**TC08005**

*INCOME TAX – partnership established for purposes of constructing a building in Montenegro - claims for sideways loss relief by partners - whether activities of Appellants amounted to a trade – if a trade, whether various payments were trading expenses - basis on which Appellants should calculate any trading loss – application of paragraph 51 of FRS 5 to Appellants' accounts – ss 25, 26, 33, 34 ITTOIA 2005*

**FIRST-TIER TRIBUNAL** **Appeal number: TC/2016/06976**

**TAX CHAMBER**

**BETWEEN**

**FOUNDATION PARTNERS (GP)**
**(a firm)** **Appellants**

**-and-**

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

**TRIBUNAL: JUDGE ALEKSANDER**

**Sitting in public at Taylor House, London EC1 on 26 November 2019 to 3 December 2019**

**James Rivett QC, counsel, instructed by Greenwoods GRM, for the Appellants**

**David Yates QC, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

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## DECISION

### INTRODUCTION

1. This is an appeal against a review decision dated 31 October 2016, following a closure notice dated 13 May 2016 into the Appellant's ("Foundation's") partnership tax return for the tax year ended 5 April 2009. The effect of the closure notice (which was upheld on review) is to reduce Foundation's partnership trading loss from £36,381,500 to nil. Foundation say that the loss arose in relation to a project for the construction of a 160 bed 5-star hotel and 250 room apartment complex in Budva, Montenegro ("Project Adriatic").

2. This appeal is not concerned with the allocation of Foundation's profits and losses amongst its partners.

3. At the hearing of the appeal, Mr Rivett represented Foundation and Mr Yates represented HMRC.

4. I heard factual evidence on oath on behalf of Foundation from Timothy Levy, Robert Hannington, and Kevin McGovern. I heard expert accounting evidence on oath from Bee-Lean Chew on behalf of Foundation, and from Michael Vaughan Bach on behalf of HMRC.

5. 20 bundles of documents were provided in evidence, and additional documents were handed up during the hearing. I have considered all the evidence placed before me, even when it has not been referred to within the body of this decision. Given the volume of this evidence it is impossible to refer to it all. That does not mean that I have not given it due consideration. At the end of March 2020, Foundation sent to the Tribunal a copy of the grant of Concept Design Approval (together with a translation) for Project Adriatic that was made following its successful appeal against the decision of the Budva municipal architect to refuse consent. Unfortunately, due to the impact of the COVID-9 pandemic, the copy did not reach me until after a draft of this decision was circulated to the parties for their review for typographical errors, but I have since taken it into account in finalising this decision (and I note that the impact of the pandemic also seriously delayed the production of this decision).

### WITNESSES

6. Mr Levy is the CEO and one of the founders of Future Capital Partners Limited ("FCP"), a subsidiary of Future Capital Group Holdings Limited (which is ultimately beneficially owned by Mr Levy). He is the managing partner of Foundation, and one of its two Founding Partners. He is a director of Cocoon Design and Build Services Limited and managing partner of Cocoon Wealth LLP which act as consultants to the limited liability partnership to which Foundation was later converted. He is also one of the ultimate (indirect) beneficial owners of the property in Montenegro to which this appeal relates. Although the companies controlled by Mr Levy do not necessarily form a "group" for the purposes of company law, it is convenient to refer to them (as does Mr Levy) as "Future Group".

7. Mr Hannington retired in 2009 as a "proprietary partner" in Knight Frank, the well-known firm of surveyors and property consultants. Mr Hannington has a degree in surveying and is a fellow of the Royal Institution of Chartered Surveyors ("RICS"). Since 1989, until his retirement, he was responsible for Knight Frank's worldwide Commercial Investment and Investment Management Divisions, and responsible at various times for their US practice and their Australian practice. Whilst a partner at Knight Frank, he has acted for various substantial pension funds in relation to their UK and European property investments. Mr Hannington is a partner in Foundation.

8. Mr McGovern is the chief executive officer of DML Development Managers Limited (previously named Manly Development Services Limited) ("Manly"), which is a real estate development and project management business. Mr McGovern has a degree in quantity

surveying and is a member of the RICS. Mr McGovern has considerable experience in managing substantial property development projects worldwide, including managing the construction of the Greater London Authority building, the new wing at the Natural History Museum, the redevelopment of the Café Royal Hotel, as well as major property construction schemes in Africa and Asia. He founded Manly in 2005, where he leads a group of 16 professionals. Manly was appointed as project managers for Project Adriatic in June 2009, a role it held until 2014.

9. Ms Chew MSc FCA MAE is a chartered accountant. Since 2005 she has been a partner in the firm of Wilder Coe Limited, a firm of chartered accountants based in the City of London. She is a member of the Academy of Experts, is accredited as a forensic accountant by the Institute of Chartered Accountants of England and Wales and is the editor and a co-author of the textbook "Forensic Accounting and Finance: Principles and Practice".

10. Mr Bach FCA is a chartered accountant, and since 2000 has been employed by HMRC as an advisory accountant within their Fraud Investigation Service based in Ipswich. Prior to joining HMRC, Mr Bach trained with, and then was employed by, two of the "big four" accountancy firms in their Leicester and Norwich offices, and as an accountant within a commercial business.

