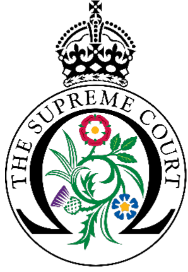

Trinity Term
[2026] UKSC 17
On appeal from: [2024] EWCA Civ 813

JUDGMENT

Commissioners for His Majesty's Revenue and Customs (Appellant) *v* HFFX LLP (Respondent); Atkins and others (Appellants) *v* Commissioners for His Majesty's Revenue and Customs (Respondent)

before

Lord Lloyd-Jones
Lord Sales
Lord Hamblen
Lord Burrows
Lady Rose

JUDGMENT GIVEN ON
17 June 2026

Heard on 17, 18 and 19 June 2025

Appellant/Respondent
Rupert Baldry KC
Thomas Chacko
James Kirby
(Instructed by HMRC Legal Group)

Respondent/Appellant
Kevin Prosser KC
David Yates KC
(Instructed by Macfarlanes LLP)

LORD SALES (with whom Lord Lloyd-Jones, Lord Hamblen, Lord Burrows and Lady Rose agree):

Introduction

1. This case is concerned with the tax treatment of profit-sharing arrangements for individual partners in a foreign exchange trading firm, HFFX LLP ("HFFX"). There are two appeals: (i) an appeal by the Commissioners for HM Revenue & Customs ("HMRC"), number UKSC 2024/0122 ("the HMRC appeal"), concerning the correct allocation of partnership profits for income tax purposes between the members of HFFX under section 850 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"), in which HFFX is the respondent; and (ii) an appeal by the individual partners of HFFX (whom I will call "the individual members"), number UKSC 2024/0123 ("the individual members' appeal"), concerning whether they are liable to income tax on receipts under a deferred remuneration mechanism operated by HFFX, either under section 687 of ITTOIA (headed "Charge to tax on income not otherwise charged") or Chapter 4 of Part 13 of the Income Tax Act 2007 ("ITA 2007") (headed "Sales of occupation income"), in which HMRC are the respondents. The HMRC appeal raises an issue regarding the limits of the purposive approach to the interpretation of legislation imposing liabilities to tax.

2. HFFX is a limited liability partnership. In the relevant period, it was a very successful trading entity in the foreign exchange ("forex") market. Large profits were generated by its trading activities. HFFX sought to devise a method to distribute those profits to its members in a way which minimised the tax which would be imposed, involving a mechanism to pay them deferred remuneration in later tax years. The question is whether that mechanism is effective to achieve that objective.

Factual background

(a) HFFX and the individual members

3. HFFX was established in 2010 as an entity within an investment management business known as GSA. Its individual members had previously been employed as a team of researchers and software developers by another company in the GSA group, GSA Capital Services Limited ("GSACS"). They were involved in researching and formulating high frequency forex trading strategies for implementation through automated trading. The team was led by Mr Alexander Gerko, who became the Managing Member of HFFX when it was set up.

4. Before the creation of HFFX the team had been entitled to 35% of the profits generated by their work. This element was known as the Trader Pay-Out. Mr Gerko

decided as a matter of his own discretion how this would be shared out amongst the team. About 30% of the Trader Pay-Out was required to be used to purchase Restricted Fund Shares, which were a form of deferred remuneration for Mr Gerko and the team. GSA agreed to increase the Trader Pay-Out to 50% with retrospective effect from 31 January 2010 on the basis that the team was spun out into a separate limited liability partnership (HFFX) which would then provide services to GSA.

5. After the creation of HFFX, the team continued to work for GSA under secondment agreements with GSA Capital Partners LLP ("GSACP"), of which HFFX was a member. The Trader Pay-Out was paid to the team via a profit allocation by GSACP to HFFX (less any reasonable costs incurred by GSACP in relation to HFFX). The team's role continued to be the creation and implementation of forex trading strategies. GSA provided the trading infrastructure and the actual trading of forex instruments was carried out automatically via GSA's computers.

6. These appeals are concerned with the deferred remuneration arrangements for Mr Gerko and the team as members of HFFX put in place when it was created in 2010. These arrangements involved a Capital Allocation Plan ("the CAP"). As was found as a fact by the tribunals below, the CAP had as one of its main objects the avoidance or reduction of liability to tax. This is not contested on the appeal to this court. In addition, the CAP had commercial purposes, including in particular the retention and incentivisation of individual members of HFFX. Under the terms of the CAP, a member who left HFFX in certain circumstances (as what is called a "bad leaver") would lose his entitlement to receive the deferred remuneration to which he was otherwise entitled under the CAP; hence the operation of the CAP gave them an incentive to remain with HFFX and to adhere to the terms of their contract with HFFX. An individual member also had the hope that Mr Gerko would exercise his discretion to award him rights under the CAP which reflected their contribution to the profits generated by HFFX's work, and so was incentivised to work to maximise those profits.

7. The CAP came to an end in 2015 when the HFFX business was transferred to another entity known as XTX, which was led by Mr Gerko and was independent of GSA.

(b) The operation of the CAP

8. The legal arrangements governing the affairs of HFFX and the operation of the CAP were set out in the limited liability partnership deed dated 28 October 2010 ("the LLP Deed"). They were elaborate. For the purposes of exposition, before setting out the relevant terms of the LLP Deed, it is helpful to give an account of how the CAP was to work:

(a) Mr Gerko was designated as the Managing Member of HFFX. As before, he would have discretion as to how the Trader Pay-Out would be divided among his team.

(b) Following the end of each financial year, a proportion (typically about 50%) of the profits that would potentially otherwise have been allocated to each participating individual member of HFFX for that financial year was instead allocated to a corporate member, GSA Member Limited ("GSAM"). GSAM's sole share in issue was held by Walkers SPV Ltd as trustee of the GSA Member Limited Star Trust, a Cayman Islands business purpose trust established for purposes that included promoting the business of HFFX.

(c) Subject to the consent of GSACS, Mr Gerko would send a letter to GSAM to recommend what percentages of the allocation made to it were to be held for potential later payments to each individual member of HFFX, whilst stating that he acknowledged that GSAM could deal with the profits at its complete discretion. The letter recommended that GSAM would sell the GSA fund shares it held for that member's deferred award in three equal annual tranches and contribute the net proceeds to HFFX as "Special Capital". At GSAM's discretion, it would then reallocate that Special Capital to individual members, who could then withdraw it. Special Capital could only be reallocated to other members (including restricted members, ie "good leavers").

(d) GSAM followed the recommendations it received from Mr Gerko. It would pay corporation tax and running expenses out of its profit allocation, then invest the net amount in shares in GSA funds and proceed to reallocate as described further below.

(e) Around the same time that the recommendation letter was sent to GSAM, the individual members of HFFX participating in the CAP would be informed by letter that a recommendation had been made to GSAM for them to receive an award falling within one of five broad monetary bands. It was explained that any award would be granted over a period of three years, from profits allocated to GSAM, contributed to HFFX as "Special Capital", and reallocated to the individual at GSAM's discretion. It was noted that GSAM should invest the profits in shares or funds and that this meant the value of the award available for reallocation could be higher or lower reflecting the rise or fall of investments. The letter also stated that there could be further or amended recommendations to take into account matters related to the individual's performance or conduct or the performance of HFFX, or other events or circumstances that HFFX would

be required to take into account. Finally, the letter set out that the individual could only be reallocated Special Capital if they remained a full or restricted member on the vesting date (with a restricted member being a "good leaver").

(f) The discretion to vary the actual allocation of Special Capital to individual members from that set out in the indicative letters sent to them was a real discretion which was in fact exercised in some circumstances. For example, the amount of an actual allocation might be reduced to reflect poor results by GSA in the years leading up to the allocation, poor performance by the individual member or the need to redistribute capital to new members joining HFFX in that period, or to penalise an individual member who left HFFX in that period and was deemed to be a "bad leaver". In particular, in the relevant tax period with which these proceedings are concerned, there was an example of an individual member who left HFFX who was deemed to be a "bad leaver" who accordingly had his indicative allocation of Special Capital reduced, with it being distributed to other individual members instead according to an exercise of discretion by GSAM.

(g) Mr Gerko's recommendations were reviewed on each anniversary and from time to time on other occasions. In the case of the person deemed to be a "bad leaver", Mr Gerko amended his recommendations to remove the award to him and to reallocate it to other members (including new joiners). Mr Gerko also amended his recommendations when a "good leaver" agreed to a three-year non-compete agreement in exchange for HFFX recommending to GSAM that he receive his CAP awards on a quarterly basis over three years, subject to confirmation of compliance with the non-compete agreement. GSACS usually consented to Mr Gerko's recommendations, although it could, and on occasion did, vary them.

(h) Under the CAP Mr Gerko's role as Managing Member involved making recommendations to GSAM. However, GSACS had the power to terminate his position as Managing Member, in which case it would take over as Managing Member.

(i) The LLP Deed stipulated that GSAM was given "absolute discretion" as to whether or not to make reallocations of Special Capital as at sub-para (e) above, and that (apart from the question whether an individual member had fulfilled the deferral conditions, ie remained a member or restricted member) it might take into account matters including losses caused to GSA by HFFX, or changes in the recommendations made to it by Mr Gerko. It is common ground that the exercise of this discretion

was subject to an implied duty according to the principles set out by this court in *Braganza v BP Shipping Ltd* [2015] UKSC 17; [2015] 1 WLR 1661 ("*Braganza*"), meaning that GSAM had to exercise its discretion rationally and for the purposes for which it was conferred (see *British Telecommunications plc v Telefónica O2 UK Ltd* [2014] UKSC 42; [2014] Bus LR 765, para 37).

(j) It is also common ground that prior to a reallocation of Special Capital contributed by GSAM, GSACS had discretion to determine that GSAM would not withdraw or reallocate the Special Capital in circumstances where GSA, GSACS or an associated company incurred a liability (or was likely to incur a liability) as a result of an act or omission of any individual member or employee where that act or omission was in breach (or potentially in breach) of contract or was negligent or in breach of a statutory duty, or fraudulent, or in circumstances where the calculation of the Trader Pay-Out produced a loss.

(k) The intended tax effect of the CAP was that the profits allocated to GSAM would be subject to corporation tax (rather than income tax) in GSAM's hands and that there would be no tax charge on the amounts of Special Capital subsequently re-allocated to the individual members, on the basis that the re-allocations were capital. (By the time these proceedings reached this court, however, it was conceded by the individual members that the re-allocations constituted income of the individual members).

9. A principal objective of the CAP arrangements was that the profits allocated to GSAM would be taxed at the much lower rate which applied for corporation tax, as compared with the significantly greater tax charge to which the individual members might be subject if they received their share in them as part of their taxable income, subject to the higher rate of income tax.

