Neutral Citation Number: [2017] EWCA Civ 77

Case No: A3/2015/2441 and A3/2015/2443

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
MR JUSTICE NUGEE AND JUDGE SINFIELD
[2015] UKUT 211 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 24/02/2017

Before:

LADY JUSTICE ARDEN
LORD JUSTICE DAVID RICHARDS
and
LORD JUSTICE HENDERSON

- -

Between:

(1) SAMARKAND FILM PARTNERSHIP No. 3 **(2) PROTEUS FILM PARTNERSHIP No. 1** **(3) THE PARTNERS OF SAMARKAND FILM PARTNERSHIP No. 3** **(4) THE PARTNERS OF PROTEUS FILM PARTNERSHIP No. 1** **(5) A PROTEUS PARTNER**	**Appellants**
- and –	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

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Mr Michael Furness QC (instructed by **Pinsent Masons LLP**) for the **Appellants**
Mr John Tallon QC and Mr David Yates (instructed by **the General Counsel and Solicitor to HMRC**) for the **Respondents on the Tax appeal**
Mr Jonathan Swift QC and Ms Joanne Clement (instructed by **the General Counsel and Solicitor to HMRC**) for the **Respondents on the Judicial Review appeal**

Hearing dates: 29 and 30 November and 1 December 2016

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Judgment Approved

Lord Justice Henderson:

Introduction

1. The main issue on these appeals is whether two "film scheme" partnerships, which were marketed to wealthy individuals resident but not domiciled in the United Kingdom who wished to generate substantial first year losses to set against their taxable income, were carrying on a trade. If the partnerships were not trading, the schemes failed to achieve their fiscal objective in accordance with the relevant legislation governing the grant of tax relief for the financing of films. The First-tier Tribunal (Judge Hellier and John Robinson) ("the FTT"), in a decision released on 20 September 2011 after a ten day hearing in May 2011, found that the partnerships were not trading, so the schemes failed. The FTT also dealt with a number of subsidiary issues in their long (514 paragraphs) and careful decision: see [2011] UKFTT 610 (TC), reported at [2012] SFTD 1 as Samarkand Film Partnerships No. 3 v HMRC ("the FTT Decision").

2. The taxpayer partnerships then appealed to the Upper Tribunal (Nugee J and Judge Sinfield) ("the UT"), and also sought judicial review of HMRC's decision to refuse the relevant reliefs on the principal ground that they had a legitimate expectation, derived from representations and assurances allegedly made by HMRC in a published Business Income Manual ("BIM"), or from HMRC's settled practice, which precluded HMRC from relying on the main arguments which they had advanced to the FTT. In particular, the taxpayers relied on a "plain vanilla" example of a sale and leaseback arrangement in the BIM which, it was said, HMRC had undertaken not to challenge, and was materially indistinguishable from the facts of the present case. The application for judicial review could not have been made to the FTT, because (unlike the UT) the FTT has no jurisdiction to entertain such claims.

3. The UT released its decision ("the UT Decision") on 29 April 2015: see [2015] UKUT 211 (TCC), reported at [2015] STC 2135. The UT dismissed the taxpayers' appeals on the trading issue, holding that the FTT had been entitled to conclude on the facts that the partnerships were not carrying on a trade, and had not erred in law in reaching that conclusion. The UT also dismissed the applications for judicial review, holding in particular that no legitimate expectations could be derived from the BIM in circumstances where (as the UT found to be the case) HMRC had reasonable grounds to suspect tax avoidance, because the guidance given in the BIM was expressly made subject to such a qualification. The UT also found that HMRC had no settled practice upon which reliance could legitimately have been placed by the taxpayers, and rejected a further argument based on the principle of conspicuous unfairness.

4. The taxpayers now appeal to this Court, with permission granted by the UT on 30 June 2015 on all grounds. In granting permission, the UT were satisfied that the grounds of appeal raised important points of both principle and practice, and therefore satisfied the requirements for a second appeal in article 2 of the Appeals from the Upper Tribunal to the Court of Appeal Order 2008 (SI 2008/2834).

5. The appellants were represented before us by Mr Michael Furness QC, as they had been before the UT (although he then appeared with a junior, Mr Conall Patton). Before the FTT, the appellants had been represented by different counsel and solicitors. HMRC were represented before us by Mr John Tallon QC, leading Mr

David Yates, on the tax appeal, and by Mr Jonathan Swift QC, leading Ms Joanne Clement, on the judicial review appeal, all of whom had also appeared before the UT. Mr Tallon and Mr Yates had also represented HMRC before the FTT.

The facts in outline

6. The two partnerships are Samarkand Film Partnership No. 3 ("Samarkand") and Proteus Film Partnership No. 1 ("Proteus"). The appellants are Samarkand, Proteus, the respective partners of Samarkand and Proteus, and a representative individual partner of Proteus.

7. In the tax year 2005/6 Proteus acquired an interest in the film "Oliver Twist", and in 2006/7 Samarkand acquired interests in the films "The Queen" and "Irina Palm". In each case, as the FTT found at [2], the films were acquired as part of a single transaction which encompassed their acquisition and their associated leaseback in return for fixed, increasing, secured and guaranteed rental payments for a 15 year period. As the FTT also found at [51], the films were "real films intended for real cinematic audiences". Indeed, each of them enjoyed a considerable measure of artistic and popular success. Each film was also certified by the Department for Culture Media and Sport as a qualifying film within Schedule 1 to the Films Act 1985, that is to say as a British film which qualified under the relevant film acquisition relief provisions in the UK tax legislation.

8. In the FTT Decision at [45], the FTT described "the broad pattern of events" in relation to each of Samarkand and Proteus as follows:

> "(1) a partnership agreement under Jersey law was executed by two persons, one of whom was designated as the managing partner;
>
> (2) an agreement was signed between Future [*i.e. Future Capital Partners Limited, which promoted the schemes*] and the managing partner under which Future was appointed the agent of the partnership for finding films for it to exploit. That agreement contemplated that Future would receive a fee;
>
> (3) a film was found by Future and Future made arrangements for a transaction comprising its sale to the partnership and its leasing by the partnership;
>
> (4) a Proposal document (a Business Plan or an Information Memorandum) was issued to potential investors …;
>
> (5) Bank of Ireland (the Facility Bank) produced letters to potential investors setting out the terms on which it could lend them up to 90% of their commitment to invest in the partnership. There was no limitation of the Bank's recourse to the partners' other assets;

> (6) either (1) a certificate of the production cost of the film was to be provided or (2) Malde & Co provided an opinion letter relating to the price to be paid for the film …;
>
> (7) persons who decided to invest signed deeds of adherence to the partnership;
>
> (8) the partnership signed agreements to purchase films and related agreements to lease them to Haiku Releasing Ltd ("Haiku") for fixed but escalating rentals over a primary 15 year period. The purchase was conditional upon the lease agreement and vice versa;
>
> (9) the investors paid their monies, and their loans from the Facility Bank were drawn down;
>
> (10) the monies from the partners' aggregate contributions were paid by the partnership: (a) to the vendor of the film (or to the lessee at the request of the vendor), and (b) to Future by way of fees under the agency agreement, thus exhausting the partnership funds;
>
> (11) Haiku placed on deposit an amount equal to about 80% of the sale price of the film. The deposit was charged as security for its rental obligations (which would be discharged from the deposit);
>
> (12) Haiku licensed the film directly or indirectly back to the seller, for a sum equal to the amount it put on deposit;
>
> (13) the partnerships charged their assets (including the interest in the Haiku deposit) to the Facility Bank to secure its lending to the partners;
>
> (14) the Partners' loans and interest thereon were discharged from the rental payments emanating from Haiku's deposit."

The FTT recorded that the precise events and their sequence were different in each case, but nobody has suggested to us that anything turns on these minor differences of detail.

9. The sale and leaseback structure, together with the associated cash flows, are illustrated in simplified form in a helpful diagram which Mr Furness appended to his skeleton argument, and which is reproduced as Appendix 1 to this judgment. In short:

   (1) the partners borrowed 8 from the Facility Bank;

   (2) the partners contributed 10 to the partnership, i.e. the 8 borrowed from the Facility Bank and 2 from their own funds;

   (3) the partnership bought a film from the seller for 9;

(4) the partnership leased the film to Haiku for a period of 15 years in return for fixed but escalating rentals;

(5) Haiku licensed the film directly or indirectly back to the seller;

(6) the seller paid or procured the payment of 8 to Haiku (retaining a "producer's net benefit" of 1);

(7) Haiku placed 8 on deposit to secure the guarantee of its rental obligations;

(8) the partners' loans and interest were discharged from the rental payments made out of Haiku's deposit; and

(9) the partnership paid a fee of 1 to Future who acted as agent for the partnership and negotiated the transaction on its behalf and provided other services.

See the UT Decision at [3], which is a slightly amplified version of the FTT Decision at [73].

10. Under the heading "Cashflows", the FTT then made the following findings:

> "74. Thereafter it was intended that Haiku's rental obligations would be met in their totality by payments from the deposit (from the original 8 deposit and interest accruing thereon). Rental payments originating from the deposit would pass into an account of the partnership and thence to the Facility Bank and thereby discharge the loan obligations of the partners.
>
> 75. Since the first lease rental payment was due on the payment date the deposit and the Facility Bank loan were each reduced by the amount of that payment on that day.
>
> 76. The interest rate charged on the partners' loan accounts with the Facility Bank was marginally higher than the rate of interest paid on the deposit. In the case of Proteus/Oliver Twist the cashflow statements prepared by Future showed a lending rate of 4.38% compared with a deposit rate of 4.36%. As a result the payments of the lease rentals funded by the deposit plus interest would not precisely repay the loan plus interest. The difference was described as the Bank Margin. In the case of Proteus/Oliver Twist Future's calculations showed that the present value (at an appropriate discount rate) of that difference was £870,694. The cashflow evidence indicated that this cost was borne or paid by Future, effectively from its fee. As a result, taken with this receipt the leasing income fully funded the repayment of the partners' loans, but did not provide any additional payments to the partners above the repayment of their loans."

11. One point which it is worth stressing at this early stage is that the arrangements for the sale and leaseback of each film were made by Future, and became unconditional, before any of the external investors adhered to the partnership and subscribed their

capital. Once the partners had all joined, and their capital contributions had been made, the arrangements were then finalised on a financial closing date. From the point of view of the investors, their active involvement in the partnership's business began and ended with the completion and signature of an adherence agreement and the payment of their initial contributions.

12. The detailed findings of the FTT in relation to the transactions in issue are set out in the FTT Decision at [44] to [191]. There is no dispute about any of those findings.

The background to film finance tax relief

13. The background to film finance tax relief is helpfully summarised by the UT at [10], drawing on a witness statement by Mr Martyn Rounding, the head of the litigation team in HMRC's Corporation Tax International and Anti-Avoidance Directorate. As the UT explained, expenditure on the production or acquisition of a film would normally have been capital expenditure which formerly qualified for 100% first year capital allowances. This gave rise to substantial tax avoidance, however, and in 1982 legislation was introduced which deemed such expenditure to be revenue expenditure to be written off over the lifetime of the film against income from the film. In 1992, a new tax relief was introduced to ease cash flow difficulties faced by film producers, contained in section 42 of the Finance (No. 2) Act 1992. This allowed expenditure on the production or acquisition of British qualifying films to be written off over three years rather than matched against income. In 1997, a further new tax relief was introduced with the object of stimulating the production of films in the UK, contained in section 48 of the Finance (No. 2) Act 1997. This allowed expenditure on the production or acquisition of British qualifying films with budgets of £15 million or less (a "limited-budget film") to be written off fully on completion.

14. In practice, film makers and producers could not normally take advantage themselves of relief under section 42 of the 1992 Act or section 48 of the 1997 Act, because they had little income against which to offset the relief when the film was completed. Instead, the reliefs were normally exploited indirectly through arrangements with third parties, either subsidiaries of banks or partnerships of wealthy individuals.

15. The Queen and Irina Palm were both limited-budget films, but Oliver Twist (directed by Roman Polanski) was not: it cost some £25 million to produce.

16. By the time of the relevant events giving rise to the appeals, the statutory provisions were contained in sections 130 to 144 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"). Those provisions were amended by section 47 of the Finance Act 2006, but the amendments do not apply to the Samarkand appeals, even though they relate to the 2006/7 tax year, because (in accordance with the relevant transitional provisions) the principal photography on the films began before 1 April 2006 and the relevant expenditure was incurred before 5 April 2007. The provisions of ITTOIA therefore apply in the same form to each set of appeals.

Legislation

17. The relevant provisions of ITTOIA relating to film relief, together with the provisions in the Income and Corporation Taxes Act 1988 ("ICTA") governing the "sideways" loss relief claimed by the partners, are clearly and comprehensively set out and

explained by the UT in [12] to [26] of the UT Decision. Those paragraphs are reproduced as Appendix 2 to this judgment.

18. Chapter 9 of ITTOIA (comprising sections 130 to 144) is headed "Trade profits: films and sound recordings". Section 130(1) states that Chapter 9:

> "makes provision about –
>
> (a) expenditure incurred on the production or acquisition of the original master version of a film or sound recording, and
>
> (b) preliminary expenditure in relation to a film."

19. The key provision which contains the requirement for the taxpayer to be carrying on a trade, if the favourable tax treatment described above is to be obtained, is section 134(1) which states (with my emphasis) that:

> "If a person *carrying on a trade* incurs production or acquisition expenditure, the expenditure is treated for income tax purposes as expenditure of a revenue nature."

The requirement is then repeated in sections 138(1) and 140(1), the former of which contains the provisions enabling qualifying expenditure to be deducted over three years, and the latter of which enables the whole of it to be deducted in the first year if the film is a limited-budget one.

