case II rather than Case VI.

31. Although the facts were not in dispute, it is not easy to state them succinctly. I therefore adopt, without repetition, [3] to [12] of the decision of the First-tier Tribunal and the summary in [3] to [16] of the decision of Rose J.

32. As recorded in [20] of Rose J's decision, Mr Manduca applied to the First-tier Tribunal for permission to appeal on the grounds that the Tribunal had misdirected themselves in law as to the nature of the capital asset because the Bonus was payment for goodwill which counts as a business asset for capital gains tax purposes. Permission was refused on the basis that there was no error of law identified. Permission was also refused, in the Upper Tribunal, by Judge Berner on the papers.

33. There are similarities between that case and the present case in that both Mr Manduca and Mr Smiley had developed customer relationships and in both cases, the claim was that there was an intangible asset owned (by Mr Manduca/Mr Smiley) which was sold (to Dexia/S&W). The First-tier Tribunal addressed that argument in Mr Manduca's appeal at [48] to [56] of their decision. They carried out an analysis of *Hose v Warwick*. They concluded that the essence of that decision was that Mr Hose had given up something valuable to Lambert and that the £30,000 payment to him was compensation or payment for what had been lost or given up; something had been "wiped out" and "abandoned" to Lambert.

34. They also referred to *Jarrould v Bowstead* [1964] 3 All ER 76, where a signing-on fee paid to a professional rugby player was held to be consideration for relinquishing his amateur status for life and was for that reason held to be a capital payment.

35. The First-tier Tribunal in Mr Manduca's appeal accepted (see [54] of their decision) that the success of the OEF fund management business depended on the

continuing involvement of Mr Manduca and Mr Jerez; and accepted that, if Mr Manduca and Mr Jerez had left Tilney without Tilney agreeing to transfer the business, the OEF and its investors would not have stayed with Tilney but would either have followed them to a new fund-management company or would have taken their investments elsewhere. The Tribunal nonetheless rejected the comparison with *Hose v Warwick*. Mr Hose had brought his personal connection with him when he first joined Lambert; the £30,000 was paid to him only later when he subsequently became managing director. Pertinently, they said this at [55]:

> "There is no suggestion that the tax treatment of the £30,000 would have been the same if it had been paid to Mr Hose when he first joined the company, on the basis that it was the purchase price of the clientele that he would be bringing with him the company's business. On the contrary, the court found that for the whole time that Mr Hose worked for the company until he became managing director, "His clients were, and remained, his personal clients", and "if he left the company his connection would go with him". It was rather at the subsequent point when his clients ceased to be his own personal clients and became instead clients of the company that it was said that the payment was compensation for the abandonment or wiping out of his personal connection."

36. Of course, the decision of the First-tier Tribunal is not binding on me and does not, in any case, directly provide an answer on the facts of the present case. It is, nonetheless, interesting to see the approach which they adopted and to see what they saw as the basis of the decision in *Hose v Warwick*.

37. On the question of goodwill and customer connection, it is worth citing a short passage from *Asprey & Garrard Ltd v WRA (Guns) Ltd* [2001] EWCA Civ 1499. This was an action for passing off. Mr William Asprey had previously been employed by the claimant, the shares in which had been sold by the Asprey family in 1995. At [36] of his judgment, Peter Gibson LJ said this:

> "The goodwill generated by the six generations of Aspreys previous to William Asprey, trading for two centuries and more, unquestionably belongs

> to the Claimants…… Any goodwill resulting from William Asprey's work for the Claimant as its employee also belongs to the Claimant and he cannot properly seek to associate any business in which he is now interested with the Claimant's goodwill. Of course, the fact that he established personal contacts whilst so employed cannot be taken from him and in the absence of a restrictive covenant restraining him from making use of such contacts, he is free to do so…."

38. One sees clearly articulated in that short passage the distinction between goodwill and the personal contacts, which is simply another way of describing customer connection.

39. An authority which throws some light on the nature of goodwill as an asset is *Kirby v Thorn EMI plc* 60 TC (the judgments in the Court of Appeal starting at p 535). This case raised an issue concerning capital gains tax. The question raised was stated shortly by Nicholls LJ at p 535 G-H:

> "As part of a transaction whereby three trading companies in a group were sold for a cash consideration, the ultimate holding company in the group, for a further cash consideration of US$575,000, entered into a covenant with the purchaser that companies in the group would not, for a defined period, engage in the business carried on by the three trading companies being sold. Is capital gains tax payable in respect of that further cash consideration in return for the covenant?"

40. The argument on behalf of the Crown which found favour with the Court of Appeal was that there was a pre-existing asset owned by the holding company (referred to as Thorn), namely the goodwill of Thorn. And this was so even though the trading activities were carried out by the three trading companies and not by Thorn itself. It was accepted, and there could be no doubt in the light of sections 33(6) and 34(6) Finance Act 1965 which proceeded on this footing, that goodwill is an asset for the purposes of capital gains tax. Thorn argued that, although goodwill is an asset, the relevant goodwill was not owned by it but was owned by the three trading companies so that Thorn itself did not make a disposal. It also argued that, although by giving the covenant which it did Thorn curtailed

its liberty to trade, it did not thereby dispose of an asset (or derive a capital sum from an asset) because the liberty to trade is not "property". At p 540 C-E, Nicholls LJ said this:

> "….I agree that the liberty or freedom to trade, enjoyed by everyone, is not a form of "property" within the meaning of s 22 [Finance Act 1965]. This liberty, or freedom, is a "right" if that word is given a very wide meaning, as when we speak of a person's "rights" in a free society. But in s 22 the words used are "assets" and "property". "Property" is not a term of art, but it takes its meaning from its context…… The context in the instance case is a taxing Act which is concerned with assets, and with disposals and acquisitions, gains and losses. I can see no reason to doubt that in s 22 "property" bears the meaning of that which is capable of being owned, in the normal, legal sense, and that it does not bear the extended meaning that would be needed if it were to include a person's freedom to trade.
>
> I accept, therefore, that, if Thorn had no goodwill in respect of the trades in question, and its non-competition covenant impinged only on its freedom to trade, the giving of the covenant would not constitute the disposal of an asset."

41. Nicholls LJ went on to consider, from p 540H to 542 F, the nature of non-competition covenant given by a vendor on the occasion of the sale of a business and the "somewhat elusive concept" of goodwill of a business. I do not think that there is anything at all controversial in what he said. I quote only one short passage, at p 541 F-G:

> "The covenant is the means by which, amongst other matters, the vendor, for the benefit of the purchaser, precludes himself from exploiting the reputation he has regarding the trade in question. That reputation, as already mentioned, is a form of goodwill. It is not something possessed by everyone. It has a value, even though of its nature it is not assignable. It can be protected by an action for passing off. It is discernibly distinct from a mere liberty to trade."

42. I will return to this decision later. At this point I remark only that Nicholls LJ said what he did in the context of the sale of a business and in the context of reputation as an element of the goodwill attached to that business. He said nothing expressly about the customer connection of an employee of a person owning a business; it is not immediately apparent, to me at least, that it is appropriate to apply his analysis

of reputation, which he carried out in the context of the sale of a business, to customer connections established by an employee.

The Facts in more detail

43. I take the following facts from the Decision together with the document referred to, making observations as I go along. I should point out that the Judge structured the Decision by reference to a number of questions which Mr Maugham, who appeared for SWCS before the Judge as he does before me, had posed. Interesting as it is to have an answer to some of those questions, or perhaps all of them, it is important not to lose sight of the ultimate, and only statutory, question which is whether the payment received by Mr Smiley was from his employment. I fear that the Judge, in answering Mr Maugham's questions, has done just that and, notwithstanding some of things which he actually said, has lost sight of the only statutory question, namely whether the Payment arose from the employment.

44. Since 1996, Mr Smiley had been head of a team of individuals (the "**Team**") which worked, initially, for Panmure Gordon and then Leopold Joseph & Sons Ltd (which latter was taken over by Butterfield). Between 1996 and 2004 the Team built from scratch a customer portfolio with funds under management exceeding £400m. (Decision [12])

45. The Group is an independent financial services group. SWIM and SWCS are members of the Group. SWIM provides investment management services and private banking facilities. Most of the Group's employees are employed by SWCS. Employees' services are supplied, and costs recharged, by SWCS to other Group companies, including SWIM. (Decision [13])

46. In 2005 the Group decided to pursue a strategy of increasing funds under management by SWIM. It sought to execute that strategy through the acquisition

of discrete fund management units such as the Team. The Group intended the Team's customers to become customers of SWIM, and to bring with them the funds under their management. (Decision [14])

47. The reference in Decision [14] is to fund management units. In Decision [28] the Judge puts it this way (which perhaps captures the idea more precisely):

> "The Group, and relevantly SWIM, sought to increase private clients' funds under management mainly through a series of acquisitions of business units."

48. The Judge goes on, in Decision [29], to record Mr Pearce's point that SWIM's purpose was to increase funds under management rather than to recruit additional fund managers. There was already adequate front office capacity. Why, one might ask, did the Group then go on to employ the Team? The answer to that, it seems to me, is that that was perceived as an appropriate way to ensure that the members of the Team would (i) bring the Butterfield business to the Group and (ii) be bound by appropriate restrictive covenants.

49. I note that investors were not customers of the Team; they were customers of the Team's employer. Although there is a finding (see Decision [14]) that the Group considered that the funds it wished to acquire belonged to particular teams of individuals at its competitors, that was not, of course, the legal position. The Team did not own the assets of the customers: they were simply fund managers. The Judge cannot have been using the word "belong" in the sense of legal ownership. The word must be being used to convey the idea that the relationship of the relevant clients with the employer (Butterfield) was conducted by a member of the Team.

50. Mr Smiley was approached in 2005 as head of the Team at Butterfield with a view to recruitment of the Team. (Decision [15])

51. The Decision records that terms of employment were agreed with members of the Team on about 18 August 2005. On 21 August, Mr Smiley accepted the offer made to him and on 17 March 2006 he signed a contract of employment ("**the Employment Contract**") stated to have effect from 23 February 2006. (Decision [16]) That is what is recorded in the Decision. I should give a little more detail.