11. The Tribunal's directions in this appeal required the experts' evidence to comply with CPR Rule 35, which requires their evidence to meet the requirements of Practice Direction 35. Practice Direction 35 provides that expert evidence must be the independent product of the expert uninfluenced by the pressures of litigation, and that the expert must assist the court by providing objective unbiased opinions on matters within their expertise and should not assume the role of an advocate. Expert witnesses must also make it clear when a question falls outside their expertise.

12. Although not cited to me, I note the decisions of the Upper Tribunal in *Forager Limited v Natural England* [2017] UKUT 0148 (AAC), and in *Natural England v Warren* [2019] UKUT 300 (AAC) which addressed (amongst other things) the weight to be placed on expert evidence where the expert is an employee of the party on whose behalf she or he is giving evidence. The Upper Tribunal said the following in *Warren*:

> [103] The first error is that the First-tier Tribunal incorrectly said at paragraph 43 that none of Natural England's witnesses had the status of an expert witness because they were employed by Natural England. In *Forager* the Upper Tribunal rejected a similar submission, saying that it "confuse[d] the concepts of "independent" and "expert". As long as the fact that a witness is employed by one of the parties is disclosed, it is open to the First-tier Tribunal to take into account that kind of lack of independence of witnesses in deciding what weight to give to their expertise." That approach is fully supported by the Court of Appeal in *R (Factortame Ltd) v Secretary of State for Transport (No. 8)* [2002] EWCA Civ 932, [2003] QB 381 at [69]-[70].

13. It is not ideal that an employee of one of the parties should provide expert evidence on behalf of his employer – indeed HMRC challenged Foundation's original choice of expert because of her perceived lack of independence, requiring Foundation to appoint another expert instead. But I appreciate that many accountants in professional practice are not prepared to act for HMRC as an expert witness (which makes it difficult for HMRC to instruct external accountancy experts). But that makes it all the more important for HMRC's accountants to exercise professional detachment and to be able to demonstrate deep expertise in relation to the issues on which they are asked to opine. Whilst hindsight is a wonderful thing, where such deep expertise is not available within HMRC (and perhaps even when it is)

it would have been better for a single individual to be instructed jointly by the parties to act as an expert to the Tribunal.

**BACKGROUND FACTS**

14. I find the background facts to be as follows.

## Project Adriatic

15. FCP has a background in devising and promoting investments in film production which attracted tax reliefs. In about 2007 it became clear to Mr Levy that (what he described as) the tax-advantaged environment for film production was coming to an end. Mr Levy looked for ways to diversify his business, and investors were telling him that the asset classes that they were interested in were real estate and renewable energy. Mr Levy decided that there should be a strategic shift in his business. In 2007 he renamed his company, which had been called Future Film Group, to Future Capital Partners to give a broader impression of its scope than just film. He started to pursue opportunities in the real estate sector.

16. Mr Levy identified an opportunity to put together a structure in conjunction with Irvine Seller (the developer), for the financing of the development of the Shard, a high-rise building being constructed above London Bridge Station. He spent about a year working with KPMG, tax advisers, and lawyers, and spent “an awful lot of money” creating a “structured investment opportunity for investors” for the Shard. The Chancellor of the Exchequer announced in his 2008 Budget that the Government would impose a £25,000 limit on the extent to which losses made by individuals in a trade carried on in “a non-active capacity” could be set off against their income or capital gains. The legislation was enacted as Schedule 21, Finance Act 2008 which inserted sections 74A to 74D in the Income Tax Act 2007 ("ITA 2007"). The legislation provides that an individual carries on a trade in a “non-active capacity” if he or she does not spend at least ten hours a week personally engaged in the activities of the trade in question over the “relevant period” (which is a period of at least six months). FCP's Shard proposal did not proceed, as its investors would be "non-active", and would therefore be limited in the tax relief they could claim.

17. Project Adriatic was first introduced to Tim Levy and FCP in 2007 at a trade event in Frankfurt by John Kennedy. Mr Kennedy managed Boka Real Estate Managers Limited (“Boka”), a property investor. The project was to construct a hotel, residential apartments, and a trade fair at Budva, Montenegro. In the correspondence and discussions, the residential apartments are often referred to as being "condominiums", even though the title to the apartments does not take the form of a condominium or strata title in any legal sense. At that time the project was an informal co-venture between Boka, Shedlin Capital (“Shedlin” - a German fund manager) and La Cite Development LLC (“La Cite” - a US real estate and hotel developer, who had a good relationship with InterContinental Hotels, a major international hotel management group). It was anticipated that each of Shedlin and La Cite would be investors in the project, each providing equity and La Cite procuring debt finance and introducing InterContinental Hotels. The site for the development was the site of a trade fair owned and operated by the Atlas Group and persons connected with them (“Atlas”). Atlas was the largest privately-owned property group in Montenegro, and from the evidence before me, it appears that the shareholders in Atlas had close connections with the Montenegrin federal government.

18. Mr Levy had some familiarity with the region, as his then wife was a Croatian national, and he had visited the Adriatic coast and Montenegro with her.