20. There is no definition of "trade" in Chapter 9, which therefore has its normal meaning in tax law which has been the subject of judicial exposition for well over a century. The only statutory guidance at the relevant time was to be found in section 832(1) of ICTA, which provided that:

> ""Trade" includes every trade, manufacture, adventure or concern in the nature of trade."

More concisely, section 989 of the Income Tax Act 2007 now simply provides that:

> ""Trade" includes any venture in the nature of trade".

Did the partnerships carry on a trade?

(1) The decision of the FTT

21. The FTT began their consideration of this issue by reminding themselves that the key provisions in sections 138 and 140 of ITTOIA, and section 380 of ICTA, each direct attention "to the question of whether at a particular time, or in a particular period, a person was trading": [192]. They correctly noted that it was clear from the definition of "trade" in ICTA section 832, quoted above, that "one off" transactions, such as the acquisition of an asset and its later sale, were capable of being trading transactions.

22. After summarising the main submissions of Mr Jonathan Peacock QC, who then appeared with Mr Jolyon Maugham for the appellants, and of Mr Tallon QC for HMRC, the FTT began by asking themselves when the question of trading should be assessed. They answered this question at [197] by saying that the relevant time was after the adherence of the investing partners, because the statutory question was whether a trade was being carried on at the time when the expenditure was incurred. They pointed out at [198] to [199] that a partnership is not a separate legal entity, and that what has to be assessed is the business carried on in common by the partners.

23. The FTT then set out the principles to be applied in assessing whether the partnerships were trading, at [200] to [210]. They agreed with Mr Peacock that what had to be assessed was the activity of the partnership, and the fact that the partners intended to obtain tax relief could not prevent activities which were otherwise trading in nature from constituting a trade: [200]. They then said:

> "201. However, in our judgment that assessment must be of the business of the partnership, not that business aggregated with the separate individual affairs of the partners. As a result neither is any borrowing undertaken by a partner to fund his interest in the business, nor is any tax relief or liability of a partner, or the way in which that partner might use the benefit of such relief relevant to determining whether that business is a trade."

The FTT distinguished the situation in Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes) [2004] UKHL 51, [2005] 1 AC 684 ("BMBF") on the ground that the business of BMBF encompassed its financing arrangements and the use of tax reliefs and the payment of tax, whereas in the present case the partners borrowed from the Facility Bank and claimed loss relief in their personal capacities, not as partners carrying on the partnership's business.

24. At [204], the FTT said:

> "We are not asking whether the fiscal element denatures a trading transaction. Nor are the sale and lease backs in these appeals acknowledged to be part of a continuing trade. We are considering instead whether on their own these transactions were adventures in the nature of trade. We have no doubt that, just as the deposit of cash and interest is part of the trade of a bank but normally a non-trading transaction of an individual, these transactions could be trading transactions when conducted by particular businesses. Nor do we doubt that the single purchase and leasing of an asset can be a trade. But we do not believe that these transactions in these appeals which were the businesses of the partnerships were trading in nature despite the fact that they were created in the form of the sale and leaseback of an asset."

25. The FTT did not find BMBF helpful, because it had been common ground in that case that the transactions involved (namely the purchase and leaseback of a gas pipeline) formed part of BMBF's finance leasing trade, and the contentious issue was whether

expenditure had been incurred on the pipeline, or on something else. This was the context in which the FTT made the remarks in [204] which I have just quoted.

26. The FTT also referred to Ensign Tankers v Stokes [1992] 1 AC 655 ("Ensign Tankers"), where the question of trading had been considered by Millett J in the High Court. Millett J set out nine principles of law (at [1989] 1 WLR 1222, 1232-1234), of which the FTT considered the following to be of particular relevance:

(a) in order to constitute a transaction in the nature of trade, the transaction in question must possess not only the outward badges of trade but also a genuine commercial purpose;

(b) the test is an objective one; and

(c) in considering the purpose of a transaction, its component parts must not be regarded separately and the transaction must be viewed as a whole.

27. The FTT then said, at [210]:

> "The last of these principles finds authoritative voice in the judgments in the *Ramsay* line of cases. In determining whether a transaction is a trading venture regard must be had to the purpose of the statute and the transaction must be viewed realistically. In the case of a statutory provision which requires an answer to the question of whether something is a trade, it is clear to us that a broad commercial approach to the facts is required, and transactions executed as composites of linked parts should be viewed as a whole rather than piece by piece. Trade is not a narrow legal concept but a broad commercial one: connected transactions planned and executed as a single transaction must be viewed as a whole."

28. Incidentally, the FTT were wrong to say at [206], and the UT were also wrong to say in the UT Decision at [33], that the issue of trading in Ensign Tankers had been argued only in the High Court. The question remained very much alive in the higher courts, although the focus was mainly on the purpose with which the transactions had been undertaken, and the relevance of the taxpayers' motives, in deciding whether the composite transaction was genuinely commercial in nature. It was in this context that Lord Templeman said, at 677D:

> "The facts are undisputed and the law is clear. Victory Partnership expended capital of $3¼ m for the purpose of producing and exploiting a commercial film. The production and exploitation of a film is a trading activity. The expenditure of capital for the purpose of producing and exploiting a commercial film is a trading purpose. By section 41 of the Act of 1971 capital expenditure for a trading purpose generates a first year allowance. The section is not concerned with the purpose of the transaction but with the purpose of the expenditure. It is true that Victory Partnership only engaged in the film trade for the fiscal purpose of obtaining a first year

> allowance but that does not alter the purpose of the expenditure. The principles of Ramsay and subsequent authorities do not apply to the expenditure of $3¼ m because that was real and not magical expenditure by Victory Partnership."

See too 680B, where Lord Templeman pointed out that this expenditure "was not a sham and could have resulted in either a profit or a loss".

29. The FTT then turned to the application of the principles which they had identified to the question whether the partnerships were trading. Subject to two points, the FTT were not persuaded by HMRC's attack on the organisation of the partnership businesses. There had been some sloppy execution, and some initial muddle about Samarkand's partners, but (at [210]):

> "the central transactions under which substantial sums were to be paid and received were subject to tightly drawn agreements. There was no sloppiness in ensuring the receivability or receipt of rentals. The core of the business (the exchange of cash today for cash over the next 15 years) was not so slapdash as not to be a trade."

30. The FTT's first caveat related to the title in The Queen, to which I will need to return later in this judgment. The second point related to the prices paid for the films, which the FTT said at [215] was irrelevant in view of the approach which they took to the transactions. They pointed out that, because the transactions were composite sale and leaseback transactions:

> "the price paid had little commercial effect: the greater the amount paid the correspondingly greater the rentals which would be received … The only commercial loss was that the fee paid to Future (being a percentage of the capital raised) would be higher."

31. The FTT continued, in an important passage:

> "216. Once the investing partners adhered, what did the partnerships do? The answer is:
>
> (1) they received certifications such as that from DCMS for Irena Palm;
>
> (2) through Future they set the levels of rental payments by reference to LIBOR and the amount eventually agreed as the price of the film; and
>
> (3) they completed the sale and leaseback agreements by making payments under them.
>
> 217. The activities were confined to and centred on the financial closing of the sale and leaseback agreements. Thereafter for 15 years the activities of the partnerships were to

> be limited to the management of their fixed guaranteed receipts under those agreements.
>
> 218. In our view this activity cannot be treated, for the purpose of assessing whether it was a trade, as a separate acquisition of the film and its later leasing. These transactions were part of a whole, and the whole was different from the sum of its parts.
>
> 219. Save for partners' personal cachet and interest in individual films ("I've invested in the latest James Bond film"), and their tax considerations – both of which were not part of the partnership business – and the value of the Rights and Extra Profits, it mattered not what asset was being bought and leased back: it could have been a computer program, a painting or a patent. It mattered not what profits might be made by distributing or hiring out the film because the major returns were fixed by the sale and leaseback transaction and were unaffected by the film's performance.
>
> 220. The commercial nature of these agreements was the payment of a lump sum in return for a series of fixed payments over 15 years. That type of transaction carried out on its own is not in our view an adventure in the nature of trade."

32. The FTT's findings in [216(2)] may at first sight seem difficult to reconcile with the proposition, which I do not understand to be disputed, that the sale and leaseback arrangements had become unconditional before the investors adhered to the partnerships. Mr Tallon explained to us, however, that the rental payments were left blank in the initial agreements, and there was a side letter which provided for them to be inserted at the time of financial close in the light of interest rates prevailing at that time. He also said that the agreements contained their own formula for ascertaining the price to be paid for the films, and this is what the FTT meant when they referred to "the amounts eventually agreed". It follows that there is no inconsistency, because the matters to be agreed or inserted had already been unconditionally agreed in principle, and it was only the ascertainment or working out of the final figures which remained to be done.

33. I can deal with the remainder of the FTT's decision on the trading issue more briefly. At [221] to [222] they compared the composite transaction with the "badges of trade" described by Sir Nicolas Browne-Wilkinson V.-C. in Marson (Inspector of Taxes) v Morton [1986] 1 WLR 1343 at 1348-1349, finding that only one of them, namely the commercial subject matter of the transaction, pointed towards trading. At [223], the FTT found it unnecessary to rely on HMRC's argument based on the decision of the House of Lords in the Lupton case (FA and AB Ltd v Lupton (Inspector of Taxes) [1972] AC 634), whereby a prima facie trading transaction may be "denatured" if its true nature is tax avoidance. The FTT said they had not got that far, because looking at what the partnerships did "we do not see elements of trading".

34. At [225], the FTT said that on balance they accepted Mr Tallon's argument that, before the investors adhered, the nature of the relationship between the initial partners was not one of partnership because they did not have a view of profit for themselves

as parties in the venture. This question is relevant to some of the grounds of appeal, and I will return to it in due course.

35. The FTT then said that their conclusion would have been no different, even if it were relevant to look at the earlier activities of the partnerships before the investors joined them: see [226] to [228]. They observed at [227]:

> "Before the agreements were signed the partnerships engaged Future to set up a transaction if it could. But until the agreements were signed all the partnerships did was to retain Future: that was not a trade. The real business started when the agreements were signed."

36. At [229] to [230], the FTT considered whether their conclusion would be different if, instead of regarding the transactions as a composite whole, each element of them were considered separately. They concluded that this would make no difference, because the transactions were still uncommercial in the sense used by Millett J in Ensign Tankers.

37. Finally, at [232] to [244], the FTT examined the residual rights retained by Proteus and Samarkand at the end of the 15-year lease period, finding that they were all essentially immaterial, and insufficient to convert what was not a trading activity into one which was: [231].

(2) The Decision of the UT

38. The UT dealt with this issue at [71] to [90] of the UT Decision.

39. The core of the UT's reasoning is contained in [86], where they said this:

> "86. In our view, the FTT were entitled to conclude that the partnerships were not carrying on a trade.
>
> (1) We agree with the FTT (indeed it was not disputed by Mr Furness) that when a new partner is admitted to a partnership, there is in law a new partnership. Since the relief under s138 or s140 of ITTOIA applies if "the person carrying on the trade has incurred acquisition expenditure", it follows that the FTT was correct to say that the relevant question is whether the partnership as constituted after the adherence of the individual partners was carrying on a trade, and was doing so at financial close when the acquisition expenditure was incurred.
>
> (2) That requires a close focus on what that partnership actually did. The question whether a transaction is an adventure in the nature of trade is not to be answered by asking whether the transaction is of a type which may in other cases have been held to constitute trading (is it a sale and leaseback?), but by examining the particular transaction in question.
>
> (3) This is what the FTT did. There is no identifiable error of law in their statement of the principles at [200]-[210]. There

> they accepted in terms that a single purchase and leasing of an asset can be a trade (at [204]); that the purchase of a film with a view to its distribution or exploitation for profit was a typical transaction of a commercial nature (at [205]); and that a single leasing can be a trade (at [208]). None of this, however, was determinative of the question whether the partnerships were trading in this case, which depended on what the partnerships actually did.
>
> (4) Nor do we consider that it can be said that the only true and reasonable conclusion from the facts was that the partnerships were trading. On the contrary, the FTT very clearly found as a fact that the leasing agreements could not be divorced from the sale and purchase agreements: see, for example, [45(8)] ("the purchase was conditional on the lease agreement and vice versa"), [59] ("There was no doubt in our minds that the SPA agreement was not contemplated and would not have been completed without the lease and vice versa … They were legally and commercially one transaction") and [67]; see also [331]-[332] ("The partnerships never acquired the film without the burden and benefit of the lease. Without the film they never would have had the lease, but also without the lease they could and would never have acquired the film".). This justified their conclusion at [208] that "the acquisition and hiring out were accomplished by a single composite transaction", and their findings at [216] as to what the partnerships actually did once the investing partners adhered (see [37] above). In these circumstances, the FTT's description (at [212]) of the lease and acquisition as "one transaction whose material features were the payment and receipt of monies" and (at [220]) of the commercial nature of the agreements as being "the payment of a lump sum in return for a series of fixed payments over 15 years" seem to us to be factual conclusions that they were fully justified in reaching. Having done so, we see no error of law in their characterisation of such a transaction as not being an adventure in the nature of a trade."