52. On 18 August 2005, Mr Lyttelton (of SWIM) wrote to Mr Smiley enclosing an offer of employment in standard form, found in an offer letter of the same date. But that offer did not stand in isolation. The Covering Letter ("**the Covering Letter**") includes (see also Decision [18] which does not quote the sentence accurately) this:

> "We have agreed that we will make a payment to you in consideration of the of the business of any clients you are able to bring to Smith & Williamson after two years' employment."
> [Clearly something has gone wrong here: either "the of" is superfluous or some words have been missed out between "the" and "of".]

At that stage, it was envisaged – as appears from the final paragraph of the Covering Letter – that the payment would relate to the funds under management by the Team at the end of the two year period. Letters to other Team members were shorter; the one to Mr Fisher (and I imagine others were in similar form) appears in the bundle and stated "It is intended that you will receive an additional payment after two years' employment and further details of the criteria for this will be notified to you if you accept our offer of employment".

53. Although the Judge does not say so expressly, this letter reflected the advanced stage which the relationship between the Group and the Team had reached. As the Decision makes clear, the Group's strategy was to acquire business units: the letter to Mr Smiley (and those to other members of the Team) reflected the intention that the Group would acquire as its own clients as many as possible of

the clients of Butterfield serviced by the Team. That intention would be implemented in practice by (i) the Team becoming employees within the Group (in the event as employees of SWCS) and (ii) by the Team bringing with them those clients of Butterfield who chose to move their business from Butterfield to the Group. Those two elements went together: as Mr Pearce made clear (see paragraph 80 below), the Group's desire was to increase funds under management and it had no need for further staff to service the funds. It is not possible to conclude other than that the Team were employed because of the business it was hoped and expected they would bring with them; nor is it possible to conclude that the Team would have been employed if they had been left free to introduce the clients of Butterfield whom they had serviced to a third party, receiving payment from such third party for the making of such introductions to it. Had the Judge reached either of those conclusions, he would clearly have been wrong to do so. Further, although it might, in theory, have been possible for the Team to agree, without becoming employed, to use their best endeavours to persuade their Butterfield clients to move to SWIM and to receive a payment from SWIM or another member of the Group according to their success in doing so, that is not the way in which the agreement was structured. In fact, the Team <u>were</u> employed; and that course was certainly a sensible, and perhaps even the only practical way of achieving the transfer of clients which both the Group and the Team wanted to see happen.

54. The Covering Letter also expressly states that the offer is being made on the basis that Mr Smiley confirms that he is not and has not been and will not be in breach of any of his obligations to his current employer by accepting the offer and

performing his duties under his new contract. Further, the paragraph of the Covering Letter quoted at paragraph 52 above also contains the following:

> "However, you should bear in mind at all times your obligation as above and should not act contrary to those obligations for the relevant period."

55. There was, in fact, later correspondence with Butterfield from which it is perfectly clear that the position of the Team and the Group was that the Team had not taken with them any confidential information (such as customer lists) but that the members of the Team were using their memories and public available data to identify the book of business which they hoped would pass to SWIM.

56. Both the Covering Letter and the offer letter were written on the notepaper headed "Smith & Williamson Investment Management". The footer on the same page explains that that name is a trading name of NCL Investments Ltd and also a trading name of SWIM. No mention is made in either letter of SWCS.

57. On 21 August 2005, Mr Smiley signed the offer letter, indicating a preferred start date of 23 February 2006. The offer letter provided, among many other matters, for a notice period on the part of Mr Smiley of 6 months. It stated that, once Mr Smiley had confirmed acceptance and start date, he would be sent "a copy of your Contract of Employment, which sets out your terms and conditions in full". This was to be returned, signed, on "your first day with us".

58. The formal contract of employment (*ie* the Employment Contract) appears to have been issued on 27 February 2006. The employer under the Employment Contract was SWCS not SWIM. The Employment Contract and was issued already signed on behalf of SWCS. Mr Smiley signed it on 17 March 2006.

59. The terms of the employment as set out in the offer letter, included employment as a "Director" of SWCS and payment (as found by the Judge) of a market rate salary (*ie* in line with existing employees of a similar level and seniority) and

payment of a commercially competitive discretionary bonus. The Employment Contract itself was on standard terms save for somewhat tougher restrictive covenants. (Decision [17]) The terms of the restrictive covenants are not set out in the Decision. They are found in the second half of clause 30. In essence, the important restrictions are as follows:

a. At clause 30.1, a covenant not, for 6 months after termination of employment, to solicit or entice away senior employees.

b. At clause 30.2, a covenant, of the same duration, not to solicit or interfere with the Company's or any Group company's relationship with or entice away any person "which is a Restricted Client or Prospective Client with whom you have had business dealings during your employment with the Company….".

c. At clause 30.3, a covenant, again of the same duration, not directly or indirectly to have business dealings with or solicit such business from any person who is a Restricted Client or a Prospective Client "with whom you have had business dealings during your employment with the Company…".

60. A "Prospective Client" means any person, who at the date of termination of employment or at any time during the one year period prior to the date of termination was a prospective client of any Group company and with whom, during that one year period "you shall have had dealings". A "Restricted Client" means any person who, at the date of termination of employment or at any time during the one year period prior to the date of termination was a client of any Group company and with whom, during that one year period "you shall have had business dealings".

61. I mention at this stage part of clause 5 of the Employment Contract which sets out Mr Smiley's duties. Positive obligations on him are to be found out in six bullet points, including the following:

    a. To perform such duties as may from time to time reasonably be assigned by Mr Smiley's head of department, the Chairman or the Board.

    b. To devote his "full time and attention, endeavour and abilities to promoting the interest of the Company and the group".

    c. To carry out his duties in a proper, loyal, careful, skilful and efficient manner and to use his "best endeavours to maintain, develop and extend the business of the Company and the group and not to act in any manner whatsoever to its detriment".

62. According to the Judge, SWIM also offered to acquire from each member of the Team the right to exploit his or her relationship with private client customers (the Judge explaining that he uses the phrase "client connections" to include the entirety of the relationships). (Decision [19]). The word "exploit" does not appear in either of the letters dated 18 August 2005 or in any other contractual documentation. Nor was there any evidence in which that word was used to describe what it was that the Team agreed to do.

63. So far as the implementation of the terms of the Covering Letter concerning payment in respect of clients, the Decision does not explain in any detail the negotiations which led to the 2006 Contract. It is clear, of course, that Mr Smiley and the Team were approached because it was hoped and expected that they would bring clients across from Butterfield and that they would be paid for doing so. The Covering Letter makes that clear and sets out the broad parameters of the basis of the payment, it being expressly stated that SWIM "will pay to you

following the second anniversary of the date on which you join us, a sum equal to 1.5% of qualifying sums under management by you and the team for which you will be responsible at Smith & Williamson as measured on that date". Whether or not there was a binding contract to that effect as a result of the Covering Letter has not been debated before me and was not expressly considered in the Decision.

64. What the Decision does record, at [20] is that, on 18 December 2006, "each member of the Team entered into the 2006 Contract for the transfer of the client connections". In Mr Smiley's case, this was by his counter-signing of a letter to him dated 16 November 2006. Pursuant to that, the Team as a whole was to receive, at the end of the "Goodwill Period" a "Goodwill Payment" (*ie* the Payment) equal to 1.5% of "funds under management" (as defined in the 2006 Contract) adjusted for expenses. This payment, it is to be noted, reflects the same 1.5% figure found in the Covering Letter. The Judge records that "the Payment was to be divided among the Team in a manner determined by the Team, subject to the initial control and approval of Mr Pearce, but contractually adjustable by the Team without that control".

65. The "funds under management" were defined in the 2006 Contract as those funds on all dealing accounts which were introduced to SWIM by a Team member and where a Team member had a pre-existing relationship with the owner of those funds [21]. This, I add, was clearly designed to catch, and was effective to catch, the funds of the Team's clients at Butterfield.

66. The Judge makes a finding at Decision [22] that the terms of the 2006 Contract:

> "were negotiated by Mr Smiley and others on behalf of the Team independently of the terms of the contract of his employment and those of other members of the Team. In particular, it was not a condition of Mr Smiley's contract of employment by SWCS that SWIM should enter into the 2006 Contract."

67. There are two comments which I must make on those findings. The first is that, the Judge does not say, and did not find, that there was no understanding, at the time of the Employment Contract, that SWIM would enter into arrangement eventually formalised in the 2006 Contract. Quite clearly it was contemplated (see Decision [18]) that the Team would bring business from Butterfield to the Group and would be paid for it. As I have already noted, the Covering Letter (whether or not giving rise to contractual obligations concerning the relevant payment) expressly contemplated what might reasonably be described as a success payment of 1.5% of the qualifying funds. So, although, as the Judge correctly held, it was not a condition of the Employment Contract that SWIM would enter into the 2006 Contract, it is clear that the Employment Contract and the 2006 Contract both sprung form the same source, namely the Covering Letter. The Team might have been very surprised if, having entered into employment contracts with SWCS, SWIM had then turned round and refused to honour its commitment in the Covering Letter concerning the payment. All sorts of legal disputes could have arisen if SWIM had taken that course, especially in the light of the positive obligations on the Team whilst still employed and the restrictive covenants imposed on them for 6 months after termination of employment. That did not happen: SWIM, whose integrity there is not the slightest reason to doubt, in fact honoured the letter and spirit of the Covering Letter by entering into the 2006 Contract.