19. Montenegro became independent of Serbia following a referendum in June 2006. Mr Levy's evidence was that Montenegro was expected to be the world’s fastest growing tourist economy over the next decade, and there was research which showed that residential real

estate prices had increased dramatically since independence from Serbia and were expected to continue to rise.

20. Budva is situated along a sandy bay on Montenegro's Adriatic coast. The walled medieval old town is at the northern end of the bay. A range of mountains lies behind Budva. The site of the project is on the Budva seafront in a central position on the bay, with beach access. Mr McGovern described the site as then comprising a single storey low rise, low quality, trade fair building, with a car park for visitors to the trade fair, and second car park which generated income during the popular summer months.

21. Mr Levy visited the site in 2007 with Mr Kennedy. Although FCP had no formal involvement with the project at the time, he was kept informed of relevant matters, with a view to FCP's potential future involvement. Mr Levy's evidence was that in June 2008 the co-venturers were in negotiation with Atlas to purchase the whole of the site for which Atlas were asking an initial price of €100m.

22. Mr Levy's evidence was that in around 2008 and 2009, the only way in which investors could invest in a "tax effective manner" was where they were actively engaged in the business in which they were investing. His view was that there were very few asset classes where there would be enough investors with the requisite skills to contribute effectively to such a business. But the development, construction, design, sales, and marketing of real estate was such a business, and one with investor appetite. This would mean that the business model previously used for FCP's film projects would have to change to a new model which, according to Mr Levy, was more about investment and less about tax than had historically been the case with his structures. Mr Levy's evidence was that the potential tax relief (namely "sideways" relief for initial losses which could be set against an investor's other income) would provide a level of commercial protection against what might be an attractive, but risky, commercial proposition.

23. Mr Levy considered that the structure that FCP had intended to be used for the Shard could be adapted for use for Project Adriatic. The key elements of the Shard that were adapted for use with Project Adriatic were that (a) the "vehicle" would be a partnership which would not own the real estate, but instead would provide construction services to the property owner in consideration for a future income stream, and (b) a proportion of the partnership's capital would be contributed by a "founder" corporate entity.

**Project structure**

24. The team at FCP with responsibility for Project Adriatic included Mr Levy, Peter Young, Gavin Harrison, and Paul Nghi. Mr Young was a tax accountant who dealt with structured finance. Mr Young and Mr Levy, between them, played the key roles in dealing with the relevant parties, negotiations, and correspondence. Mr Harrison dealt with financing matters. Mr Nghi was a tax accountant, and assisted Mr Young.

25. Mr Levy acknowledged that neither he, nor anyone else at FCP, had any experience of property development (other than the FCP's involvement in the Shard, which aborted at an early stage) or hotels – or indeed of anything like the Project Adriatic transactions. I find that no one in the FCP team had any experience, let alone expertise, in the construction, development, and sale of real estate – let alone a mixed-use hotel/leisure/residential property project - whether in the UK, or in a country such as Montenegro. While FCP previously had some (abortive) involvement with the Shard, Project Adriatic was very different. In the case of the Shard, FCP had not been involved in (for example) site assembly, building design, or the need for planning and building consents. Whereas (as will be seen) these were key issues that needed to be addressed in the case of Foundation's involvement with Project Adriatic.

26. The structure envisaged by Mr Levy for Project Adriatic was that Foundation would be established as a partnership. The partners would be (a) the various individual investors to whom FCP would promote the project, (b) Mr Levy, and (c) a company within the Future Capital group (which, in the end, was Foundation Design and Build Services (Jersey) Limited ("FDBS") – a company of which Mr Levy is a director, and whose shares are beneficially owned by Mr Levy). Mr Levy's original intention was that Foundation would raise £25m from the individual investors. This would be "geared" or "leveraged" by a £75m capital contribution from FDBS.

27. Mr Levy's plan was that Foundation would be engaged by the co-venturers to act – in essence – as the prime contractor for the design and construction of the hotel part of the project. It would receive, as consideration for undertaking the design and construction, an income stream linked to the profits generated by the hotel (once completed and operational). Foundation would sub-contract its construction obligations to a local Montenegrin company established by the co-venturers, in consideration for a payment corresponding to much of the capital Foundation raised. Part of the payment received by the local company would provide finance to the co-venturers for the purchase of the site from Atlas. The balance would be utilised by the Montenegrin sub-contractor to meet its own expenses, including the costs of the professional team and contractors who would actually undertake the design and construction of the project, and who would be engaged by it.

28. Boka Property Holding Services (Jersey) Limited ("BPHS") was to be the principal company for the structure and would acquire ownership of the site (through its subsidiaries). It was incorporated in Jersey and its shares were beneficially owned by Mr Levy.

29. Its 50% subsidiary, Boka Adriatic Developments (Montenegro) Limited ("BAD"), would engage Foundation to design, construct, and develop the hotel part of the project. It was never satisfactorily explained to me why BPHS did not itself engage Foundation, nor why BAD was only 50% owned by BPHS.

