# In Case You Missed It… (August 2024)

*George, Christine and Henry take a look at three recent court cases of interest which cover both the FCA's enforcement powers and also the taxation of income reallocated to individual members of a limited liability partnership.*

## *FCA Final Notice Following – Financial Conduct Authority v Skinner and others (2020) EWHC 1097 (Ch)*

On 12 July 2024, the FCA published a final notice banning Clive Harris Mongelard ("**Mr CM**") from performing any function in relation to any regulated activity carried on by an authorised or exempt person or exempt professional firm again. How did the FCA arrive at issuing such a ban?

In the case of *Financial Conduct Authority v Skinner and others (2020) EWHC 1097 (Ch),* the FCA first brought proceedings against a series of defendants who promoted a share offer by Our Price Records Limited ("**OPR**"). Although initially intended to be a promotion solely to high net worth individuals and sophisticated investors, when no funds were raised, the directors of OPR subsequently decided to next market the offering to retail investors. Over two offerings in 2014 and 2015, £3.6 million was raised from 259 investors (the "**OPR Share Offer**").

Two marketing agents (Miller & Osborne Associates Limited and Venor Associates Limited (the "**Agencies**")), who were jointly managed by Mr CM and Mr Miller, introduced the majority of retail investors (over 175 individuals) to the OPR Share Offer. In October 2015, the FCA wrote to OPR alleging that Mr CM was knowingly concerned in the introductions made by the Agencies and that this breached the general prohibition on unauthorised financial promotions contained in s21 of the Financial Services and Markets Act 2000 ("**FSMA**"). The FCA decided to apply to the Court for a restitution order under s 382 FSMA in favour of the retail investors who had participated.

It was admitted by Mr CM that he was knowingly concerned in the contravention of s21 FSMA. The issue was therefore whether Mr CM should make restitution and what was a just amount. Mr CM argued he should not make restitution on the basis he believed the communication was approved following confirmation from the directors of OPR (and that such approval had been obtained).

The Court held that 'knowledge' of a contravention of s 21 (for the purposes of restitution under s 382) requires knowledge of the facts giving rise to the contravention. Mr CM should have made his own independent enquiries or taken professional advice himself, e.g., as to the legality of his involvement in the OPR Share Offer. Mr CM further admitted that he was knowingly concerned in the separate breach of s19 FSMA and s89 FSA by the Agencies.

In May 2020, the Court therefore ordered the Agencies (despite Miller & Osborne since being dissolved), Mr CM and Mr Miller to repay the full sum of the investor losses caused by the Agencies.

Mr CM subsequently failed to satisfy the order and, as such, the FCA made an application to the court to petition for his bankruptcy. This order was made in April 2021.

The final notice issued on 12 July 2024 explained that the findings against Mr CM, concerning his breaches of FSMA demonstrated a lack of integrity such that Mr CM was not fit and proper to perform regulated activities. The FCA has chosen to prohibit Mr CM from performing any function in relation to any regulated activity carried on by an authorised or exempt person or exempt professional firm.

**Key takeaway** – Although an extreme example of non-compliance primarily with the applicable UK financial promotion regime, it is a timely reminder of the importance of adherence to compliant promotion and marketing in respect of new investment opportunities, particularly where retail investors are being promoted to.

***KVB Consultants Ltd and others v Jacob Hopkins McKenzie Ltd and others [2024] EWCA Civ 765 (9 July 2024) (Sir Geoffrey Vos MR, Lewison and Males LJJ)***

Kession Capital Ltd ("**KCL**"), an FCA-authorised firm, entered into an appointed representative agreement (the "**Agreement**") with Jacob Hopkins McKenzie Ltd ("**JHM**") under s.39 of the Financial Services and Markets Act 2000 (“**FSMA**”) pursuant to which JHM became an appointed representative of KCL.

JHM promoted and operated property investment schemes ("**Schemes**") in which claimants invested approximately £1.7 million. Following the Schemes' failure, claimants sought to recover their losses from KCL (as JHM’s principal). The Court initially found KCL liable for damages and costs. KCL appealed on two grounds.

First, KCL argued the Agreement prohibited JHM from conducting Schemes. Males LJ dismissed the appeal, noting that although the Agreement did not explicitly permit JHM to operate the Schemes, KCL had elsewhere granted permission to advise and arrange deals in the Schemes, therefore had accepted responsibility for JHM's activities.

Second, KCL contended the Agreement prohibited JHM from promoting the Schemes to retail clients, restricting the scope of permission. Males LJ held that the critical issue was whether s.39 of FSMA allowed such a limitation. He interpreted "description" in section 39(1)(a) FSMA to refer to the activity (advising on and arranging investment deals), not the client classification. He further explained that the Agreement's stipulation for JHM to deal only with professional clients and eligible counterparties was a contractual term and did not impact the scope or KCL's accepted responsibility under s.39 of FSMA. The Court of Appeal therefore dismissed both grounds and KCL remained liable.

**Key takeaway** – The Court of Appeal's decision acts as a reminder for FCA-authorised firms where operating an appointed representative business to always properly document their arrangements with appointed representatives and to have robust systems and controls in place to closely monitor such appointed representatives' activities.

***HMRC v HFFX LLP and others [2024] EWCA Civ 813***

This appeal concerned certain incentivisation arrangements operated by HFFX LLP for its individual members and is one of a number of similar such cases which have been going through the appeal process over the past couple of years (cf *Odey* and *BlueCrest*).

Subject to satisfying certain requirements, individual members of a limited liability partnership (an “**LLP**”) would typically be treated as self-employed rather than as employees for tax purposes. As LLPs that carry on a trade or business with a view to profit are treated as transparent for income and corporation tax purposes, members are taxed on the basis of their respective share of the profits in accordance with the partnership profit sharing arrangement.

In this case, HFFX LLP operated a deferred profits arrangement whereby a proportion of the profits of the LLP, which could otherwise have been allocated to the individual members, were instead allocated to a corporate member and invested by it. The proceeds of realisations were contributed back to the LLP as 'Special Capital' which the corporate member could then, in accordance with the partnership deed, allocate, at its discretion, to individual members. It was intended that this allocation would not constitute taxable income for the individual members.

Inevitably, HMRC challenged the tax treatment on the basis that:

- The profit share allocated to the corporate member should be subject to income tax under section 850 ITTOIA 2005 as the individual members had the right to share in those profits; and

- The sums received by the individual members when 'Special Capital' was reallocated to them were subject to income tax as miscellaneous income (section 687 ITTOIA).

Both the First-tier Tribunal (2021) and the Upper Tribunal (2023) found against HMRC on section 850* but for HMRC on section 687 ITTOIA.

Section 687 ITTOIA is a general sweep up provision and taxes "*income from any source that is not [otherwise] charged to income tax*". As it was accepted that the reallocated sums were income, the issue before the Court of Appeal essentially involved consideration of whether the income had a "source".

Falk LJ held that it was not necessary for there to be a legal right to the income for it to have a source for these purposes, and that the decisions taken to reallocate funds to individual members, in combination with their rights under the partnership deed (which provided the legal context for the decisions) were capable of amounting to a source from which the receipt of funds were derived.

*on authority of BlueCrest which may yet be appealed

**Key takeaway** - The case provides useful guidance on the likely tax treatment of deferred allocation and reallocation schemes in the LLP context and highlights the need to consider all relevant contractual terms and rights when advising on such arrangements.

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