(c) The provisions of the LLP Deed and how they were implemented in practice

10. Clause 10.3 of the LLP Deed provided for the allocation of HFFX's profits among its members. Clause 10.3(D) provided for allocations to GSAM (the Retention Member) as follows:

"Fourthly, subject to clause 11.10(A), there shall be allocated to the Retention Member an amount equal to the higher of:

> (1) 30% of the Pre-Retention Amount for all Individual Members; or
>
> (2) such other amount as the Managing Member may determine for the purposes of incentivisation of Members or as may be required by applicable law or regulation."

11. Clause 11.10(A) provided for the purchase of Restricted Fund Shares. This was an alternative deferral mechanism to the CAP. This was used by one member who was a US national because of the US tax consequences from use of the CAP.

12. The Pre-Retention Amount was defined in clause 1.1 as follows:

> "'Pre-Retention Amount' means, for each Individual Member, such sum as the Managing Member would potentially have allocated to such Member in any financial year of the Partnership pursuant to clauses 10.3(E) and 10.3(F) had there been no allocation to the Retention Member pursuant to clause 10.3(D), nor any purchase of Restricted Fund Shares pursuant to clause 11.10(A), to the extent that such sum (when added to Priority Drawings) exceeds such Member's Applicable Threshold. For the avoidance of doubt, no individual Member shall have any right or entitlement to or interest in any Pre-Retention Amount. Such sum shall be calculated by the Managing Member solely for the purpose of calculating the allocation to the Retention Member under clause 10.3(D) and shall be confidential to the Managing Member."

13. Clause 10.3(E) gave Mr Gerko a discretion as to the allocation of 90% of the remaining profits (after prior allocations) among the individual members. The Applicable Threshold was defined in clause 1.1 as an amount to be specified by the Managing Member (Mr Gerko), but which was not to be increased above $300,000 without the consent of GSACS.

14. Each individual member's Pre-Retention Amount, therefore, was the amount that each individual member would potentially have been allocated but for the CAP (or the alternative deferral mechanism of Restricted Fund Shares), to the extent that this amount, plus their monthly drawings, exceeded their Applicable Threshold. Clause 10.3(D) then required at least 30% of the Pre-Retention Amount for each individual member to be allocated to GSAM.

15. In practice, the first £100,000 of each individual member's Pre-Retention Amount was allocated to them without deferral. Fifty percent of the excess of the Pre-Retention Amount over £100,000 was also allocated to them without deferral, with the other 50% being allocated to GSAM for the purposes of the CAP.

16. Clause 11.9 of the LLP Deed dealt with Special Capital. Clause 11.9(A) provided that any Member could contribute cash or assets as Special Capital. The cash or assets so contributed were to be credited to the relevant Member's Special Capital Account and, "[s]ubject as hereinafter provided", the monies credited to the Special Capital Account were to be "held exclusively for the benefit of the relevant Member". Any income profits or losses arising from them were the profits or losses of HFFX, but were to be allocated to the Member for whom the Special Capital was held. Members' Special Capital contributions were independent of, and did not include, contributions to their separate Member's Capital Contribution Account in accordance with clause 7.1.

17. Clause 11.9(B) prohibited GSAM from reallocating its Special Capital without GSACS's consent in certain circumstances (eg to cover liabilities, or potential liabilities, incurred by GSA as a result of the acts or omissions of the individual members or in the event that the Trader Pay-Out calculation produced a loss).

18. Clause 11.9(C) provided that any Member who had Special Capital "may, in his sole and absolute discretion, decide that all or part of the interest of such Member in any Special Capital … should be reallocated to any other Member or Members … so that such other Member or Members will, following such reallocation, become beneficially entitled to the relevant part of such Special Capital … and shall give notice of any such decision to the Managing Member."

19. The second paragraph of clause 11.9(C) provided that, within 30 days of making an allocation of profit to GSAM under clause 10.3(D), the Managing Member could (with GSACS's consent) make recommendations in writing to GSAM in the form set out in Schedule 6 to the LLP Deed as to the investment of the profit (after meeting tax and other liabilities) in GSA fund shares, the contribution of the proceeds of those fund shares as Special Capital and the reallocation of that Special Capital to other Members. The Managing Member could also notify the Member of the recommendation in the form set out in Schedule 7 to the LLP Deed. In addition, he could make further or alternative recommendations from time to time (again with GSACS's consent). It was stated that "For the avoidance of doubt, the Retention Member shall be under no obligation to follow the recommendations of the Managing Member and shall have absolute discretion as to how it applies any profit allocations it receives from the Partnership."

20. Clause 11.9(D) permitted any Member with Special Capital credited to their Special Capital Account to withdraw it by giving 14 days' notice to Mr Gerko. On the expiry of the notice, they were entitled to be paid the amount of their Special Capital.

21. In January or February each year, Mr Gerko carried out the exercise of calculating the Pre-Retention Amount which involved a notional division of HFFX's total profits between the individual members. This was sent to GSACS with a proposal that the deferral rule for that year should be that the first £100,000 of the Pre-Retention Amount, plus 50% of the balance, would be in cash, with the remaining 50% being deferred. The cash sums were allocated under the LLP Deed to the individual members, and the deferred sums were allocated under the LLP Deed to GSAM.

22. Having obtained GSACS's consent (and with the assistance of GSACS), Mr Gerko would then send GSAM a letter in the form set out in Schedule 6 to the LLP Deed (a "Recommendation"), usually recommending that:

(a) After paying tax and expenses, GSAM should apply the balance of the allocation to purchase shares in specified GSA funds.

(b) GSAM should sell those shares in three equal annual tranches on or before the first, second and third anniversaries of the Recommendation and contribute the proceeds (after payment of tax and expenses) to HFFX as Special Capital.

(c) At the end of one month following the contribution of Special Capital, and subject to certain conditions, GSAM should reallocate the Special Capital to the individual members in specified percentage shares. (Those percentage shares were intended to reflect the deferred balance of each individual member's Pre-Retention Amount as a percentage of GSAM's original profit allocation. These recommendations as to percentages could be replaced by revised recommendations.)

23. The Recommendations also stated that:

(a) HFFX could make further recommendations or modify recommendations to take into account matters related to the individual's performance or conduct or the performance of HFFX or GSA, or other events or circumstances that HFFX would be required to take into account.

(b) GSACS could require GSAM to sell the fund shares and contribute the proceeds as Special Capital, in which case the Special Capital could not be reallocated to any individual member without GSACS's consent.

(c) Reallocations could not be made to individuals unless they remained Members or Restricted Members, and if they had ceased to be a Member, the Recommendations stated that reallocation should be made to GSACS, HFFX or Mr Gerko (depending on the year). In the case referred to above where an individual member left and was deemed to be a "bad leaver", the money was reallocated to other individual members and to fund HFFX's legal costs in dealing with that individual member.

(d) HFFX made the recommendations "in furtherance of its business and in order to incentivise and retain its Members, but acknowledges that [GSAM] may deal with the Profit Allocation at its complete discretion".

(e) The Managing Member was to notify each relevant individual member of the fact of the recommendation and "the broad bracket of remuneration within which such recommendation falls", but otherwise the Recommendation was confidential.

24. At or around the same time, Mr Gerko would send the individual members who were participating in the CAP a letter in the form set out in Schedule 7 to the LLP Deed notifying them of their "potential award" under the CAP, including the monetary band within which their recommendation fell (eg the band $1million to $3million). It also outlined the recommendations made to GSAM as to how it should deal with the profits allocated to it, including the recommended reallocations of Special Capital in three equal annual tranches.

25. GSAM would then be paid the profits allocated to it under the CAP and would duly invest them in GSA fund shares, after paying corporation tax and providing for its running costs. HMRC accepts that if their appeal succeeds, this corporation tax would have to be repaid.

26. Before each anniversary, Mr Gerko would write to GSACS to obtain consent to his provisional further recommendation letters to GSAM confirming or varying the original Recommendation he had made for the CAP award for the year in question. The approved, varied or confirmed Recommendation would then be made to GSAM. Although GSACS usually gave its consent to Mr Gerko's provisional recommendation, it withheld it on one occasion when he initially requested a reallocation to himself of the indicative award to the individual member who left as a deemed "bad leaver".

27. In each case, GSAM (acting by its sole director, Mr Bruder) resolved to act in accordance with the Recommendations (as confirmed or varied).

28. GSAM would then redeem the relevant one-third tranche of the amounts invested in the GSA funds and contribute the redeemed amount to HFFX as Special Capital. At least one month later, it would reallocate this amount to the individual members in the proportions stated in the Recommendations (as confirmed or varied).

29. Shortly afterwards, HFFX sent a letter to the relevant individual members confirming the amounts that had been reallocated to them by GSAM and the process by which members could withdraw their Special Capital. Individual members would then duly withdraw their Special Capital in accordance with their rights under clause 11.9(D) of the LLP Deed.

The statutory provisions in issue

(a) Section 850 of ITTOIA (profit-sharing arrangements)

30. Section 850 appears in Part 9 of ITTOIA. It provides:

> "**850 Allocation of firm's profits or losses between partners**
>
> (1) For any period of account a partner's share of a profit or loss of a trade carried on by a firm is determined for income tax purposes in accordance with the firm's profit-sharing arrangements during that period. This is subject to sections 850A and 850B.
>
> (2) In this section and sections 850A and 850B 'profit-sharing arrangements' means the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade."

31. Section 850 operates in the context of the basic scheme of taxation of trading and other income set out in ITTOIA. Section 5 provides that income tax is charged on the profits of a trade, profession or vocation. Section 7 provides that tax is charged on the full amount of the profits of the tax year, which are defined to be "the profits of the basis period for the tax year". Section 8 states that the person liable for any tax charged "is the person receiving or entitled to the profits". A partnership (or firm) is not regarded for

income tax purposes as an entity separate from the partners: section 848. Section 863 makes similar provision in relation to limited liability partnerships. Section 849 explains how the profits or losses of the trade of a partnership are calculated: "For any period of account" in which the partner is a UK resident individual the relevant part of the profits or losses is calculated as if the firm were such an individual (and if the partner is a non-UK resident individual, then as if the firm were such an individual).

(b) Section 687 of ITTOIA (income not otherwise charged to tax)

32. Section 687 appears in Chapter 8 of Part 5 of ITTOIA. Subsection (1) provides:

> **"687 Charge to tax on income not otherwise charged**
>
> (1) Income tax is charged under this Chapter on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act."

