IN THE SUPREME COURT OF JUDICATURE
COURT OF APPEAL (CHANCERY DIVISION)
ON APPEAL FROM LIGHTMAN J

CHRVF 98/1378 A3

Royal Courts of Justice
Strand
London WC2A 2LL

Thursday 24 February 2000

B E F O R E:

THE PRESIDENT

LORD JUSTICE ROBERT WALKER

and

LORD JUSTICE MAY

B E T W E E N:

TRUSTEES OF BT PENSION SCHEMES & OTHERS

Appellants

- and -

CLARK (HM INSPECTOR OF TAXES)

Respondent

Mr Michael Flesch QC and **Mrs Felicity Cullen** (instructed by Maxwell Batley for the Appellants)

The Solicitor-General (Mr Ross Cranston QC) and **Mr Timothy Brennan** (instructed by the Solicitor of Customs and Excise for the Respondent)

Lord Justice Robert Walker:

Introductory

This appeal is concerned with the taxation of pension schemes. Occupation pension schemes are of enormous social and economic importance to national life. Pension funds, held by responsible trustees and segregated from the assets of the employer, provide employees and pensioners with a measure of protection against the risks of the employer's insolvency and the erosion of pensions by inflation. The importance of occupational pension schemes has been marked by tax exemptions and reliefs first introduced in 1921, which have the general effect of allowing deduction of employers' and employees' contributions to exempt approved schemes, and of exempting income and gains accruing to the trustees of exempt approved schemes from income tax and capital gains tax respectively. The income tax exemptions and reliefs are conferred by ss.592-4 of the Income and Corporation Taxes Act 1988 (the 1988 Act), subject to various charges and qualifications in ss.595 ff.

The exemption for income of exempt approved schemes is not however complete. It extends (by s.592(2)) to income derived from investments or deposits and (by s.592(3))

> "in respect of underwriting commissions if, or to such extent as the Board [of Inland Revenue] are satisfied that, the underwriting commissioners are applied for the purposes of the schemes and would, but for this subsection, be chargeable to tax under Case VI of Schedule D."

For present purposes the most important omission from the exemption is trading income taxable under Case I of Schedule D rather than under Case VI, which is a residual case catching "any annual profits or gains not falling under any other case of Schedule D".

The principal issue in this appeal is whether income derived from the sub-underwriting activities of the trustees of some of the country's largest private-sector pension schemes was trading income (and so outside the exemption conferred by s.592(2)). The secondary issue is as to the rate at which it should be taxed, if it is not exempt: that is whether it should be taxed only at the basic rate, or at the additional rate as well as the basic rate. The statutory provision relevant to the secondary issue is s.686(2) of the 1988 Act, which prescribes what trust income (in general, income of discretionary or accumulation trusts) is to be charged with additional rate tax. Section 686(2) makes an exception for

> "income from investments, deposits or other property held –
> (i) for the purposes of a fund or scheme established for the sole purpose of providing relevant benefits within the meaning of s.612 [a category which includes all exempt approved funds]"

The crucial point here is the meaning of the general words "or other property".

The appeals

The appeal is from an order of Lightman J made on 14 October 1998 allowing the appeal of HM Inspector of Taxe from a decision of the Special Commissioners made on 16 December 1997. The Commissioners had heard appeals by three sets of pension scheme trustees against estimated assessments for years of assessment going back to 1981-2.

The Commissioners had to decide three issues. Two of these (identified above as the principal issue and the secondary issue) were live before Lightman J and are still live in this court. The third, relating to the meaning of "options contracts" in s.659A of the 1988 Act, has not been raised in this court and need not be considered further. The Commissioners decided the principal issue in favour of the trustees. That was determinative of the appeal, but the Commissioners would have been against the trustees on the secondary issue had it arisen. The judge reversed the Commissioners' decision on the principal issue but agreed with the Commissioners on the secondary issue. So the effect of his decision is that the trustees' sub-underwriting income is taxable as trading income and so does not gain exemption under s.592(3); and that it is taxable under s.686 at the additional rate as well as the basic rate. Against that decision the trustees have appealed to this court.

