



[2014] UKUT 0360 (TCC)

Appeal number: FTC/129/2013

Income tax – Industrial buildings allowance – Commercial building in enterprise zone – Building leased by health board for use as laundry – Agreement with two other health boards for use of laundry by them in consideration of payment comprising share of total cost – Whether First-tier Tribunal entitled to find that building used for the purposes of a trade (yes) – Capital Allowances Act 2001, sections 271 and 281 – Appeal refused.

**UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)**

**ON APPEAL FROM THE
FIRST-TIER TRIBUNAL (TAX CHAMBER)**

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

Appellants

v

DAVID THOMSON

Respondent

TRIBUNAL: LORD TYRE

Sitting in public at George House, 126 George Street, Edinburgh on 9 and 10 June 2014

**Iain Artis, Advocate, instructed by the Office of the Advocate General for Scotland, for
the Appellants (HMRC)**

Keith Gordon, Barrister, for the Respondent (David Thomson)

© CROWN COPYRIGHT 2014

DECISION

LORD TYRE

Introduction

1. The respondent is a member of a syndicate which funded the construction and fitting out of a building procured by Lanarkshire Primary Care NHS Trust for use as a laundry. The building is located within the Lanarkshire Enterprise Zone at Wishaw, and the expenditure incurred by the respondent qualifies for an initial industrial buildings allowance of 100% if the building is used for the purposes of a trade. In its decision dated 4 September 2013, the First-tier Tribunal (FtT) held that the building met this condition. HMRC now appeal against that decision. The issue is whether the FtT could reasonably have found that the laundry building is used for the purposes of a trade.

The First-tier Tribunal's findings in fact

2. The FtT's findings in fact were derived largely from the evidence of Mr Graham Johnston, head of management services at NHS Lanarkshire ("Lanarkshire"). Mr Johnston was familiar with the background to the construction and operation of the laundry. He provided a witness statement and gave evidence at the hearing before the FtT.
3. As the issue arising in this appeal is whether the FtT could reasonably make the inference that the laundry was used for the purposes of a trade, it is appropriate to set out in full its primary findings in fact:

"4. A decision had been made by the Lanarkshire Primary Care NHS Trust in about 2002 to investigate the possible forms of alternative laundry facilities. The optimum size for this, having regard to fixed and operating costs, was significantly in excess of Lanarkshire's requirements, and therefore consideration had to be given to using up the excess capacity to minimise unit costs. The obvious other users were other Health Boards but consideration was given to attracting private sector users such as hotels. Lanarkshire had such customers using their then laundry facilities but, perhaps as a result of the attendant publicity generated by the new facilities, there was some perceived risk of contamination which, Mr Johnston considered, had affected their interest. In the event two other Health Boards, NHS Ayrshire and Arran ("A&A") and NHS Dumfries and Galloway ("D&G") entered into an arrangement for laundry services with Lanarkshire. The laundry's work in its first year of operation may be apportioned between the principal users broadly as follows, viz 40% Lanarkshire; 40% A&A; and 20% D&G. Apart from that a relatively small amount of laundering was done for other customers, all as set out in the "Income Report" which was produced in the course of Mr Johnston's evidence.

5. We noted that Mr Johnston described the laundry provision as a “commercial arrangement”. Lanarkshire “provided a service” for which the other users paid a “price”, he said. In calculating prices charged Lanarkshire aggregated all its costs and sub-divided this by the total number of items processed. There was not an additional profit element, but Lanarkshire required to defray its expenditure and maximise the laundry’s throughput. At the start of each Year a “price” was projected, which would be reviewed in the course of the Year and adjusted to take account of, say, any fluctuations in fuel prices. The laundry provided also a “replacement” service for worn or damaged items. It was noted by Mr Johnston that Lanarkshire could competently charge other NHS bodies only for costs and not in addition a profit element.

6. In cross-examination Mr Johnston explained that Lanarkshire had entered into two contracts, one a lease of the building and the other a lease of the necessary plant and equipment. There was no direct or contractual relationship between the landlord/lessor and the other Health Boards.