40. The UT then referred, at [87], to the decision of this court in <u>Eclipse Film Partners No. 35 LLP v Revenue and Customs Commissioners</u> [2015] EWCA Civ 95, [2015] STC 1429, ("<u>Eclipse</u>") which had been handed down on 17 February 2015, several months after the conclusion of the hearing before the UT in June 2014, but over two months before the UT finally released its decision on 29 April 2015. The UT said they had reached their conclusion in [86] (quoted above) before the judgment in <u>Eclipse</u> had been handed down, but there was nothing in it which caused them to alter their views. They continued:

> "On the contrary the references in [111] to an "unblinkered approach to the analysis of the facts", a "realistic approach to the transaction" and to it being necessary to stand back and look at the whole picture and, having particular regard to what

> the taxpayer actually did, ask whether it constituted a trade seem to us to be exactly in point, and to be the approach that the FTT correctly took. In the circumstances, we did not think it necessary to invite any further argument as a result of that decision."

41. Finally, at [88] to [89] the UT considered an argument based on Lupton which HMRC had advanced to them. For essentially the same reasons as the FTT had given, the UT found it unnecessary to deal with this argument.

42. The UT's conclusion on the trading issue meant that all the taxpayers' appeals before them had to be dismissed: see [90].

(3)The correct approach to the trading issue: legal principles

43. The relevant legal principles concerning the meaning and application of the concept of "trade" in tax legislation have recently been analysed and restated by the Court of Appeal (Sir Terence Etherton C, Christopher Clarke and Vos LJJ) in Eclipse, at [109] to [117] of the judgment of the court. That analysis is, of course, binding on us, but in any event I respectfully agree with it.

44. To place the analysis in context, it is necessary to say a little about the background to the case. Like the present case, it concerned a film scheme, and the critical issue was whether the appellant limited liability partnership (a corporate entity, and not as in the present case an ordinary partnership) was trading when it entered into a suite of pre-ordained transactions; but the character of the scheme was different, and the legislative provisions in issue were also different, although the trading requirement was in substance the same as the trading requirement in this case.

45. The issue was described by the court in Eclipse as follows:

> "[4] Members of Eclipse 35 borrowed money to contribute to its capital. They paid interest on the money borrowed. They may be able to claim tax relief in respect of that interest but only if Eclipse 35 was carrying on a trade and only if the borrowed money was used wholly for the purpose of that trade. That is the combined effect of [*ITTOIA*] s 863 and [*ICTA*] ss 353 and 362.
>
> …
>
> [7] Eclipse 35's case is that in the relevant year of assessment it carried on the trade of acquiring and exploiting film rights. The case for [*HMRC*] is that Eclipse 35 has never carried on a trade but has merely organised a sophisticated financial model involving licensing and distribution rights in respect of two Disney films designed to give a series of pre-determined cash flows and with the ultimate object of giving rise to interest payments by the members (accelerated by prepayment) on borrowings for which they can claim tax relief to set against other income they have which is otherwise taxable.

> [8] The FTT decided that what Eclipse 35 actually did was not a trading transaction at all but rather it carried on the business of exploiting films not amounting to a trade, that is to say it carried on a "non-trade business" of film exploitation within ITTOIA, s 609."

46. The court began its discussion of the relevant legal principles at [109], referring to the observation of leading counsel for the appellant, Mr Graham Aaronson QC, that tax on profit from carrying on a trade has been a feature of our tax legislation for some 200 years. The court then briefly reviewed the modern approach to the interpretation of tax legislation in [110], beginning with the Ramsay case (W T Ramsay Ltd v IRC [1982] AC 300) and proceeding, via BMBF and IRC v Scottish Provident Institution [2004] UKHL 52, [2004] 1 WLR 3172, to the "elegant summary" of the modern approach by Ribeiro PJ in the Arrowtown case (Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] HKCFA 46, (2003) 6 ITLR 454), at [35]:

> "[T]he driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

47. The court continued:

> "[111] The concepts of an "unblinkered approach to the analysis of the facts" and a "realistic approach to the transaction" derive at least in part from the speeches in *Ransom v Higgs*. There, Lord Morris said ([1974] 1 WLR 1594 at 1606) that "[i]n considering whether a person "carried on" a trade it seems to me to be essential to discover and examine what exactly it was that the person did", and Lord Reid ([1974] 1 WLR 1594 at 1601) specifically examined what Mr Higgs had himself done. It is necessary to stand back and look at the whole picture and, having particular regard to what the taxpayer actually did, ask whether it constituted a trade.
>
> [112] The Income Tax Acts have never defined trade or trading further than to provide that (in the words of TA 1988, s 832(1) which was applicable to the relevant tax year) trade includes every trade, manufacture, adventure or concern in the nature of trade. As an ordinary word in the English language "trade" has or has had a variety of meanings or shades of meaning. Its meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation, depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular factual characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the

> particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles. To that extent the conclusion is one of fact, or, more accurately, it is an inference of fact from the primary facts found by the fact-finding tribunal.
>
> [113] It follows that the conclusion of the tribunal of fact as to whether the activity is or is not a trade can only be successfully challenged as a matter of law if the tribunal made an error of principle or if the only reasonable conclusion on the primary facts found is inconsistent with the tribunal's conclusion. These propositions are well established in the case law: *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14 at 29-32, 33, 36, 38-39 … per Viscount Simonds and Lord Radcliffe respectively; *Ransom v Higgs* [1974 1 WLR 1594 at 1601, 1611, 1618 per Lord Reid, Lord Wilberforce and Lord Simon respectively; *Marson (Inspector of Taxes) v Morton* [1986] 1 WLR 1343 at 1348 (Sir Nicolas Browne-Wilkinson V-C). An appeal from the FTT is on a point of law only: Tribunals, Courts and Enforcement Act 2007, s 11."

48. After some further discussion of Marson v Morton and Ransom v Higgs, which I need not set out, the court concluded:

> "[117] Finally, on legal principles, it is elementary that the mere fact that a taxpayer enters into a transaction or conducts some other activity with a view to obtaining a tax advantage is not of itself determinative of whether the taxpayer is carrying on a trade: *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] 1 AC 655 at 677 (Lord Templeman)."

49. Applying this approach to the facts found by the FTT, the court found no reason to interfere with the FTT's conclusion that the business of Eclipse 35 did not constitute a trade. As the court said, at [123] to [124]:

> "[123] … Our reasons can be stated quite briefly. The proper characterisation of the business of Eclipse 35 depends upon the totality of its activity and enterprise. Stripping the business down to its essential elements, the transactions on which Eclipse 35 was engaged had two aspects. One aspect was that a payment by Eclipse 35 of £503 m would be repaid with interest over a 20-year term and would produce a profit unrelated to the success or otherwise of the exploitation of the Rights sub-licensed. That aspect had the character of an investment. Mr Aaronson did not argue to the contrary.
>
> [124] The second aspect was the possibility of Eclipse 35 obtaining a share of Contingent Receipts and the activity on the part of Eclipse 35 to secure such a share. The FTT considered that this second aspect was in real and practical terms

> insufficiently significant in the context of Eclipse 35's business as a whole to lead to a proper characterisation of Eclipse 35's business as one of trade within the meaning of the tax legislation. In our judgment, that was a conclusion which the FTT were entitled to reach and, indeed, with which we agree."

50. On 13 April 2016 the Supreme Court refused Eclipse 35's application for permission to appeal to it.

Discussion

51. In their grounds of appeal, the appellants seek to identify a number of specific errors of law in the FTT Decision which, they say, cumulatively vitiated the FTT's conclusion that the partnerships were not trading. But for those errors, the only conclusion reasonably open to the FTT, on their undisputed findings of primary fact, was that the partnerships were indeed trading. Before coming to these alleged specific errors, however, I will first examine an overarching argument which Mr Furness placed at the forefront of his oral submissions.

52. In answer to questions from the court, Mr Furness submitted that the critical issue of law which the court has to consider is whether or not it was permissible for the FTT to ignore the activities which the partnership had actually undertaken, and to re-characterise them as transactions of an investment nature. He submitted that the purchase and onward leasing of a film were transactions of an essentially trading character, in the same way as the purchase and leaseback of the gas pipeline in BMBF had formed part of the financial trade of the taxpayer company in that case. The nature of the trade in BMBF, as in the present case, was shaped and moulded by fiscal incentives which Parliament had chosen to enact, and which taxpayers were free (indeed, encouraged) to take advantage of: in BMBF, the availability of 100% first year allowances for capital expenditure on plant and machinery, and the finance leasing industry which exploited such allowances; in the present case, the film finance legislation, which was intended by Parliament to provide incentives for the financing of British films by external funders.

53. The inevitable result of these fiscal incentives, submits Mr Furness, was the creation of artificial-looking structures designed to exploit them in the most efficient manner. None of this, however, should be allowed to detract from the inherently trading nature of what the partners actually did. Nor is it an objection that their activities were carried on through the instrumentality of an agent, Future, rather than by the individual exertions of the partners themselves. There is no reason in law why a trade may not be carried on through an agent.

54. Mr Furness buttressed these submissions by referring us to the course which the BMBF litigation had followed in its passage through the courts, while accepting (as he had to) that there was no live issue whether BMBF was itself carrying on a trade; it was at all stages common ground that it did. The relevant issue was whether BMBF had expended £91.292 million on the purchase of plant and machinery, within the meaning of section 24(1) of the Capital Allowances Act 1990. The Special Commissioners, who were the tribunal of fact, took the view that it was necessary to look at the whole of the transaction, and not merely at what BMBF actually did. Adopting this approach, they concluded that even if BMBF could be said to have

incurred expenditure, it could not be said to have been expenditure on the pipeline. The payment by BMBF achieved no commercial purpose, because it did not provide BMBF with working capital: the money was instead deposited pursuant to the pre-ordained and circular financing arrangements which had been set up. The Special Commissioners accordingly identified the purpose of the expenditure by BMBF as the obtaining of capital allowances, which would result ultimately in a profit to one company and fees payable to two other companies: see [2002] STC 1068 at 1082-1084. This conclusion was then upheld by Park J in the High Court, for substantially the same reasons: see his judgment ([2002] EWHC 1527 (Ch), [2002] STC 1068) at [64].

55. In agreeing with the Special Commissioners' conclusion that the payment of money by BMBF could not be said to have been expenditure on the pipeline, Park J said at [58]:

> "I agree with them, although I would be inclined myself slightly to expand the proposition and say: the expenditure by BMBF, looked at commercially and from the point of view of what it was really for, was not incurred on the provision of the pipeline. That proposition naturally prompts the question: Well, what was it incurred on? The Special Commissioners do not answer the question. My answer is that the expenditure was really incurred on the creation or provision of a complex network of agreements under which, in an almost entirely secured way, money flows would take place annually over the next 32 or so years so as to recoup to BMBF its outlay of £91m plus a profit. The £91m never passed out of the network created by the agreements (substantially an enclosed network). The £91m was merely part of what the Special Commissioners record Mr Goy [*counsel for HMRC*] as describing (not inappropriately, in my view) as "financial engineering". I consider that it was the money flows which mattered, and it was on the rights to the money flows that, as a commercial matter, BMBF really expended the £91m which it had borrowed."

56. So far, submits Mr Furness, there is a close parallel to the approach and reasoning of the FTT on the trading issue in the present case. Looking at the finance leasing transactions as a whole, including the circular finance arrangements, it could be seen that in reality BMBF had spent the £91 million on obtaining the relevant money flows, not on the acquisition of plant. But this analysis was then overturned in the Court of Appeal, and HMRC's further appeal to the House of Lords was unsuccessful. The leading judgment in the Court of Appeal was delivered by Peter Gibson LJ. The core of his reasoning (see [2002] EWCA Civ 1853, [2003] STC 66) may be found at [37] to [47]. For present purposes, it is sufficient to quote the summary of his conclusion at [46]:

> "In my judgment, the incurring by BMBF of the expenditure was wholly and exclusively for the purposes of its trade of providing asset-based finance. With respect to the judge, in the light of the evidence … I can see no basis for re-characterising

> the transaction in the way the judge did. It seems plain to me that BMBF incurred expenditure on the provision of the pipeline by a transaction which, despite having a fiscal element in it, in that capital allowances were to be obtained and passed on to the lessee in the form of lower rentals, was a genuine trading transaction."

57. In the House of Lords, the opinion of the appellate committee was delivered by Lord Nicholls of Birkenhead: see [2004] UKHL 51, [2005] 1 AC 684. The main significance of the case lies in the influential restatement by the House of Lords of the Ramsay principle. For present purposes, however, it is enough to focus on what Lord Nicholls said at [41]:

> "So far as the lessor is concerned, all the requirements of section 24(1) were satisfied. Mr Boobyer, a director of BMBF, gave unchallenged evidence that from its point of view the purchase and leaseback was part of its ordinary trade of finance leasing. Indeed, if one examines the acts and purposes of BMBF, it would be very difficult to come to any other conclusion. The finding of the special commissioners that the transaction "had no commercial reality" depends entirely upon an examination of what happened to the purchase price after BMBF paid it to BGE. But these matters do not affect the reality of the expenditure by BMBF and its acquisition of the pipeline for the purposes of its finance leasing trade."

58. In relation to the decision of this court in Eclipse, Mr Furness accepted (as again he had to) that it provides an authoritative statement of the legal principles to be applied in deciding whether a particular activity constitutes a trade for tax purposes. He sought, however, to distinguish the decision on its facts, arguing that the transactions there in issue were very different from those in the present case. The issue in Eclipse was whether Eclipse 35 was carrying on the trade of acquiring and exploiting film rights, in a context where the legislation expressly envisaged that there might be a non-trading business of film exploitation: see section 609(1) of ITTOIA, which provides that:

> "[i]ncome tax is charged on income from a business involving the exploitation of films or sound recordings where the activities carried on do not amount to a trade."

In that context, submits Mr Furness, it is relatively easy to see that the limited activities undertaken by Eclipse 35 amounted to little more than the monitoring of a financial investment, and fell short of trading properly so-called. By contrast, the purchase and leaseback of a film are quintessentially transactions of a trading nature.