The judge rightly paid tribute to the Commissioners' written decision, which sets out very clearly their findings of fact and their reasoning. Their decision is fully reported with the judgment at [1998] STC 1075 and no criticism is made of their findings of primary fact (as opposed to the conclusions which they drew). It is not therefore necessary to repeat the facts in detail in this judgment. But a brief summary is called for.

The facts

The appellants are:

(i) (i) the trustees of the British Telecom Pension Scheme (BTPS)

(ii) POSSS Custodian Trustee Ltd as administrator of the Post Office Staff Superannuation Scheme (POSSS) and

(iii) POPS Custodian Trustee Ltd as trustee of the Post Office Pension Scheme (POPS)

The background to these different schemes is that in 1969 the Post Office became a public corporation and POSSS was established with initial funding from central government. When the Post Office's telecommunications services were privatized British Telecom plc in 1983 established a new scheme (now BTPS) and 57.674 per cent of the assets of POSSS were transferred to the new scheme. In 1987 POPS was established and POSSS was closed to new entrants. BTPS is the largest private sector pension scheme in the United Kingdom and in 1993 had assets to a total value in excess of £17,000m. POSSS is about half that size and POPS is considerably smaller. In 1996 the three schemes had a total of over 750,000 members of all classes (that is current pensioners, persons with deferred pension rights and members currently in employment).

All three schemes were regulated by trust deeds or rules conferred on the trustees wide powers of investment. The deeds regulating BTPS and POSSS expressly authorized underwriting. The rules regulating POPS did not expressly refer to underwriting but did (in the context of investment) authorize the trustees to "enter into any contract or incur any obligation". All of them authorized the trustees to delegate their powers. None of them expressly authorized trading activities.

The management of the funds available for investment in POSSS was initially put in the hands of merchant banks as investment managers. But as the funds grew, internal managers were recruited, and in 1983 an investment management company called Pos Tel Investment Management Ltd (Pos Tel) was established. Initially it was jointly owned by BTPS and POSSS. In 1995 it came to be owned by BTPS alone and its name was changed to Hermes Investment Management Ltd (Hermes). Its chief executive (from 1993) was Mr Alastair Ross Goobey, who was one of the witnesses who gave oral evidence to the Commissioners. The others were Mrs Ingrid Kirby, the director of index-tracking at Hermes, and Mr Thomas Carlton, a director of Mercury Asset Management plc (MAM). MAM and Schroders continued to manage parts of the funds on a discretionary basis throughout the relevant period, Schroderss being responsible for two overseas portfolios.

In 1992-3 (the period to which the trustees' evidence was particularly directed) Pos Tel was managing no less than 84 per cent of the total assets of BTPS, with a market value of the order of £7,500m. That scheme's basic strategy, according to its 1993 annual report, was to hold most of its United Kingdom equities in a core fund matching the composition of the Financial Times Actuaries All-Share Index. Pos Tel had discretion, in relation to a proportion of the core fund, to try to beat the index; and in addition it managed a small companies portfolio and an investment trusts portfolio. The position in relation to POSSS and POPS was not so fully documented but was similar, except that POPS was not large enough to track the index fully, and instead held shares selected to match the risk profile and return of the shares in the index. The practical effect was that Pos Tel held in its core portfolio a fraction (in 1992-3 about 1.7 per cent) of the issued ordinary share capital of all the companies in the All-Share Index (during the whole period covered by the assessments the number of these companies increased, the court was told, from about 600 to about 900). During 1992-3 Pos Tel entered

into about 5,500 transactions of sale or purchase on behalf of the three sets of trustees, and 68 issues were underwritten by BTPS and POSSS, 16 of which were also underwritten by POPS. In 1992-3 BTPS received just over £800,000 in gross underwriting commission. For most pension schemes that would be a considerable sum but it was less than one-eighth of one per cent of its total income from United Kingdom equities). In the seven years to 1994 the highest figure for sub-underwriting income, as a percentage of total investment income, was about 0.34 per cent.