68. The second comment relates to the first sentence of Decision [22]. Although nothing I think turns on this, there is nothing to suggest that there was in fact any negotiation about the terms of the Employment Contract; the offer letter envisaged Mr Smiley being provided with his detailed contract of employment upon

acceptance of the offer in the offer letter, for him to sign, as he did, before taking up his post but there is nothing in the Decision to indicate that the detailed terms were subject to any further negotiation. The point which the Judge is making, however, is that the terms of the 2006 Contract were negotiated independently of the terms of the Employment Contracts. If by "independently" the Judge meant that the detailed terms of the 2006 Contract were not tied to the detailed terms of the Employment Contract, there can be no complaint about his finding (and I do not understand any complaint to be made by HMRC).

69. But if he meant that the 2006 Contract and the Employment Contract were unrelated contracts and that one or the other might in practice have been entered into regardless of the other, he cannot have been right. Such a conclusion would be wholly inconsistent with not only the linkage in the Covering Letter but also his own, obviously correct, conclusions concerning the Group's strategy in acquiring businesses and the lack of need for further front office staff about which Mr Pearce gave evidence. Thus, a conclusion (had the Judge reached it, which he did not) that the Group would have employed Mr Smiley if he had said he was going to introduce his Butterfield clients to a competitor would have been perverse; similarly, a conclusion that Mr Smiley would have accepted the offer in the offer letter and entered into the Employment Contract if there had been no understanding, at the very least, that he would be appropriately rewarded in relation to the transfer of Butterfield clients is not one which the Judge could properly have reached (and he did not do so). See also at paragraph 82 below in relation to Mr Pearce's evidence.

70. I do not think that the Judge can possibly have meant to say that the two contracts were unrelated in that sense. He was doing no more than finding that the detailed

terms of the two contracts were not tied to each other: there was no weighing of the advantages and disadvantages of the two contracts.

71. Before leaving the 2006 Contract, I note that the Judge had defined "the 2006 Contract" in Decision [1] where he describes it as one "under the terms of which [SWIM] acquired certain client relationships of the Team". At this early stage of the Decision, one therefore sees the Judge using language which carries with it the idea that these client relationships are some sort of asset. There is no objection to the use of the words actually used provided that it is acknowledged that this is only a pithy and shorthand way of describing the effect of the 2006 Contract which is a matter for careful analysis. It is, in my view important not to allow the use of such language to determine the proper categorisation of the 2006 Contract and what its terms actually provided.

72. I make the same point in relation to Decision [20], where he said that "each member of the Team entered into the 2006 Contract for the transfer of the client connections". Further, the 2006 Contract does not, expressly, require Mr Smiley to do anything, let alone to "transfer" any "client connection".

73. It is also to be noted that the 2006 Contract provides that:

> "Any element of the Goodwill Payment to which you are entitled will only be payable to you if you are still employed by SWIM or any of its associated companies at the end of the Goodwill Period [*ie* 30 April 2008]……."

74. In fact, one member of the Team, Annabel Somers, did leave (see Decision [23]) although the circumstances of her departure do not appear in the Decision. She was paid £57,400 under a compromise agreement dated 11 January 2008. SWIM later explained to HMRC that £57,300 was paid in respect of her loss of office and that there was no element of goodwill, with the remaining £100 being expressed to be for a restrictive covenant. [23] I understand that, when it is said that the sum of

£57,3000 was paid in respect of loss of office, that means in respect of the coming to an end of the Employment Contract. It was not seen as an element of compensation in relation to the loss of the share of the Payment.

75. In due course the amount of the Payment was determined at £3,810,000 less the amount already paid to Annabel Somers. The Payment was made to the Team; Mr Smiley's share was £957,295.92. [23] and [24] Since, on Mr Smiley's case, the Payment was not derived from employment, it is not easy to understand why the Payment divisible between other members of the Team was reduced by the amount paid to Ms Somers in respect of her loss of office.

76. As the Judge found at [122],

> "the method of payment of the Payment was structured to ensure that the Team found it in their interests to remain in SWIM's employment, and calculated by reference to such part of the client connections as SWIM retained at the end of the Goodwill Period."

In relation to the use of the words "client connections… retained", I reiterate what I have said in paragraph 70 above. There is a danger that the constant repetition of the words "client connection" of itself leads to the conclusion that there is "something" which is an asset itself and can be the source of a payment. That may or may not be the correct conclusion, but if it is correct it is one which must be reached by analysis.

77. SWIM capitalised the Payment in its accounts as expenditure on goodwill. Later, on a review, it reclassified the client connections as "client relationships" and according to the Judge

> "decided to amortise them [a number of payments] on a straight line basis over a ten year period from the date on which the goodwill had been recognised consistently with International Financial Reporting Standard 3 (2008). SWIM claims to have correctly done so for, had the Payment been in respect of emoluments, the proper accounting treatment thereof would have been to write it off in the year in which it was made." [26]

78. From the perspective of each of the Group, the Team, the Group's accountants Deloittes, and its lawyers, Taylor Wessing, the Payment was made for an asset. (Decision [31])

79. At [31] the Judge made a finding that, from the perspective of each of the Group, the Team, the Group's accountants, Deloittes, and its lawyers, Taylor Wessing, the Payment was perceived as being made for an asset. I comment that this is not a finding that the Payment was in fact made for an asset.

80. The Judge explains in succeeding paragraphs why that was the perspective of each of those parties. So far as the Group is concerned, it comes down to the conclusion that the Payment was

> "to increase the funds it held under management, with the aim of improving margins rather than recruiting additional front office staff. I so find."

As Mr Pearce had put it:

> "But what we really wanted from the teams we were interested in was the funds under management that they could bring with them; we already had the capacity to service those funds."

81. Mr Pearce's evidence (clearly accepted by the Judge) is important. It shows not only that the funds under management were what Mr Pearce was after, but also that the way in which those funds could be acquired was by the relevant team bringing the funds with them. In other words, SWIM would acquire the fund by acquiring the Team. There is nothing to suggest that it was contemplated by anyone concerned that somehow the funds could be acquired by the Group without the Team.

82. I have no difficulty at all with the Judge's conclusion as just set out. I do not, however, understand why that conclusion leads to the further conclusion that the Payment was perceived by the Group or accountants as being made for an asset, by which I understand the Judge to be referring to a pre-existing asset somehow

owned by the Team. And yet that conclusion was the only basis, so far as I can see, on which the Judge reached his conclusion that the Group's perception was that it was acquiring an asset. Whether the Group perceived the result of the transfer of funds under management and the start of a relationship between SWIM and the relevant customers as the acquisition of an asset and the correct accounting treatment are different issues. From the Group and accountancy perspectives, that result and the commencement of those new relationships might properly be seen as goodwill in the hands of SWIM. But that was not the position with the Team where the goodwill of the business (namely the management of the relevant funds) belonged to Butterfield, not to the Team.

83. So far as Mr Smiley is concerned, he understood, as found by the Judge, that the Payment consisted of a capital sum for the acquisition of client connections as distinct from the remuneration (basic salary, bonus, share options) set out in the Employment Contract. The Group had indicated that it was interested in buying the book of business which the Team had built up and was prepared to discuss how such a purchase might be achieved. Mr Smiley consistently understood these discussions to be separate from the negotiations relating to the terms of the Employment Contract.

84. It is not apparent from the Decision what discussions and negotiations there were prior to the 18 August 2005. By that time, the structure of a deal had been agreed. That structure, which was in fact adopted and implemented, was that disclosed in the Covering Letter and offer letter dated 18 August 2005. It involved the Team being employed. And it involved the Team being paid according to their success in obtaining for SWIM the funds which they had been responsible for at Butterfield. There is no finding by the Judge that there was any other way in

which a deal could, in theory, have been structured, let alone any indication that there was an alternative structure offering a practical way forward. Clearly the Group attached importance to the presence of the Team within SWIM for a significant period as can be seen from the condition, in the 2006 Contract, for a member of the Team to be employed at the end of the two year period if he or she was to receive a payment.

85. Mr Smiley's understanding is further explained in Decision [39] where the Judge accepted Mr Smiley's claim that "client connections [can] best be understood as a 'book of business' composed of a set of client relationships built over time by the Team individually and collectively at Panmure Gordon, Leopold Joseph & Sons Ltd and Butterfield". As Mr Smiley put it, he "had built up valuable connections from the long standing client relationships with whom I had direct responsibility" and similarly for other members of the Team.

86. Indeed (see Decision [40]) those relationships were so strong that the Team "gave serious consideration to setting up a fund management business of their own". However, they did not do so. And, in any case, I do not understand how that possibility has any relevance to the question whether the client connection is properly to be seen as an asset. Had the Team set up their own business, that business might then have had valuable goodwill which could be sold. But such goodwill would be different in character from what is now claimed to be an asset in the shape of client relationships.

87. The Judge found that some clients who followed Mr Smiley from Panmure Gordon to Leopold Joseph & Sons Ltd remained clients of his on the sale of the latter company to Butterfield. They then followed him from Butterfield to SWIM. (Decision [38(1)]) He held that the Team was able to deliver its clients to SWIM.

Over 90% of the Butterfield clients followed the Team to SWIM. (Decision [41]) Once there, clients did not follow those members of the Team who subsequently moved on. (Decision [38(2)])

88. That is unsurprising in the light of Decision [42]. In the opening words of that paragraph, the Judge relates that SWIM took the following steps to ensure that clients of the Team would remain with it rather than follow any departing members of the Team. I note that the Judge refers to steps taken by SWIM. In fact, some of the steps are to be found in the Employment Contract to which SWIM was not a party, those steps being the contractual agreement for a member of the Team to be put on 6 months' gardening leave (during which period they could not deal with clients of SWIM) and the imposition of the restrictive covenants to which I have already referred. The underlying point remains, however, a good one; but the reference by the Judge to SWIM is not insignificant in that it reflects the reality that, although SWCS is the nominal employer, the entity with the real interest in obtaining the clients and increasing the funds under its management was SWIM.