59. These submissions were attractively presented by Mr Furness, but I am unable to accept them. At the most basic level, it is now clear from Eclipse, if it was not clear before, that the question whether what the taxpayer actually did constitutes a trade has to be answered by standing back and looking at the whole picture: see [111]. Although it is a matter of law whether a particular activity is capable of constituting a trade, whether or not it does so in any given case "depends upon an evaluation of all

the facts relating to it against the background of the applicable legal principles": see [112]. It follows that it can never be appropriate to extract certain elements from the overall picture and treat them, viewed in isolation, as determinative of the issue. But that, in essence, is what Mr Furness is inviting us to do, when he says that the purchase and leaseback (or onward lease) of a film are inherently trading activities. There is no dispute that such activities are capable of forming part of a trade, and in many contexts the only reasonable conclusion would be that they did form part of a trade. But when the whole picture is examined, the conclusion will not necessarily be the same. The exercise which the FTT has to undertake is one of multi-factorial evaluation, and their conclusion can only be challenged as erroneous in point of law on Edwards v Bairstow grounds: see Eclipse at [113].

60. This is the exercise which the FTT undertook in the present case, and subject to the specific alleged errors of law which I have yet to consider it seems to me, as it did to the UT, that the approach and evaluation of the facts by the FTT cannot be faulted. In particular, I respectfully agree with everything said by the UT in the UT Decision at [86], quoted above.

61. In the interests of clarity, it is important to distinguish between the evaluative exercise which the FTT has to perform, on the one hand, and the proposition that a taxpayer cannot be taxed by re-characterising what he has actually done as something else, on the other hand. Mr Furness submitted that the FTT were guilty of such a re-characterisation, but I am satisfied that they did not fall into an elementary error of this description. Their overall assessment of the commercial nature of the agreements as the payment of a lump sum in return for a series of fixed payments over 15 years (at [220] of the FTT Decision) was not a crude conclusion based on an impermissible transformation of the taxpayers' activities into an economic equivalent, but rather a way of expressing the ultimate inference of fact which they drew from the totality of the primary facts which they had found.

62. I am also satisfied that the BMBF litigation does not provide the support for Mr Furness' argument that he would have us accept. The statutory provisions on which BMBF turned were entirely different, and it was common ground that BMBF carried on a trade of finance leasing. The circularity of the finance arrangements in BMBF was irrelevant, because the only issue was whether BMBF had incurred expenditure on the acquisition of the pipeline. The acquisition of the pipeline undoubtedly took place, and had enduring effects in the real world. It could not somehow be disregarded as "the fifth wheel on the coach", as Park J had suggested at [61]. The focus of the relevant legislation was on the acquisition of the pipeline by the taxpayer, not on the financial arrangements which enabled that acquisition to be made. There is no comparable issue in the present case, where the question is not whether the partnerships genuinely acquired and leased the films – they obviously did – but rather whether those activities, viewed in the context of each partnership's business as a whole, constituted the carrying on of a trade. The analogy which Mr Furness seeks to draw with the facts of BMBF is therefore an unhelpful one.

63. I am equally unpersuaded by his attempt to distinguish the decision of this court in Eclipse. It is true that there are important factual differences between the film scheme in Eclipse and the film scheme in the present case, and account has to be taken of those differences in answering the question whether the partnerships carried on a trade. The importance of Eclipse, however, lies in the statement of the principles of

law by reference to which the question has to be answered, and its reaffirmation of the limited grounds upon which an evaluative decision by the FTT may be successfully challenged as erroneous in point of law.

64. For all these reasons, I would reject Mr Furness' overarching submission. I now turn to consider the specific errors of law alleged in the grounds of appeal. I will deal with them comparatively briefly, because to a considerable extent they stand or fall with the appellants' more general submissions which I have already rejected.

65. The first alleged error of law is that the FTT wrongly ignored activities undertaken by each partnership before the date when the taxpayer partners had joined it. Thus in the FTT Decision at [216] to [222] the focus is only on what the partnerships did once the investing partners had adhered. This was a significant error, say the appellants, because the FTT failed to take into account the work done by Future in identifying the films to be purchased and negotiating the deals. It is true that a new partnership technically came into existence as and when each investing partner joined, but it does not follow that the business of the partnership should be treated as having started afresh on each such occasion. By ignoring the pre-accession activity of each partnership, the FTT wrongly failed to take account of all the preparatory work which made each partnership a suitable vehicle for the taxpayer partners to invest in. Another way of making the same point is to say that whether or not a particular transaction is or is not trading cannot be assessed without looking at the entire context of the transaction, including its genesis.

66. In my judgment there is nothing in this argument. It is common ground that the question of trading had to be determined at the time of financial close, when the acquisition expenditure on each film was incurred. The terms on which the investing partners joined entitled them to the entire profit (and, more relevantly, made them liable for all losses) of the business to the entire exclusion of the initial partners, who retained only a valueless nominal share in the business. HMRC agree that regard must be had to the entire context of the transaction, including its genesis, but correctly point out that the context here was that the founding partners did not carry on any business for their own gain, but merely acted in concert at the behest of Future to find and promote an investment opportunity for investors. By the time when the investors adhered, the contractual framework of the deal was unconditional, subject only to finalisation of the figures, so the only real choice for the investors was whether to become parties to a transaction under which they paid their money and received in return a rental stream. That is why the FTT correctly focused on the position after the investors joined the partnerships, and treated the previous activities of the founding partners as preparatory steps which in themselves threw no light on the question whether the partnerships were trading when the deals were eventually closed.

67. The second ground of appeal is related to the first. It says the FTT erred in law in concluding that there were no partnerships in existence before the adherence of the taxpayer partners. The reference is to [225] of the FTT Decision, where they accepted Mr Tallon's argument that the nature of the relationship between the initial partners was not one of partnership, because they did not have a view of profit for themselves as parties in the venture: see [34] above. This ground of appeal raises a question of some general importance in the law of partnership, upon which there appears to be no authority. Section 1 of the Partnership Act 1890 defines partnership as "the relation which subsists between persons carrying on a business in common with a view of

profit". The question which arises is whether that test is satisfied where two or more persons carry on a business in common with a view of profit, not for themselves, but for future new partners who will for all practical purposes replace them.

68. We heard brief argument on this point from both sides, but in view of its potential wider significance I would be reluctant to express a view upon it unless it were necessary to do so. In my opinion there is no such necessity, because the FTT went on to say at [227] that their conclusion would have been the same, even if the activity of Future as agent of the partnership in sourcing and negotiating the sale and leaseback transactions would have to be taken into account: see [35] above. Having said that "[t]he real business started when the agreements were signed", the FTT continued:

> "Those agreements were single composite transactions which would complete with payment. We cannot see how an extension of the horizon to encompass both the signing and completion of those agreements can turn activity of making payment under the agreements into part of an adventure in the nature of … trade."

I agree, and therefore prefer to express no view on the question whether there was a partnership in existence within the meaning of section 1(1) of the 1890 Act before the adherence of the investing partners. This is also a convenient point at which to record that, although the partnerships were established under Jersey law, no expert evidence on the law of partnership in Jersey was adduced before the FTT, and it was common ground that it should be treated as being the same as the English law of partnership.

69. The third ground of appeal challenges the approach taken by the FTT in the FTT Decision at [227]. As I have already explained, I see no reason to criticise the approach to the pre-adherence activities of the partnerships in that paragraph. Accordingly, I would reject the first and third grounds of appeal, while finding it unnecessary to rule on the second.

70. The fourth ground of appeal is that the FTT erred in disregarding the individual commercial arrangements (including borrowings) and the tax position of the partners when assessing whether the partnership was trading. The challenge is accordingly to [201] of the FTT Decision quoted at [23] above. The central issue here is whether the external borrowings by the partners, and their intention to use their shares of the partnership's losses to set against their taxable income from other sources, were factors of no relevance in determining whether the partnerships were trading. In his skeleton argument, Mr Furness submits that the FTT's approach betrays a fundamental misunderstanding about the nature of partnership trading. Since an English partnership is not a legal person, both as a matter of general law and as a matter of tax law any trade carried on by a partnership is carried on by the partners themselves. Indeed, ITTOIA section 848 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."

It follows, submits Mr Furness, that the existence and commerciality of the trade cannot be assessed in the abstract, but only by reference to the financial interests of the partners. In his oral submissions, Mr Furness emphasised that the borrowings of the investing partners were all co-ordinated, and each of them borrowed on the same terms. This was enough, he said, to make the borrowings akin to partnership borrowings, the only difference being that the liabilities of the partners were several, not joint and several.

71. In my judgment the FTT were entirely right to disregard the borrowings made, and the loss relief claimed, by the individual partners in their personal capacities. The fact that the partnership has no separate legal identity is a red herring, because it is still necessary to distinguish between the partnership business (i.e. the activity carried on by the partners acting in common together) and the separate affairs of the individual partners. The fact that the tax reliefs which the partners hoped to obtain (sideways loss relief, and relief for interest paid) were dependent on the partnership carrying on a trade could not alone cause the partnership's business to constitute a trade if it otherwise did not, nor could it somehow transform the actions undertaken by the partners in their personal capacities into partnership activities. To take the case of the partners' individual borrowings, there is a real and substantial difference between borrowings made by a partner on his own account, which enable him to invest in the partnership business, and for which he is solely liable to the lender, on the one hand, and borrowings made by the partners collectively, for which they are jointly and severally liable, on the other hand. Any attempt to conflate the two types of borrowing, as Mr Furness at times appeared to invite us to do, would as Arden LJ pointed out in argument be a true example of impermissible re-characterisation.

72. Furthermore, the distinction between partnership activities and the affairs of individual partners is clearly recognised both in the authorities and in the legislation. Mr Tallon referred us to the decision of this court in Heastie v Veitch [1934] 1 KB 535, where the issue was whether, in computing the profits of a partnership, a deduction was available in relation to the payment of rent to one of the partners who owned the premises from which the firm operated. In order to be properly deductible, the rent had to be wholly and exclusively incurred for the purposes of the partnership's business. This court held, reversing Finlay J, that this test was satisfied, even though the rent was paid to one of the partners, because the payment was made to him in his capacity of landlord of the premises, not in his capacity of partner: see the judgment of Romer LJ at 547.

73. So far as tax legislation is concerned, sections 353 and 362 of ICTA provided relief for a partner in his personal tax return for interest paid on a loan taken out by him for certain qualifying purposes, including where the money is contributed or advanced to the partnership and is used wholly for the purposes of the partnership's trade. These were the provisions of which the scheme in Eclipse unsuccessfully sought to take advantage.

74. I would therefore dismiss the fourth ground of appeal.

75. The fifth ground is that the FTT were wrong (in the FTT Decision at [202] to [204]) to distinguish the position of the partnerships from that of the taxpayer in BMBF, on the ground that in BMBF the obtaining of the relevant tax reliefs was an integral part of the company's business. I have already explained why I do not consider that

BMBF provides any helpful analogy with the present case. The point which the FTT were making in these paragraphs, with which I agree, is that the borrowings which BMBF made in order to acquire the pipeline, and the capital allowances which it thereby hoped to obtain, all formed an integral part of the finance leasing trade carried on by that company. The situation was therefore entirely different from the borrowings made by the individual partners in their personal capacities in the present case. I can see nothing in this ground of appeal.

76. The sixth ground is that the FTT were wrong (at [220]) to disregard the legal nature of the acquisition and onward lease transactions, whether taken separately or as a composite whole. They were also wrong to assert (at [218]) that for the purpose of assessing whether it was a trade, "the whole was different from the sum of its parts". The fact that the transactions were interdependent did not entitle the FTT to ignore the nature of those transactions, and to substitute for them what it considered to be an economically equivalent transaction (i.e. a payment of a lump sum in return for a series of fixed payments over 15 years).

77. This ground of appeal raises essentially the same issues as the general argument which Mr Furness placed at the forefront of his oral submissions, and which I have already rejected. I agree with HMRC that the appellants could have no real prospect of success on this ground unless the Supreme Court gave permission to appeal in Eclipse and then overturned the judgment of the Court of Appeal. Since the Supreme Court has now refused permission to appeal, this ground cannot in my view succeed.

78. The seventh ground alleges that the FTT erred in law in distinguishing BMBF on the basis that the taxpayer in that case had a pre-existing finance leasing trade of which the disputed transaction was a part, and further erred in distinguishing an earlier case (Bennet v Rowse (1957) 38 TC 476) where a single leasing transaction was held to be by way of trade. I am satisfied that there is no substance in these alleged errors. The FTT were clearly well aware that a single transaction was capable of being an adventure in the nature of trade: see for example the FTT Decision at [204]. Everything depends on the context, and where there is a single composite transaction, on how that composite transaction is to be characterised. I have already discussed BMBF. The facts of Bennet v Rowse were so distant from those of the present case that it provides no assistance, and Mr Furness wisely did not refer us to it in his oral submissions.

79. The eighth ground alleges that the FTT made further errors of law in their treatment of certain other authorities. Mr Furness accepted that these points were all of a minor nature, and in my view they do not require separate comment. It is quite clear that none of them could save the day for the appellants, if (as I would hold) the principal grounds of appeal on the trading issue fall to be dismissed.

80. Finally, the ninth ground of appeal criticises the FTT for finding that only one of the badges of trade, namely the commercial nature of the subject matter, was satisfied: see the FTT Decision at [221] and [222]. It is said that at least the fourth, fifth and eighth badges were also satisfied, and that this should have led the FTT to conclude that the transaction was of a trading nature. But the badges of trade are no more than a guide, and the FTT only considered them as something in the nature of a cross-check after they had reached their conclusion about the true commercial nature of the agreements. It cannot seriously be suggested that their conclusion would have been

any different if they had analysed the badges of trade more closely, and the criticisms made by the appellants do not raise any matters not already covered by the other grounds of appeal. In substance, therefore, this ground is a makeweight which adds nothing to the other grounds.