Opportunities for sub-underwriting most often arise either on a rights issue by a listed company, or on an initial public offering of previously unlisted shares, or on a takeover when a listed company wishes to offer new shares as consideration for an acquisition, but with a cash alternative. The primary underwriter (often the merchant bank handling the issue) undertakes to purchase any unsold shares at the issue price, for which it receives an underwriting commission (generally two per cent). The primary underwriter retains 0.5 per cent but passes on the balance, generally 0.25 per cent to the broker who arranges sub-underwriting, and 1.25 per cent to institutions such as insurance companies, pension funds and unit trusts which agree to purchase a proportion of any unsold shares. The balance of risk and reward involved in sub-underwriting is neatly summed up on para 32 of the Commissioners' decision:

> "In most cases the rights issue or initial public offering was fully subscribed and the primary underwriters and the sub-underwriters received their commissioner without any further obligation. However if the issue was not fully subscribed the company would require the primary underwriter to purchase the unsubscribed shares at the issue price and, if the primary underwriter could not sell the shares in the market at or above the issue price, he would require the sub-underwriters to purchase their proportion of the unsold shares at the issue price. So, for example, if a sub-underwriter sub-underwrote 1.5% of the issue he had to purchase up to 1.5% of the unsubscribed shares. Such shares are known as "stick". The primary underwriter only took stick if a sub-underwriter defaulted, unless he had retained some of the risk."

It is not necessary to go further into the facts at this stage except to note that the background facts as to underwriting and sub-underwriting are set out more fully at paras 30-34 of the Commissioners' decision. The practices and procedures adopted by Pos Tel and MAM, as regards sub-underwriting for these schemes, are set out (with references to specimen documentation and some detail about particular instances of the 68 issues underwritten by BTPS and POSSS during 1992-3) at paras 35-56. The Commissioners' findings as to the policies and reasons underlying the investment managers' practices are set out at paras. 57-65.

The Commissioners' decision

Having found the primary facts the Commissioners proceeded in their written decision to summarise the competing submissions of counsel as to whether the profits of the trustees' sub-underwriting activities fell within the scope of Case I or Case VI of Schedule D. After some preliminary observations about Case VI the Commissioners referred to the notorious difficulty of any precise definition of trade, citing Lord Reid and Lord Wilberforce in *Ransom (HMIT) v Higgs* [1974] 1 WLR 1594. Lord Wilberforce said at pp1610-1,

> "'Trade' cannot be precisely defined, but certain characteristics can be identified which trade normally has. Equally some indicia can be found which prevent a profit from being regarded as the profit of a trade.

> Sometimes the question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, or organisation, even of intention, and in such cases it is for the fact-finding body to decide on the evidence whether a line is passed."

(The task of the fact-finding body, and the limited powers of any appellate tribunal to depart from its findings, are matters to which it will be necessary to return.)

The Commissioners correctly identified that sub-underwriting of share issues has features indicative of trade (para 85):

> "Its essence is the acceptance of a risk for reward. The economics are based on the assumption that in most cases there will be no stick, but that in some there will. By its very nature sub-underwriting is mainly undertaken by relatively substantial and sophisticated persons or institutions capable of taking a speedy decision and assuming a substantial risk."

Here the Commissioners were going a considerable way to accepting the five points relied on by counsel for the Revenue (Mr Timothy Brennan, who on the further appeals has been led by the Solicitor-General), that the sub-underwriting activities were habitual, organized, for reward, extensive and business-like. They did not however accept that those five points were conclusive of the issue. They attached great weight to the oral evidence of the three witnesses (and especially Mrs Kirby, on whose evidence they commented favourably in para 60) as to the purpose of the trustees' sub-underwriting activities, and the part which they played in the trustees' larger duty of managing these enormous pension funds.