30. Integrated Property Contractor Services (Montenegro) Ltd doo ("IPCS") was incorporated in Montenegro as a 100% subsidiary of BPHS. Mr Levy is described in IPCS's minutes as its Deputy Executive Director. It would be Foundation's sub-contractor. IPCS would provide a loan to BPHS (from the fee paid to it by Foundation), which would enable BPHS to buy from Atlas the shares in the company that actually owned the site.

31. As things turned out, the project did not proceed in the manner originally intended.

32. First, the capital raised by Foundation from investors fell short of the £25m target by a significant margin. Between 9 July 2008 and 3 April 2009, Foundation was only able to raise £10,088,750 from investors, which was leveraged by an investment of £30,266,250 from FDBS (which itself was borrowed – albeit indirectly - from Barclays Bank under a "daylight" facility). When Foundation's fundraising closed, there were 23 individual investors and one corporate investor (excluding Mr Levy and FDBS), who all became partners in Foundation. For ease of reference, these 24 "external" investors in Foundation are referred to in this decision as the individual partners or investors.

33. Second, neither La Cite nor Shedlin contributed any equity towards the project, explained by Mr Levy as being in part due to their own issues and in part due to difficulties the co-venturers had in buying the development site from Atlas. Under the terms of the Teaming Agreement signed on 27 November 2008 (described below), La Cite had agreed to provide equity and obtain debt financing for the hotel part of the project. The intention was that this would refinance the amount borrowed by BPHS from IPCS – and IPCS would then have the funds to meet its construction obligations. But by the time the Teaming Agreement was signed on 27 November 2008, Shedlin had withdrawn from the project. Because La Cite

was unable to secure a management agreement for the hotel with a leading hotel management group, it later left the joint venture group as well (Mr Levy's evidence was that La Cite were "kicked out").

34. Third, it took a considerable period of time for BPHS to acquire 100% ownership of the land-owning companies. As at 1 April 2009, the site was owned by Atlas through a series of subsidiary companies. Atlas was the owner of all the shares in Expom Hotel Partners Limited ("Expom"), which was in turn the owner of all of the shares in Safiro Beach Resort DOO Podgorica ("Safiro"). Safiro was the registered owner of the site. However, the beneficial ownership of the site was vested in Lenley Holdings Limited ("Lenley"), a Jersey company which was a subsidiary of Expom. The intention was – as described above – that BPHS would utilise borrowings from IPCS to finance the acquisition of the Lenley shares from Atlas. But as Foundation was not able to raise the planned £25m, the fee paid by Foundation to IPCS was less than originally anticipated – resulting in a reduction in the amount of the loan to BPHS. Consequently, BPHS was not able to buy all the Lenley shares at the outset, and these were acquired piecemeal over several years, with the final tranche only being acquired by BPHS in June 2012.

35. Fourth, the site was the subject of security in favour of Piraeus Bank ("Piraeus"). This was part of a wider package securing borrowings by Atlas from Piraeus. When the final tranche of Lenley shares was acquired by BPHS in July 2012, these were acquired for €17m, but subject to the assumption of a liability to Piraeus of €11m. As at the date of the hearing of this appeal, €3.1m of that debt remained outstanding. The existence of the continuing security in favour of Piraeus has constrained BPHS in obtaining construction financing.

36. And finally, the process for designing the hotel and residential apartments, and obtaining all necessary regulatory approvals, turned out to be much more complicated that Mr Levy had initially envisaged, and not only took time to be achieved, but also cost a considerable sum of money by way of professional and other costs.

37. As at the date of the hearing, construction had not commenced on either the hotel or the residential apartments. There are negotiations in progress with a Turkish company to take over the development, but it is highly likely that there will be no financial return to the investors in Foundation, and they will have lost all of their investment.

**Joint venture negotiations**

38. It is convenient to review the negotiations for Project Adriatic with the co-venturers and Atlas separately from Foundation's fundraising exercise with potential investors.

39. In May 2008, Boka wrote to FCP inviting it to participate in Project Adriatic. FCP accepted that invitation in a letter dated 9 July 2007 (I find, for the reasons given below, that there was a typographical error in the year – and the letter must have been written on 9 July 2008). In the letter to Boka, FCP set out the intention of Foundation to pay "100% of the project build costs", in consideration for a contingent revenue stream and a debt facility (of between 60% and 70% of the build costs) being made available to Foundation's corporate partner. The build costs are stated to be about €100m, so that Foundation's net contribution will be €30m to €40m. Foundation is described as an English partnership whose founding partners are Mr Levy and Future Capital (Foundation) Limited.

40. On 9 July 2008, the original agreement establishing Foundation was executed as a deed. The initial partners were Mr Levy and Future Capital Partners (Management Services) Limited ("Management Services"), which was a subsidiary of FCP. The partnership agreement is governed by English law, and Foundation was therefore governed by English

common law and the Partnership Act 1890. The partnership agreement was subsequently amended and restated on several occasions.

41. As Foundation was only established on 9 July 2008 (precisely one year later than the date of FCP's letter to Boka), and the heads of terms signed on 4 August 2008 refer to Boka making an invitation to participate in the project in May 2008, and to FCP accepting that invitation on 9 July 2008 (annexing the 9 July 2007 letter to the heads of terms), I find that there must have been a typographical error in the dating of the letter, and I find that the correct date of the letter was 9 July 2008. This is consistent with the dating of the Foundation partnership deed.