(c) Chapter 4, Part 13 of ITA 2007 (sales of occupation income)

33. Section 773 of ITA 2007 provides an overview of Chapter 4. Chapter 4 imposes a charge to income tax where transactions are effected or arrangements made to exploit the earning capacity of an individual in an occupation and the main object, or one of the main objects, of the transactions or arrangements is the avoidance or reduction of liability to income tax. Section 774 defines "an occupation" to mean "any activities of a kind undertaken in a profession or vocation", regardless of whether the individual is carrying on a profession or vocation on their own account or is an employee or an office-holder.

The decisions of the tribunals and the Court of Appeal

(a) The First-tier Tribunal

(i) Section 850 of ITTOIA

34. HMRC sought to tax the individual members in relation to the indicative allocations of Special Capital under the CAP arrangements, as then received by them, by relying on section 850 of ITTOIA. Before the First-tier Tribunal (Judge Fairpo) ("the FTT") HFFX contended that section 850 of ITTOIA had no application to the indicative allocations of Special Capital. Individual members had no right existing in each relevant period to share in the profits of HFFX allocated to GSAM; instead, they only had a right

to be considered for a distribution under the CAP arrangements. The interposition of a discretionary decision by GSAM regarding the amount to be received meant that shares of profits for individual members were not a matter of contractual entitlement and so were not "determined … in accordance with the firm's profit-sharing arrangements" within the meaning of section 850. It made no difference that as a matter of practice, rather than legal entitlement, the exercise of discretion in a particular way was predictable. GSAM's discretion was a genuine one. It was also submitted that GSAM's discretion was absolute and unlimited. The CAP was not a disguised scheme to distribute the firm's profits to individual members, since (as is now accepted by HMRC before this court) it had a genuine commercial purpose.

35. HMRC contended that the amounts allocated to GSAM in any year in respect of HFFX's profits were in fact allocated to individual members in the amounts set out in the recommendation made by Mr Gerko to GSAM and constituted allocations to them of HFFX's profits, falling within section 850. The rights set out in the LLP Deed under clauses 10.3(E), 10.3(D) and 11.9(C) to be considered for an allocation of profits were sufficient to bring that statutory provision into operation. GSAM's discretion (and any discretion Mr Gerko had to make recommendations) was not unfettered, but was limited according to the *Braganza* obligations (as is now common ground in this court). Further, GSAM was required to use its assets to support HFFX's business and had no genuine entitlement of its own to enjoy profits made by HFFX. The amounts received by individual members (by way of both immediate and deferred payments) were rewards for the work they did for HFFX, and they were taxable on them even though they had consented to their redirection to GSAM in the first instance. HMRC maintained, therefore, that the calculation of the Pre-Retention Amount should be regarded as an allocation of profit to the individual members and not to GSAM, so that it fell within section 850.

36. The FTT accepted the main thrust of the submissions of HFFX on this issue. The terms of the LLP Deed defined the relevant entitlements and had the effect that individual members had no entitlement in any relevant period to receive a share of HFFX's profits allocated to GSAM. GSAM received payments out of HFFX's profits in its own right, and not on behalf of the individual members. There was no redirection or transfer of profits to which individual members were entitled to GSAM. Section 850 did not apply. Even if GSAM's discretionary power under the LLP Deed was qualified as indicated in *Braganza*, it was still a genuine discretion and had the effect of excluding the operation of section 850.

(ii) Section 687 of ITTOIA

37. In the alternative to their case based on section 850, HMRC submitted that section 687 of ITTOIA applied in relation to the deferred remuneration sums in fact received by the individual members. The individual members argued that for that provision to apply,

the income had to be "from [a] source" and that a purely voluntary payment could not constitute a "source" within the meaning of section 687. The payments to individual members were purely voluntary because GSAM was not under any legal obligation to reallocate its Special Capital, or even to consider whether to do so, because the LLP Deed gave it an absolute discretion in that regard. They contended that *Braganza* had no application, but even if it did apply so as to confer a right to be considered for a payment, such a right to be considered was not sufficient to constitute a source of income (relying in that regard on *Drummond v Collins* (1915) 6 TC 525, 540; [1915] AC 1011).

38. HMRC contended that the payments by GSAM to the individual members were for the purpose of rewarding them for their performance and incentivising them to be of good behaviour, which meant that there was a link between their work for HFFX and the reallocations under the CAP so that their activities for HFFX were the relevant source for the purposes of section 687. The reallocation by GSAM was not purely voluntary, because by application of *Braganza*, GSAM was subject to obligations in respect of reallocation of Special Capital.

39. On this issue the FTT accepted the submission of HMRC that section 687 applies. The reallocation of profit by GSAM was not purely voluntary, but took place by virtue of rights to consideration under the CAP arrangements set out in the LLP Deed; there was therefore a relevant and sufficient relationship between the reallocation and individual members' rights under the LLP Deed such that there is a source for the purposes of section 687. The individual members were therefore liable to income tax under that provision.

(iii) Chapter 4 of Part 13 of ITA 2007 (sale of occupation income)

40. The regime under this part of the tax code applies where transactions are effected or arrangements are made to exploit the earning capacity of an individual in an occupation, and the main object, or one of the main objects, of the transaction or arrangement is the avoidance or reduction of liability to income tax. As a further alternative submission, HMRC contended that the individual members were liable to income tax under this regime in respect of the sums they received as deferred remuneration.

41. The individual members argued that the individual members were not carrying on a profession or vocation, nor activities of a kind undertaken in a profession or vocation within the meaning of the relevant rules. Rather, they were carrying on a trade of devising strategies for high frequency forex trading and achieving profits from such trading, as the profits of HFFX were derived from the profits of GSACP. These activities were properly to be classified as carrying on a trade, which is not caught by the regime. They also submitted that they were engaged in giving commercial advice, which could not be

regarded as a professional or vocational activity. Moreover, they did not have personal clients or customers as would be the case if they were carrying on a profession.

42. HMRC submitted that, if section 850 of ITTOIA did not apply and there had been a genuine allocation of profits to GSAM, those arrangements had been made to exploit the earning capacity of the individual members, because by those arrangements GSAM was put in a position to enjoy part of the income derived from their activities. The rules are intended to catch schemes by which individuals effectively sell their earnings potential in exchange for capital payments, and that general purpose would be frustrated if the terms "profession" or "vocation" were interpreted in a narrow, technical or outdated manner. On a proper interpretation, the individual members were carrying on regulated research activities of a kind undertaken in a profession (applying guidance given in *Inland Revenue Commissioners v Maxse* [1919] 1 KB 647, 657; (1919) 12 TC 41, 61—"*Maxse*"). The activities should also be regarded as those of a vocation, in that they were a method of earning money in a systematic way which did not involve buying and selling.

43. The FTT held in favour of HMRC on this part of the case. It found that the activities carried on by the individual members were of a kind undertaken in a profession, applying the guidance in *Maxse* (and it did not matter whether they might also be characterised as activities in the course of a trade: these were not mutually exclusive concepts). It was not necessary to decide whether they also qualified as activities of a kind undertaken in a vocation. The FTT rejected the argument of the individual members that their activities amounted only to making arrangements for, or the exercise of commercial knowledge in giving advice about, the buying and selling of commodities. The buying and selling of forex instruments was undertaken by GSA, not by the individual members.

44. The individual members also submitted that the CAP arrangements did not have as one of their main objects the avoidance of tax. The FTT found as a fact that this was one of the main objects of the arrangements and this submission is no longer pursued by the individual members.

45. The individual members appealed to the Upper Tribunal in relation to section 687 of ITTOIA and Chapter 4 of Part 13 of ITA. HMRC appealed in relation to section 850 of ITTOIA.

46. Two other issues raised before the FTT (concerning a discovery assessment made in relation to Mr Gerko and an application to redact commercially sensitive information from the FTT's judgment) have not been pursued in this court and it is not necessary to consider them further.

(b) The Upper Tribunal

(i) Section 850 of ITTOIA

47. The Upper Tribunal (Mellor J and Upper Tribunal Judge Raghavan) drew the attention of the parties to the Upper Tribunal decision in *Revenue and Customs Comrs v BlueCrest Capital Management LP* (*Dodd v Revenue and Customs Comrs*) [2022] UKUT 200 (TCC); [2022] STC 1696 ("*BlueCrest UT*"), which concerned a limited partnership with a similar deferred remuneration arrangement to the CAP. In *BlueCrest UT* HMRC's attempt to invoke section 850 was also rejected. The tribunal did not accept HMRC's argument that the share allocated to the corporate partner (the equivalent of GSAM in the present case) could be treated as an allocation to the individual members; nor could it be treated as a redirection or transfer to the corporate partner of profits due to the individual members. The tribunal had applied a contractual analysis equivalent to that applied by the FTT in the present case, explaining (*BlueCrest UT* at para 79) that according to the terms of the partnership deed, which had to be respected, the individual member had no right to share in the profits of the partnership at the time when allocations were made to the corporate partner; although individual members might have a legitimate expectation that their provisional award under the deferred remuneration arrangement would be made final unless they failed to meet the eligibility conditions, they only had a right or entitlement to receive their deferred payment awards once they were entitled to withdraw the Special Capital; so, "Even adopting a purposive construction of section 850 … the PIP [the deferred payment plan] did not form part of the profit-sharing arrangements of the Partnership".

48. Following the analysis in *BlueCrest UT*, the Upper Tribunal considered that the FTT's reasoning in the present case was correct. It therefore dismissed HMRC's appeal: [2023] UKUT 73 (TCC); [2023] STC 678.

(ii) Section 687 of ITTOIA

49. Section 687 of ITTOIA was also in issue in *BlueCrest UT*. The Upper Tribunal in that case had explained (para 109) that section 687 re-enacted a residual charge to income tax under (old) Case VI of Schedule D on any annual profits or gains not falling under any other Case of Schedule D and not charged to tax under (old) Schedules A, E and F; and also that the conditions that had to be satisfied in order for section 687 to apply included that the receipts must be of an income nature, must be analogous to some other head of charge under what was previously Schedule D, must be the recipient's income and "must involve a sufficient link between the source and the recipient". The Upper Tribunal in the present case stated that the main area of dispute concerned this "sufficient link" requirement, in particular regarding what form of legal obligation to make the payment was required.

50. The individual members argued that there was no legal obligation on GSAM to pay deferred remuneration to the individual members, and therefore no sufficient link between the source (whatever that was) and the payments they received. As part of this argument they disputed the finding of the FTT that the payments were made to reward them for their performance and to incentivise particular behaviour.

51. HMRC submitted that *BlueCrest UT* was authority to the effect that a sufficient link exists not only where there is a full legal obligation to pay the sum in question but also where payment is made pursuant to a legal obligation (that is, it is sufficient if the payor acts in accordance with legal duties to which it is subject, and not freely by making a payment by way of gift). Therefore, on the footing that the *Braganza* obligations applied, HMRC contended that a sufficient link between payment and a relevant source existed for the purposes of the application of section 687.