In relation to the regularity of the trustees' sub-underwriting activities the Commissioners stated (at para 90),

> "In 1992-93 68 issues were underwritten, between two and three a fortnight on average. In some contexts for example land transactions this would constitute a high level of frequency and regularity. Mr Flesch relied upon Jenkins LJ in Davies v The Shell Company of China 32 TC 138, when he said at page 155,
>
> > "… the mere fact that a certain type of operation is done in the ordinary course of a company's business and is frequently repeated, does not show that the transaction in question is a trading transaction; you have to look at the transaction and see what its nature was; …"
>
> These were very large institutions for whom Pos Tel effected some 5000 purchases and sales in 1992/93, around 20 per working day. Furthermore the frequency arose from the implementation of the Index tracking strategy."

They stated at para 92,

> "We consider that, giving proper weight to the scheme of the Act including section 592(3), the subject matter of the transactions, their frequency, length and the fact that they were habitual and organized do not determine whether they were trading. These are all features which are characteristic of sub-underwriting in respect of the exempt approved schemes. In our judgment the crucial factor is the motive viewed not only subjectively but also objectively in the light of the surrounding circumstances."

One important issue in the appeal is whether the judge was correct in concluding that the Commissioners were at this point (and also in paras 86, 87 and 103) demonstrating that they had fallen into error in accepting arguments based on the need to give s.592(3) a purposive construction.

Between paras 93 and 103 the Commissioners considered in relation to Pos Tel's core index-tracking fund the submission of leading counsel for the trustees (para 93)

> "that the sub-underwriting transactions were undertaken as an essential part of the investment process and were integral to, and ancillary to, and took their colour from, the process, see *Imperial Tobacco v Kelly (HMIT)* (1943) 25 TC 292 and *Davies v Shell Company of China* (1951) 32 TC 133".

In paragraph 103 (another of the paragraphs which is attacked on the 'purposive construction' point) the Commissioners stated their conclusion in relation to the core index-tracking funds:

> "In relation to the core Index-tracking funds we find that the sub-underwriting did not constitute a trade. Bearing in mind the provisions of section 592(3) we consider that the subject-matter, frequency, organization and extent of the transactions were not determinative. The answer depends on the nature of the Appellants' activities and their motive. It is we consider important that sub-underwriting was not regarded as a separate profit-centre nor was it treated as such in the accounts. We accept Mr Flesch's submission that the sub-underwriting in fact formed an integral part of the investment process and took its colour therefrom. This seems to us a logical result and distinguishes these activities from those in which scheme trustees might sub-underwrite issues where they do not hold stock and do not intend to retain any stick."

In the next four paragraphs the Commissioners considered the other funds (those managed by MAM, the smaller companies fund and the investment trusts portfolio) and reached the same conclusion. In this court there have been no separate submissions about these smaller funds and it is possible to concentrate on the core index-tracking fund.

The Commissioners' acceptance of the submission that sub-underwriting "formed an integral part of the investment process and took its colour therefrom" was of central importance to their final conclusion, which was ultimately based on the Commissioners' view of the trustees' purpose (or intention, or motive) in engaging in this activity. Another important issue in the appeal is whether these findings by the Commissioners, and the conclusions which they drew, were soundly based, or whether the Commissioners were inveigled into error by plausible but insubstantial phrases which (as the judge put it) could not obliterate or obscure the commercial reality.

In his judgment ([1989] STC 1075, 1003) the judge summarized the facts, with a lengthy quotation from the Commissioners' decision (paras. 39-65), and the relevant statutory provisions. He correctly reminded himself of the limited function of an appellate court on an appeal from the Commissioners under s.56A(4) of the Taxes Management Act 1970, the classic statement of which is the very well-known speech of Lord Radcliffe in *Edwards v Bairstow* [1956] AC 14, 35-6 and 38-9. The judge set out a passage from the judgment of Nourse J in *Cooper (HMIT) v C&J Clark* [1982] STC 335, 340-1. The passage ends as follows,

> "The question whether a given state of affairs does or does not amount to a

> trade is one of fact and degree. Sometimes it is clear, as it was to Pennycuick J in *Lewis Emanuel & Son Ltd v White (Inspector of Taxes)* (1965) 42 TC 369, that there was a trade. At other times it is clear, as it was to the House of Lords in *Ransom (Inspector of Taxes) v Higgs* [1974] STC 539, that there was not. In those cases the court can and must interfere with the Commissioners' decision. But often, as Lord Simon of Glaisdale well put in *Ransom (Inspector of Taxes) v Higgs* (at 561), between the two extremes there lies a "no-man's land" of fact and degree where it is for the commissioners to evaluate whether the activity amounts to a trade or not. The court can only interfere where the degree of fact is so inclined towards one frontier or the other as to lead it to believe that there is only one conclusion to which the commissioners could reasonably have come."