42. On 15 July 2008, Boka appointed Vector Management International ("Vector") as project management consultants for Project Adriatic.

43. On 27 July 2008 there is an email exchange between Mr Levy and Mr James of Boka, which reviews the terms on which Foundation will contribute to the financing of Project Adriatic, and "the share of revenues that [Foundation] will receive for providing its services and financing." Attached to Mr Levy's email is a spreadsheet setting out a financial model for illustrative purposes. The spreadsheet shows construction costs of €136 million and advisory fees to be charged by FCP. The total construction costs are €147 million – which are shown as to be funded by €39.69 million of partners' cash, and the balance by a limited recourse loan to Foundation's corporate partner – a 27:73 ratio. The spreadsheet gives Foundation an initial allocation of 20% share of net revenues under €100 million, which increases to 50% once net revenues exceed €500 million.

44. On 4 August 2008, legally binding heads of agreement were signed between Boka, Foundation and FCP. The "9 July 2007" letter from FCP to Boka was annexed to the heads of agreement. At this stage, Foundation did not have any investors, and its only partners were Mr Levy and Management Services. Under the heads of agreement, Foundation agreed to contribute €30,000 to the setup costs of the project (which would be provided to Foundation by Mr Levy). The setup costs are listed as being €62,000 in total, comprising €20,000 to Vector for project management, €25,000 to "K & N" for legal work, €8,000 to Boka for investment management costs, and €9,000 to Sovereign for legal work. In return, Foundation was granted a 90-day exclusivity period to negotiate and agree terms for its participation in the project. There were provisions for repayment of all or part of Foundation's contribution if the project proceeded without Foundation's participation. I have assumed that the reference to "K & N" is to Karanovic & Nikolic ("K&N"), who are Serbian law firm who were engaged to report on the title to the site.

45. On 5 August 2008 there is an email from "JK" at Boka to Mr Levy and which is copied to Mr Young. Mr Young then emails Mr Levy:

> I am guessing you want me to highlight that the partnership needs to show a serious level of income to ensure tax is robust. […] I am also wanting to see if the project will allow a capital appreciation income stream to help the tax commercial story but may not be the case as mostly a resi sales product.

46. Mr Levy in his evidence said that at the time this email was sent, Mr Young had only recently joined FCP, and so

> … he was not quite in the flow of how our transactions had historically worked. So, some of the language he uses is not appropriate.

47. Mr Levy responds to Mr Young's email to explain the deal:

> Broadly the commercial deal we seek is that we get an equity return equal to the net present value of our contribution to equity. At the moment the

> expected equity is 70m€ and we are generating, on the numbers I included in my s'sheet, about 29m€ or 41% of the equity.
>
> However, for tax reasons, we will expect to take slightly less of the earlier income and more of the later income.
>
> Clearly the loan repayment circulates back to them a large part of the income – so this has been built in.

48. The model set out in the spreadsheet of 27 July and the description of the deal in Mr Levy's email of 8 August was not the deal as eventually concluded – but was probably based on the abortive proposals that FCP had put together for the Shard.

49. On 14 August 2008 there were a series of emails between Mr Levy, Mr Young, Mr Astaire, and Mr Harrison. Mr Astaire was an employee of FCP on the "sales" side, who liaised with financial advisors and accountants whose clients included prospective investors in Foundation. Mr Levy, in an email to Mr Young, refers to having to "balance the offering between something very commercially driven, which [various financial advisors] would like to see, and something that the guys who cannot sell investment products can still sell." This latter reference is to the market for "tax only" products. Mr Harrison in his emails writes that:

> "… At 20p this is getting more and more down towards a tax deal with upside …"

And

> " … - sub 25p suggests it is more a tax product and if so, then the tax is no longer so much an ancillary benefit but a critical part of the return."

Mr Young's email included the following sentence:

> My initial thought so far is that we should be able to achieve the tax outcome on the expenditure side, including the gross up, but we will need to work hard to backload the income, possibly with some form of synthetic[?] to draw out and backload the income as taking pari passu share of hotel income and particularly the residential sales.

50. Mr Levy was cross-examined about "backloading" the income. He explained that this meant that Foundation would initially share in very low levels of income (up to specified levels of overall performance – as seen in the spreadsheet of 27 July), and subsequently at an increasing level. Mr Levy was questioned about why he wanted to consider "backloading" income for Foundation:

> Q. I see. I can understand why you would want that from a tax perspective because it allows for greater write off …
>
> A. Correct.
>
> Q. … but it's in tension with a commercial drive to try and get more secure income up front, is it not?
>
> A. But we did not end up using a structure like this.
>
> Q. I appreciate that, Mr Levy but what I find interesting is that you and Mr Young are all willing to consider this. The fact you did not do it, that is one thing and that is your defence.
>
> A. Yes.
>
> Q. But what I want to say is: the fact you were even thinking about this is antithetical to a commercial operation, because no businessman in his right mind would want to take a junior share in profits and push everything off into the long grass, they want to be treated equally.