89. At [43], the Judge accepted that the strategy to ensure that clients remained with the Group had been successful; client connections, once acquired by SWIM, tended to remain with it notwithstanding staff turnover in the various investment management teams or departure of individual members of the Team. Interestingly, he quotes with approval from Mr Pearce's own explanation where, in relation to both Ms Chambre and Mr Boucher, Mr Pearce refers to them as helping to introduce pre-existing clients; and where, in relation to Mr Boucher, he draws no distinction in terms of retention of clients between Mr Boucher's pre-exiting relationships before he joined the Group and those acquired through his

efforts whilst with the Group. I regard that evidence (clearly accepted by the Judge) as having some importance because (i) it demonstrates that one role of the Team once they had been employed was to introduce clients to SWIM through their pre-existing client relationships at Butterfield and (ii) it necessarily recognises that there is a connection between the Employment Contract and the 2006 Contract, since it is through the protective mechanisms of the former (in particular the restrictive covenants after cessation of employment and duties as an employee/Director during employment) that the benefit of the latter to the Group can be legally enforced.

90. At Decision [44], the Judge recites some of the evidence on which SWCS relied as demonstrating that the Payment was inconsistent with its being from the employment of the Team. It is not clear to me whether the Judge intended his recitation of the evidence as a finding of fact that the evidence was accepted, although I think that is what he did find. Whether it justifies the conclusion which SWCS said it supports is another matter.

91. At Decision [45], the Judge identified one basis on which the Payment might be said to derive from Mr Smiley's employment, namely at clause 5, 4th bullet point, mentioned at paragraph 61c. above. The Judge, in response to that suggestion refers in Decision [46] to Mr Pearce's explanation that "the Team's reward for attracting new clients under the Employment contract lay in a deferred share and discretionary bonus plan". The Judge quotes a passage from Mr Pearce's evidence. Mr Pearce explains that all fund managers were expected to try "to attract new clients with funds under management" and that achievement in net funds under management by an individual is rewarded by a deferred share plan and a discretionary bonus plan (the reward depending on the level of

achievement). He also explains that these bonus arrangements apply to all fund managers adding that "this sort of 'organic' growth in funds under management achieved by team members is certainly not part of the Qualifying funds introduced for the purposes of quantifying the capital payment, whatever the level or return by way of fee and commission".

92. What is unclear from the passage quoted by the Judge in Decision [46] is whether Mr Pearce is saying that the Butterfield clients introduced by the Team counted as new clients for the purposes of their remuneration under the share option and bonus schemes or whether he is saying that these clients did not count as part of the organic growth to which he refers. Mr Pearce says clearly that the organic growth in funds achieved by Team members is not part of the Qualifying funds; in other words, a non-Butterfield client obtained by the Team does not count towards quantification of the Payment. When Mr Pearce refers to "this sort of organic growth" he appears to be referring back to the new clients which all fund managers are expected to attract, the implication being that Butterfield clients introduced by the Team are not "new" clients in the sense in which Mr Pearce is using the word "new". He does not actually explain one way or the other whether the Butterfield clients in fact count towards quantification of the share options and bonuses of the Team. However, in an earlier passage, not quoted by the Judge, from the same paragraph of his witness statement, Mr Pearce said this:

> "I should say that these criteria for awarding bonuses are applied equally to 'existing' staff and teams who join us bring [sic] funds under management. Putting the matter another way, any goodwill payment paid to such teams is in addition to these bonuses."

93. The passage quoted by the Judge in Decision [46] must be read in the context of that earlier passage. It is perfectly clear that Mr Pearce's evidence was that

rewards derived in respect of transferring Butterfield clients included (i) the Payment in respect of those clients who still remained with SWIM after 2 years and (ii) share option and bonuses to the extent to which those options and bonuses were calculated by reference to a formula which took account of income/profits derived from those clients (which in practice may have related only to those clients whom the Team did service while employed by SWCS).

94. At this stage, I observe that the Judge seems to have thought that the passage of Mr Pearce's evidence which he quoted dealt with any argument in favour of HMRC based on clause 5 of the Employment Contract, introducing that evidence with the words "However, Mr Pearce explained….". Mr Pearce, for his part, does not, in the passage quoted by the Judge in Decision [46] (or anywhere else so far as I am aware), deal with the part of clause 5 set out in Decision [45]. The Judge's reasoning is not, therefore, based on anything expressly said by Mr Pearce about clause 5 (even assuming that such evidence could be relevant to a matter of construction). Nor does his conclusion appear to be based on the proposition that clause 5 simply does not apply in relation to Butterfield clients. If I am right in thinking that the Judge considered Mr Pearce's actual evidence to dispose of the argument based on clause 5 (assuming that it does apply in relation to procuring the transfer of Butterfield clients), his thinking must have been along these lines:

    a. Although clause 5 does require the Team to use their best endeavours to procure the transfer of the relevant clients' funds from Butterfield to SWIM, the reward for using their best endeavours is to be found in the Employment Contract in the form of share options and bonuses (on top of basic salary, I might add).

b. Since that remuneration is full remuneration (as it is for any other employees acting a fund managers for SWIM), the Payment is not remuneration for using best endeavours but is instead remuneration for something else.

95. The Judge has more to say about this in Decision [122] (as well as his summary in [125]) to which I will come in due course and when I will have more to say about clause 5.

96. Other factors relied on by SWCS were these:

a. The amount of the Payment did not depend on whether the Team continued to service the relevant clients. The Payment was calculated by reference to the funds under management by SWIM irrespective of whether the Team had continued involvement or not. (Decision [44(7)])

b. The 2006 Contract was with SWIM not SWCS, Mr Smiley's employer. The Payment was made under the 2006 Contract with SWIM and not the Employment Contract with SWCS.

c. The Payment was a one-off payment calculated by reference to funds under management at a particular point in time. It was not an ongoing payment for services under a contract of employment Decision [47(6)], [129]. The quantum of the share of the Payment to a member of the Team would increase if members of the Team left. So the quantum of the share of the Payment involved a contingency which, at a minimum, had nothing to do with the employment status of the recipient of the share and, at most, was inconsistent with the Payment being from employment of the Team. (Decision [47(7)], [131])

97. As to a. and b., I do not understand why they point one way rather than the other on the question whether the Payment was derived from employment. So far as concerns a., I can see that, had the Team continued to service the relevant clients, there might be an argument that the payments to them were partly in consideration of that continuing function and therefore were payments from the employment. That argument is clearly not available in the light of the finding of fact that the Payment was due (and in fact paid) notwithstanding that the Team ceased to service the relevant clients. The fact that that argument is not available is not a pointer against the conclusion that the Payment arose from the employment it is simply that the argument is not available in favour of that conclusion.

98. As to b., this carries very little, if any, weight. The employer identified in the offer letter dated 18 August 2005 was SWIM, not SWCS. The Group chose to use SWCS to employ the staff who carried out the activities of fund management for the benefit of SWIM as well as many other staff members who carried out activities for other Group companies. It does not follow that payments by SWIM for the introduction of clients to SWIM did not arise from the employment of the Team by SWCS. As *Shilton* demonstrates, a payment by a third party who is not the employer can arise "from" employment. And this can be so whether or not the third party is under a contractual obligation to make the payment. In the present case, the Team were employed by SWCS to carry out the function, among other activities, of managing funds and acquiring new funds for SWIM. If the Payment from SWIM would have been employment income had the Team been employed by SWIM under each Employment Contract, then it is, I think, hard to maintain that Payment is not employment income simply because the employer is SWCS. It is worth noting also that, at Decision [119], the Judge himself refers to SWIM

acquiring the client connection as a result of its employment of the Team. Now "its" may be a slip since it was SWCS which employed the Team, but the slip reflects the lack of importance which is to be attached – and the lack of importance which the Judge attached – to this distinction for the purposes of the issues in the case.

99. As to c., it is correct that the Payment was a one-off payment calculated by reference to funds under management at a particular point in time. I think the Judge accepted that. On a related point, I add that the Judge was also entitled to hold, as he did at Decision [129], that the Payment was not made for the management by the Team of the funds acquired by SWIM from Butterfield but that the members of the Team obtained their reward for managing the funds well (to the extent that they retained such management at all) under the terms of their respective Employment Contracts. The Payment was not a reward for managing the funds but for having obtained or assisted in obtaining their transfer, although the Payment would fall to be made only if the funds remained under management for the relevant 2 year period.

100. It is also correct that the Payment was not an on-going payment for services under a contract of employment as was submitted to the Judge. (Decision [47(6)]) The reason that it is correct is because it was not an ongoing payment but a one-off payment to be made in certain events (namely the transfer of a client from Butterfield and retention of that client until the end of the two year period). It may also be correct for the reason that it was not a payment under a contract of employment in the sense that it was not made under the Employment Contract but was made under the 2006 Contract which is not, standing by itself, an employment contract. However, the Judge, in recording the submission to him in

Decision [47(6)], cannot be read as making a finding to the effect that the Payment was not for any service or that it did not arise from employment. Although the second of those is a conclusion which he did eventually reach, it was only after consideration of the factors he considered relevant and after attaching to those factors the weight which he saw as appropriate.

101. In Decision [47], the Judge records the point made by SWCS that the quantum of the share of the Payment due to a member of the Team would or could increase if members of the Team left. So the share of the Payment, it was said, involved a contingency which, at a minimum, had nothing to do with the employment status of the recipient and, at most, was inconsistent with the Payment being from employment of the Team. The Judge's actual findings are at Decision [131] where he said this:

> "If a Team member were to leave before the end of the goodwill period, that would or could reduce the expenses element of the Payment. It is also the fact that, if a Team member left SWCS before the end of the goodwill period his or her share would be distributed amongst the remaining members of the Team. Consequently, the Payment involved a contingency which had nothing to do with the employment status of the recipient. I accept that that was inconsistent with the Payment being from the employment of the Team. I further accept that if a Team member left before the end of the goodwill period, his or share of the Payment would be distributed amongst the remaining members of the Team – another contingency that had nothing to do with the employment status of the recipient."