7. Mr Johnston was invited to comment on certain of the documents produced which were relevant to the laundry and its use. He explained that the construction of the new laundry had been preceded by several years’ discussions involving other potential users including other health boards. He spoke to the terms of the Full Business Case and the consideration of the various business options. The status of the agreement between the Health Boards as to the use of the laundry was described as an “NHS contract” rather than a “lawyers’ contract”. All this was in terms of the NHS (Scotland) Act 1978. While the agreement was not enforceable at law, any dispute between parties would be referable to the national Health Board and the Scottish Ministers, so providing a means of recourse. The agreement sets out the arrangements between Lanarkshire and the other Health Boards, A&A and D&G. (The Tribunal notes at para 4.4 the dilapidation provision acknowledging Lanarkshire’s sole liability as tenant in terms of the Leases relating to the laundry.) The concluded relationship was described as the “West of Scotland Laundry Consortium”.

8. The new laundry was opened in early November 2003. It was handed over then by the construction teams to Lanarkshire. Initially there was a 3-4 week phased introduction, with Lanarkshire testing its operational efficiency with its own laundry.

9. We found Mr Johnston an impressive and informed witness. Although he was involved in establishing the laundry, he has no financial interest in the outcome of this appeal. We found him wholly credible and reliable. His recollection, we considered, was accurate. His account in terms of his Witness Statement and evidence, as we have narrated it, should be considered to be our **Findings-in-Fact.**”

4. I read the words “as we have narrated it” in paragraph 9 above as referring to Mr Johnston’s oral evidence; I accept the respondent’s submission that the FtT has adopted Mr Johnston’s witness statement as part of their findings in fact. Nothing, however, turns on this. Having regard to the terms of paragraph 9 above, I decline the respondent’s invitation to treat certain later paragraphs of the FtT’s decision as additional findings in fact. I note for the sake of completeness that, prior to the execution of the agreement with

A&A and D&G, the powers and functions of Lanarkshire Primary Care NHS Trust had been transferred to Lanarkshire Health Board.

Industrial buildings allowance

5. Industrial buildings allowances, including initial allowance, are available under section 271(1)(b)(iv) of the Capital Allowances Act 2001 for expenditure incurred on the construction of a building in a qualifying enterprise zone which is used or to be used as a commercial building. In terms of section 306, the rate of the initial allowance is 100%. Section 281 provides that “commercial building” means *inter alia* a building which is used for the purposes of a trade, profession or vocation.

The FtT’s decision

6. The FtT noted that although there is extensive case law on the meaning of “trade”, there is no comprehensive definition. The concept included an isolated adventure as well as a continuing activity, but no profit motive was necessary. In the present case, the defraying of Lanarkshire’s overheads and other expenses by means of the agreement with A&A and D&G approximated to a profit motive. A “price” had to be determined as consideration, and the absence of an excess element of profit made little difference. Apart from that element, Lanarkshire had to view the laundry enterprise as any entrepreneur would do. A service was provided on a frequent and repeated basis, to a competitive standard, and for a price reflecting the full cost of its provision. Lanarkshire’s position and interests were distinct from those of the other Boards. Lanarkshire had liabilities under the lease. The three Boards operated independently of one another although participating in the provision of the health service in Scotland. The arrangements between them were at arm’s length, and all aspects of arm’s length trading were present except a desire to make a profit. The provision in the agreement for reference of disputes to the Secretary of State was akin to an arbitration clause in a contract. For these reasons the FtT found that the laundry activity fell within the definition of a trade. The FtT then addressed an argument by HMRC regarding “first use” which was not renewed on appeal to the Upper Tribunal.

Argument for HMRC

7. On behalf of HMRC it was contended that the FtT had erred
 - in treating its primary findings of fact as sufficient to support a conclusion that Lanarkshire’s laundry activity was a trade, when the preponderance of evidence reflected in these findings pointed to the opposite conclusion;
 - by applying a test of whether the supply of laundry services was at arm’s length;
and