That passage refers to interference by an appellate tribunal with conclusions (or inferences) drawn from findings of primary fact. Of course the appellate tribunal also has the power (and duty) to overturn the Commissioners' conclusion on the ground of an error of law, but only if that error of law, but only if that error vitiates the conclusion. An error of law which has no real causal connection with the conclusion can be disregarded.

The judge then identified four errors of law for which the Revenue contended (para. 12 of the judgment, [1998] STC at p.112),

> "(a) concentration on Case VI instead of Case I; (b) the 'purposive construction' applied to s.592(3) of the 1988 Act; (c) the relationship of the trustees' sub-underwriting and investment activities; and (d) the weight given to the trustees' motives for carrying on the sub-underwriting activity."

The judge rightly treated the first point as having little weight. The Commissioners had well in mind that Case VI has a residual character, and that if profits fall within Case I they cannot fall within Case VI. Although many profits taxed under Case VI arise from transactions of a casual (or one-off) nature, that is not always so. The residual Case VI can also apply to continuing transactions such as furnished lettings (and although this is partly provided for by an express provision, subject to a right of election, in s.15(1) of the 1988 Act, the letting of the furniture itself is a simple example of a continuing transaction falling naturally within Case VI). *Cooper v Stubbs* [1925] 2 KB 753 is of interest mainly as an example of a division of opinion among appellate tribunals, before *Edwards v Bairstow* [1956] AC 14, as to how to treat a rather aberrant decision of the Special Commissioners.

Purposive Construction

The second point relates to the purposive construction of s.592(3). The courts have moved on some way from the robust simplicity of Rowlatt J's very well-known statement in *Cape Brandy Syndicate v IRC* [1921] 1 KB 64, 71:

> "In a taxing Act one has to look merely as what is clearly said. There is no room for any intendment. There is no equity about a tax."

The progress has been reviewed by Lord Steyn in a passage of his speech in *IRC v McGuckian* [1997] 1 WLR 991. 999-1000, a case on artificial tax avoidance. Before the Commissioners leading counsel for the trustees (Mr Michael Flesch QC, who has appeared throughout with Mrs Felicity Cullen) relied on this passage to make a submission about s.592(3) which the Commissioners seem to have accepted, at least in part, but which leading counsel may since have come to regret. He argued that the provisions of s.592(3) must be construed in such a way as to provide a generous measure of relief for pension schemes, since

it cannot have been Parliament's intention to afford relief only to schemes which undertook very occasional sub-underwriting, and to deprive very large pension schemes of any relief.

The judge was right to view this submission with disfavour. It is unprofitable to speculate as to what view Parliament took, when this provision was first introduced by the Finance Act 1971, as to how the Case I/Case VI dividing line would work in practice, whether for small, medium-sized or large pension schemes. Even if the answer to that question could be known, it could hardly justify, on grounds of an allegedly purposive construction, the attribution of a special meaning to the expression 'trade' (which does not appear in s.592(3)). In *Craven v. White* [1989] AC 398, 442 Parker LJ observed,

> "In this limited sense the purpose does not appear to be of any assistance in the present appeals for the detailed and elaborate provisions of the Finance Act 1965 make it clear that the purpose was to tax some people and not others in respect of certain transactions and not others, and one can only determine which people and which transactions by looking at the words of the sections."

The provisions of s.592(3) are not detailed or elaborate, but the case-law on Case I of Schedule D is extensive, and it is that, rather than any supposedly purposive construction of s.592(3), which must be the guide.