81. I have now reviewed all the individual grounds of appeal, and concluded that none of them should succeed. It follows that the taxpayers' appeal on the central trading issue must in my view be dismissed.

If the partnerships were trading, did they do so on a commercial basis?

82. The next issue arises only if the partnerships were carrying on a trade. It concerns a further requirement which had to be satisfied if the partners were to be able to set off their share of the partnership losses against other income, pursuant to sections 380 or 381 of ICTA. Section 380 permits trading losses sustained in a year of assessment to be set off against other income in the same or preceding year of assessment. Section 381 extends the period of carry back for losses incurred in the early years of a trade, and permits them to be set off against income in the three years preceding the year in which the loss was incurred. Both sections provide that the relief is subject to a condition, which is worded in similar but not identical terms for each section.

83. The condition applicable to relief under section 380 is contained in section 384(1), which states that relief shall not be available for a loss unless "… the trade was being carried on on a commercial basis and with a view to the realisation of profits in the trade". The condition applicable to relief under section 381 is contained in section 381(4), which states that relief shall not be given unless "… the trade was carried on throughout [*the period in which the loss was sustained*] on a commercial basis and in such a way that profits in the trade … could reasonably be expected to be realised in that period or within a reasonable time thereafter".

84. The conditions therefore embody two tests: a test of commerciality, and a profits tests. The profits test is differently worded in the two sections, but broadly speaking it requires the trade to have been carried on with a view to making profits. The FTT decided that the profits test was satisfied, because the gross receipts from the leases would exceed the initial outlay on the purchase of the film over the fifteen year term of the leases, and the word "profit" in the legislation was intended to refer to the excess of income over expenditure on a simple arithmetical basis: see the FTT Decision at [308] to [310]. The correctness of that conclusion is not challenged by HMRC.

85. The FTT held, however, that the commerciality test was not satisfied, and the UT agreed with them. The grounds on which the appellants seek to challenge this conclusion are set out in the grounds of appeal as follows:

> "8. On this issue the UT (agreeing with the FTT) held that a trade which was bound to produce a loss in net present value terms could not be said to be carried on [*on*] a commercial basis absent "collateral benefits" (Decision paragraph 97). The UT accepted that the availability of tax relief could constitute such a collateral benefit, and enable a trade conducted at a loss in pre-tax terms to be treated as commercial if it appeared

> profitable in post-tax terms. However, it refused to take account of the loss relief available to the partners in assessing the commerciality of the trade, instead holding that the commerciality of the trade had to be assessed solely by reference to the trade of the partnership.
>
> 9. This approach discloses two errors of law (which were also committed by the FTT):
>
> (a) It is wrong to treat the requirement of commerciality as turning on the degree of profitability of the trade. There is a separate requirement for loss relief, which is to the effect that the trade be carried on with a view to making a profit …, which the taxpayers won. The requirement that the trade be carried on "on a commercial basis" is looking not at whether the trade will be profitable (which is the purpose of the "with a view to a profit" limb), but at the manner in which the trade is actually conducted.
>
> (b) In any case, it is permissible to take account of the availability of loss relief to partners in a partnership when assessing whether the business they carry on as partners is carried on on a commercial basis."

86. The grounds of appeal therefore raise two issues:

    (a) whether the profitability of the trade is relevant to the commerciality test; and

    (b) whether it is permissible to take account of the availability of loss relief to the individual partners in assessing the commerciality of the trade.

    I will now consider these issues in turn.

(1) <u>The relevance of profitability to the commerciality test</u>

87. The UT dealt with this question at [96] and [97] of the UT Decision, where they said this:

> " "Commercial" and "with a view to profit" are two different tests but that does not mean that profit is irrelevant when considering whether a trade is being carried on on a commercial basis. The reference in *Wannell v Rothwell* to the serious trader who is seriously interested in profit is not only relevant to deciding whether a person is a serious trader or an amateur or dilettante. We consider that the FTT were right when they said, at [253], that the serious interest in a profit is at the root of commerciality. We also consider they were correct in regarding "profit" in the context of commerciality as a real, commercial profit, taking account of the value of money over time, and not simply an excess of income over receipts.

> 97. The FTT were, in our view, right to conclude that a trade that involved transactions that were intended to produce a loss in net present value terms, with no compensating collateral benefits, was not conducted on a commercial basis. No one who was seriously interested in running a business or trade on commercial lines would pay £10 for an income stream with a net present value of £7 unless there were some good reason to do so. Of course in this case the reason why the partnerships were willing to do this was because they believed that tax relief would be available to the partners."

88. The appellants challenge this reasoning on two grounds. First, they say that to import a stricter test for profitability into the commerciality test renders the profitability test redundant, which Parliament cannot have intended. Secondly, the commerciality test involves an assessment whether the manner in which the trade is run is commercial, not whether its profits are considered commercial. They argue that this approach reflects the presumption that Parliament intended every part of a statute to have some meaning and effect, and only thus can proper and separate meaning be given to the profitability test and the commerciality test.

89. In support of his submission that the commerciality test is primarily concerned with the manner in which the trade is conducted, Mr Furness referred us to the helpful observations of Robert Walker J in Wannell v Rothwell [1996] STC 450 at 461, with reference to a claim by the taxpayer for loss relief under similarly worded predecessor legislation:

> "I was not shown any authority in which the court has considered the expression "on a commercial basis", but it was suggested that the best guide is to view "commercial" as the antithesis of "uncommercial", and I do find that a useful approach. A trade may be conducted in an uncommercial way either because the terms of trade are uncommercial (for instance, the hobby market-gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable costs of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby art gallery or antique shop where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante. There will no doubt be many difficult borderline cases … for the commissioners to decide; and such borderline cases could as well occur in Bond Street as at a car boot sale."

90. It seems to me that this passage does little to advance Mr Furness' argument, because Robert Walker J himself identified a serious interest in profit as a hallmark of commerciality. That must in my view be correct, but it shows that considerations of profitability cannot be divorced from an assessment of the commerciality of a business. In my judgment it is wrong to regard the profitability and commerciality

tests in the legislation as mutually exclusive, and they necessarily overlap to an extent which will vary from case to case. I therefore see no error of law in the approach which the FTT adopted to this question, and I agree with the observations of the UT in [96] and [97] of the UT Decision, quoted above.

(2) The relevance of the availability of loss relief

91. I can deal with this question briefly, because it raises essentially the same issue as I have already discussed in the context of trading. The availability of loss relief to the individual partners in their personal capacities cannot in my view be a relevant factor in assessing the commerciality of the partnership's business. Furthermore, there is a logical difficulty with the argument to which HMRC rightly draw attention. In order to obtain loss relief, the partners have to show that the trade is commercial; but they can only do this if they assume their entitlement to obtain such relief, which is the very issue under consideration. In other words, the argument is circular and proves nothing. The question of commerciality must therefore be addressed without reference to the availability or not of loss relief to the individual partners.

92. Finally, HMRC also rely on the findings made by the FTT at the very end of their discussion of commerciality, where they said at [297]:

> "… the partnerships were not seriously interested in making profits. Instead the business focus was on ensuring that investors got tax relief and Future got its fee. Those were not serious financial benefits to the business of the partnership. That is another aspect of the lack of commerciality displayed in the purchase of a rental stream for more than its value."

HMRC submit, and I agree, that on the basis of these findings alone, from which there has been no appeal, it is clear that any trades (assuming them to have existed) were not carried on on a commercial basis.

93. I would therefore dismiss these grounds of appeal.

The length of Proteus' initial relevant period

94. I now come to the last of the appellants' grounds of appeal, which relates to the amount of relief Proteus is entitled to for its first period on the assumption that it carried on a trade. The issue affects Proteus only, because Proteus claimed relief under ITTOIA section 138 which spreads relief over three years, whereas Samarkand claimed relief under section 140, which allows all the relevant expenditure to be claimed in the first year. It will be recalled that Samarkand was able to take advantage of section 140, because both its films were low budget, whereas Proteus' film (Oliver Twist) was not. Under section 138(5), the relief is calculated by allocating one third of the total acquisition expenditure to the first period. This is subject, however, to section 138(6) which states that:

> "If the relevant period is less than 12 months the above references to one-third are to be read as references to a proportionately smaller fraction."

95. "Relevant period" is defined in ITTOIA section 133 to mean:

> "(a) a period of account of the trade, or
>
> (b) if no accounts of the trade are drawn up for a period, the basis period for a tax year."

Section 199 of ITTOIA defines the basis period for the first year of trading as the period from the date of the commencement of the trade to the following 5 April. Since Proteus did not commence its trade (if it had one) until 2 December 2005, when the external partners joined it, the basis period for its first year of trading would have been approximately four months, with the consequence that if the basis period was the relevant period for the purposes of section 138(6) the amount of relief which Proteus could have claimed for its initial period would have been reduced accordingly.

96. The expression "period of account" was itself defined in ICTA section 832 as meaning:

> "(a) in relation to a person, … any period for which the person draws up accounts, and
>
> (b) in relation to a trade, profession, vocation or other business … any period for which accounts of the business are drawn up."

It is common ground that Proteus did not draw up any separate partnership accounts for the tax year 2005/06 for the trade that it commenced on 2 December 2005. Proteus did, however, draw up accounts of its business for the entire tax year. Proteus therefore argues that these accounts fall within section 832(b), as being accounts for "any period for which accounts of the business are drawn up". If that contention is correct, the relevant period of account was the whole of the tax year 2005/06, and no apportionment falls to be made under ITTOIA section 138(6).

97. This contention was rejected by both the FTT and the UT, for the same reason. Each Tribunal was satisfied that, on the true construction of section 832 of ICTA, the second occurrence of the word "business" in paragraph (b) should be read as referring to whichever "trade, profession, vocation or other business" in the first part of the paragraph was under consideration, and did not envisage the possibility that the accounts of a trade could be subsumed in the accounts of a preceding non-trading business. In my judgment, that construction is plainly correct. As the FTT put it in [498] of the FTT Decision, the period in section 832(b) "cannot encompass any time when the trade is not conducted: accounts of the trade can only reflect a period when the trade was being carried on".

98. I also agree with the UT, when they said at [140] of the UT Decision:

> "We consider that the interpretation for which Mr Furness contends lacks logic. It amounts to saying that a period when a business existed but before it started trading must be regarded as a period of account for the trade simply because the accounts are drawn up to cover the pre-trading period. As Mr Tallon

> suggested, that introduces an element of arbitrariness to the definition of period of account."

Put shortly, it makes no sense to say that, even though one is required to consider a trade, one can nevertheless look at accounts of something other than the trade when ascertaining the "relevant period" for the purposes of section 138(6).

99. It follows that I would dismiss the appeal on this issue too.

HMRC's cross appeal: the Queen quantum issue

100. HMRC cross appeal to this court on the one issue on which they lost before the UT. The issue is whether the FTT were entitled to conclude, as they did, that Samarkand incurred no more than 1% of the sum of £8,162,791 which it paid to Pathé Slate on the acquisition of the master negatives and rights to exploit "The Queen". The UT were divided on this issue. Nugee J considered that the FTT were wrong to conclude that no more than 1% of the sum spent by Samarkand was spent on The Queen, while Judge Sinfield considered that the FTT were entitled to conclude as they did. Nugee J therefore exercised his casting vote (under article 8 of the First-tier Tribunal and Upper Tribunal (Composition of Tribunal) Order 2008, SI 2008/2835) in upholding the view which he favoured and reversing the decision on this point of the FTT. By their respondent's notice filed on 28 August 2015, HMRC now ask this court to reinstate the decision of the FTT.

101. The background to the issue, and the way in which the FTT dealt with it, are conveniently set out in the UT Decision at [104] to [107], as follows:

> "104. Section 140 of ITTOIA required the person carrying on the trade to have incurred "acquisition expenditure in respect of the original master version of a film". In relation to The Queen, the FTT found that Samarkand had acquired the master negatives and certain rights to distribute and exploit it from Pathé Slate. The relevant issue for this appeal was whether the amount of £8,162,791 paid by Samarkand was expenditure on the acquisition of the negative and rights in respect of The Queen or expenditure on something else.
>
> 105. Under the pre-release sale and purchase agreement dated 11 September 2006 ("the PRSPA"), Pathé Slate agreed to deliver the master negative and to license certain rights in The Queen to Samarkand. The PRSPA provided that the rights were to be granted by a licence subject to and with the benefit of the "Prior Agreements". The Prior Agreements were defined in another document, the lease dated 12 December 2006, which was the same date as the licence of the rights to Samarkand. The Prior Agreements included agreements that conferred distribution rights in relation to every territory on various persons, not including Pathé Slate. By cl 3.5 of the PRSPA, Pathé Slate agreed to pay Samarkand 1% of the share of the net profits of The Queen "accruing to and actually received by

Pathé Slate", after deduction of amounts payable to others for services in connection with the production of the film.