52. The Upper Tribunal referred in particular to previous Upper Tribunal decisions in *Spritebeam Ltd v Revenue and Customs Comrs* [2015] UKUT 75 (TCC); [2015] STC 1222 ("*Spritebeam*") and *BlueCrest UT* and the decision of the Court of Appeal on the previous regime under (old) Schedule D in *Cunard's Trustees v Inland Revenue Comrs* [1946] 1 All ER 159; (1945) 27 TC 122 ("*Cunard's Trustees*"). That case concerned the exercise by trustees of a discretionary power under the terms of a trust in a will to supplement income with capital payments to maintain a beneficiary under the will; the additional payments made in exercise of the trustees' discretion were held to be income taxable under the (old) Schedule D provision which was the forerunner of section 687. In *Spritebeam* and *BlueCrest UT* the Upper Tribunal applied an equivalent analysis in finding that a payment in the nature of income made pursuant to a contractual discretion governed by the implied obligations set out in *Braganza* fell within section 687.

53. The Upper Tribunal in the present case dismissed the appeal of the individual members in relation to section 687. Contrary to their contention, it held that the *Braganza* obligations applied to the exercise of discretion by Mr Gerko and GSAM under the LLP Deed and the CAP arrangements (as mentioned above, the individual members no longer dispute this). On that footing, accepting HMRC's submission and following the analysis in *Spritebeam* and *BlueCrest UT*, the Upper Tribunal held that there is a sufficient connection between a receipt and a source for the purpose of section 687 if there is a legal obligation to exercise a discretion and a payment following that exercise. The Upper Tribunal held that the FTT's analysis was valid.

54. The Upper Tribunal considered that the FTT had also adopted an alternative analysis to the effect that the individual members' activities (working to help generate profits for HFFX and also behaving properly in accordance with their contractual obligations) were the relevant source; and the existence of the *Braganza* obligations meant that the payments received were not gratuitous. The Upper Tribunal said it was not

necessary to decide this issue, but if it had been it would have followed what it understood to be part of the reasoning in *BlueCrest UT* and would have endorsed it.

(iii) Chapter 4 of Part 13 of ITA 2007

55. It was common ground in the Upper Tribunal that the establishment and operation of the CAP were "arrangements" for the purposes of this regime and that as part of, or in connection with, or in consequence of, those arrangements a capital amount was obtained by the individual member concerned for themselves or another person.

56. A further condition for application of the regime (referred to as "Condition B") is that the arrangements are made to exploit the relevant individual's earning capacity in the relevant occupation by putting another person (GSAM) in a position to enjoy all or part of the income or receipts derived from the individual's activities in the occupation. In the FTT, the individual members did not dispute that this condition was satisfied. In *BlueCrest UT* (paras 134–136) the Upper Tribunal held that this condition was satisfied and that section 777(3) of ITA 2007 applied to the allocation of profits to the corporate partner pursuant to the deferred remuneration arrangements in that case. In the Upper Tribunal in the present case, the individual members indicated that they did not agree with this reasoning, but they did not seek to argue the point, saying instead that they reserved their right to raise it on appeal, if permitted to do so by an appellate court.

57. The individual members submitted that the FTT had committed an error of law, in the *Edwards v Bairstow* sense ([1956] AC 14), of making findings which were irrational or which were unsupported by any evidence, when finding that the individual members carried on an "occupation" in the UK within the definition of that term in section 774 of ITA 2007 as covering "activities of a kind undertaken in a profession". However, the Upper Tribunal held that the FTT had been entitled to find that the activities of the individual members did have this character.

58. The individual members also submitted, unsuccessfully, that the FTT erred in law in finding that a main object of the CAP arrangements was the avoidance or reduction of liability to income tax (as mentioned above, this point is not pursued in the appeal to this court).

59. The Upper Tribunal therefore dismissed the appeal of the individual members regarding the application of the regime in Chapter 4 of Part 13 of ITA 2007.

60. The individual members appealed to the Court of Appeal in relation to that issue and the application of section 687 of ITTOIA. HMRC appealed in relation to section 850 of ITTOIA.

(c) The Court of Appeal

61. The Court of Appeal, in a judgment given by Falk LJ (with whom Asplin and Whipple LJJ agreed) ([2024] EWCA Civ 813; [2024] STC 1371) dismissed the appeal by the individual members and also dismissed HMRC's cross-appeal.

(i) Section 850 of ITTOIA

62. By the time of the Court of Appeal's decision, the decision in *BlueCrest UT* had been taken on appeal and the Court of Appeal had given judgment in that case: *Dodd v Revenue and Customs Comrs (Revenue and Customs Comrs v BlueCrest Capital Management LP*) [2023] EWCA Civ 1481; [2024] STC 92 ("*BlueCrest CA*"). HMRC accepted that the decision in *BlueCrest CA* was determinative of the section 850 issue in favour of HFFX. The Court of Appeal therefore found it unnecessary itself to examine the arguments on the section 850 issue and dismissed HMRC's cross-appeal in relation to it. HMRC reserved their right to seek permission to appeal to this court on that issue. HMRC have been granted permission to appeal to this court in the present proceedings to challenge the reasoning in the decision in *BlueCrest CA*.

(ii) Section 687 of ITTOIA

63. *BlueCrest CA* was also concerned with the application of section 687 of ITTOIA in relation to the similar deferred payment arrangements at issue in that case (the partner incentivisation plan, or "PIP"). The lead judgment was given by Sir Launcelot Henderson (with whom Lewison and Falk LJJ agreed). At para 102 he concluded that, as is implicit in the wording of section 687(1), the income must arise from an identifiable source in the relevant tax year. In the present case Falk LJ noted that in *BlueCrest CA* two questions had to be determined in relation to section 687: whether the reallocation of Special Capital gave rise to income rather than capital in the hands of the recipients (in the present case this question is not relevant since it is agreed that the reallocation amounts constitute income); and whether the decision of the corporate partner (equivalent to GSAM under the CAP arrangements) to make an award by way of such reallocation amounted to a "source" within the meaning of section 687. On that question, Sir Launcelot Henderson reviewed *Spritebeam* and *Cunard's Trustees*. He concluded (paras 123 and 125) that there was a "source" for the income, which was the exercise of discretion by the corporate partner: the individual members had no right to withdraw their Special Capital unless the corporate partner made a decision to re-allocate it to them and made their awards under the PIP final.

64. In the present case, the Court of Appeal held that the *Braganza* obligations apply in relation to the exercise of discretion by Mr Gerko and GSAM to award deferred remuneration to individual members under the LLP Deed and the CAP; they were not

excluded by the terms of the LLP Deed, as argued by the individual members (relying in particular on clause 11.9(C)) (as mentioned above, it is now common ground that the *Braganza* obligations do apply). The case was not materially distinguishable from *BlueCrest CA*. Although that decision did not support the proposition that the existence of *Braganza* obligations is sufficient without more to satisfy the requirement of a "source" under section 687, it also did not support the contention (advanced by the individual members) that section 687 was only found to be applicable because the exercise of discretion by the corporate partner conferred an enforceable legal right to the transfer of Special Capital. Rather, "what was held to be sufficient to create a source was the exercise by the corporate partner of its decision to reallocate Special Capital <u>in the context</u> of a legal agreement which conferred certain rights on the individual members" (per Falk LJ at para 45, emphasis in original). Falk LJ considered that this analysis was supported by *Cunard's Trustees* and by Sir Launcelot Henderson's consideration of that decision. It was not undermined by other authorities relied on by the individual members, including *Drummond v Collins*. On this basis, Falk LJ held that section 687 applied to the individual members, who were therefore obliged to pay income tax on the deferred remuneration amounts received by them pursuant to the LLP Deed and the CAP.

(iii) Chapter 4 of Part 13 of ITA 2007

65. The Court of Appeal in *BlueCrest CA* found it unnecessary and inappropriate to determine this issue, which has a complex background, whilst at the same time indicating that they should not be taken to endorse the reasoning in *BlueCrest UT*. The Court of Appeal in the present case adopted the same position, and indicated that they should not be taken to endorse the reasoning in the Upper Tribunal.

The issues on the appeals

(a) HMRC's appeal

66. The issue in HMRC's appeal is whether the profit shares that were allocated to GSAM are to be regarded as the individual members' profit shares in accordance with HFFX's "profit-sharing arrangements" under section 850 of ITTOIA. HMRC invite this court to overrule the reasoning on this point in *BlueCrest CA*.

(b) The individual members' appeal

67. The issues in the individual members' appeal are as follows:

(1) Whether the Special Capital which they received under the CAP is income charged to income tax under section 687 of ITTOIA (income not otherwise charged to tax).

(2) If not, whether these receipts are deemed to be their income under Chapter 4 of Part 13 of ITA 2007 (sales of occupation income). This raises the following sub-issues:

(a) whether there was an error of law in the findings of the FTT and the UT that the individual appellants' activities were of a kind undertaken in a profession and, if so, whether their activities were of a kind undertaken in a profession or vocation; and

(b) whether Condition B of the sales of occupation income rules can apply to arrangements involving the allocation of profits among members of a partnership or LLP,

it being accepted that those rules (and, in particular, section 778 of ITA 2007) otherwise apply.

The outcome of the appeals

68. It may assist the reader if I state the outcome of the appeals at this stage, before setting out my analysis.

69. For the reasons given below, I would dismiss HMRC's appeal in relation to section 850 of ITTOIA. I would dismiss the appeal of the individual members in relation to section 687 of ITTOIA. Since section 687 applies, it is not necessary for this court to determine the issue in relation to Chapter 4 of Part 13 of ITA 2007, and in circumstances where this court does not have the assistance of decisions of the Court of Appeal on the point it would not be appropriate to do so. Like the Court of Appeal in *BlueCrest CA* and the present case, I should not be taken to be endorsing (or disapproving) the reasoning of the Upper Tribunal in the present case or in *BlueCrest UT*. The point should be argued out afresh in a case in which it is determinative of the issue whether income tax should be paid.

Discussion

(a) The application of section 850 of ITTOIA

70. HMRC say that consideration of the context and purpose of section 850 of ITTOIA indicates that the Court of Appeal erred in their decision in *BlueCrest CA*. In his judgment in that case, Sir Launcelot Henderson relied on the ordinary meaning of the words used in section 850, read in context, for his conclusion that it did not apply to the deferred remuneration element received by the individual members under the PIP arrangement. HMRC's submission therefore gives rise to an issue regarding the relationship between the ordinary meaning of words used in a statutory provision and the general purpose which might be taken to underlie the provision.