To that extent, therefore, I agree with the judge on the second point also. But I respectfully differ from him in his assessment of the effect which this submission had on the Commissioners' ultimate conclusion. The judge (paragraph 18, [1998] STC at 114) regarded the Commissioners as having on this point made a 'critical mistake' which vitiated their decision. I do not interpret their decision in that way. There are two paragraphs of their decision (paras 86 and 87), and passing references to s.592(3) in two other paragraphs (paras 92 and 103), which show some inclination towards error. In particular the Commissioners' conclusion in para 87,

> "For the subsection to have any real significance there must *a broad spectrum* of factual situations where underwriting for exempt approved schemes is within Case VI" (emphasis supplied)

cannot be supported (and leading counsel for the trustees did not attempt to support it). It is however a valid point if 'some' is substituted for 'a broad spectrum'. However the conclusions in paras 92 and 103 are not vitiated if the Commissioners were correct (apart from any special approach to the construction of s.592(3)) in their view that "the subject matter, frequency, organization and extent of the transactions" were not sufficient to determine the appeal in favour of the Revenue.

Badges of trade, intention and colour

In my judgment, those factors could not by themselves be determinative. Subject-matter (which broadly corresponds, as I understand it, to what the Solicitor-General referred to as the legal character of the transaction) is plainly very important and may in some cases be decisive, or almost decisive; but the Commissioners rightly did not treat this as one of those cases. Frequency cannot by itself be decisive, since an investor may change his investments frequently (as the trustees did) without the investments losing their character: see also *Davies (HMIT) v. Shell Company of China* (1951) 32 TC 133, 155-6, where Jenkins LJ said,

> "the mere fact that a certain type of operation is done in the ordinary course of a company's business and is frequently repeated, does not show that the

> transaction in question is a trading transaction; you have to look at the transaction and see what its nature was."

He went on to give the example of an expanding retail business which frequently acquires new branches, but acquires them as fixed capital. Organisation cannot be decisive: as Lord Wilberforce said in Ransom (HMIT) v Higgs [1974] 1 WLR, 1613, 'organisation' as such is not a principle of taxation:

> "All depends on what you organize."

Probably the most important missing factor is purpose, or intention. If the legal or commercial characteristics of a transaction point unequivocally to trading, the trader's subjective purpose or motive cannot change the character of the transaction. But the character of the transaction may be ambiguous until resolved by reference to purpose or motivation. In *Iswera v. CIR* [1965] 1 WLR 663, 668 Lord Reid (delivering the opinion of the Privy Council) said:

> "If, in order to get what he wants, the taxpayer has to embark on an adventure which has all the characteristics of trading, his purpose or object alone cannot prevail over what he in fact does. But if his acts are equivocal his purpose or object may be a very material factor when weighing the total effect of all the circumstances."

The point can be illustrated by two examples. Consider the example (perhaps fanciful) of a large firm of marketing consultants which decides to open and run a supermarket simply in order to observe, more closely and more systematically than would otherwise be possible, the reactions of shoppers to different types of display, lighting, check-outs and so on. The experiment involves selling real goods to real customers for real money. If it makes a profit that profit is taxable under Case I, and liability is not avoided by evidence that the marketing consultants were not in the least interested in making a profit and that the whole enterprise was akin to a covert surveillance operation. Contrast with that the less fanciful example (suggested by Mr Flesch of a man who contracts to buy an attractive house for his own occupation but is unexpectedly presented, before completion, with an offer so extravagant that he cannot refuse it. At first glance his contract to purchase and rapid resale might appear to be an obvious adventure in the nature of trade. But closer investigation of the facts would show that appearances were deceptive. So it is necessary to go on (as the judge did, but from the different starting-point of making his own determination) to consider the third and fourth points identified by the judge, which are the relationship between the trustees' sub-underwriting and investment activities, and the weight to be given to their intentions.

As already noted, the Commissioners recognized at the outset of their discussion of the principal issue that the trustees' activities had features indicative of a trade. But they did not regard the legal characteristics of "the acceptance of a risk for reward", together with frequency, as pointing unequivocally to trade, and in my view they were right not to do so.