106. The FTT accepted, in [180], that Pathé Slate had the rights to distribute and exploit the film (subject to certain rights previously assigned to others) at the time of the sale and lease. In relation to the value of those rights, the FTT found, at [182], that relevant agreements, including the Collection Account Management Agreement, provided that all receipts from the distribution of the film and the sales agents were to be paid into a collection account out of which monies were to be paid to specified parties in order. Pathé Slate was not one of the specified parties. Mr Furness accepted that, apart from recoupment of a small cost, Pathe Slate was not entitled to be paid anything from the collection account. On the basis of the agreements and because no assets were shown in the accounts of Pathé Slate (which was dormant at the time), the FTT concluded, in [186], that Pathé Slate had no right to receive and did not actually receive any monies representing net profits from the film. The FTT noted that Samarkand had received a cheque from Pathé Productions in relation to Samarkand's right to 1% of Pathé Slate's share of the net profits of The Queen. Samarkand subsequently issued an invoice to Pathé Slate in respect of the payment. As no payments were actually received by Pathé Slate, the FTT concluded, in [187], that Samarkand had no enforceable right to the 1% payments. The FTT considered that it was likely that the payments were made by Pathé Productions because it considered that it was under a moral obligation to do so.

107. In [346], the FTT found, on the balance of probabilities, that Samarkand, through Future, either knew or had means of knowledge that Pathé Slate had no right to receive any share of the net profits from The Queen. The FTT considered that the ownership of the negative and the residual rights did not confer any economic power on Samarkand. The FTT considered that, notwithstanding that the agreement expressed the payment as being for the film, the expenditure must have been to obtain some other benefit because the film was worth very little. The FTT concluded that Samarkand did not incur expenditure in relation to the film but on the benefits of the leasing arrangement which was the only thing of real value that Samarkand received. In [347], the FTT concluded that Samarkand did not incur expenditure of £8,162,791 on the acquisition of The Queen. The FTT considered that the amount incurred in acquiring The Queen was no more than 1% of the amount paid which could be said to relate to the limited rights that it obtained."

102. It is now accepted that the rights to The Queen which Samarkand acquired from Pathé Slate were indeed worthless, or virtually worthless. Mr Furness submitted to the UT that the rights were not worthless, because the FTT had failed to construe the pre-transaction documentation correctly. That submission was rejected by the UT, and the appellants have not sought to resurrect it in this court. His second submission to the UT was that, even if the rights were worthless, the FTT were wrong to hold that Samarkand did not incur the amounts paid in acquiring the film in the absence of any finding that Samarkand knew that it was paying more than the asset was worth when it did so. This argument was accepted by Nugee J, but rejected by Judge Sinfield.

103. In support of his second argument, Mr Furness relied before the UT (as he did before us) on two authorities, the decision of the Court of Session in IRC v George Guthrie & Son (1952) 33 TC 327 ("Guthrie") and the decision of the House of Lords in Stanton (Inspector of Taxes) v Drayton Commercial Investment Co Ltd [1983] 1 AC 501 ("Stanton"). In Guthrie, the taxpayer, who traded as a butcher in Glasgow, paid approximately £1,144 on the intended acquisition of a motor car for the purposes of his business. Owing to a fraud by the vendor, however, he did not obtain title to the car, which had already been sold to a third party. The taxpayer claimed an initial capital allowance in respect of the sum which he had paid, under section 15(1) of the Income Tax Act 1945 which gave an initial allowance equal to one-fifth of the expenditure where "a person carrying on a trade incurs capital expenditure on the provision of machinery for plant for the purposes of the trade". The claim was upheld by the Special Commissioners, and (on appeal) by the Court of Sessions. The Lord President (Cooper) said at 330:

> "When, as in this case, there has been a bona fide expenditure of capital for an approved purpose, I consider that the Special Commissioners were justified in concluding that their concern was with the fact and the object of the expenditure and not with the subsidiary question whether the money was well spent or ill spent, or whether (bona fides being always assumed) the intended object was or was not actually realised."

For present purposes, the important part of this reasoning is the reliance by the Lord President on the fact and object of the expenditure in the absence of any bad faith on the taxpayer's part. The fact that the intended object was not actually realised did not matter under the 1945 Act, but would matter under the modern code governing capital allowances which includes (in response to the decision in Guthrie) a requirement that the plant or machinery should belong to the taxpayer.

104. The second case, Stanton, concerned a share purchase agreement entered into by an investment company (the taxpayer), under which the consideration for the shares was to be satisfied by the allotment of a specified number of shares in the taxpayer company at an issue price of 160p. The bargain was a commercial one made at arm's length. The proposition for which the case is authority is that, where the parties to a transaction have agreed in good faith on the value to be assigned to the consideration, it is not open to the Revenue to go behind the agreed consideration and substitute a different figure. As Lord Fraser of Tullybelton said, at 513B:

> "One consequence of taking the agreed value of the shares as conclusive is that cases may occur in which that value may

> seem surprising … But, provided the agreed value has been honestly reached by a bargain at arm's length, it must, in my opinion, be final and it is not open to attack by the Inland Revenue. Not only is that right in principle, but it is very much in accordance with practical convenience."

105. Nugee J's reasons for accepting that the full amount of Samarkand's expenditure was incurred on acquiring the rights to The Queen are set out at [118] to [123] of the UT Decision. He took as his starting point the factual findings of the FTT, summarised in the passage from the UT Decision which I have already quoted. In relation to the finding at [346], that it seems likely that Samarkand, through Future, "knew or had means of knowledge" that Pathé Slate had no right to receive income in relation to the film, Nugee J commented at [118]:

> "There is however no finding that Future or Samarkand actually knew that Pathé Slate had no right to receive income, or actually appreciated that the rights which Samarkand acquired were of only nominal value. It does not seem possible on these findings of fact to conclude that Samarkand was acting other than bona fide in the belief that it was acquiring valuable rights, however careless this belief may have been."

106. Nugee J then discussed Guthrie, concluding at [120] that the relevant inquiry was "not what the rights acquired by Samarkand were actually worth, but what was Samarkand's object in spending the money". From one point of view, Samarkand's object was obviously to acquire the benefits of the leasing arrangement under the single composite transaction of sale and leaseback; but since this was also true of the other transactions, where the price paid for the film represented its full value, this could not provide an adequate justification for the FTT's conclusion that the partnerships incurred expenditure on the acquisition of the film in the cases of Irina Palm and Oliver Twist but not in the case of The Queen.

107. Nugee J then returned to the point that this was not a case where it could be shown that the acquirer actually knew that the rights were valueless. The FTT's finding that Samarkand had the means of knowledge was an insufficient basis on which to conclude "that it did not spend the money with the object of acquiring the film". Nugee J continued, at [121]:

> "Samarkand's object was to acquire the film precisely so that it could enjoy the agreed rentals from leasing it; but it needed to acquire the film in order to do that and, on the basis of their findings, it was not open to the FTT to conclude that Samarkand knew that it was paying more for the film, and the rights that it was acquiring with the film, than the film and those rights were worth, or that it spent the money on anything else."

108. Judge Sinfield's reasons for reaching the opposite conclusion are set out at [124] to [125]. In his view, the FTT were entitled to conclude as they did, taking account of all the circumstances, including the commercial context of the sale and leaseback transaction and the fact that it included the right to future rentals. Since the vendor of

The Queen had nothing of value to sell, Samarkand must have incurred its expenditure (or at least 99% of it) to acquire something else, and that something else could only have been the benefits of the leasing arrangement. Judge Sinfield distinguished Guthrie on the basis that it was an agreed fact in that case that the taxpayer incurred expenditure with the object of acquiring the car for the purposes of his trade: there was no question of the taxpayer buying anything other than or in addition to the car.

109. The parties repeated and developed before us the same submissions as they had addressed to the UT on this issue. I do not find the point an entirely easy one, but on balance I prefer the approach and reasoning of Nugee J. In particular, I agree with him that the issue has to be addressed on the footing that Samarkand entered into the sale and purchase agreement with Pathé Slate in good faith, and with the intention of paying the whole purchase price for the master negative and other rights in The Queen. In those circumstances, Stanton provides strong support (by analogy, if not directly) for the proposition that it is not open to HMRC to go behind the contractual consideration which the parties by their contract allocated to those rights. Stanton was a case about tax on chargeable gains, but I see no reason why the same principles should not be applied in answering the question of what it was for which Samarkand paid the purchase price. In my respectful opinion, Judge Sinfield's analysis seeks to go behind the contractual position agreed between the parties, in a way which would be permissible only if the contract had not been made in good faith.

110. I also find Guthrie of assistance, because it shows that in answering the question what expenditure is incurred on, in a statutory context designed to provide relief for the expenditure, the focus should be on the fact and the object of the expenditure, rather than on whether the money was well spent. I agree with Nugee J (at [119]) that no distinction can sensibly be drawn between the statutory language of the relevant provisions in ITTOIA, which refer to a person who has "incurred acquisition expenditure", which itself means "expenditure incurred on the acquisition of" the original master version of a film, and the wording in section 15(1) of the Income Tax Act 1945, which refers to a person who "incurs capital expenditure on the provision of machinery or plant".

111. For these reasons, I would dismiss HMRC's cross appeal.

112. The end result, therefore, subject to the judicial review appeal, and if Arden and David Richards LJJ agree, is that the appeals by Samarkand, Proteus and their respective partners will all be dismissed, as will HMRC's cross appeal.

The judicial review claim

Introduction

113. I now turn to the judicial review claim, which falls to be considered on the footing that (as I have now held) the tax appeals would otherwise all be dismissed. On the true construction of the relevant tax legislation, as it applies to the facts found by the FTT, the taxpayers are not entitled to any of the reliefs they claim, principally because the partnerships never carried on a trade. The question is whether the taxpayers are nevertheless entitled to succeed by invocation of a public law remedy which would prevent HMRC from denying tax relief to the transactions in accordance with tax law.

The taxpayers' primary contention is that HMRC are so precluded because the BIM contained representations and assurances that HMRC would allow claims for relief in circumstances materially indistinguishable from those of the present case, thereby giving rise to a legitimate expectation that HMRC would act in accordance with those assurances from which HMRC have unlawfully departed. The taxpayers also place reliance on HMRC's alleged settled practice in dealing with claims in this area, and advance an alternative fall back argument based on the principle of conspicuous unfairness.

114. The UT considered the judicial review applications in the UT Decision at [150] to [203]. Their conclusion was that the applications failed in their entirety. I will say at once that the UT were in my judgment clearly right to reach this conclusion. Furthermore, their judgment is comprehensive, clear, and cogently reasoned. In truth, I could content myself with saying that (subject to one minor qualification: see [124] below) the judicial review appeal should be dismissed for the reasons given by the UT. In deference to the arguments addressed to us by Mr Furness, however, and in view of the potential significance of the claim to other cases, I will proceed to deal with the claim, taking the decision of the UT on it as read and concentrating on the aspects of the claim which seem to me most important.

115. I would add this general observation. Although it is now well established that the doctrine of legitimate expectation in public law can extend to substantive as well as procedural expectations, and can in an appropriate case prevent a public body, including HMRC, from applying the law correctly where to do so would frustrate the claimant's expectation, experience shows that the cases where such a claim has succeeded, at any rate in the field of taxation, are relatively few and far between. This is in my view hardly surprising. There is a strong public interest in the imposition of taxation in accordance with the law, and so that no individual taxpayer, or group of taxpayers, is unfairly advantaged at the expense of other taxpayers. There is also a real public interest in the Revenue making known the general approach which it will adopt, and the practice which it will normally follow, in specific areas. The publication of the BIM is a good example of this principle in operation. But there are likely to be few cases where a taxpayer can plausibly claim that a representation made in general material of this nature is so clear and unqualified that the taxpayer is entitled to rely on it and to be taxed otherwise than in accordance with the law.

116. For the reasons given by the UT, and developed by Mr Swift QC in his helpful written and oral submissions, I am satisfied that the present case is not one of that exceptional character.

The doctrine of legitimate expectation

117. The UT recorded at [151] that there was no significant dispute between the parties about the law relating to the doctrine of legitimate expectation. They cited a convenient summary of the relevant principles given by Leggatt J in R (on the application of GSTS Pathology LLP) v Revenue and Customs Commissioners [2013] EWHC 1801 (Admin), [2013] STC 2017, at [72] to [73]. This summary makes it clear, as I have already said, that English law will sometimes protect a substantive legitimate expectation. In particular, it is well established in the field of tax law that a taxpayer who receives a ruling from HMRC on the application of the law to his

particular case may acquire a substantive legitimate expectation to be taxed according to that ruling.

118. The pioneer decision in this area was R v IRC, ex p. MFK Underwriting Agencies Ltd [1990] 1 WLR 1545, where a strongly constituted Divisional Court (Bingham LJ and Judge J) gave important guidance on the circumstances in which a taxpayer might be able to found a legitimate expectation on rulings or statements of practice issued by the Revenue: see in particular the judgment of Bingham LJ at 1567H to 1570B, and the judgment of Judge J at 1573G to 1575B. Of particular relevance to the present case are the following observations of Bingham LJ at 1569:

> "I am, however, of the opinion that in assessing the meaning, weight and effect reasonably to be given to statements of the Revenue the factual context, including the position of the Revenue itself, is all-important. Every ordinarily sophisticated taxpayer knows that the Revenue is a tax-collecting agency, not a tax-imposing authority. The taxpayer's only legitimate expectation is, prima facie, that he will be taxed according to statute, not concession or a wrong view of the law … No doubt a statement formally published by the Inland Revenue to the world might safely be regarded as binding, subject to its terms, in any case falling clearly within them. But where the approach to the Revenue is of a less formal nature a more detailed inquiry is in my view necessary. If it is to be successfully said that as a result of such an approach the Revenue has agreed to forgo, or has represented that it will forgo, tax which might arguably be payable on a proper construction of the relevant legislation it would in my judgment be ordinarily necessary for the taxpayer to show that certain conditions had been fulfilled. I say "ordinarily" to allow for the exceptional case where different rules might be appropriate … First, it is necessary that the taxpayer should have put all his cards face upwards on the table … Secondly, it is necessary that the ruling or statement relied upon should be clear, unambiguous and devoid of relevant qualification."