71. In my view, on its proper interpretation section 850 (para 30 above) has the following meaning:

(1) Subsection (1) states that for any period of account, a partner's share of a profit or loss of a trade carried on by a firm (here, HFFX) is determined for income tax purposes "in accordance with the firm's profit-sharing arrangements during that period". It is implicit in this provision that it must be possible to tell from the profit-sharing arrangements in place in the firm in that period whether any part of the profit or loss of the firm's trading in that period is definitively attributable to the individual and if so in what amount. In my view, this means that the arrangements have to include a contractual right for the partner to receive (or suffer) the part of the firm's profit (or loss) which is to be treated as his or her income under this provision in that period.

(2) This interpretation is confirmed by subsection (2), which defines the term "profit-sharing arrangements" to mean "the rights of the partners" to share in the profits (or the losses) of "the trade" (that is, the trade of the firm as carried on during that period). Since, under subsection (1), the determination of the partner's share in the profits or losses is determined "in accordance with the firm's profit-sharing arrangements during that period", reading that provision together with the definition in subsection (2) requires that the translation of the firm's profit or loss into something which affects the income of the partner requires that the partner has a contractual right to share in the profits (or the losses) of the trade in the relevant period of account. It is that contractual right, as applicable in that period of account, which determines the amount of the firm's profit (or loss) which is translated into something which affects the income of the partner in that period.

72. Mr Kevin Prosser KC, who appeared for HFFX and the individual members, rightly observes that the point in para 71(2) above, namely that the reference to the rights

of the partners to share in the profits "during that period" is to rights which exist during the relevant period of account (so that an allocation of profit shares in accordance with an agreement made after the end of the period is not relevant for income tax purposes), is supported by the law as it stood prior to ITTOIA. He referred to *Bucks v Bowers* [1970] Ch 421, 441E-G (Pennycuick J), in relation to the application of the related concept of earned income relief. Moreover, by virtue of the ordinary rule applicable in respect of partnerships, the relevant rights would exist during that period since, absent any other agreement, "[a]ll the partners are entitled to share equally in the … profits of the business": section 24(1) of the Partnership Act 1890. It is a fair inference that section 850 was drafted with this background in mind. The Explanatory Notes available in Parliament when ITTOIA was a Bill confirm that this part of ITTOIA was drafted in the light of the 1890 Act regime: paras 1706–1709.

73. This indicates that by using the expression "to share in the profits" in section 850(2) the drafter intended to follow the 1890 Act regarding what is meant by sharing in partnership profits. A number of features of the 1890 Act regime are relevant. There is a distinction between the assets of a partnership and its profits for a given period: *Reed v Young* [1985] 1 WLR 649, 654–655 (Lord Oliver). A profit is an accounting concept, so a partner may become entitled to a profit share without necessarily receiving or becoming entitled to any partnership money or assets: although a division of profits has taken place, it does not follow that each partner will necessarily be entitled to withdraw his share, since that will depend on what agreement the partners have made regarding the use of the share of the profit to which they are entitled (see *Lindley & Banks on Partnership*, 21st ed (2022), para 21–10). A partner to whom profits are allocated is entitled to be credited in the partnership's books with an amount equal to his profit share (see ibid, paras 22-04 and 22–07). Subject to the partner's net financial position in relation to the firm and to any contrary agreement, a partner to whom profits are allocated is in principle entitled to withdraw his profit share (see ibid, para 10–172 and *Dinham v Bradford* (1869) LR 5 Ch App 519, 542 per Lord Hatherley).

74. Applying section 850 in accordance with the interpretation set out above in the present case means that profits of HFFX in the relevant period of account are translated into income of the individual members in that period of account only to the extent that they had a contractual right in that period to share in those profits (ie a contractual right subsisting in that period to have a share of HFFX's profits paid to them, even if the right was satisfied by a payment in fact made after the end of that period). Since section 850 contemplates that the amount of the impact on an individual partner's income should be a specific amount in respect of that period which is knowable because it is determined by contractual rights subsisting in that period, the provision does not have the effect of converting deferred remuneration received by an individual member under the CAP into his income during the relevant period. This is because the individual member had no contractual right subsisting in the relevant period to receive that sum of money as part of the ordinary profit allocation process.

75. This analysis is in accordance with and follows the reasoning of Sir Launcelot Henderson in *BlueCrest CA*. He explains how section 850 features as part of the general scheme for taxation of partnership profits, which was not in issue in that case or in this: paras 42–46. In what follows I draw on his account.

76. All types of partnership, including limited liability partnerships such as HFFX, are generally treated for income and corporation tax purposes as transparent, and are therefore taxed on a "look-through" basis. Thus, section 848 of ITTOIA provides that "Unless otherwise indicated (whether expressly or by implication), a firm is not to be regarded for income tax purposes as an entity separate and distinct from the partners", and section 847(1) defines a "firm" collectively as "persons carrying on a trade in partnership". Those partners can be either individuals or corporate partners. As a matter of general law limited liability partnerships have a separate corporate identity. However, section 863 of ITTOIA provides that:

> "(1) For income tax purposes, if a limited liability partnership carries on a trade, profession or business with a view to profit–
>
> (a) all the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),
>
> (b) anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and
>
> (c) the property of the limited liability partnership is treated as held by the members as partnership property."

77. The way in which a partnership's trading profits are to be calculated is set out in section 849:

> "(1) If-
>
> (a) a firm carries on a trade, and
>
> (b) any partner in the firm is chargeable to income tax,

> the profits or losses of the trade are calculated on the basis set out in subsection (2) or (3) as the case may require.
>
> (2) For any period of account in which the partner is a UK resident individual, the profits or losses of the trade are calculated as if the firm were a UK resident individual."

78. In my view, the location of section 850 in this general scheme of taxation of partnerships supports the interpretation of it set out above. As Sir Launcelot Henderson observed (para 44), "[t]he crucial point is that, for any period of account, an individual partner's share of a profit or loss of the trade carried on by the firm is determined for income tax purposes 'in accordance with the firm's profit-sharing arrangements during that period'", and those arrangements are defined as "the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade". (An equivalent regime applies in relation to corporate partners, under sections 1262 and 1273 of the Corporation Tax Act 2009—"the 2009 Act"). The regime requires certainty as to who has responsibility for payment of tax in relation to profits and losses of a partnership, and section 850 provides it. It states a simple rule which minimises the difficulties of application and the dangers of capriciousness (and scope for avoidance) in its operation which might otherwise arise.

79. In order for the "look-through" basis of assessment to be workable, in accordance with this general scheme, in any relevant accounting period, it is necessary for the rights of the individual partner to share in the profits or losses of the trade in that period to be known at the time of the trading in that period. Taxation of the individual partners is by reference to the profits and losses of the partnership actually achieved in the relevant period, not by reference to the assets of the partnership, nor by reference to what an individual partner ultimately receives from the partnership at a later point in time. So it is the relationship of the individual partner to the profits and losses of the partnership in that period which has to be determined under this regime.

80. Moreover, the "look-through" principle which governs the regime requires that the whole of the trading profits and losses of the partnership in that period be attributed to the partners whether they are individuals or corporate partners (under the parallel provisions in respect of corporate partners in the 2009 Act), which again supports the view that it is their rights applicable in that period which are the critical indicator. There is no provision under the regime for later adjustment of the shares of those partners of profits and losses, as a departure from their rights arising in the period. Sir Launcelot Henderson rightly observed in *BlueCrest CA*, para 77: "the entirety of the partnership's trading profits has to be allocated between the partners in [the relevant period], and not at any future date".

81. As Sir Launcelot Henderson put it in *BlueCrest CA*, para 72:

> "there is nothing optional or provisional about this process of allocation. The full amount of the profits (or losses) for the period must be divided between the partners, in accordance with their rights (or liabilities) to share in them. Furthermore, there is no requirement that the partners should have actually received their allocated shares. What matters is the partner's entitlement to it, even if (for example) the partner is contractually obliged to plough it back into the business. Nor … is there any necessary correlation between the size of a partner's share and the nature or value of the partner's contribution to the business. In principle, it is open to the partners to agree the shares in which the profits will be divided between them, and tax law normally follows and respects such agreement. The fundamental protection for HMRC is that 100% of the profits must be allocated pursuant to section 850 (or, in the case of a corporate partner, section 1262 of [the 2009 Act]), and each allocated share will then (for a trading partnership) be taxed as trading income of the entitled partner in the relevant year, under section 5 of ITTOIA 2005 for an individual partner and section 35 of [the 2009 Act] for a corporate partner."

82. At para 71 of the judgment in *BlueCrest CA*, Sir Launcelot Henderson said that the regime "requires the actual profits of the partnership for the relevant accounting period to be allocated between the partners in accordance with their profit-sharing arrangements during that period". Mr Rupert Baldry KC for HMRC submitted that this was a material error which serves to undermine Sir Launcelot Henderson's analysis, because there is a difference between the (actual) accounting profits of a partnership (specifically here, HFFX), to which the contractual arrangements for division between the partners apply, and the taxable profits of a partnership (arrived at after certain adjustments are made to the accounting profits).

83. I do not accept that the way in which Sir Launcelot Henderson expressed the position in para 71 reveals any error in his approach. The technical difference between accounting profits and taxable profits was not in issue in *BlueCrest CA*. For the application of the tax regime in relation to partnerships, it is of course taxable profits (or losses) which are the relevant profits (or losses). Section 850 requires that they be allocated according to the contractual rights which apply in relation to actual profits (or losses) of the partnership, ie as determined according to the relevant partnership agreement. But there is no difficulty in transposing the contractual share in relation to actual profits (or losses) into a contractual share in relation to taxable profits (or losses) by making relevant adjustments pro rata. That is what section 850 requires. It speaks in simple terms of profits and losses in an accounting period, which must mean profits or losses which count for tax purposes, but treats them as being allocated according to the contractual rights of the partners, which refer to accounting profits. Accordingly, it is

inherent in the regime that each partner's share in the taxable profits (or losses) is determined by that partner's entitlement to share in the actual profits (or losses), subject to relevant adjustments.

84. The overarching submission of Mr Baldry was that the interpretation of section 850 given by Sir Launcelot Henderson in *BlueCrest CA* failed to give proper weight to the object and purpose of section 850, in accordance with the approach to statutory interpretation set out in *Rossendale BC v Hurstwood Properties (A) Ltd* [2021] UKSC 16; [2022] AC 690. According to Mr Baldry, the object and purpose of section 850 is that members of the partnership should be taxed in accordance with the division of partnership profits as a matter of commercial reality, and the commercial reality here was that through the operation of the CAP and by application of the LLP Deed, the individual members received sums of money which reflected their contributions to the business of HFFX in the relevant period.