A. I do not think that is fair. Firstly, there is, I think, no harm in thinking about things and dismissing them, even if they are things that you may think are antithetical from a commercial point of view. Secondly, our boutique, for want of a better word, at that time was creating structured investment opportunities. As the name implies, they were trying to combine together tax structuring and investment opportunities. So, creating a harmony that would work structurally and appeal to the investment community was an art, not a science, and it was evolving at this point in time. So, I think it is reasonable that we considered structures and language that were used before but ultimately moved on to something that was different from anything we had used before.

Q. What I suggest Mr Young's reaction shows is that you were - at least he was, and I would suggest it is endemic in terms of Future as a whole - were willing to throw commercial upside under the bus in so far as it was in tension with getting a tax loss.

A. I do not think that is fair.

51. The "backloading" issue is considered also in the following answers given by Mr Levy during cross-examination:

Q. [Mr Webber, head of tax at FCP asks in an email to Mr Levy]: "How do you propose to yield the upfront write-off and maintain the commercial hallmarks of the deal for the tax side?" […] So, what he's exploring there is the tension between this apparently being a good investment opportunity and the ability to write off large amounts of the […] expenditure on day one as well. […] And your solution there appears to be, yes, the returns are high, and then you say you can heavily backload [Foundation's] participation.

A. Yes.

Q. Is that essentially the same point that we were discussing earlier, that you would essentially negotiate away your share of the income into the future so that you could write down, as it were, the value of it?

A. Again, recollecting the discussions at the time, I think our frame of reference was still very much around the sort of deal we had negotiated on The Shard where there was a much greater level of certainty of income and therefore to get a write-off that was high enough for the overall deal to work, we needed to have a structuring of the way that the Partnership was going to participate in income. That obviously ended up being very different in Montenegro because the risks were significantly greater in Montenegro and therefore the certainty of income was much lower. But yes, at that time that was obviously the thinking that we were going through.

Q. And I appreciate that the deal that you ended up with was different […] - but what I suggest is rather than the Revenue taking this email chain out of context, doesn't your response show an artificial structuring in order to achieve a maximum write-off so that you are deliberately creating a commercial disadvantage in order to seek a tax advantage. Would you say that's a fair characterisation, Mr Levy?

A. I don't actually. I think what we were going through here was a process of R&D effectively in creating a structured product, or a structured transaction. And we were obviously taking into account a lot of different competing tensions as we tried to assemble elements of that transaction. And we had a frame of reference which related to a very different transaction that we had spent a lot of time on and which the team was very familiar with and which we were using language that reflected that. Where we ended up was

> extremely different because the commercial reality of the deal that we ended up doing was very different. So, I think really if you take it in context and you understand the times we were in, the evolution the business was making, I think it's very understandable.

52. On 22 August 2008, La Cite produced a document titled “The Royale InterContinental Hotel Development Project, Budva, Montenegro”, relating to the hotel element of the project. The document set out a proposal for a 10 storey, 200 bed, hotel on the site which would potentially be managed by InterContinental Hotels.

53. On 27 August 2008, Mr Young prepared a memorandum on the key commercial and structural issues relating to Project Adriatic, which he circulated to Mr Levy, Mr Harrison, and Mr Astaire. In the executive summary section of the memorandum, there is an outline of the "wish lists" of the different stakeholders in Project Adriatic. As regards Foundation, the memorandum states:

> Foundation Partners GP: The GP needs to decide the product it wishes to package, which broadly could be either (a) A pure investment product; (b) an investment product which uses an active trader structure and share revenue returns pari passu to the other investors in the deal or (c) an active trade tax deal which profiles revenue [on some basis to be discussed and determined] which generates > 80-90 FY GAAP relief. This will likely need to synthetically engineer a return profile which in my view is not likely to be possible.

54. Mr Levy's was asked whether option (c) was selected, but his answer was that option (b) was the one ultimately chosen for Foundation. He agreed that both (c) and (b) generated 80% to 90% full year GAAP relief, but the difference was whether the return profile was *pari passu* or "synthetic"- and a *pari passu* return profile was the one that was adopted.

55. After the executive summary, the next section of the memorandum considers the "commercial position", and states that, of the total equity of €70 million, €20-€30m would be invested by Foundation – which will "enable a part share of the hotel and residential apartment revenue". There is reference in the memorandum to the use of borrowing/leverage – but this is a reference to bank finance to be sourced by La Cite. Mr Levy agreed in his oral evidence, that there was no reference in the memorandum to the equity contribution by the FDBS or the fact that this contribution would be financed using a bank loan facility.

56. On 3 September 2008 there is an exchange of emails between Mr Young, Mr Harrison and Mr Astaire discussing a meeting that Mr Young had had with a financial advisor whose clients might invest in Foundation. Mr Young says that:

> First and most importantly, he [the financial advisor] does not want to do an investment product. He still wants to do this deal, however. So … we are left with a tax shagger or a so called investment product, the former priced at circa. 18p and the latter closer to 25. Both to be up on tax alone.

The reference to a "tax shagger" is, according to Mr Levy, a reference to something at the lower end of pricing, where there is no real commercial involvement, and FCP is just trying to get a big tax deduction for the investor. The "investment product" is, according to Mr Levy, the transaction that was ultimately done.