119. More recently, in R (Davies) v Revenue & Customs Commissioners [2011] UKSC 47, [2011] 1 WLR 2625, where the issue was whether taxpayers who had moved abroad could claim non-resident tax status on the basis of certain paragraphs in the Inland Revenue Booklet IR20, Lord Wilson JSC confirmed at [29] that Bingham LJ's requirement that representations should be "clear, unambiguous and devoid of relevant qualification" applied also to representations made in a booklet formally published by HMRC to the world. Lord Wilson continued:

> "It is better to forsake any arid analytical exercise and to proceed on the basis that the representations in the booklet for which the appellants contend must have been clear; that the judgment about their clarity must be made in the light of an appraisal of all relevant statements in the booklet when they are read as a whole; and that, in that the clarity of a representation depends in part on the identity of the person to whom it is

> made, the hypothetical representee is the "ordinarily sophisticated taxpayer" irrespective of whether he is in receipt of professional advice."

120. For completeness, I should record that we were also referred by Mr Swift to:

(a) the observations of Lord Hoffmann in R (Bancoult) v Foreign Secretary (No. 2) [2008] UKHL 61, [2009] 1 AC 453, at [59] to [63];

(b) the valuable discussion of the doctrine of legitimate expectations by Laws LJ in R (Bhatt Murphy) v Independent Assessor [2008] EWCA Civ 755 at [26] and following; and

(c) the decision of this court in R v Education Secretary, ex p. Begbie [2000] 1 WLR 1115.

The last of these cases is authority for the proposition that an expectation is "legitimate" if it is one which will be protected by law: see per Peter Gibson LJ at 1125C.

The BIM

121. The BIM is one of the Guidance Manuals published by HMRC. These manuals were originally purely internal documents produced for the guidance of HMRC staff, but for many years they have been made available to the public and may also be accessed online. They are prefaced by a general introduction, which includes the following important statements:

> "These manuals contain guidance which has been prepared for HMRC staff. It is being published for the information of taxpayers and their advisors in accordance with the Code of Practice on Access to Government Information.
>
> It should not be assumed that the guidance is comprehensive nor that it will provide a definitive answer in every case …
>
> The guidance in these manuals is based on the law as it stood at date of publication. HMRC will publish amended or supplementary guidance if there is a change in the law or in the Department's interpretation of it …
>
> Subject to these qualifications readers may assume that the guidance given will be applied in the normal case; but where HMRC considers that there is, or may have been, avoidance of tax the guidance will not necessarily apply."

It can be seen, therefore, that all of the manuals, including the BIM, are subject to the general "health warning" that the guidance given will not necessarily apply in cases where HMRC consider that there is, or may have been, tax avoidance. This warning is then repeated several times in the relevant part of the BIM.

122. The main relevant sections of the BIM dealing with film reliefs are set out by the UT in the twelve sub-paragraphs of [160]. They include, in sub-paragraph (10), the entirety of the "plain vanilla" example upon which the taxpayers place particular reliance. Mr Furness helpfully confirmed in his oral submissions that, although the extensive extracts set out by the UT form only a relatively small part of the section of the BIM dealing with film and audio products, he was content to found his case on the passages quoted by the UT. He thus realistically accepted that, if he could not find representations in those passages which were sufficiently clear and unqualified to satisfy the MFK requirement, he could not hope to find them elsewhere. For convenience, I reproduce the "plain vanilla" example as Appendix 3 to this judgment.

123. The following points emerge with clarity from the extracts from the BIM set out in the UT Decision at [160]:

(1) First, the general purpose of the film reliefs was to encourage investment in qualifying British films with the aim of building a profitable and self-sustaining industry. Because the reliefs were generally of no immediate use to the film producer, since the producer would have no immediate income to set the reliefs against, the reliefs were usually accessed through third party financiers, including partnerships of wealthy individuals. These arrangements would typically involve sale and leaseback or production and licence schemes, allowing the financiers to obtain tax relief in the early years, while deferring liability to tax on the income stream generated by the arrangements.

(2) Secondly, the involvement of third party financiers had been accompanied "by a great many complex and artificial tax avoidance schemes" based on exploitation of the tax reliefs for qualifying British films. Various specific measures had been introduced since 1997 in order to tackle such tax avoidance, but these measures were not comprehensive, and if HMRC staff encountered any film schemes or arrangements where they thought that tax avoidance was apparent, they should make a report outlining the facts to the relevant technical specialists, including the Anti-Avoidance Group (Films).

(3) The way in which the tax deferral arrangements were intended to operate depended on the income streams from the sale and leaseback transactions being subject to UK income tax in the hands of the financiers throughout the duration of the scheme (typically 15 years). This is clearly explained in the "plain vanilla" example at sub-paragraphs (13) to (22). This would be the case provided that the partnership remained resident in the UK, but would not necessarily be the case if "exit" arrangements were planned under which the partnership would cease to be UK-resident after the investors had obtained the initial tax reliefs. In particular, this might apply to schemes marketed for UK-resident but non-UK domiciled individuals, who are in principle liable to income tax on income arising outside the UK only if it is remitted to the UK (the so-called "remittance basis" of taxation).

124. On the strength of the quoted extracts from the BIM, the taxpayers sought to derive five key representations which are set out by the UT at [162], as follows:

> "(1) You as a taxpayer will not lose the tax relief just because your objective is to access the relief.

> (2) HMRC will not take the point that you are not trading just because you have taken no risk because of the guarantee arrangements.
>
> (3) HMRC will not take the point that an activity is not trade or is not carried on commercially simply because of the net present value point [*i.e. the point that the discounted present value of the income stream will always be significantly less than the purchase price of the film*].
>
> (4) HMRC accepts that tax benefits to partners can be taken into account in assessing the commerciality of the trade.
>
> (5) HMRC accepts that a single transaction partnership will not fail to be trading merely because it has no trading activity."

The first of these alleged representations dropped out of the picture, because it is relevant to a Lupton argument which is no longer pursued by HMRC. The taxpayers continue to rely on the other four. The UT also put on one side representation (5), being unpersuaded that anything was said in the BIM about single transaction partnerships as such: see the UT Decision at [165]. I am not sure that the UT were right about this. I agree with Mr Furness that there are passages in the "plain vanilla" example which appear to accept that the partnership may be involved in a single transaction, and it is of course common ground that a single transaction may constitute an adventure in the nature of trade. However, the point does not assist the taxpayers, precisely because it is common ground that the partnerships are not disqualified from trading merely because they had no previous trading activity. The focus is therefore on representations (2) to (4), all of which are principally based on the "plain vanilla" example.

125. In relation to these representations, the UT rightly accepted at [166] that it is implicit in the example that HMRC may be prepared to accept that the partnership can be trading, and doing so on a commercial basis, even though these features are present. But the BIM nowhere says that HMRC agree never to take such points, particularly where tax avoidance is suspected. There is no challenge to the legality of the BIM as a whole, or to the parts of it which relate to film finance, so (as Mr Swift submitted) it is not open to the taxpayers to pick and choose: they have to accept the guidance as a whole, including the qualifications to which it is subject. Once this fundamental point is appreciated, it seems to me impossible for the taxpayers to contend that they have a legitimate expectation to be taxed in accordance with the three alleged representations, even in circumstances where tax avoidance is reasonably suspected by HMRC. Furthermore, tax avoidance, in this context, must mean, or at least include, any arrangements which are reasonably suspected of being designed to obtain reliefs in the early years for the investors without then incurring the corresponding liabilities to income tax on the interest element of the income streams as the scheme unwinds over its full fifteen year term.

126. If the case is one where tax avoidance is reasonably suspected, I can find nothing in the BIM which precludes HMRC from advancing any arguments on the law or the facts which are properly open to them, including arguments which they have arguably agreed to forgo in cases where no tax avoidance is suspected. As it was graphically

put in argument before the UT, HMRC's position in cases of suspected tax avoidance is that "all bets are off". In my judgment it cannot be either unfair or unjust for HMRC to seek to apply the law as enacted by Parliament to the facts of a particular case, unless they are precluded from doing so by a representation which meets the stringent requirements laid down by Bingham LJ in MFK. By no stretch of the imagination, however, can the representations relied on by the taxpayers be characterised as "devoid of relevant qualification". To the contrary, the guidance is permeated with qualifications relating to tax avoidance.

Were there reasonable grounds for HMRC to suspect tax avoidance?

127. On this part of the case, I have nothing to add to the full and careful analysis of the evidence, both documentary and in the witness statements and cross-examination before the FTT, contained in the UT Decision at [173] to [186]. On the strength of this evidence, viewed as a whole, it seems to me the UT were fully entitled to conclude that HMRC did have reasonable grounds to suspect tax avoidance in the relevant sense. Indeed, it is striking that the evidence of two of the taxpayers' own witnesses, Mr Gough (a solicitor and partner of DLA Piper LLP UK) and Mr Levy (the managing director of Future) in significant respects supported the inference that the schemes were indeed designed for tax avoidance. Equally striking is the fact that Proteus apparently migrated to Jersey in December 2012, and the fact that all of the members of Samarkand were non-UK domiciled.

Settled practice

128. I can deal with this very briefly. Mr Furness accepted before us, as he had before the UT (see [190]), that he relied on the alleged settled practice of HMRC only in support of the taxpayers' understanding of the BIM. He did not suggest that settled practice alone would be sufficient to ground a legitimate expectation. In the light of the conclusions which I have reached about the BIM, and in the absence of any argument that settled practice alone would suffice, it is clear to me that settled practice (even if established) could not save the day for the taxpayers. In any event, as the UT explained at [190] to [193], the evidence of practice adduced by the taxpayers fell well short of establishing a settled practice in relation to cases which share the salient features of the present case.

Conspicuous unfairness

129. In my judgment the UT were clearly correct to reject the appellants' fall back argument based on the principle of conspicuous unfairness. The doctrine of conspicuous unfairness in public law has its origin in the judgment of Simon Brown LJ in R v IRC, exp. Unilever [1996] STC 681, and has been applied in a number of later cases, but as Elias LJ explained in R (Lewisham London Borough) v Assessment and Qualifications Alliance [2013] EWHC 211 (Admin), at [111], the concept is no more than "a particular and distinct form of irrationality". It is not for the court to form its own judgment of the fairness or otherwise of the conduct complained of, and as Elias LJ went on to say:

> "… it is only if a reasonable body could not fairly have acted as the Defendants have that their conduct trespasses into the area

> of conspicuous unfairness amounting to abuse of power. The court's role remains supervisory."

130. Approaching the matter in this way, it seems obvious to me that it was not irrational for HMRC to deny the appellants the relief sought and to advance the arguments which they did before the Tribunals below. I would accept HMRC's submission that it cannot be said to be irrational to act in this way in circumstances where:

   (a) the taxpayers were not entitled to that relief as a matter of law;

   (b) the BIM contained no clear, unambiguous and unequivocal promise that the relief would be granted to the taxpayers;

   (c) HMRC had never given the impression that all sale and leaseback transactions would be eligible for relief, but had raised repeated concerns about tax avoidance in this area; and

   (d) HMRC had no settled practice of granting relief to taxpayers in the same situation as the appellants. In such circumstances, the UT rightly concluded at [202] that it was not unfair, let alone conspicuously or outrageously so, for HMRC to do exactly what they had said they might do, which was not to apply the guidance in the BIM where they considered that there was or might be tax avoidance.

Overriding public interest

131. By their respondent's notice, HMRC raised a fall back argument to the effect that, even if the taxpayers did have a legitimate expectation derived from the BIM or HMRC's settled practice, HMRC were nevertheless entitled to depart from it on the grounds that there was a sufficient overriding public interest not to grant tax relief other than in accordance with the relevant statutory provisions.

132. In view of the conclusions which I have reached, this question does not arise and in common with the UT (see [196]) I think it preferable to say nothing about it.

Conclusion

133. For the above reasons, I would dismiss the judicial review appeal. The overall result, if Arden and David Richards LJJ agree, is that all of the taxpayers' appeals, and HMRC's cross appeal, will be dismissed.

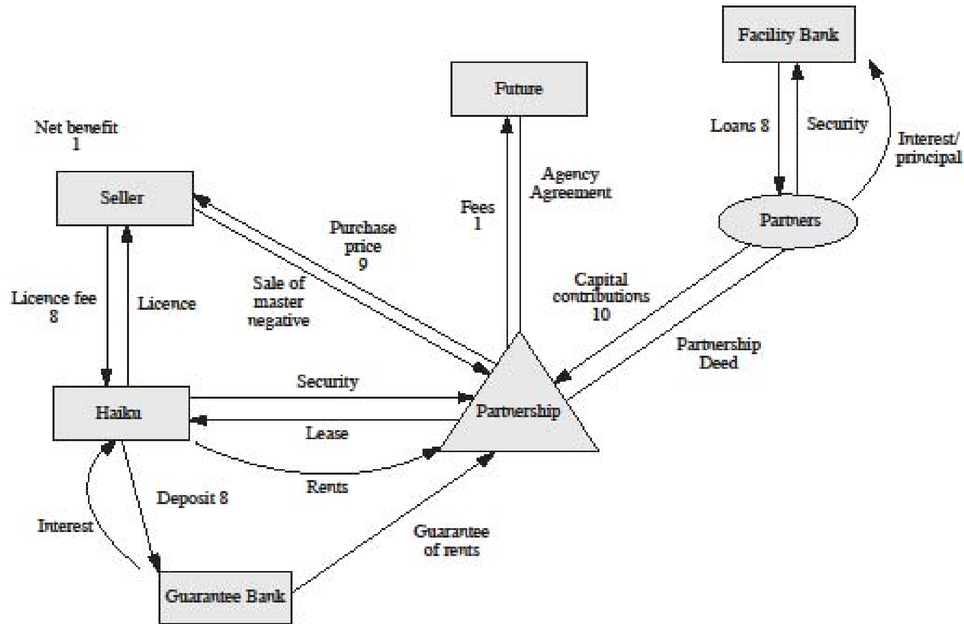
Lord Justice David Richards:

134. I agree

Lady Justice Arden:

135. I also agree.

Appendix 1



Appendix 2

The Relevant Legislation

(taken from [2015] UKUT 211 (TCC))

12 "Sections 130 to 144 of ITTOIA provided the reliefs for expenditure incurred on the production or acquisition of the original master version of a film or sound recording and certain preliminary expenditure in relation to a film. Section 130(3) defined acquisition expenditure as "expenditure incurred on the acquisition of the original master version of a film or sound recording". The original master version of a film was defined by section 132(1) as the original master negative, tape or disc, including the soundtrack. Section 130(4) provided that references to the original master version of a film included "any rights in the original master version of a film or sound recording that are held or acquired with it".