85. Sir Launcelot Henderson rejected that submission by HMRC in *BlueCrest CA* at paras 75–76 in these terms:

> "75. I fully accept that the PIP scheme must be critically examined as a whole, and that the statutory concept of a 'right' to share in the profits of the partnership's trade in section 850(2) of ITTOIA 2005 is not in principle immune from a *Ramsay* approach [*WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300] which might, in an appropriate context, give it a broader meaning than an enforceable legal entitlement, which is what I take to be the normal connotation of a 'right'. But any wider approach of that nature could only be justified if, as in *Rossendale*, the statutory purpose of the relevant provision can be safely identified, and the wider meaning, when realistically applied to the facts, is needed to prevent the frustration of Parliament's intention in enacting it. That is where, in my view, HMRC's supposedly purposive approach to the construction of section 850 breaks down. The purpose of section 850 is to determine the shares of the partners in the actual profits of the partnership trade for the relevant accounting period, and this can only be done by examining the rights of the partners, including the corporate partner, to share in them. There is nothing illusory, or unreal, about the share allocated to the corporate partner, and it cannot therefore be simultaneously treated as consisting of separate slices of profit allocated to the participating PIP partners in addition to their direct shares.

> 76. The unreality of HMRC's approach is illustrated, to my mind, by their acceptance that, if it is adopted, the corporate partner cannot be charged to corporation tax on its allocated profit share. This concession may be tactically prudent, but I cannot discern any principled basis for it. The corporate partner was undoubtedly allocated its share, and the PIP arrangements were predicated on the fact that the corporate partner would then be liable to corporation tax in respect of it, at a lower rate than the top rate of income tax payable by the individual partners. Rates of income tax and corporation tax are, of course, set by Parliament, and if the former are significantly higher than the latter, that must be taken to reflect Parliament's intention. It follows that, if a partnership arranges its affairs so that a substantial proportion of its profits is payable to a corporate partner, and the arrangement is genuine and has a real commercial purpose, HMRC cannot complain and their remedy, if the arrangements are considered objectionable, is to procure a change in the law as happened in 2014."

86. I agree with this reasoning. The CAP arrangement in the present case, like the PIP arrangement in *BlueCrest CA*, had a valid commercial purpose: see para 6 above. Unlike in the *Ramsay* case, there was no part of its operation which did not share in that purpose, so as to justify ignoring it. The purpose of the statutory regime is to be determined primarily by reference to the language used by Parliament, read in context. That purpose is to impose taxation on the "look-through" basis described above and in accordance with the contractual rights of the partners (including GSAM) applicable in the relevant period.

87. Mr Baldry submits that the court should apply section 850 in a way which reflects what he says is the commercial reality of the case, that absent a positive decision being taken that an individual member will not be paid the deferred remuneration sum which was previously indicated to him, he will receive that sum. However, Mr Baldry's appeal to the general object and purpose of section 850 is pitched at a level which is too general and abstract, and is untethered from the language used by Parliament to impose the tax charge. The meaning of a provision is to be derived from the words used, according to their ordinary and natural meaning as read in context. In my view, section 850 applies in accordance with the ordinary and natural meaning of the words used in it and the determinate legal concepts to which those words refer.

(b) The application of section 687 of ITTOIA

88. Section 687 of ITTOIA is set out at para 32 above. In order for section 687 to apply, there must be a relevant "source" of the income in question. Mr Prosser, for the individual members, submits that there is no relevant source in this case. He contends that

in order for there to be a relevant source for the purposes of the provision, it has to be something which is possessed by the recipient of the income; and in this case, there was nothing in the possession of the individual members which led to their receipt of the income which is sought to be taxed.

89. Section 687 formed part of the Tax Law Rewrite Project and was designed to replace the residual charge to income tax previously contained in Case VI of Schedule D in the old tax regime. The most recent iteration of the previous charge was contained in section 18 of the Income and Corporation Taxes Act 1988, as amended, which charged tax under Case VI "in respect of any annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of [certain other statutory provisions] as employment income, pension income or social security income". As explained in *BlueCrest CA* (para 97), the Explanatory Notes for this part of ITTOIA prepared by the Rewrite Project confirm that it is based on section 18 of the 1988 Act, and explain (at para 2628) that Schedule D was "the residual Schedule into which income falls for income tax purposes if neither [other tax legislation] nor another Schedule of ICTA applies to it" and (at para 2629) that "Case VI is itself the residual Case under Schedule D".

90. It was common ground before us, as it was in *BlueCrest CA* and in the Court of Appeal and the tribunals in these proceedings, that section 687(1) was intended by Parliament to have the same scope as the earlier legislation, and that the authorities relating to Case VI of Schedule D (which go back many years) remain relevant to its interpretation. On any view one cannot be sure about the intended effect of section 687 without going back to the antecedent tax regime and the caselaw on it, and in cases of significant uncertainty or ambiguity the presumption in respect of legislation produced pursuant to the Tax Law Rewrite Project is that the meaning of the antecedent legislation is not changed. This is in line with the position in relation to a Consolidation Act according to the principles set out in *Farrell v Alexander* [1977] AC 59, as adopted by this court in relation to legislation produced as part of the Tax Law Rewrite Project: see *R (Derry) v Revenue and Customs Comrs* [2019] UKSC 19; [2019] STC 926, paras 7–10.

91. In *BlueCrest CA* there was an issue whether the deferred sums paid under the PIP arrangements constituted "income" to which section 687 applied and an issue whether there was a relevant "source". In the present case, the individual members accept that the deferred sums paid under the CAP arrangements constitute "income", and the only issue is whether there is a relevant "source".

92. It is now common ground that the payments were not purely voluntary, since they were paid pursuant to the exercise of a contractual discretionary power governed by the *Braganza* principles. HMRC submit that in these circumstances the deferred payments under the CAP fall within section 687. They are income not otherwise charged to tax and they have a source of a kind recognised under the current and previous tax codes, since it is clear where the payments come from, why they are made and that they are not purely

voluntary or in the nature of a gift. They are paid by reason of the individual members' rights under the CAP and the LLP Deed in combination with the exercise of discretion under the provisions of the LLP Deed. As Falk LJ said (para 79), "the individual members' rights under the [LLP Deed], combined with decisions taken in their favour to reallocate Special Capital, amounted to a source from which the receipt of the Special Capital pursuant to those decisions was derived".

93. In stating the point in that way, Falk LJ was following the approach adopted by Sir Launcelot Henderson in *BlueCrest CA*, in which (having held that payments of deferred remuneration under the PIP arrangement were indeed "income" in the relevant sense) he held that that income had a relevant "source" and fell within section 687. Sir Launcelot Henderson rightly held (para 102) that it is implicit in the wording of section 687(1) that the income must arise from an identifiable source in the relevant tax year. This is common ground in these proceedings.

94. In deciding that there was a relevant source, Sir Launcelot Henderson referred in particular to the decision of the Upper Tribunal in *Spritebeam* and to the decision of the Court of Appeal in *Cunard's Trustees*. He analysed *Cunard's Trustees* with care (paras 120–123). In the light of that decision, he said (para 123): "I … see no difficulty in holding that a source for the final PIP awards may be found in the exercise by the corporate partner of its discretion whether or not to follow the recommendations of the Board [of directors] and make the awards, especially as it is common ground that the discretion was not unfettered and had to be exercised in accordance with the principles of the *Braganza* case".

95. In *Cunard's Trustees* the trustees of a will were directed to hold the residuary estate of the testatrix on trust to pay the income to her sister during her life, with power to supplement the income from capital if the income alone was insufficient to enable the sister to live in the same degree of comfort as she had during the testatrix's lifetime. This power was exercised by the trustees. The sister was then assessed to income tax under Case III of Schedule D and to surtax on the whole of the payments made to her, including the supplements from capital. The main argument for the taxpayer ([1946] 1 All ER 159, 161; 27 TC 122, 130–131) was that "the payments in question, having been made out of capital at a time when the residue had not been ascertained, were not [her] taxable income". Lord Greene MR delivered the leading judgment, with which the other members of the court agreed. He held that the will, properly construed, authorised the application of capital in this way from the date of the testatrix's death, and not merely from the date when the administration of the residuary estate was completed. Lord Greene said ([1946] 1 All ER 159, 163; 27 TC 122, 132):

> "The payments, therefore, in my opinion, were properly made and at the moment of payment became income of the recipient [sister]… [Her] title to the income arose when the trustees

> exercised their discretion in her favour and not before. *At that moment a new source of income came into existence*. The payments came to [the sister] under the express terms of the will and not by virtue of what I may call the quasi-interest enjoyed by a residuary legatee pending completion of administration …" (Emphasis added.)

96. The question whether there was a "source" as a matter of law was not specifically in issue, but it was an important feature of Lord Greene's reasoning to explain that the payments out of capital in the hands of the trustees acquired the character of income in the hands of the sister of the testatrix. Lord Greene's statement indicates that it is entirely natural to regard the exercise of a discretion framed by a legal instrument to pay a sum as income as a "source" for the purpose of the tax regime.

97. As Mr Chacko (who presented this part of the argument for HMRC) rightly observed, the question whether a payment constitutes income (which requires that it should not be purely voluntary) and the question whether it has a source are closely bound up together. Lord Greene's analysis bears this out. Whilst it is not necessary to decide whether "income" for tax purposes always necessarily has a relevant "source", it will usually be the case that it does. Absent some special factor bearing on the legal analysis, where there is an identifiable reason, framed by powers and obligations arising from a legal instrument, for a payment of income to be made, that is properly to be identified as the relevant "source" of the payment so as to satisfy the requirement in section 687.

98. The remaining part of Lord Greene's judgment supports this approach. He went on to deal with further arguments of the taxpayer that the payments were not taxable under Case III of Schedule D because (a) they were not annual payments, and (b) they were discretionary and therefore voluntary payments which the taxpayer could not claim as of right ([1946] 1 All ER 159, 163; 27 TC 122, 133). The answer to the first point was that the payments were capable of recurrence on a yearly basis, even if they varied in amount, while the second argument also fell to be rejected. The fact that, subject to an obligation to consider the sister's position, the trustees had an absolute discretion and might conclude that no supplementary payment was required (so that the sister could not claim one as of right) did not give a payment, if and when made, the character of a voluntary payment which would not have qualified as income (in the context of the present appeal it is not contended that the deferred remuneration payments were voluntary in nature). Lord Greene distinguished purely voluntary payments, saying ([1946] 1 All ER 159, 163–164; 27 TC 122, 133–134):

> "But the payments here were of a totally different character. They were not voluntary in any relevant sense, but were made in the exercise of a discretion conferred by the will out of a fund provided for the purpose by the testatrix. It is true, of course,

> that the trustees had an absolute discretion whether to make a payment or not. But the question whether they should do so is one which they were bound to take into their consideration. … The money, when received by [the sister], was received by her through the joint operation of the will and the exercise of their discretion by the trustees."