57. K&N’s report on title was dated 12 September 2008. This identified the owner of the site as being Jadranski Sadram, a company within the Atlas group. The report identified (amongst other things), the security interest of Piraeus in the site.

58. On 17 September 2008, Vector produced the first of a series of monthly reports. At this stage Vector are engaged by, and acting for, Boka. The report recommended changes to the

original proposed layout in consequence of a meeting with Atlas on 24 July 2008. It was recommended that the hotel and residential elements be moved further towards the coast, and that the trade fair element be moved further away from the coast. Vector recommended that La Cite should confirm whether the amended site layout would be acceptable to "Ritz-Carlton" as soon as possible. Vector also recommend that geological, environmental, and topographical surveys are obtained. The reference to Ritz-Carlton (a competitor of InterContinental) is probably an error. The report confirms that Vector provided "cost input" for Boka's costs estimate. It is apparent from the spreadsheet included in the report that the construction costs estimate is calculated using an estimated build cost "per GFA" (gross floor area). The report states that €93m is thought to be an acceptable order of cost estimate "at this stage".

59. On 18 September 2008, Chris Ward (an independent financial advisor) pitched the outline of Project Adriatic to directors of Knight Frank and CB Richard Ellis (both well-known firms of property advisors). Subsequently the pitch is discussed in a series of emails between Mr Levy, Mr Young, Mr Astaire, and Mr Norris (an FCP employee). Mr Levy is asked about the "economics" of the deal, and responds

> Where I see the economics coming out
>
> Broadly 25p in, tax benefit of 30p – baseline ROE[1] over 3 yrs of 2.5x

Mr Young replies by saying that the high case could be as high as 5 times total equity investment. He goes on:

> Investors will just come in with their 25p and will not be taking out a loan. The 75p leverage will come from the developer providing a loan to FCP vehicle and then backed out to developer subsidiary co funding the construction cost. Or alternatively a bank daylight facility mechanism with security by way of charge on the 75p provided by other investors.
>
> The other investors in the deal must seed their investment in a traditional investment fund structure and will not facilitate capitalising and receiving their returns through the Foundation Partnership.

60. Mr Young's email sets out an outline of the structure that was eventually used: the developer (the "FCP vehicle") would be BPHS and the developer subsidiary would be IPCS, and a daylight loan facility would be provided by Barclays. This structure provided the finance for the purchase of the site from Atlas by BPHS. Mr Levy described it as follows during cross-examination:

> A. […] at this point in time what we thought we had was that leverage to the Future corporate member that was going to invest in the partnership might have come from funding provided by the partners. It might have come from a daylight facility at that point in time. We didn't know which it was going to come from. That would enable the partnership to be funded. It would enable the contractor in Montenegro to be funded. It would allow the project to proceed. It would give the investors broadly the tax treatment that we were looking for, and would encourage them through the mixture of both the tax and the commercial potential of the project to invest in the project. So that was the approach.

[1] return on equity

> Q. But when you really break it down, Mr Levy, all the investors were doing here was providing funds in order for a Future entity to acquire the land. That is all they were doing, in return for an income stream.
>
> A. I disagree. And certainly, in terms of how things panned out, as we see later, because those parties that we saw as development partners at this point in time ended up not being part of the development at all: La Cite, Boka obviously were for a while, but never financially. So, in fact what we ended up with was Future owning the developer.
>
> Q. What development expertise did Future have?
>
> A. Very little. Partners in Foundation, including individuals who had significant development expertise, driving a hell a lot of the process in terms of how this project moved forward. So that is what ended up happening. Encourage them through the mixture of both the tax and the commercial potential of the project to invest in the project. So that was the approach.
>
> Q. But the difficulty for the partners, Mr Levy, is that you can have all the expertise you want, but unless you actually have the money to do anything with it, i.e., buy the land and build, it is completely pointless, is it not?
>
> A. I don't think it is pointless. It has clearly, if you look with the benefit of hindsight, been a very long process.

61. On 23 September 2008, Mr Young sends spreadsheets to Mr Astaire which sets out a model of the proposed financial structure. In the covering email, Mr Young says:

> … attached is the commercial structure (which I still need to cover off on the local tax/accounting points), in addition to obtaining a local GAAP write down

A footnote to one of the spreadsheets discusses a €75 million loan facility to FDBS, and how this is to be provided.

62. Vector's report of 17 October 2008 addressed issues relating to planning consent, design, and strategy. The site plan included in the report shows two plots (urban parcels ("UPs") 24.1 and 26.1) facing the seafront (with the trade fair to the rear of one of the plots). The report noted that although Atlas had title to most of the site, Atlas would need to acquire some parcels around the perimeter of the site (the "yellow strip" land) for the development to be able to go ahead. As regards planning, the report gives a formula for the height of the development:

> MAX height for both UPs are G+M+9 (ground floor + mezzanine + 9 floors).

being 11 floors above ground altogether. Vector anticipated that approval for Budva's Detailed Urban Plan ("DUP") purposes could be obtained by December 2008, with the Building Permit permission being obtained by July 2009.