102. That paragraph deserves some attention. The Goodwill Payment under the 2006 Contract was to be 1.5% of funds under management at the end of the Goodwill Period "LESS 50% of the amount (if any) by which the Expenses exceed 60% of the gross revenues received by SWIM in respect of Funds Under Management during the Goodwill Period. Expenses were defined (with certain detailed adjustments) as 96.67% of the costs incurred by the Team in managing the funds during the Goodwill Period". I appreciate, of course, that if a member

of the Team leaves employment, he or she will cease to incur any expenses: that may or may not result in an overall reduction in Expenses, depending on what, if any, additional expenses are incurred by other members of the Team. If that is all that is being said in the first sentence of that passage, then I agree. But if the Judge is saying something more than that, I do not understand what it is.

103. The second sentence may be correct. So far as the Decision is concerned, [47(7)] records the point made by SWCS that the share of a departing member will accrue to the remaining members of the Team; the Judge makes a finding to that effect in Decision [131]. I do not know the basis of the submission or the finding. It is certainly the case that the Covering Letter envisages a goodwill payment but at that stage the whole amount was apparently payable to Mr Smiley ("We will pay to you… a sum equal to 1.5% of qualifying funds…."). The letter did, however, make clear that SWIM was hoping to recruit other individuals (*ie* members of the Team) with Mr Smiley being asked to advise, in such cases, how the payment should be divided. This detail does not, perhaps, matter; the relevant point is that 100% of the goodwill payment would fall to be divided among the Team. The eventual agreement, that is to say the 2006 Contract, does not reflect that principle. Instead, the 2006 Contract in relation to Mr Smiley sets out the formula for the calculation of the Goodwill Payment and then states "You will be entitled to 25% of the Goodwill Payment". There is nothing in the 2006 Contract about what is to happen to the share of a departing member who ceases to be entitled to his or her share. In practice, this has not been an issue.

104. Returning to Decision [131] as just quoted, I fail to see how what is said in the third sentence ("Consequently…") and the fourth sentence follow on from the propositions in the first two sentences. The eventual quantum of the share of the

Payment to Mr Smiley would depend on whether other members of the Team had left service, but the source for tax purposes of the eventual payment cannot depend, in my view, on whether or not his share might increase as the result of a member of the Team leaving employment. In any case, his entitlement to his minimum share (*ie* 25%) would not be subject to any contingency. If that minimum share is properly to be seen as arising from his employment (the ultimate issue in the case), the fact that it might increase as a result of the departure of another member of the Team does not, in my view, change the essential nature or source of the entire Payment.

105. Consider these analogies. Suppose that an employer creates a bonus pool of X% of profits which he agrees with a selected group of employees will be shared equally among them, but the bonus is conditional upon being employed at the end of the financial year. It could not possibly be suggested that the bonus, when paid, does not arise from the employment because it "involved a contingency which had nothing to do with employment status". Or consider a tronc which is divided among the waiting and kitchen staff of a restaurant at the end of the month, but only among staff who were in employment at the end of the month. The whole share of a recipient would arise from his or her employment, notwithstanding that that share is larger because an individual member of staff had left before the end of the month.

106. In my judgment, the Judge was wrong to conclude in Decision [131] that the possibilities of increase or decrease in the quantum of the Payment resulted in inconsistency with the Payment being from the employment of the Team.

107. The Judge appears to have attached considerable weight to HMRC's earn-out criteria in the Employment Related Services Manual ("**ERSM**"): see Decision

[48] and [49] where he identifies factors which Mr Maugham had relied on as relevant and applicable by analogy. The relevant "key indicators" are set out in Decision [48]. Mr Maugham submits that they provide a fair analogy and were properly relied on by the Judge. Ms Wilson, who appears for HMRC, submits that they are irrelevant, being applicable guidance in a completely different and non-analogous set of circumstances and, in any case, being only guidance and not binding on HMRC. The Judge, in Decision [136], accepted all Mr Maugham's contentions (which, in point of fact, he does not identify in the Decision) "as being key indicators that the Payment was consideration for the client connections rather than remuneration". That approach, unfortunately, is to my mind to beg the central question which is whether it is possible to have "consideration for the client connections" in the first place. The Judge has relied on the analogy of the ERSM in choosing between a categorisation of the payments as consideration for an asset or remuneration. Although I would be rather more cautious than the Judge in the application of that analogy, it can be applicable in the first place only once it has been decided that "client connections" are such as to be at least capable of being a source of the payments and as giving rise to a capital payment when turned to account. Unless and until a decision to that effect has been made, there is simply no analogy with the ERSM. The ERSM cannot, in my judgment, be relied on to create – or as I myself would put it, conjure up from thin air – an asset in any way analogous to a business or share in a business with which the ERSM is concerned.

108. The Judge recorded the party's submissions in Decision [66] to [115] before passing to his discussion and conclusions, to which I now turn.

109. In addressing the question whether the Team had an asset to sell, being its client connections, the Judge said, in [117], that he needed to make some preliminary findings. The first was clearly a finding of fact and could hardly be controversial, namely that the Team was able to, and did, introduce their clients to SWIM. The Judge had no hesitation in also finding that some investment clients who were originally clients of Panmure Gordon and/or Leopold Joseph & Sons Ltd and/or Butterfield followed the Team to SWIM.

110. The Judge then went on to say in [118] that he accepted Mr Rivett's submission that "client connections" or (to use Mr Smiley's expression, "book of business") can, as a matter of principle, be an asset; and that "the client connections as transferred to SWIM were an asset in the hands of Mr Smiley and the other members of the Team". He expressed the view that the client connections clearly fell within the capital gains tax definition of "assets".

111. One must be very careful, as I have already suggested, about the use of words in this context. By describing a state of affairs in a particular way, one may reach a conclusion about categorisation which is not correct. What the Team clearly had, as the Judge held, were working relationships with a number of clients of their employer, Butterfield. They did not own the goodwill of Butterfield's business even to the extent that that goodwill reflected the benefit to Butterfield of management of the funds belonging to clients serviced by members of the Team. To describe, by way of shorthand (see Decision [19]), the relationships as "client connections" is perfectly acceptable and does not of itself suggest whether those connections are properly to be seen as an asset. But when the phrase "book of business" is used, it carries with it the idea that there is something out there – a book, albeit a virtual book – which has an existence of its own. It also carries the

idea that there is a business as indeed there was. But that business did not belong to the Team: it belonged to Butterfield. So when Mr Smiley referred to a "book of business" he was doing no more than to use a different shorthand to describe the factual situation where (i) there were a number of investors (ii) being investors who were clients of Butterfield (or in some cases, previously of Panmure Gordon and/or Leopold Joseph & Sons Ltd) (iii) who were serviced by the Team as employees of Butterfield and (iv) who, through their personal connection with the Team as a result of (ii) and (iii), had formed relationships which the Team might be able to turn to their own advantage. I will return to this aspect of the case later. I would only add, at this stage, that the Judge correctly notes, at Decision [53], that an asset for capital gains tax purposes can include an asset which comes to be owned without being acquired. There is nothing, therefore, inconsistent between (i) the client connection as enjoyed by the Group, and forming part of its goodwill, being an asset, or part of an asset, in its hands and (ii) the client connection which the Team had with their clients not being an asset of the Team.

112. At [119], the Judge referred to the submission made on behalf of HMRC that the Payment was from employment, not from the disposal of a capital asset. He made the following observations about that:

> "I accept that the 2006 Contract made no mention of the sale of anything by Mr Smiley to SWIM, and that the Team did not own the client relationship forming the client connections either individually or collectively. I further accept that SWIM acquired the client connection as a result of its employment of the Team."

113. Those, it seems to me, are important observations. There is recognition of the fact that the Team did not own the client relationships: this is a reflection of the fact that a relationship is precisely that and not, of itself, an asset, although in some circumstances the relationship may be turned to account. I say "of itself"

because, had the Team itself been carrying on business, the client relationships might form part of the goodwill of that business and therefore have formed part of an asset, namely goodwill.

114. There is also recognition of the fact that SWIM acquired the client relationships as a result of the employment the Team – here the Judge is making no distinction between SWIM and SWCS and is looking at the commercial reality, treating the Group as a whole. This is important because it demonstrates that the Judge accepted that the employment relationship (formalised in the Employment Contract) and the introduction of the clients to SWIM were not independent transactions. This is not inconsistent with the Judge's finding that the Employment Contract and the 2006 Contract were negotiated separately, a finding which I have considered at some length already.

115. I have already commented (see paragraph 53 above) that that the Team would not have been employed unless they were to bring the business to SWIM. Equally, it is clear from the Judge's observation in Decision [118] and [119] that SWIM would not have enjoyed the benefit of the client connections if the Team had not been employed. In theory, I suppose that an arrangement could have been entered into under which the Team were not employed but agreed with the Group to introduce their clients. But this might not have been satisfactory. The reaction of a client who is told by a Team member that he or she is moving to Smith & Williamson and who is invited to move his business might be very different from that of a client who is told by a Team member that he or she is ceasing to work for Butterfield and suggesting that the client might like to move his business to Smith & Williamson. It is one thing to follow the Team member; it is quite another simply to move. But this is all speculation because that is not what in fact

happened; in fact what happened was that the Team were employed and, as the Judge recognised, the clients moved (or, to use the Judge's words, SWIM acquired the client connections) as a result of the Team's employment.

116. At this stage, it is worth mentioning that SWIM did not, in fact, acquire the client connections in the sense in which the Judge was using that phrase. As already noted, he used that phrase (see Decision [19]) as shorthand for "the entirety of the relationships". Those relationships were, in essence, the personal relationships developed between a client and a member of the Team and the reliance which a client was prepared to place on the individual who managed his account; there were no contractual relationships between the client and the Team member, the contractual relationships subsisting between the client and Butterfield. The relationship (included in what the Judge called "the client connection") between a particular client and a particular member of the Team was not something which could be disposed of by the member of the Team or acquired by SWIM. What could be done, and what was in fact done, was for the Team to introduce to SWIM the Butterfield clients whom they serviced. The Decision does not record the "pitch" which the Team member gave, but he or she would have been well aware of the cautionary words from SWIM that they must not breach their obligations to Butterfield.