- by adopting an approach of drawing an analogy with commercial activities rather than by considering whether the laundry activity was a commercial activity, with the consequence that it failed to give due weight to a number of cogent circumstances demonstrating that it was not.
8. The activity of washing laundry was not of itself a trade but a domestic chore, even if carried out on a large scale and on a regular basis. The part of the activity that served Lanarkshire was merely its in-house resource; on no view was the whole activity a trade. There was no practical difference between the costing and management arrangements by which the service was obtained by and charged to Lanarkshire on the one hand and A&A and D&G on the other. In a real sense, the arrangements amounted to NHS Scotland dealing with itself. There was no profit motive, merely a cost-sharing motive. Losses were not possible and there was no prospect of a loss of or a return on capital. There was no evidence that the arrangements were of a kind characteristic of ordinary trading in the provision of laundry services. Lanarkshire's hope of providing a laundry service to private users had not been fulfilled. The Tribunal had perhaps been distracted by Mr Johnston's use of the word "price", which was no more than a label for a recharge at cost. The FtT had also erred in applying a criterion that there be arrangements at arm's length, instead of ascertaining whether the commercial characteristics of trading were present. The authorities did not support using arm's length relationship as a test.
 9. In reasoning by analogy with commercial activities, the FtT had failed to take proper account of the differences disclosed by the comparison. These included the in-house nature of the laundry, the participants' function as providers of health care free at the point of delivery, the reason for development of the laundry to implement a NHS strategy as opposed to a commercial decision, the participants' cost-sharing motivation, and the participation of all three Boards in directing the laundry. Had the FtT taken these factors properly into account, and having regard to the dearth of factors pointing towards the laundry activity being commercial in nature, it could only have concluded that no trade was being carried on.

Argument for the respondent

10. The respondent submitted that the FtT had reached the correct conclusion and, indeed, the only conclusion available to it on the facts, which fell squarely within the meaning of trade as explained by Lord Reid in *Ransom v Higgs* [1974] 1 WLR 1594 at 1600: "operations of a commercial nature by which the trader provides to customers for reward some kind of goods or services". The absence of a profit motive did not preclude trading, but in any event Lanarkshire received a profit in the broader sense of a significant financial advantage. Transactions effected in the laundry were sufficiently commercial to fall within the meaning of trade. Discussions of the concept of commerciality in cases concerning transactions effected solely for tax avoidance purposes ought to be applied with circumspection to the present case. Where, as here, the only feature distinguishing

the arrangements from private sector comparators was the absence of profit motive, it was clear that the laundry activity must constitute a trade.

11. It was accepted that public authorities did not generally carry on a trade when performing their statutory functions. This case was not, however, concerned with the provision by Lanarkshire of health care services, but with the provision of a different service to third parties for a charge. The test of whether a public body was trading was an objective one: *JP Harrison (Watford) Ltd v Griffiths* [1963] AC 1, Lord Guest at 26-27. Performing laundry services for third parties was *prima facie* a trade. The scale and regularity of the activity was a material consideration. Self-use by Lanarkshire was irrelevant. Close co-operation between the users could not de-nature the trading relationship between them. HMRC's assertion that there was no capital risk to any party was contrary to the findings in fact regarding Lanarkshire's liability under the lease. The FtT had not relied upon Mr Johnston's terminology; it had assessed the evidence and reached its own conclusion.
12. As regards HMRC's second and third contentions, it was acknowledged that not all transactions at arm's length were carried on by way of trade. The FtT had not, however, committed the error attributed to it by HMRC; rather, it had adopted the correct approach of taking into account, as a relevant consideration, the extent to which transactions were entered into at arm's length. The FtT's analogy with profit-seeking commercial activities was properly drawn; contrary to HMRC's submission, the Tribunal had taken all of the factors mentioned into account when reaching its conclusion. For these reasons all of the grounds of appeal should be rejected and the appeal refused.

The role of the appellate tribunal

13. There has been much judicial discussion of the basis upon which an appellate court or tribunal may interfere with a finding by a first instance tribunal as to whether an activity does or does not constitute a trade or an adventure in the nature of a trade for income tax purposes. It is clear that such a finding is by no means a no-go area for the appellate tribunal. In *Edwards v Bairstow* [1956] AC 14 at 30, Viscount Simons put it this way:

“When the commissioners, having found the so-called primary facts which are stated in paragraph 3 of their case, proceed to their finding in the supplemental case that ‘the transaction, the subject-matter of this case, was not an adventure in the nature of trade’, this is a finding which is in truth no more than an inference from the facts previously found. It could aptly be preceded by the word ‘therefore’. Is it, then, an inference of fact? My Lords, it appears to me that the authority is overwhelmingly for saying that it is... Yet it must be clear that to say that such an inference is one of fact postulates that the character of that which is inferred is a matter of fact. To say that a transaction is or is not an adventure in the nature of trade is to say that it has or has not the characteristics which distinguish such an adventure. But it is a question of law, not of fact, what are those characteristics, or, in other words, what the statutory language means...”