In his submissions as to the legal characteristics of the trustees' activities the Solicitor-General referred the court to the detail of one offer to participate in sub-underwriting (the Stagecoach Holdings plc rights issue mentioned in para 35 of the Commissioners' decision). He rightly pointed out that the trustees obtained a share of commission from the lead underwriters, not from the company making the rights issue. It did not form part of the price of any shares, nor was it credited against the cost of acquisition of any shares.

However as Mr Flesch pointed out, a transaction can be closely integrated with

another actual or intended transaction, and take its colour from it, even though the subsidiary transaction is not essential to the main transaction and even though the transactions are between different parties. That is illustrated by *Imperial Tobacco v. Kelly (HMIT)* (1943) 25 TC 292, in which the forward purchase of dollars (from a bank) took its colour from the intended purchase of tobacco leaf (from producers in Virginia and other states in the United States) and was therefore a trading transaction.

Whether the trustees' sub-underwriting was an integral part of their investment activities, so as to take its colour from them, or whether that was a bit of rhetoric obscuring the commercial reality, was a matter which called for a very careful appraisal of the evidence placed before the Commissioners. It appears to me that the Commissioners did undertake such an appraisal, at a four-day hearing with about a day of cross-examination of the witnesses on their witness statements.

At this stage I must, at the risk of some repetition, draw attention to some of the primary facts found by the Commissioners. The starting point is the index-tracking system of investment which was the guiding principle for BTPS's core fund. This is described in paragraph 27 of the Commissioners' decision, although with an unfortunate misprint (65 per cent instead of 1.7 per cent) which mars an otherwise clear explosion. BTPS was so huge that it aimed at permanently holding about 1.7 per cent of the ordinary share capital of every company comprised in the Financial Times-Actuaries All-Share Index (this was at a time when there were about 800 such companies; the court was told that the number rose from about 600 to about 900 during the whole period of the years of assessment under appeal, and that the trustees' target 'index-weighting percentage' fell proportionately). Because the trustees' strategy and index-weighting percentage were well known in the City, lead underwriters would without prompting offer Pos Tel participation in sub-underwriting on that scale. That is illustrated by the details of the Stagecoach rights issue which I have already mentioned. Although Pos Tel did (under the powers delegated to it by the three sets of trustees) have a discretion to exercise on every occasion when it was asked to participate in sub-underwriting, its general strategy made the decision a routine matter in most cases. The five occasions during 1992-3 on which Pos Tel declined sub-underwriting (described in paragraph 46 of the Commissioners' decision) were exceptions which could be said to prove the rule, because in four of the five cases the stock on offer was not in the index.

Because of the index-tracking strategy it was rare for Pos Tel to make an early disposal of stock on those occasions when it had taken stick because an issue had proved unsuccessful. It was inherent in the strategy that Pos Tel should (except in the proportion of its core portfolio in which it was trying to beat the index) hold the index-weighting percentage of all the shares in the index, even if they were temporarily out of favour with the market. The strategy was the antithesis of short-term opportunism.

One consequence of this strategy is that the degree of risk which the trustees ran 'for reward' was quite limited. That can be seen from considering what seems to have been the most common type of issue, a conventional rights issue by a listed company, such as the rights issue by Marshalls plc mentioned in para 43 of the Commissioners' decision. From the point of view of Pos Tel the sequence of events would be deciding whether to participate in sub-underwriting (which it did to the extent of 360,000 shares); deciding whether to take up the rights in respect of its existing shareholding (which it did to the extent of 260,004 shares). That evidently took its holding of the increased share capital over the target index-weighting percentage, and so 260,004 shares were sold at a small loss. Mrs Kirby said in her evidence that it was an instance of misjudgment.

These considerations persuade me that there were substantial grounds for the Commissioners' conclusion that the sub-underwriting activities did form an integral part of

the investment process and took its colour from that process. I do not think the Commissioners should have attached weight to the trustees' view that sub-underwriting was not a separate profit center (that was a subjective perception) or to the absence of any separate business organisation for sub-underwriting (as the Solicitor-General said, they had all the organisation that they needed). Nor do I overlook the evidence (recorded in para 23 of the Commissioners' decision) that in 1992 the trustees were told in a memorandum from their secretary that sub-underwriting was a useful source of extra income. The trustees did not want to participate in sub-underwriting at a loss. But the memorandum is neutral as to whether the extra income would be income of a trade taxable under Case I of Schedule D.