117. At [42(2)], the Judge noted that "the Team did not service all the client relationships it transferred to SWIM". What this means is that the clients who followed the Team to SWIM did not then have ongoing relationships with the Team; such relationships as it did have must therefore have been with different personnel within SWIM. Those latter relationships are, it seems to me, different relationships from those which the clients had with members of the Team. To

describe the relationships as having been transferred is no more than a shorthand description of what actually happened in practice as I have just described at the end of the immediately preceding paragraph.

118. The next point to make is that neither the Covering Letter nor the 2006 Contract contain any reference to client connections, to exploiting such connections or to assigning or transferring to SWIM the benefit of any contract with clients of Butterfield (which of course only Butterfield could agree to do) or to assigning or transferring to SWIM the benefit of the client connections. They do not contain the offer described by the Judge in Decision [19] or anything like it. Nor is there any scope, in my judgment, for the implication of any term into the 2006 Contract viewed in isolation to that effect. It is simply unnecessary to do so in order to give effect to the commercial intention of the parties.

119. This is for at least two reasons. First, even without any obligation to exploit the client relationships or even an obligation to use best endeavours to procure transfers, it was clearly in the interests of both the Team and the Group that as many Butterfield clients as possible transferred to SWIM; that of itself might be thought to render any implied obligation unnecessary. Secondly, if it is necessary to find an obligation at all, a "best endeavours" obligation would be enough. Rather than imply such an obligation into the 2006 Contract, all that is needed in that regard is to adopt a construction of clause 5 of the Employment Contract as covering such an obligation, a construction which I am bound to say strikes me as the most natural reading applying conventional canons of constructions and from which there is no reason to depart.

120. The Judge returned to this aspect of the case at Decision [157], asking himself whether the Team had an asset to sell. He said this:

> "…Since the Team did not own the client connections, it could not have sold them. Thus my answer to the question is "No". What it was capable of doing, and in my judgment did, was to transfer to SWIM the right to exploit its client connections with the clients of Butterfield; and SWIM paid for and received, or came into possession of, those relationships, but no more. As Mr Rivett submits, as a matter of construction the 2006 Contract made plain that the Payment was made for the acquisition of the client connection. I regard it as self-evident from the steps taken by SWIM to protect its investments that it did not regard itself as owning the client connection transferred to it."

121. I have no doubt that the Judge was correct to say that the Team did not have an asset to sell. The Judge does not say so expressly, but it appears from the last sentence of that paragraph that he did not regard SWIM as coming to own any client connection either although for my part I would not reject the idea that the new relationships built up by SWIM as a result of the introduction of Butterfield clients by the Team formed part of its goodwill.

122. In using the words which he did in Decision [19] and [157], the Judge was, in my view, doing no more than explain in his own words the effect of the Covering Letter and the 2006 Contract. He is not to be read as saying that there was some legal right to exploit the clients which could be assigned to SWIM for it then to exploit to its own advantage. He can only be read as describing what would happen in practice, namely that the Team would introduce its clients to SWIM, perhaps recommending that the clients move their business to SWIM, and would continue (to the extent that SWIM allowed them to do so) to manage the clients' funds. If he intended to go further, he would have been wrong to do so since it is clear, in my judgment, as a matter of construction that neither the Covering Letter nor the 2006 Contract can be construed as containing an offer by SWIM to acquire a right to exploit relationships. The Team did not have any right to exploit their relationships with clients, in the sense of legal rights constituting something which was capable of being owned, any more than the freedom to trade considered by

Nicholls LJ in *Kirby v Thorn EMI plc* constituted something which was capable of being owned. All that the Team had, to repeat, was the ability to effect introductions and to procure (or at least attempt to procure) a transfer of funds to SWIM. I think that the Judge himself recognises this in Decision [119] in accepting that the Team did not own the client relationships either individually or collectively and in Decision [157] in concluding that SWIM did not regard itself as owning "the client connection transferred to it". It might have been more accurate for the Judge simply to have described the Payment as a success fee.

123. Mr Maugham submits that in Decision [17] to [19] the Judge is making findings of fact pertinent to what is recorded in the Covering Letter and the accompanying offer letter rather than just summarising them. He suggests that in Decision [19] the Judge is making a finding, in light of the terms of the Covering Letter and the oral evidence from Mr Pearce, Viscount Cobham and Mr Smiley, about the nature of the offer contained in that letter.

124. I do not accept those submissions. The true meanings of the Covering Letter and the offer letter are matters of construction which are matters of law. Although the background is, of course, a relevant circumstance to be taken into account, the intention of the parties is not admissible. There is no justification at all, in my judgment, to construe the Covering Letter as reflecting anything other than the reality of that which the Team was intended to deliver and which I have explained above on more than one occasion.

125. This also deals with Mr Rivett's submission recorded by the Judge in Decision [157] that, as a matter of construction, the 2006 Contract made plain that the Payment was made for the acquisition of client connections. As I have already said more than once, there is a real danger that repeated use of words such as

"client connections" being "transferred" and "exploited" gives an independent life to the concept of client connections which is not justified. In the context of the present case, to transfer or exploit client connections means simply (i) that the Team had established relationships with Butterfield's clients (ii) that they were able to, and in fact did introduce all or some of those clients to SWIM and were instrumental in the transfer of those clients to SWIM with the results (iii) that SWIM took over management of the funds of the transferring clients and (iv) that in the course of time SWIM's own relationship with those clients would develop and the relationship with members of the Team diminish. As to that last point, the Judge refers in Decision [157] to the steps taken (as to which see Decision [42]) by SWIM to protect its interests, steps which included some clients ceasing to be serviced by members of the Team, the absorption of the Team into the company so that it ceased to exist as a separate business unit and the imposition of restrictive covenants.

126. In Decision [121], the Judge addresses the relationship between the Payment and the remuneration from the Team's employment. He accepts (by which I mean he finds as a fact) in [121] that the negotiations for the terms of the Team's contracts of employment and the terms of the 2006 Contract were separate and distinct; they were conducted independently and over different time-frames. He accepted that the level of remuneration was similar to that of other employees in similar positions of responsibility and represented a market rate. These are matters which I have already examined. He also found that the Payment was calculated by reference to the "client connections delivered by the Team as a whole", being apportioned in a way determined by Mr Smiley. The amount of the

Payment did not turn on who serviced the client funds under management. It did not need to be a member of the Team who did so.

127. The Judge regards all of those matters as suggesting that the Payment was "for the client connections, and did not arise from the employment of the Team". He does not explain why he regarded them in that way. They are, I agree, certainly consistent with the Payment not arising from employment but they are consistent, too, with the contrary conclusion. In particular, it will be apparent from my discussion of the Employment Contract and the 2006 Contract that they are closely linked. It is, in my judgment, entirely artificial to regard them as separate contracts with no linkage between them. I am bound to say, however, that the impression which I gain from reading the Decision in its entirety is that this is precisely what the Judge did. But if that is not a fair reading, the Judge certainly attached a great deal of weight to the fact that they were separately negotiated: he has taken no account, at least expressly, of the Covering Letter as the source of both Contracts and has not explained why this separate negotiation is significant given his own analysis in Decision [119] that "SWIM acquired the client connections as a result of its employing the Team".

128. His use of the words quoted at the beginning of the immediately preceding paragraph is, as I see it, another example of the shorthand description giving rise to misapplication of the facts. If instead of saying that the Payment was "for the client connections" he had said "for introducing clients to SWIM and in assisting in the transfer of Butterfield clients to SWIM" in the context of a situation where the employment of the Team was a *sine qua non* (from the perspectives of both the Team and SWIM) it is far from clear that even the Judge would have said that

the Payment did not arise from the employment of the Team, especially in the light of his conclusion quoted at the end of the immediately preceding paragraph.

129. Further, I find difficulties with the Judge's analysis in Decision [119]. The Judge accepts that the 2006 Contract made no mention of a sale of anything by Mr Smiley to SWIM. He also accepts that the Team did not own the client connections and yet accepts that SWIM acquired them. If by saying that SWIM acquired the client connections he is saying simply that, as a result of the Team's relationships with their clients, they were introduced and brought about a transfer of funds to SWIM which in turn acquired its own relationship with those clients, then that makes perfectly good sense. But if he is saying more, it is difficult to understand what; in particular, the Team's own personal relationships with the clients were precisely that, and could not be acquired by SWIM. This is a situation very different from the acquisition of goodwill of a business from a trader.

130. I also find some difficulty in reconciling what the Judge said in Decision [119] and in the first part of Decision [157] with what he said in the second part of [157]. In [119] and the first part of [157] he says that SWIM acquired the client connections and yet in [157] he says that SWIM did not regard itself as owning the client connections (implicitly agreeing that it did not own the client connections). To reconcile these statements, and other uses of the phrase "client connections", one must, I think, always go back to what it is that the Team was able to provide to SWIM and what benefit SWIM obtained from that provision. And so one always comes back to the fundamental feature that the Team had personal relationships with the clients of Butterfield whom they serviced: that is one sense in which the phrase "client connection[s]" is used. And to repeat yet

again, the Team, as a result of those relationships, were able to introduce the clients to SWIM and in some cases to achieve or assist in achieving a transfer of the client and his or her fund to SWIM.

131. In using the phrase "client connection[s]" transferred to, or acquired by SWIM, the Judge must once again be taken as describing the result of the Team's involvement through introduction and transfer of clients and funds. If one asks what is meant when it is said that SWIM has acquired the client connections, the answer is that it means no more and no less than that the Butterfield clients serviced by the Team have been introduced by the Team to SWIM and become clients of SWIM. Having received that benefit, SWIM was obliged to meet the Payment (subject to the relevant clients remaining with SWIM for the two year period); and in order to protect the benefit for which it was to pay, the Group among other things obtained the restrictive covenants and took the protective measures referred to in Decision [42].