In *Griffiths v JP Harrison (Watford) Ltd* (above), where once again the issue was whether the taxpayer company was trading, Lord Reid referred to *Edwards v Bairstow* and continued:

“Where, as in this case, the question is a question of fact, that means that the decision of the commissioners cannot be reviewed by the court. But if a decision of any tribunal on a question of fact is unreasonable, looking to the facts on which it is based, the court can and must intervene. The question in this case is therefore, not whether the commissioners were wrong, but whether their decision was unreasonable.”

14. On the basis of these and other equally well-known dicta, the role of the appellate tribunal may be summarised as follows. The question of what constitutes a trade or an adventure in the nature of a trade within the scope of the statute is one of law. The question whether the circumstances of a particular case amount to trading is one of fact to be determined by the fact-finding tribunal. An appellate tribunal may intervene only if either (a) it is apparent from the decision of the fact-finding tribunal that it has misdirected itself as to the law, or (b) the facts found by the tribunal are such that it could not reasonably have made the finding which it did as to whether or not the circumstances amounted to trading: this, too, is characterised as an error of law.

The meaning of “trade”

15. There is no comprehensive statutory definition of a trade, and no court has ever attempted one. Judicial pronouncements must be approached with caution because they are inevitably influenced by the context in which the expression falls to be applied. In particular, some of the most influential dicta, from cases such as *Griffiths v JP Harrison (Watford) Ltd* and *Ransom v Higgs*, concern transactions entered into primarily for the purpose of tax avoidance, and so observations regarding concepts such as “commercial purpose” must be read in that context. Much of the case law, including *Inland Revenue v Livingston* 1927 SC 251, has been concerned with whether a single transaction constituted trading, and is not therefore of direct relevance to the circumstances of the present case.
16. Certain observations of a general nature may, however, be made. Although a trade is usually carried on with the intention of making a profit, the absence of such an intention does not necessarily mean that there is no trade (*Griffiths v JP Harrison (Watford) Ltd*, Lord Morris of Borth-y-Gest at 23-24). The test is not the intention underlying an activity but what was in fact done by the person concerned (*Carnoustie Golf Course Committee v Inland Revenue* 1929 SC 419, Lord President Clyde at 424-5; *Griffiths v JP Harrison (Watford) Ltd*, Lord Guest at 26). It has also been said that the test is whether activities are of a commercial character, or run on commercial lines: *British Legion, Peterhead Branch, Remembrance and Welcome Home Fund v IRC* (1953) 35 TC 509, Lord Russell at 516, although as subsequent case law makes clear, it would be incorrect to equate the phrase “commercial character” with “profit-making”. In *Ransom v Higgs*, Lord Reid

noted (at page 1600) that the word trade was commonly used to denote operations of a commercial character by which the trader provided to customers for reward some kind of goods or services. In the same case, Lord Wilberforce (at page 1611) observed:

“Trade involves, normally, the exchange of goods, or of services, for reward, not of all services, since some qualify as a profession, or employment, or vocation, but there must be something which the trade offers to provide by way of business. Trade, moreover, presupposes a customer (to this too there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral – you must trade with someone...

Then there are elements of characteristics which prevent a trade being found, even though a profit has been made – the realisation of a capital asset, the isolated transaction (which may yet be a trade)... Although these are general characteristics which one cannot state in terms of essential prerequisites, they are useful benchmarks, so when one is faced with a novel set of facts, as we are here, the best one can do is to apply them as tests in order to see how near to or far from, the norm these facts are.”

When one sees references in judgments to “commercial character”, these should, in my view, be understood as references to the general characteristics of trade mentioned by Lord Wilberforce.

17. Can a public body such as Lanarkshire, with statutory powers and functions for which no charge may be made at the point of delivery of health care, carry on a trade? I see no reason why not. Lord Clyde’s observations in *Carnoustie Golf Course Committee* (above) make it clear that a public body conducting an activity of a commercial nature may be held to be carrying on a trade, even though the activity is not conceived in a commercial spirit and is precluded from producing divisible profits. HMRC submitted that there had to be “very clear and cogent evidence” to displace a *prima facie* presumption that activities of a public authority were carried out in pursuit of its public duties and were not conducted for any commercial purpose or in the pursuit of a trade. No authority was cited for this submission and I reject the proposition that there is any such presumption. The question whether a particular activity conducted by a public body constitutes trading will depend upon the circumstances of the case.

Did the FtT misdirect itself in law?