Sir Launcelot Henderson considered that although *Cunard's Trustees* was concerned with Case III of Schedule D, Lord Greene's observations were equally capable of application to Case VI of Schedule D and (now) section 687.

99. On this reasoning, it may be observed that the inference that the deferred payments of income to the individual members have a relevant source is even stronger in the present case than it was in *Cunard's Trustees*. The LLP Deed included, as Schedule 7, a draft pro forma letter to be used in writing to individual members, headed "Notification of Potential Award under HFFX LLP Capital Allocation Plan", to explain the operation of the Special Capital mechanism under the CAP. As part of the LLP Deed, this is relevant to its interpretation, including the extent of the *Braganza* obligations (which, in some appropriate form, would apply in any event). As Falk LJ observed (para 72) the addressee is given the clear impression that an award will only be held back or reduced in specified circumstances, namely to take account of regulatory requirements, the application in "limited circumstances" of clause 11.9(B) of the LLP Deed or where they are a "bad leaver", in particular if they are guilty of misconduct or join a competitor. Therefore, the nature of the limits on GSAM's and Mr Gerko's discretion with regard to withholding any payment are such that, broadly speaking, a payment will be made absent good reason not to make one; whereas in *Cunard's Trustees* the discretion was such that no relevant payment out of capital would be made unless there was good reason to make one. In both cases, however, a relevant source of the income could be identified. So also, as Falk LJ noted (para 45), in *BlueCrest CA* "what was held to be sufficient to create a source was the exercise by the corporate partner of its discretion to reallocate Special Capital in the context of a legal agreement which conferred certain rights on the individual members". It was not necessary to identify any entitlement to the payment in terms of an absolute obligation to make it. She rightly held (para 47) that it was nothing to the point that an original provisional decision to make the payment might be reversed (in the exercise of discretion) until such time as the payment was made and received.

100. Falk LJ analysed other authorities relied on by Mr Prosser, showing that rather than undermining this analysis they support it. I agree.

101. In *Drummond v Collins* [1915] AC 1011; (1915) 6 TC 525 non-UK resident trustees of a discretionary will trust exercised their discretion to pay income derived from property abroad to the testator's minor grandchildren. The children's mother was assessed to tax as their guardian under Case 5 of Schedule D (income from foreign possessions).

The remittances to the children arose from property outside Great Britain, within the meaning of the legislation, and the mother's argument that the payments to the children were not their "income" because they were voluntary payments by the trustees (see p 1017) failed. At p 1017 Earl Loreburn (with whom Lord Atkinson, Lord Parker of Waddington and Lord Sumner concurred) referred to the payments as:

> "…not voluntary payments in any relevant sense. They were payments made in fulfilment of a testamentary disposition for the benefit of the children in the exercise of a discretion conferred by the will."

It is implicit in this that the payments were "income" with a relevant source, which was the exercise of a discretion under a trust of foreign assets, as framed by the will. As in *Cunard's Trustees*, the issue in the case was not directly concerned with whether there was a source, but the reasoning shows that if there was a sufficient foundation of a legal reason for the payments as to make them "income", that constituted a relevant source to bring the payments within the tax regime. This supports the reasoning of the Court of Appeal in *BlueCrest CA* and the present case.

102. Mr Prosser sought to rely on two statements by Lord Wrenbury in *Drummond v Collins* at p 1020 to indicate that the relevant source was required to be a full legal entitlement to the payment (something he said was absent in the present case). In the first part of his reasoning to dismiss the mother's argument, Lord Wrenbury said that "there could be no payment except by exercise of the discretion vested in the trustees, but so soon as their discretion is exercised in favour of the child the resulting payment seems to me upon the language of the will to be a payment of income to which the child is entitled by virtue of the gift made by the testator." This meant that it was income subject to tax. In my view, this reasoning is consistent with that of Earl Loreburn and is contrary to Mr Prosser's submission. The exercise of discretion by the trustees constituted the link between the payments and the gift by the testator in the will and was a relevant source so as to make them income.

103. Secondly, Lord Wrenbury set out an alternative analysis to explain that the payments should be treated as taxable income of the child even if that income was to be regarded as only contingently theirs, but as otherwise belonging to someone else to whom it would go if the trustees did not exercise their discretion in the child's favour. For the purposes of explication he stated that the alternative analysis proceeded on the assumption "that the money which is paid for the benefit of the child is *not* income of the child rendered payable by the action of the trustees, but is income which but for the action of the trustees would have been income of someone else (the person entitled under the gift over) which only comes to the child because the trustees under the provisions of the will divert it from that other person and make it payable for the child" (emphasis added). He said this to distinguish the alternative analysis from his primary analysis, using a

description of the latter which reinforces the account of it in para 102 above. On Lord Wrenbury's alternative analysis, it remained the case that "directly the trustees exercise their discretion in favour of the child the interest of the child ceases to be contingent and becomes vested". On that analysis also, the payments would be "income" of the child subject to tax; again it is implicit in his reasoning that it is the exercise of the trustees' discretion under the trust framed by the will which qualifies as the relevant source to connect the testamentary gift (in the form of funds derived from foreign assets) and the payments which the child received as income.

104. Mr Prosser also relied on Lord Parker's speech at pp 1018–1019; however, as I read this it is also contrary to his submission. Lord Parker said that "it is enough for case 5 to apply that the person to be assessed has *such an interest in the property* as to entitle him to the profits or gains in question" (emphasis added: ie a sufficient legal interest to constitute a relevant source), and the children had such an interest. Again, the critical connecting factor between the payments received and the foreign assets so as to make the payments qualify as income derived from those assets was the exercise of discretion by the trustees. Although the children could not give a receipt for it, "the money in question was, as soon as the trustees had exercised their discretionary trust"—the relevant connecting factor constituting the source for the payment—"held in trust for [the children] as beneficiaries" (in other words, was theirs, just as the payments to the individual members upon the exercise of discretion by GSAM, and for which as adults they can give a receipt, makes those payments theirs).

105. Contrary to Mr Prosser's submission, the House of Lords in *Drummond v Collins* was not concerned with the precise nature of the entitlement acquired when the discretion was exercised in favour of the children, save only to check that a payment had been received by them or on their behalf. That was because, if no money had been paid to them or to someone representing them, there could be no question of them being in receipt of income; but as I have mentioned, there is no doubt in the present case that the individual members have been paid money pursuant to the CAP arrangement which constitutes their income. Rather, what was critical in *Drummond v Collins* was the children's interests under the terms of the will in combination with the exercise of the trustees' discretion in their favour. Both components were essential, and it is implicit that together they constituted a relevant source. The analogy with the present case is close.

106. By contrast, in *Stedeford (Inspector of Taxes) v Beloe* [1932] AC 388, the Reverend Beloe was held not to be taxable on a series of payments made to him following his retirement as headmaster of a school under a power conferred on the school's governing body under its charter. The important point was that the payments were "a mere voluntary gift" which depended on "somebody else's goodwill" (per Viscount Dunedin at p 390). While the charter permitted pension payments to be made, that was pursuant to a power conferred on the governing body to apply income for "such purposes as in their absolute discretion they may deem to be for the benefit of the college". Again, the close association of the question whether a payment is purely voluntary and whether there is a

relevant source for the sum received to qualify as taxable "income" of the recipient is evident.

107. Unlike in the present case, where the *Braganza* principles apply to give the individual members certain rights in relation to the exercise of discretion by GSAM and Mr Gerko, and hence a sufficient interest as to prevent the payments made from being a "mere voluntary gift", in *Stedeford v Beloe* the taxpayer had no right at all to seek to control the exercise of the relevant discretion. Under the school's charter, the relevant beneficiary was to be the school rather than anyone else, including retired staff. As Falk LJ pointed out (para 52) this is to be contrasted with the right of a discretionary beneficiary under a trust to be properly considered as a potential recipient and to have their interest protected by a court by compelling due administration of the trust: see *Snell's Equity*, 34th ed (2019) at 22–005; *Gartside v Inland Revenue Commissioners* [1968] AC 553, 617–618; and *Cunard's Trustees*. She correctly observed (para 58) that in circumstances where a decision is made pursuant to a legal framework of the kind considered in *Cunard's Trustees* and *BlueCrest CA* under which the recipient has a right to be considered, "the possibility of the decision being altered before it is implemented"—as Mr Prosser emphasised might happen if the power under clause 11.9(B) of the LLP Deed to prevent a reallocation to an individual member in certain circumstances were exercised—"does not affect the fact that a reallocation or payment that actually is made has its source in the decision to make it".

108. Mr Prosser also relied on *Brocklesby v Merricks (Inspector of Taxes)* (1934) 18 TC 576, a decision of Finlay J upheld by the Court of Appeal, and the decision of Rose J in *Manduca v Revenue and Customs Comrs* [2015] UKUT 262 (TCC); [2015] STC 2002. Falk LJ explained that these do not assist him: paras 53–56.

109. In *Brocklesby v Merricks* an architect arranged an introduction which led to the purchase of an estate by a client through a company. He later contracted with the company to work on a sale of the estate in return for a share of the profit. He did very little work but duly received his agreed share. An assessment to tax under Case VI of Schedule D was upheld. Finlay J commented (p 582) that anything paid for the initial introduction would have been "a perfectly voluntary payment and would not be income; it would be merely a present". However, the Special Commissioners had found that the payment the architect subsequently received was made for services rendered, and it did not matter that the architect had done very little: it was a "contract for remuneration in respect of services rendered", and it made no difference that it was very advantageous for him. The sum was paid because the architect had an enforceable right under a contract for services, rather than it being something given for a "purely voluntary service" (p 583). Again, it is striking that the relevant distinction was between a purely voluntary payment (which would not qualify as income because, implicitly, it had no relevant source) and a payment rooted in some sufficient form of legal entitlement (which would qualify as income because it did have a relevant source).

110. *Manduca v HMRC* concerned the tax treatment of an amount paid in settlement of a claim for failure to pay an agreed bonus to employees of a hedge fund manager who had been made redundant. It was common ground that the settlement amount should have the same tax treatment as the bonus would have had. HMRC's assessment under Case VI of Schedule D was upheld, on the basis that the bonus was remuneration for services provided under a binding contract, akin to profits or gains falling within other Cases of Schedule D. Rose J accepted (para 35) the submission for HMRC that:

> "…once it is established that the payment was an income receipt rather than a capital receipt and that it was paid pursuant to a binding contract in return for some kind of service then there is no need to go further to inquire into the extent of the services in fact provided".

The same comment as in para 109 above applies.