132. At [122], the Judge records HMRC's submissions "that the formula for calculating the amount of the Payment was clearly structured to encourage the Team to bring new business to SWIM, was part of the performance of the duties of their employment, and depended on the retention of that new business; and that the Payment was made as a reward for the Team's services under their contracts of employment". It is important to identify what is meant by "new" business. It might mean new to SWIM, thus including transferring Butterfield clients and funds, or it might mean new to both SWIM and the Team, and thus exclude the Butterfield clients and their funds. Clearly the amount of the Payment had nothing to do with non-Butterfield clients and clearly the formula was not structured to encourage the Team to bring non-Butterfield business. The reference

to “new” business in the submission of HMRC as recorded by the Judge must, I think, mean new to SWIM and include the Butterfield clients. I refer also to the discussion at paragraphs 93 and 94 above.

133. Equally clearly, the structure was designed to encourage the Team to do what they properly could to achieve the transfer of Butterfield clients and their funds. This is so whether or not clause 5 of the Employment Contract obliged the Team to use best endeavours to do so (although, so it seems to me, what the Judge says in both Decision [46] and [122] is an implicit recognition that clause 5 might well impose an obligation to use best endeavours to procure the transfer of Butterfield clients and their funds). That conclusion is entirely consistent with the Judge’s conclusion that “the method of payment of the Payment was structured to ensure that the Team found it in their own interests to remain in SWIM’s [an error for SWCS’s] employment, and was calculated by reference to such part of the client connections as SWIM retained at the end of the goodwill period”. That conclusion of the Judge is one with which it would be difficult to disagree. As an aside, I add that the Judge appears here to be using “client connections” in a slightly different sense from that which he defined in Decision [19]; here he is using the phrase to indicate the relationship which SWIM itself was able to form with clients who had been introduced by the Team and is not referring to the relationships which the members of the Team themselves had previously enjoyed (and which had enabled them to effect the introduction and bring about a transfer of funds under management in the first place). The sense of what he is saying is, nonetheless, clear.

134. Accordingly, I do not think the Judge can be seen as rejecting the proposition that the formula for calculating the amount of the Payment was structured so as to

encourage the Team to bring new business (*ie* Butterfield clients and their funds) to SWIM. What he is rejecting, it seems to me, is the proposition that the Payment was made as a reward for the Team's services under their contracts of employment (by which he was clearly referring to the Employment Contract in contrast with the 2006 Contract).

135. His reasons for rejecting that proposition appear in the last part of Decision [122]:

> "And since the Team did not continue to manage at least some of the sums transferred, I am unable to agree with Ms Hodge [HMRC's representative] that the introduction of new business by the Team under their contracts of employment played any part in either the structuring or the calculation of the Payment. The Team's reward for introducing new business consisted in the benefits to which they became entitled under the deferred share plan/and or bonuses for which their contracts of employment made provision."

136. It is not entirely clear to me whether or not the Judge was referring to new business as including the transferring Butterfield clients and their funds. If he was not, then quite clearly he is correct to say that the introduction of that business played no part in the structuring or calculation of the Payment. But that is completely irrelevant to whether the introduction of the Butterfield clients and their funds played any part in the structuring or the calculation of the Payment.

137. If, in contrast, he included the Butterfield business as part of the "new" business (which is my preferred reading of what he said), then the position is different. If one asks what rewards the Team received for introducing the Butterfield business (and the retention of the clients for 2 years) the answer can only be that the rewards include (i) the Payment from SWIM and (ii) such share option and bonuses as were awarded under the relevant option and bonus schemes in accordance with the Employment Contract made with SWCS. The sense of the last part of Decision [122] just quoted is clearly that the Team's reward for

introducing new business did not include the Payment. If that is a correct reading of what the Judge said, then, in my judgment, that is a conclusion which he could not properly reach.

138. But if that is not a correct reading, then the Judge must be taken as having accepted that the Payment did form part of the reward for introducing the Butterfield clients. In that case, the Judge would have been wrong to say that the introduction of new business (*ie* the Butterfield business) played no part in the structuring or calculation of the Payment unless he is simply making the point that the Team's reward under the Employment Contract for introducing Butterfield clients was to be found in the grant of share options and bonuses. But that is a trivial point since it is obvious that the reward under the Employment Contract did not include the Payment. The obligation to make the Payment was that of SWIM under the 2006 Contract, not of SWCS under the Employment Contract, but that says nothing about whether the Payment represented a reward for effecting the introductions which, in my view, it obviously did.

139. None of this is to say that the Payment arose "from" the employment: that is an entirely different question.

140. As to element (ii) of the reward, I do not know how the option scheme and the bonus scheme operated. It may be that the Team was not entitled to any option or bonus in relation to Butterfield clients whom they did not continue to service or whose funds they did not continue to manage.

141. I have already discussed the significance which the Judge appears to have attached to the fact that the Employment Contract and the 2006 Contract were negotiated separately. He returned to the point in Decision [123] where he accepted the submissions on behalf of SWCS and Mr Smiley "that, since the 2006

Contract was negotiated and made some time after the Team entered into their contracts of employment, it at least points to the Payment being inconsistent with its having arisen from the employment of the Team by SWIM". I do not understand this. Surely there is either inconsistency or there is not. I find the concept of "pointing" to inconsistency difficult to grasp. There is nothing actually inconsistent between there being separate negotiations, on the one hand, and the Payment having arisen from the employment, on the other hand. If there had been, that would provide the Judge with a short answer to the case.

142. If the Judge, in using the words which he did, is simply saying that the fact of separate negotiation of the Employment Contract and the 2006 Contract is a factor which points to the conclusion which he reached, then I understand what he is saying. I would agree with his conclusion if it were correct to view the two contracts in isolation. But for reasons which I have already given at paragraphs 66*ff* above, it would be wrong to do so. The reality is that both contracts reflect the single overarching agreement (whether or not contractually binding in all respects) found in the Covering Letter; there was a single "package" with the details to be determined later, and in fact determined through a process of separate negotiation of the 2006 Contract.

143. In Decision [125] the Judge rejects HMRC's submission that the Payment reflected the extra income/profits generated by reference to the Team's business contracts. He considered that it was the Team's contracts of employment which provided for them to be rewarded for the new business which they introduced. He is essentially making the same point as he made in Decision [122] in relation to which I have nothing to add to what I have already said.

144. In the last sentence of Decision [125], the Judge also says that the 2006 Contract was not an adjunct to the Team's employment contracts. I do not know what he meant by "adjunct" in this context. If he is saying that they were unconnected in any way, that is a conclusion which he could not properly have reached in the light of the close linkage found in the Covering Letter between offer of employment and the commitment to make a payment in relation to transferred business. If he was saying that the 2006 Contract was not simply some minor reflection of the Employment Contract, I would not disagree – it was clearly an important aspect of the relationship between the Team and the Group – but that provides no assistance in answering the question whether the Payment arose "from" the employment.

145. The Judge goes on to review what he saw as the relevant law in [139] *ff*. He looked at a number of authorities including *Hose v Warwick, Shilton, Kuehne* and *Manduca*. He attaches particular importance to *Hose v Warwick*, the facts of which he saw as closest to the present case and which he proposed to follow. He considers this case in some detail in Decision [152] to [156]. In the light of the authorities, he returns in Decision [157] to the question he had posed earlier namely whether the Team had an asset. I have addressed that paragraph of the Decision at paragraph 126 above.

146. Finally, in Decision [160], the Judge says that the answers to each and every one of Mr Maugham's questions indicated that the payment was made for the client connections. He concluded:

> "It follows that, since it [the Payment] was not from the Team's employment, I hold the Payment to have been a capital receipt in the hands of the Team in general, and Mr Smiley in particular, and not a payment from his employment liable to income tax."

Discussion and conclusions

147. I return, in a moment, to the Judge's summing up in Decision [157] which I have set out at paragraph 6 above. That summary encapsulates the material on which the Judge reached his conclusion that the Payment did not arise from the employment. In addressing that summary, the following, simple, facts must be borne in mind, namely that the Team did not own or have any legal interest in the business being carried on by Butterfield. They did not own or have any interest in the goodwill of that business. They had no right to take, and did not take, any confidential information of Butterfield with them. All that they had were personal relationships with Butterfield's clients which they had built up over the years of their employment with Butterfield and previous employers. It was open to them, so far as was consistent with their contractual obligations to Butterfield (which is not suggested were breached), to introduce to SWIM the Butterfield clients with whom they dealt and to agree to assist in or procure the transfer of those clients and their funds to SWIM.

148. Turning, now, to the summary I comment on it by reference to my inserted paragraph numbers. In what I say, take account of, without repeating here, my discussions of various aspects of the arrangement in earlier parts of this Decision where I considered the Judge's own detailed reasoning.

149. Paragraphs (i) and (ii) can be taken together. These are (i) Mr Smiley's contract of employment and the 2006 Contract were two separate and independent contracts, the former being made some time before the latter; and (ii) the negotiations for his contract of employment and those for the Payment were conducted independently. I have addressed these in detail in paragraphs 66*ff* above. I have indicated what I consider the Judge was actually saying and have concluded that, if he was saying something different, it would not have been

correct for him to do so. In particular, it is clear that the two contracts both derived from a single objective (the transfer of Butterfield clients) and from a single arrangement articulated in the Covering Letter. The Judge could not properly have decided (if this is what he in fact decided) that the two contracts were not linked or that one would have been entered into without the other. In my judgment, he was wrong to treat the two contracts as separate in this way, and attached far too much weight to the fact that there were separate contracts and that they were independently negotiated. Indeed, if by independently negotiated, he was suggesting that the two contracts were separate in the sense that one might, in practice, have been entered into without the other, he could not have reached that conclusion on the evidence before him.