18. Against the background of these general observations, I turn to consider whether the three grounds of challenge, which counsel for HMRC described as overlapping, are made out. I find it convenient to consider firstly whether the terms of the FtT’s decision indicate that it has misdirected itself in law, by determining the question before it under reference to a test of whether the arrangements between Lanarkshire on the one hand and A&A and D&G on the other were at arm’s length. If the FtT had applied this test, that would have been an error of law. But it is quite clear to me that the FtT committed no such error. I

can detect no indication that it regarded arm's length relationship as decisive or even as the principal criterion against which to make a finding as to whether or not the laundry activity constituted a trade. In my opinion the FtT was entitled to find that the arrangements between Lanarkshire and the other Health Boards were at arm's length, in the sense that each body was financially independent of the others, individually accountable, and concerned when entering into the arrangements to look after its own interests. The FtT properly regarded this as an indication (though not a decisive one) that the laundry activity was of a commercial nature, which in turn informed its finding that the activity fell within the definition of a trade. For these reasons I reject HMRC's second ground of challenge, namely that the FtT erred in law by applying the wrong test for the purposes of determining whether the laundry activity was a trade.

Was it unreasonable for the FtT to find that the laundry activity was a trade?

19. I shall address HMRC's first and third grounds of challenge together under this heading. In my opinion there is no merit in either ground. In reaching its conclusion that the laundry activity conducted in the building fell within the definition of a trade, the FtT placed weight upon:

- the payments made by A&A and D&G to Lanarkshire as consideration for use of the laundry;
- the provision of a service by Lanarkshire to A&A and D&G on a frequent and repeated basis, to a competitive standard (I take this to be a reference to a paragraph in Mr Johnston's witness statement explaining what was comprised in the service supplied), for a price which took account of all costs of provision of the service;
- the difference between the position of Lanarkshire and that of the other Health Boards, in respect that the former had liabilities in terms of the lease of the building which were not shared with the others;
- the three Health Boards' independence from one another and their arm's length relationship with regard to the laundry arrangements.

The FtT was entitled to conclude that the absence of a desire to seek a profit over and above the meeting of costs did not detract significantly from the commerciality of the arrangements. Having regard to all of these factors, I am satisfied that the FtT's finding that the laundry activity fell within the scope of trading was one that it was reasonably entitled to make.

20. Most of the arguments presented on behalf of HMRC came down, in essence, either to the absence of profit motive or to the fact that the laundry activity was carried on by three Health Boards all of whose costs come out of the public purse. It is clear from the case law that neither of these features precludes a finding that a trade is being carried on, nor,

in my opinion, does either of them render the FtT's inference unreasonable. I noted earlier that one must focus on what is done rather than on the reasons why it is done. Accordingly, even if HMRC's description of the laundry arrangements as a cost-sharing exercise were accurate, that would not address the question whether what was done by Lanarkshire amounted to trading. In any event, I do not regard the description as accurate: it disregards the very different position of Lanarkshire as promoter of the laundry project, tenant under the lease, and the only one of the three Health Boards to carry any element of financial risk should the arrangements be terminated. Focusing instead, as one should, on what was actually done by the parties to the arrangement, one finds a provision by Lanarkshire of laundry services, i.e. of a commonly-provided service of a commercial nature, in consideration for payment by two bodies who may fairly be described as customers. Contrary to HMRC's submission, it is clear that Lanarkshire did provide A&A and D&G with services for a reward and that it would not be correct to assert that there was no characteristic of trading in anything which Lanarkshire did.

21. I also hold that the FtT did not commit an error in reasoning by analogy which has led it to make an inference that could not reasonably have made. Again, in my opinion, HMRC's contentions incorrectly treat Lanarkshire's motives, and in particular its absence of a profit motive, as precluding any analogy between the activity carried on in the laundry and what HMRC describe as "commercial operations". In the first place I reject, for reasons already given, the contention that the laundry activities cannot properly be described as "commercial operations" because the charges made by Lanarkshire are calculated only to cover its costs. In the second place, the distinctions which HMRC seek to draw, relating mainly to the status of the three Health Boards as public bodies all operating within the statutory NHS framework, do not in my view constitute a sufficient reason to conclude that the activities of a commercial character carried on by Lanarkshire in the course of the laundry operation could not amount to trading.

Conclusion

22. For these reasons, the FtT did not err in law in finding that the laundry building was used for the purposes of a trade. It follows that it qualifies for industrial buildings allowance. The appeal is refused.

Lord Tyre

Released 13 August 2014