111. As Falk LJ pointed out, *Brocklesby v Merricks* and *Manduca v HMRC* are consistent with earlier case law. In *Scott v Ricketts* [1967] 1 WLR 828, at p 831, Lord Denning MR relied on Rowlatt J's judgment in *Ryall v Hoare* [1923] 2 KB 447 to say that Case VI of Schedule D included remuneration for services rendered but not gratuitous payments. Again, the comment in para 109 applies. Lord Denning observed that Case VI, the predecessor of section 687, was a "sweeping up" provision, which is a further indication that it and section 687 are to be interpreted according to the natural and ordinary meaning of the words used, and that there are no grounds for glossing them or reading them down in some way so as to narrow their application.

112. This is also in line with the interpretation given in *Cooper v Stubbs* [1925] 2 KB 753. Schedule D, as it then stood, imposed a tax on a person residing in the UK on the annual profits and gains arising "from any kind of property" and from "any trade [etc] carried on in the United Kingdom", and the predecessor provision of section 687 provided for tax to be imposed in respect of "other annual profits or gains not charged under Schedule A, B, C or E, and not specially exempted from tax". Atkin LJ said (p 774) that the profits and gains referred to in that provision "must include … profits and gains which are not derived from any property whatever and are not derived from any trade, profession, employment or vocation exercised in the United Kingdom. They are something wider and larger than that."

113. A further submission by Mr Prosser in the Court of Appeal and again to this court is that in order to qualify as a "source" of income the foundation for the income received has to be something that the taxpayer possesses, relying in particular on an observation by Lord Oliver of Aylmerton in *Bray (Inspector of Taxes) v Best* [1989] 1 WLR 167, 173,

adopting a statement in *Whiteman and Wheatcroft on Income* Tax, 2nd ed (1976), p 21, para 1–28:

> "Most types of income are classified by reference to the source from which they come. From this it was held to follow that if a taxpayer ceased to possess a particular source of income, he could not be taxed on delayed receipts from that source unless they were referable to, and could be assessed in respect of, a period during which he possessed the source."

Mr Prosser also relied on a statement by Rowlatt J in *Fitzgerald v Comrs of Inland Revenue* [1919] 2 KB 154, 159; (1919) 7 TC 284, 287, that income tax "which is imposed for the year and in respect of the several sources of income named in the several Schedules [under the old tax regime], depends upon the existence in the hands of the person assessed during the year or less period of assessment of the source of income taxed."

114. However, these statements were posed in very general terms without specific reference to the provision which has become section 687. Such statements are not a foundation for seeking to introduce qualifications which are not expressly set out in that provision or necessarily to be implied into it.

115. Falk LJ held that the concept of possession of a source was inapposite in the context of section 687: paras 63–67. I agree. In some contexts, the concept of possessing a source of income is useful; and in some contexts it may be an essential part of the process of classification of types of income, as Falk LJ pointed out. However, it is not possible to construe section 687 as importing any such requirement.

116. Section 687 refers only to there being a source of the income, not a source that is possessed by the recipient of the income. A source of income may exist so long as there is some relevant and sufficient factor connecting the income and the recipient, as there is in this case. *Cunard's Trustees* is another example of a case where the relevant source was not possessed by the recipient of the income, yet the equivalent provision was applied. The interpretation of section 687 is straightforward and should not be made more complicated than it needs to be by glossing it in the manner proposed by Mr Prosser.

117. Mr Prosser sought to derive support for his submission from a dictum by Lord Atkin in the Privy Council in *Rhodesia Metals Ltd (In Liquidation) v Commissioner Of Taxes* [1940] AC 774, at 789: "Their Lordships incline to the view … 'Source means not a legal concept, but something which a practical man would regard as a real source of income'; 'the ascertaining of the actual source is a practical hard matter of fact'". Following that approach in relation to a statute taxing income received from any source in the relevant overseas territory, the Privy Council held that, where the sole operation of

an English company was the purchase of immovable property in that territory and its development there for the purposes of transfer at a profit, the only proper conclusion was that the company received the profit in issue from a source within that territory which therefore fell to be taxed. In my view, Lord Atkin's statement does not assist Mr Prosser, but is contrary to his submission. It reinforces my view above that the concept of a "source" of income in a taxation context is one to be interpreted in a realistic way, in accordance with the ordinary and natural meaning of the word in its context.

118. The same comment applies in relation to another statement which Mr Prosser particularly sought to rely upon, by Lord Radcliffe in *Mitchell and Edon v Ross* [1962] AC 814; (1961) 40 TC 11, 61:

> "Generally speaking, the five schedules of taxable categories [under the old tax regime] are distinguished from each other by distinctions as to the nature of the source from which the chargeable profit arises. The source may be property in the ordinary sense such as land, securities, copyright, office, or it may be an activity sufficiently coherent, trade or profession for example, to be regarded as itself the stock upon which profits grow. That is not an exhaustive account, but it is, I think, a sufficient general introduction."

119. There is no suggestion there that the word "source" is to be given anything other than its natural meaning. One does not "possess" an activity (to use Lord Radcliffe's word), but it may qualify as a source. There is no reason why the decision-making process of Mr Gerko and GSAM in implementing the CAP and the LLP Deed, subject to the *Braganza* obligations, cannot qualify as a relevant "source" for the purposes of section 687. On a natural reading of that term, in its context, it is clear in my view that it is the source of the deferred income received by the individual members.

120. It follows from the analysis above that I agree with Falk LJ (para 79) that the individual members' rights under the LLP Deed, combined with decisions taken in their favour to reallocate Special Capital, amounted to a source from which the receipt of the Special Capital pursuant to those decisions was derived.

121. It is therefore unnecessary in this court, as it was in the Court of Appeal and in *BlueCrest CA*, to consider an alternative analysis proposed by HMRC, contending that a payment made in return for activities or services can fall within section 687 independently of a contractual framework of the kind in place here.

(c) A new submission: section 575 of ITTOIA

122. On the appeal to this court Mr Prosser raised a new point based on section 575 of ITTOIA. That is headed "Provisions which must be given priority over Part 5 [of ITTOIA]" and sets out a priority rule for the application of different parts of ITTOIA. Subsection (1) provides that "Any income, so far as it falls within—(a) any Chapter of this Part [ie Part 5], and (b) Chapter 2 of Part 2 (receipts of a trade, profession or vocation), is dealt with under Part 2". Section 687 is in Chapter 8 of Part 5 of ITTOIA. Mr Prosser contends that HMRC is seeking to tax the income from a trade, within Part 2 of ITTOIA, and it is the trade of HFFX which is the source of the income; therefore it is that part which applies, excluding the operation of section 687.

123. This argument was not raised in the tribunals below or in the Court of Appeal, nor in the grounds of appeal for which the individual members were given permission to argue in this court. However, I would grant permission for the point to be introduced on this appeal, so that this court can produce a definitive judgment regarding the tax position in relation to deferred remuneration schemes for partners of the kind at issue in these proceedings and in *BlueCrest CA*.

124. What was in substance the same point was addressed in the judgment of the Upper Tribunal in *BlueCrest UT*, para 127. The Upper Tribunal held that the FTT in that case "was right to identify the source of each PIP Award [ie the deferred remuneration under the PIP arrangement] as the decision of the Corporate Partner rather than the underlying trade of the Partnership". At para 127(3) the Upper Tribunal said:

> "The analogy which Mr Gammie [counsel for the individual partners] drew between the PIP and a partner who makes withdrawals of capital from the partnership is not exact and may be apt to mislead. Where a partner who reinvested his or her profit allocation back into the partnership and then later withdrew it as capital, we might well accept that the ultimate source was the partnership trade. But in the present case the profits were allocated to the Corporate Partner who re-invested those profits. It then exercised a discretion to transfer those profits to the [individual partners]. There was, therefore, a second and entirely separate stage before the [individual partners] withdrew their capital. Unlike Mr Gammie's partner in the solicitor's firm the [individual partners] had no right to withdraw their Special Capital unless the Corporate Partner made a decision to re-allocate it to them and made their PIP Awards final."

125. The Upper Tribunal's reasoning on this issue was approved by Sir Launcelot Henderson in *BlueCrest CA* at para 124.

126. At paras 128–129 of *BlueCrest UT* the Upper Tribunal dismissed a further related argument of Mr Gammie for the individual partners, to the effect that the presumption that Parliament does not intend to tax the same person on the same income twice unless it clearly and expressly legislates to the contrary (*Canadian Eagle Oil Co Ltd v R, Selection Trust Ltd v Devitt (Inspector of Taxes)* [1946] AC 119, 151–152, per Lord Macmillan) applies, so as to indicate that section 687 could not apply in relation to the income received by the individual partners. The Upper Tribunal held that the presumption was not applicable and gave the same fundamental answer: "The Corporate Partner and the [individual partners] were not the same person and they were not taxed on the same income. They were being taxed on income from separate sources".

127. I agree with the reasoning of the Upper Tribunal and Sir Launcelot Henderson. There is no relevant overlap between taxation of the profits of the underlying trading activity of HFFX and the taxation of the deferred remuneration element received by the individual members pursuant to the LLP Deed and the CAP arrangement so as to allow for the operation of section 575. Indeed, the submissions of Mr Prosser in relation to the issue arising in respect of section 850 of ITTOIA, which I have accepted above, rightly emphasise the fact that the deferred remuneration is distinct from the trading profits of the partnership.

128. Although the deferred remuneration element is paid by GSAM out of money which derives from profits of HFFX which have been taxed as profits in GSAM's hands, on the "look-through" basis described above, this is not germane to the question of the application of section 575. As Mr Chacko points out, there is no general principle that a taxpayer can deduct tax which the person paying him income has had to pay in relation to receipt of the money which put it in funds to pay that income. It is not unusual for the tax system to operate in this way. He gave the example of a company which pays tax on its profits and then uses the remainder of the money it has received to pay dividends which constitute income in the hands of its shareholders, who are taxed on that income. In a similar manner, in the present case the payments of deferred remuneration are payments out of GSAM's funds, not out of funds of HFFX.

129. I therefore dismiss Mr Prosser's submission based on section 575 of ITTOIA.

Chapter 4 of Part 13 of ITA 2007: "Sales of occupation income"

130. In view of my conclusion regarding the application of section 687 of ITTOIA in this case, it is not necessary to address this statutory regime and, without the assistance of a full discussion of it in the Court of Appeal in these proceedings or in *BlueCrest CA*,

it would not be appropriate to do so. Like those courts, I prefer to reserve my opinion and should not be taken to be endorsing or otherwise commenting on the decisions of the Upper Tribunal on this part of the case.

Conclusion

131. For the reasons given above, I would dismiss HMRC's appeal in relation to section 850 of ITTOIA and I would dismiss the individual members' appeal in relation to section 687 of ITTOIA.