150. Paragraph (iii) states that the sums payable under the contract of employment and the 2006 Contract were market rate sums calculated by the parties thereto at arm's length and on arm's length terms. The Judge considered that it followed, and he so inferred, that the sums payable under the former represented full payment to Mr Smiley for the services that he had agreed to and would in the future provide to SWIM. The sums payable under the Employment Contract did not, clearly, include the Payment: the Payment was payable under the 2006 Contract (although all sums payable under either contract stemmed from the Covering Letter and the attached offer of employment). Accordingly, he appears to be saying that the Payment was not made, even in part, in respect of any services which The Team had agreed to provide to SWIM. If that appearance is what he actually intended, then he must be saying that, in achieving the transfer of Butterfield clients to SWIM, the Team was not providing SWIM with a service (since, if that were the provision of a service, the consideration for that service

would, contrary to the hypothesis, be the Payment). However, a conclusion that the Team was not providing a service to SWIM in achieving the transfer of Butterfield clients simply does not follow from the fact that the sum payable under the Employment Contract and the 2006 Contract were market rate sums.

151. Perhaps the Judge was saying something different, namely that the Payment was what the Team received in respect of their client relationships and that the payments due under the Employment Contract did not represent any further consideration in respect of those relationships. I use the phrase "in respect of" in order to be neutral, at this stage, as to whether the Payment is to be seen as a capital payment for some sort of asset or as an income payment for a service, namely introducing the clients and assisting in the procurement of their transfer to SWIM. If that is what he was saying, then it does not assist in answering the statutory question whether the Payment was "from" Mr Smiley's employment.

152. Paragraph (iv) records that the Payment was calculated by reference to the client connections and nothing else; and the qualifying funds were only those transferred with the Team. That is entirely correct, but for reasons already given, those facts do not assist, in my view, in determining the true nature of the Payment for tax purposes.

153. Paragraph (v) records three propositions, namely that the 2006 Contract was made with SWIM, and not the employer SWCS; that the levels of the payments due under the contracts of employment were similar to those of existing employees of the Group; and that the Team's rewards for introducing new business to SWIM were to be found in their entirety in the contracts of employment in the form of pensions, share options and bonuses. The first two of those propositions are clearly correct.

154. The third proposition is not expressed in quite that way in the detailed consideration which the Judge gave to the Team's rewards. If the Judge is using "new" in the sense of non-Butterfield clients, the proposition is correct but entirely irrelevant to the matters in issue in the present appeal. If he is using "new" in the sense of new to SWIM (and thus including the Butterfield clients) he must surely be wrong. On that footing, the Payment was made in relation to the client connections. Whether or not clause 5 of the Employment Contract obliged the Team to use their best endeavours to procure a transfer of Butterfield clients, the Payment depended on the transfer of Butterfield clients to SWIM (even if it is properly to be seen as a disposal of an asset, or of the right to exploit), and to say that that was not a reward for introducing Butterfield clients would be wrong. See further my discussion of the use of the word "new" at paragraphs 92 and 134 above.

155. In paragraph (vi), the Judge says that, taking those matters in combination, he regarded them "as firmly establishing that the effect of the 2006 Contract was that Mr Smiley and the Team made over to SWIM a capital asset and the Payment represented full payment therefore".

156. With respect to the Judge, I do not consider that those matters come anywhere near firmly establishing that a capital asset was made over to SWIM. Insofar as he can be read as reaching possible conclusions (as indicated in the immediately preceding paragraphs and in the more detailed discussion in the body of the decision), those conclusions cannot justify the end result. Insofar as he is to be read as reaching inadmissible conclusions, a decision based on those conclusions cannot stand (although the ultimate conclusion may still be correct).

157. My conclusions are not altered by paragraph (vii) where the Judge held that his conclusion reflected the intention of the parties to the two contracts, and saw no reason to conclude otherwise. Insofar as this was simply a statement that his conclusion was in accord with how the parties understood matters, there can be no objection. But if he relied on it as a reason for supporting his conclusion, he would have been wrong, in my judgment to do so. The parties' perceptions that the Team held an asset of which they could dispose (namely client connections) cannot affect what it is that they actually owned (if anything) or what their legal entitlements were. Either the client connection subsisted in such a way that it was some sort of asset which could be dealt with perhaps in the same sort of way as goodwill properly so called can be dealt with. Or it was simply personal to the Team and could be turned to account only by the Team entering into arrangements with SWIM under which, in return for taking certain actions (for instance, procuring Butterfield clients to transfer to SWIM), the Team would receive a reward, thus treating the "right" to take advantage of client connections in much the same way as the "right" to trade discussed by Nicholls LJ in *Kirby v Thorn EMI*.

158. My own reading of the Decision as a whole is that he attached importance, in reaching his conclusions, to the perceptions of the parties, seeing the arrangements made as reflecting the parties' subjective intentions rather than assessing the effect of those arrangements objectively. He was wrong to do so.

159. Further, the Judge was wrong, as I have already explained, to attach the weight which he appears to have done to Mr Maugham's submissions in relation to HMRC's guidance in the ERSM.

160. As to the law, the Judge regarded *Hose v Warwick* as the governing authority which he should follow. For reasons appearing below, I do not consider that the decision in that case should govern the outcome of the present case. It is not only distinguishable but should be distinguished.

161. These errors are enough, in my judgment, for the Judge's decision to be set aside (although were I to reach the same ultimate conclusion, the right result would, nonetheless, be to dismiss the appeal).

162. Having reached the conclusion that the Judge's reasoning does not justify the ultimate conclusion which he reached, I now turn to what I see as the correct answer. The point, in the end, is a short one. It is whether the relationships built up by the Team over the years have been turned to account through the Team's employment by SWCS in such a way that the Payment arises from that employment.

163. As Ms Wilson submits, the starting point is *Shilton*. The question is whether the payment is for being (including continuing as) or becoming an employee. In the case of a payment not by the employer (SWCS here) but by a third party (SWIM here) it is right to see whether payment is motivated by a desire to see that the employee enters into or continues in the employment of another: see Lord Templeman at the passage quoted at paragraph 16 above. Clearly, on Mr Pearce's evidence and the findings of the Judge, the Team were employed in the hope and expectation on the part of the Group (including SWIM) that some, at least, of the Butterfield clients would transfer to SWIM; the way in which that hope and expectation was to be realised was through the initial employment of the Team, coupled with provisions to ensure that they stayed with the Group for a period (2 years) and provisions (the restrictive covenants in the Employment Contact)

protecting the Group from competition from members of the Team in relation to the transferring clients for a defined period after termination of service. It can be seen that the Group, and SWIM in particular, clearly had an interest in the performance of the Employment Contract. Accordingly, unless what the Judge described as client connections can properly be seen as a separate source of the Payment, the inevitable conclusion is that the Payment arose from the employment (not, I add, from the Employment Contract, which clearly it did not) and that it did so as an income, and not capital, payment.

164. In my judgment, the evidence establishes that the Payment was a reward to the Team for introducing the Butterfield clients to SWIM and procuring, or assisting in procuring, the transfer of those clients to SWIM. In other words, as Ms Wilson puts it, the Team provided a service. I do not consider that it is right to describe what the Team did as "the transfer of rights to exploit client connections".

165. Further, such power as the Team had to turn their relationships with clients to account is not, I consider, to be equated with goodwill. The decisions in *Asprey* and *Kirby v Thorn EMI* give a succinct description of the perhaps elusive concept of goodwill, contrasting it with personal connection built up over the years (as in *Asprey*) or the right to trade (as in *Kirby v Thorn EMI*). The right to exploit which the Judge seems to have identified is not the right to sell the customer portfolio, a right which belonged to Butterfield; it is not the right of ownership of the assets or of the right to manage the assets. It is not of itself goodwill, which belonged to Butterfield. Further, it makes no sense to speak of Mr Smiley as having the "right" to "exploit" his clients' personal loyalty – although he is free to take advantage of the relationships – any more than it is correct to speak of a person of having the right to trade. Further, as I have already pointed out, the client

relationships enjoyed by the Team cannot be transferred; they are personal relationships between individuals. What the Team can do is introduce their clients to SWIM and attempt to procure their transfer to SWIM. But SWIM does not thereby acquire a personal relationship between a Team member and the client. That relationship might continue if the team member continues to service the relevant client, but the relationship remains that between the member of the Team and the client; or a new personal relationship might develop between a new client manager at SWIM but it is not the same relationship. All that is obvious; but it is important to remember the obvious when analysing what it was that the Team could do for SWIM.

166. I do not consider that *Hose v Warwick* leads to a different conclusion. I have already addressed that case in some detail. It is not clear precisely what it does decide but whatever it decides it is clearly distinguishable from the present case. The tribunal in *Manduca* examined the decision and saw it as distinguishable on the grounds that it was dealing with a payment for agreeing not to do something. That is a point of distinction, but not necessarily conclusive since a payment might, in some circumstances, arise from employment even if it paid for a negative obligation. Another distinction, and one which is important for present purposes, is that in the present case, the Team was, on my analysis, providing a service namely the introduction *etc* of Butterfield clients. The Team's clients were not, unlike Mr Hose's clients, already clients of the employer.

167. Further, although the clients in *Hose v Warwick* were clients of the employer in the sense that the contracting parties were the employer and the client, Mr Hose appears to have had rights in relation to those clients which were akin to goodwill. Thus (see the quote at paragraph 29 above), Atkinson J referred to the company

circular which referred to acquisition by it of the business of Mr Hose. There is simply no parallel to that in the present case.

168. In my judgment, the so-called client connections do not provide a separate source of income. My conclusion is that the Payment arises from the employment of the Team by SWCS. This conclusion is consistent with, indeed supported by, the decision in *Kuehne* discussed at paragraphs 27*ff* above. There is the necessary link or connection identified by Mummery LJ in [33] of his judgment and the sufficient causal link identified by Patten LJ in [50] of his judgment.

169. In the light of this conclusion, it is unnecessary to address the question whether HMRC should be allowed to raise alternative arguments that the Payment is chargeable to income tax as miscellaneous income.

Disposition

170. It follows from my conclusion that HMRC's appeals in relation to both Mr Smiley and SWCS are allowed.

Mr Justice Warren

11 December 2015

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