13 The purchase of an asset which a person intends to exploit over a period of time would normally be regarded as capital expenditure but section 134 of ITTOIA provided that, in the case of a film or soundtrack, the expenditure (and any amounts received in respect of it) should be regarded as revenue in nature. Section 134 provided:

> "(1) If a person carrying on a trade incurs production or acquisition expenditure, the expenditure is treated for income tax purposes as expenditure of a revenue nature.
>
> (2) If expenditure is treated under this section as revenue in nature, sums received by the person carrying on the trade from the disposal of the original master version -
>
> (a) are treated for income tax purposes as receipts of a revenue nature, and
>
> (b) are brought into account in calculating the profits of the trade of the relevant period in which they are received.
>
> (3) For this purpose sums received from the disposal of the original master version include -
>
> (a) sums received from the disposal of any interest or right in or over the original master version (including an interest or right created by the disposal), and
>
> (b) insurance, compensation or similar money derived from the original master version."

14 Section 135 of ITTOIA contained the normal rules for allocating production or acquisition expenditure to the relevant period but the Appellants claimed relief under sections 138 and 140, which allowed relief to be claimed in advance of the normal rules. In this case, Proteus claimed relief in respect of Oliver Twist, which was not a limited-budget film, under section 138 and Samarkand claimed relief in relation to Irina Palm and The Queen, which were both limited-budget films, under section 140.

15 Section 136 of ITTOIA provided that:

> "Sections 137 to 140 (certified master versions: certain expenditure) apply for the purpose of calculating the profits of a trade of a relevant period if -
>
> (a) the trade consists of or includes the exploitation of films,

(b) the films do not constitute trading stock of the trade (within the meaning of section 174),

(c) the expenditure in question is of a revenue nature (whether as a result of section 134 or otherwise) …"

16 Section 138 of ITTOIA was amended shortly after it was enacted but the amendment did not apply to Oliver Twist because it was in production on 2 December 2004. Section 138 provided, as relevant:

"(1) This section applies if -

(a) the person carrying on the trade has incurred … acquisition expenditure in respect of the original master version of a film in, or before, the relevant period,

(b) the film was completed in, or before, that period,

(c) the original master version is a certified master version, and

(d) the film is genuinely intended for theatrical release.

…

(2) A deduction is allowed for the amount of the expenditure allocated to the relevant period, but this is subject to the application of any prohibitive rule.

(3) The person carrying on the trade may allocate up to the permissible amount of the expenditure to the relevant period.

(4) The permissible amount of the expenditure is the smallest amount given by the following calculations.

(5) The calculations [broadly, allow one-third of the expenditure for each relevant period].

(6) If the relevant period is less than 12 months the above references to one-third are to be read as references to a proportionately smaller fraction.

…"

It was not disputed that the films in this case were genuine films intended for theatrical release and certified master versions (see [48]-[52] of the Decision).

17 The version of Section 140 of ITTOIA which applied to Irina Palm and The Queen relevantly provided as follows:

"(1) This section applies if -

(a) the person carrying on the trade has incurred acquisition expenditure in respect of the original master version of a film in, or before, the relevant period,

(aa) the film was completed in, or before, that period,

(b) the acquisition was a relevant acquisition,

(c) the expenditure was incurred before 1 October 2007 …,

(d) the original master version is a certified master version,

(e) the film is genuinely intended for theatrical release, [and]

(f) the total production expenditure in respect of the original master version is £15 million or less …

(2) An acquisition is a relevant acquisition if -

(a) …, or

(b) the acquisition is directly from the producer and the original master version of the film has not previously been acquired directly from the producer,

and for this purpose 'the producer' means the person who commissions the making of the film and is entitled to control its exploitation.

(3) A deduction is allowed for the amount of the acquisition expenditure allocated to the relevant period, but this is subject to the application of any prohibitive rule.

(4) The person carrying on the trade may allocate up to 100% of the acquisition expenditure to the relevant period.

(5) But the total amount allocated under this section may not exceed the total production expenditure in respect of the original master version."

18 Section 130(7) of ITTOIA provides that:

"… 'any prohibitive rule' means any provision of the Income Tax Acts which -

(a) prohibits a deduction from being made, or

(b) restricts the extent to which it is allowed,

in calculating the profits of a trade."

19 One such prohibitive rule is found in section 34 of ITTOIA which provides:

"(1) In calculating the profits of a trade, no deduction is allowed for-

(a) expenses not incurred wholly and exclusively for the purposes of the trade, or

(b) losses not connected with or arising out of the trade.

(2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade."

20 Section 133 states that:

"… 'relevant period', in relation to a trade, means -

(a) a period of account of the trade, or

(b) if no accounts of the trade are drawn up for a period, the basis period for a tax year."

21 The partners in Proteus and Samarkand claimed sideways relief under sections 380 and 381 ICTA to allow them to set the losses against their taxable income from other sources.

22 Section 380 provides that a person who has sustained a loss in any trade carried on by him, either solely or in partnership, may claim relief from income tax on his income for that year or the last preceding year up to the amount of the loss. Section 384 imposes certain restrictions on the right to set off losses under section 380. Section 384(1) provides as follows:

> "… a loss shall not be available for relief under section 380 unless, for the year of assessment in which the loss is claimed to have been sustained, the trade was being carried on on a commercial basis and with a view to the realisation of profits in the trade …."

Section 384(9) provides that:

> "Where at any time a trade is carried on so as to afford a reasonable expectation of profit, it shall be treated for the purposes of subsection (1) above as being carried on at that time with a view to the realisation of profits."

23 Section 381 provides further relief for losses sustained by individuals in the early years of a trade. The additional relief allows the individual to claim relief from income tax for the three years last preceding the year in which the loss is sustained. Section 381(4) provides:

> "(4) Relief shall not be given under subsection (1) above in respect of a loss sustained in any period unless the trade was carried on throughout that period on a commercial basis and in such a way that profits in the trade … could reasonably be expected to be realised in that period or within a reasonable time thereafter."

24 Section 118ZE to 118ZO of ICTA and the Partnerships (Restrictions on Contributions to a Trade) Regulations 2005 ("the 2005 Regulations") contain provisions that limit the amount of loss relief which a "non-active partner" may claim under sections 380 and 381 of ICTA to the amount of the individual's contribution to the trade as at the end of that year of assessment. A non-active partner for these purposes is a partner who did not devote at least ten hours per week on average to the activities of the trade. It was not disputed that the Proteus and Samarkand partners were non-active partners.

25 Section 118ZN provides that regulations may exclude certain amounts when computing the amount of the individual's contribution to the trade for the purposes of section 380 or 381. Regulation 2 of the 2005 Regulations states that "'any other person', in relation to an individual, includes a partnership of which the individual is a member". Regulation 4, as relevant, provides:

> "(1) This regulation applies where -
>
> (a) an individual takes out a loan in connection with his financing of the whole or part of a contribution to the relevant trade, and
>
> (b) at least one of the following conditions is satisfied.
>
> *Condition 1*
>
> There is, at any time an agreement or arrangement, under which all or any of the financial cost of repaying the loan is, will or may be borne, or ultimately borne, by any other person."

26 Regulation 4(2) provides that where condition 1 is satisfied:

> "… there shall be excluded when computing the amount of the individual's contribution to the relevant trade at the time in question the financial cost of repaying the loan, which is, will or may be borne or ultimately borne by the other person …""

Appendix 3
The "plain vanilla" example
(taken from [2015] UKUT 211 (TCC))

"This example is illustrative of a sale and leaseback arrangement which accesses relief for qualifying British films to obtain a tax deferral. The example is for a partnership using films costing less than £15m to produce to which F2A97/S48 or ITTOIA/S140 … applies, although partnerships can and do fund more expensive films to which F2A92/S42 or ITTOIA/S138A … applies…

The example is simplified to show the key elements of what is often described as a 'plain vanilla' sale and leaseback scheme, although particular details and amounts may vary on a case to case basis. We do not give pre-clearance on any film schemes, and, owing to the high prevalence of tax avoidance involving film schemes, each case should be examined carefully on its own facts. The experience of Anti-Avoidance Group is that schemes that depart radically from the structure described, and in particular are more complex, are likely to carry a high risk of tax avoidance.

(1) A film production company (C) spends £10m on making a film, which is then certified as a qualifying British film.

(2) C sells the master version of the film to a partnership of wealthy individuals (P) for £10m.

(3) P immediately leases all the rights in the film back to C for a period of 15 years.

(4) Lease rentals are payable by C to P over the period of the lease on an annual basis. C may taper these lease rentals slightly so that less is payable in the early years, and more towards the end of the lease, provided the rentals increase by no more than 5% each year.

(5) In order to secure the lease rentals, C places about 82% of the £10m it has received for the sale of the film on deposit with a bank. It keeps about 14% (which is usually used to pay off loans taken out to make the film) and gives about 4% to the scheme organiser.

(6) C has a taxable receipt from sale of the film of £10m. However, under F2A92/S40B it is able to set off all the costs of production against this disposal; - generating neither a profit nor a loss. It should be noted that the treatment in the accounts of C may be radically different from the tax treatment and full tax computations to reflect this are required.

(7) C is able to set the lease rentals that it must pay as a deduction against any income it receives from exploitation of the film. It is important to note that any grants or subsidies received by C towards the

cost of making the film will be taxable receipts, as will any pre-sales received.

(8) P is able to fund its purchase of the film through capital contributions made by the partners. The partners are usually wealthy individuals, paying tax at the top rate of 40%, who have substantial taxable income that they wish to shelter. There may also be a managing partner – normally a company – that does not contribute capital, but administers the scheme.

(9) P is carrying on a trade of exploitation of the master versions of films. It has negligible overheads (that is, no costs to set against the lease rentals which it receives) so the partnership profits effectively equate to the lease rentals. The partnership profits and losses are shared between the partners in proportion to their capital contributions to the partnership and are taxable on them as profits of their trade (see section [*sic*] ICTA88/S111).

(10) Each of the partners' contributions is funded 80% by a loan from a bank and 20% by cash from the partners' own resources.

(11) The partners' loans are secured on their share of income from the partnership, that is, the lease rentals, which are in turn secured by the deposit made by C.

(12) When P acquires the film it is able to claim an immediate deduction under section 48 of the £10m it has spent on buying the master version of the film to set against income from its trade. As P has no income at this point, it generates a trading loss of £10m which it allocates to the individual partners in proportion to their capital contributions to the trade.

(13) Consider an individual partner, 'W', who contributes £100,000 to the partnership. W funds this contribution through £20,000 of his personal cash and a personal loan (secured against his future income form the partnership) of £80,000.

(14) W's share of the partnership loss in the first year is £100,000. This is a trading loss which he is able to claim against his other income and gains under ICTA88/S380 or S381. This generates a tax repayment of £40,000 (£100,000 at 40%).

(15) As a result, W has received a tax repayment which is £20,000 greater than his cash contribution of £20,000 – that is, he has a net cash benefit of £20,000.

(16) In later years W will receive his share of P's profits (arising from the lease rental stream) on which he will be taxed. However, the full amount of this income has to be used by W to pay off interest and capital on his loan.

(17) W can claim relief under ICTA88/S353 (by virtue of ICTA88/S362 – loans to buy into a partnership) equal to the amount of his income from P which is used to repay interest on his loan. However, he can obtain no relief for the amount which is used to repay capital on the loan.

(18) As a result, W pays additional tax each year on the amount of his income from the partnership which is used to repay capital on his loan. Eventually, when the loan is fully repaid, he will have paid additional tax of £32,000 (40% of £80,000).

(19) From W's perspective, the overall effect of this is that in year 1 he has received a cash benefit of £20,000 but after year 15 he is out of pocket by £12,000 (£20,000 less the £32,000 in additional tax he has paid).

(20) This is equivalent to W obtaining a loan of £20,000 for 15 years and paying – in total - £12,000 of interest on it – roughly equivalent to a loan at 5% interest per annum.

(21) If W is to profit overall from the scheme he needs to invest his net benefit of £20,000 in year 1 so as to recover £12,000 or more by year 15 – that is, to invest the net benefit to give a return greater than the 5% notional interest rate. This rate, at which the net benefit needs to be invested, is called the 'hurdle rate'.

(22) From a tax perspective (that is from the perspective of the Exchequer) after 15 years W has been given tax relief of £8,000 on his actual cash investment of £20,000, leaving him out of pocket by £12,000. In effect, as an incentive to invest in films, the Exchequer has given W a deferral of tax of £32,000 spread over 15 years."