Conclusion on the principal issue

The Commissioners had a difficult task in determining this important appeal, but they approached their task in a very responsible and thorough manner. For reasons which I have already stated and will not repeat, I consider that they showed some tendency to error in partially accepting Mr Flesch's submission as to how they should approach the construction of s.592(3), but that that tendency did not vitiate their decision. I am not sure, after two days of persuasive oral submissions from both sides in this court, that I would have reached the same conclusion as the Commissioners reached. I think I probably would have done, but in any case that is immaterial. I am satisfied that the trustees' case falls (at worst) within the 'no man's land' described by Lord Simon and that the Commissioners' decision is one with which an appellate tribunal must not interfere.

The judge took a different view. For reasons already mentioned, I consider that the Commissioners' tendency to error on the construction point did not vitiate their decision, and on the view which I take it was not open to the judge to go on to make his own entirely independent evaluation of the evidence.

So far as it is necessary for an appellate tribunal to evaluate a finding that a taxpayer was carrying on a trade, I consider that it is rarely helpful for the appellate tribunal (or indeed for the Commissioners in their initial evaluation) to divide the process into two stages, as the judge did (paras 19ff, [1998] STC at pp.1115ff). The Commissioners themselves appeared to adopt that approach, but that was in response to Mr Brennan's submission (recorded in para 86 and discussed in the following paragraphs of the decision) that the sub-underwriting activities of the trustees were "habitual, organized, for reward, extensive and business-like" and were in the circumstances a trade. Of course there may be factual situations so clear as to make inquiry into motivation unnecessary, as the Privy Council recognized in *Iswera v CIR* [1965] 1 WLR 663. But where there is any element of ambiguity the inquiry must look at all the relevant facts and circumstances in the round. A two-stage approach is akin to looking at a video film twice, first with the sound off and then with the sound on. That will rarely be the best way to proceed.

I would therefore allow the appeal on the principal issue.

The secondary issue

The secondary issue does not therefore need to be decided and I can deal with it very shortly. On this point the Commissioners and judge were in agreement, and so is this court (as became apparent when we did not call on the Solicitor-General to address us on it). Although the word "property" is an expression capable of a very wide meaning, it also has a fairly wide range of meanings, and the Commissioners and the judge were right to conclude that its meaning, in the context of s.686(2)(c) of the 1988 Act, is not as wide as Mr Flesch contended. For my part I would reach that conclusion not by the rather blunt instrument of the *esjudem generis* ('of the same kind' rule) but from a combination of contextual indications.

A test case?

In the course of his submissions, the Solicitor-General referred to this appeal as a test case. Mr Flesch, in his reply, begged to differ and stressed that this is an appeal from a particular decision of the Commissioners reached after a searching examination of a particular set of facts.

The Solicitor-General is right in the limited sense that this is an important appeal, not only because of the substantial sums of income tax in the assessments under appeal, but also because this court's decision will be scrutinized by many other sets of pension scheme trustees and their advisers. But Mr Flesch is right that this court's decision only establishes that a particular decision of the Commissioners, on a particular set of facts found by them, falls (at worst) within the 'no man's land'.

Although the court will always try to clarify the law when it has the opportunity to do so, it would in this case be quite wrong for this court to attempt to lay down even tentative guidelines as to what are essentially issues of fact. In this case it would be particularly inappropriate since the huge size of the trustees' schemes makes them untypical of the generality of pension schemes (it may conceivably be that, contrary to the 'purposive construction' argument, very large index-tracking pension schemes are not disadvantaged and that there is a bell-shaped curve with medium-sized pension schemes which engage in frequent but selective sub-underwriting most at risk; but that is mere speculation). So this appeal cannot be regarded as a test case in any full sense.

Lord Justice May:

I agree.

The President:

I also agree.