63. Mr Levy asks Mr Young by an email dated 17 October whether there are any issues with the building and construction permits not being granted until mid to late 2009. Mr Young responds that this should be OK:

> Our trade is an integrated property services business capturing construction build and design services. So we should be OK as long as the GP contract with developer is sufficiently broad to cover build and design […].
>
> We should however understand precisely the design arrangements that will be in place by 31 March and as an added protective measure engineer/make 1-2 payments to some of the actual subcontractors directly – as well as

entering into the main subcontractor arrangement to pass the €25m irrevocably.

64. Around this time, FDBS was incorporated in Jersey as a company within the Future Capital group.

65. On 27 November 2008, Boka, La Cite, Foundation, and FCP entered into a Teaming Agreement (the agreement is “dated as of February ___ 2008”, but it is not disputed that the agreement was signed on 27 November 2008, although with the intention that it took effect as between the parties as from February 2008). Mr Levy's evidence was that Boka were agitating to get the Teaming Agreement agreed and signed, to ensure that they were paid a fee when the site was acquired.

66. By the time the Teaming Agreement was signed, Shedlin had withdrawn from the project.

67. The Teaming Agreement provided that the parties intended to acquire and develop the site, which would be divided into three parcels – the “hotel parcel”, the “residential parcel” and the “fair parcel”. La Cite would develop and manage (through a third-party manager) a 200-bedroom ocean front hotel and beach club on the hotel parcel. FCP would develop and manage a multi-family luxury residential project on the residential parcel, and Atlas would retain a parcel of not less than 3,713.88 $m^2$ on which it would develop and operate the trade fair that was currently located on the hotel parcel.

68. The operative provisions of the Teaming Agreement can be summarised as follows:

(1) A newly incorporated company would acquire from Atlas the shares in the company owning the site.

(2) The site would then be divided into three parcels to be owned by three special purpose entities (“SPVs”) – the shares in the “hotel parcel” SPV would be on-sold to a company owned jointly by FCP (as to 16.5%) and La Cite (as to 78.5%), the shares in the “residential parcel” SPV would be on-sold to a company owned by FCP, and the shares in the “fair parcel” SPV would be retained by Atlas. The 5% balance of the shares in the hotel parcel SPV would be sold to third party investors to be identified and agreed between La Cite and FCP.

(3) La Cite would identify a suitable operator for the hotel by no later than 31 January 2009.

(4) La Cite would negotiate the provision of debt finance for the hotel development.

(5) Foundation will provide €25m of equity financing by no later than 31 March 2009, of which €16m will be used to acquire the shares in the hotel parcel SPV and to fund the development of the hotel. Of the balance of €9m, €2m will be used for the provision of working capital for the development of the residential element of the site, and €7m will be used to acquire the residential parcel SPV and to fund the development of the residential element.

(6) La Cite will control the development of the hotel and will enter into the management agreement with the hotel operator. Foundation will control the development of the residential development.

(7) A placement fee of 3.5% of the purchase price of the site will be paid to Atlas by Foundation and La Cite (up to a maximum of €2.1m). Boka will be paid a fee of 2% in respect of equity raised by Boka in respect of the hotel project. Boka will be paid an investment management fee of 2% per annum and a carried interest pursuant to terms to be agreed between Boka and FCP.

(8) The parties intend that the ownership of the project will be accomplished in the most tax efficient manner and will take account of funds flow and allocation of tax attributes that recognise the separate ownership of the various elements.

(9) The Teaming Agreement is stated to be legally binding, but intended to be replaced by definitive agreements, and there is a provision that the parties are bound by the Teaming Agreement until the execution and delivery of the definitive agreements (which will supersede the Teaming Agreement).

69. Mr Levy was cross examined about the Teaming Agreement, and whether it reflected the "real commercial deal" between the parties:

> Q. I suggest [that the Teaming Agreement] really tells us what the real commercial deal is, which is that this is all just a financing agreement for the construction of a hotel and residential complex and Foundation Partners' role is to supply at this stage 25 million euros of equity financing. That is how the other commercial counterparties saw everything.
>
> A. Yes. Obviously, this is a heads of agreement, it is in November, we do not ultimately actually complete on the acquisition of an interest in the land until April 2009. The structure we end up using is quite different to the one that is envisaged here, so at that point in time and as shorthand between the various parties, broadly this sets out the understanding of what was going to happen. Of course, the actuality of what ultimately happened was somewhat different.
>
> A. Yes. But as you yourself said, this envisaged a situation where Boka or BREM were going to be the entity that acquired the interest in the land, but that is not what ended up happening.
>
> Q. That is true, but this is a legal agreement whereby what the Partnership is doing is agreeing to provide equity financing.
>
> A. I do not think we spent a very long time over this document. I do not recollect spending a long time over this. I think for us it was shorthand. We were working with some other partners and we knew what we were all trying to achieve. The specifics of how the Foundation Partnership was going to work, how it would be structured, the roles that it would play, were not being discussed in detail with those partners at this point in time, as is clear from the Teaming Agreement.

70. Vector's report dated 31 November 2008 (sic) addressed planning consent, design, infrastructure, and the strategic programme. The report notes that Budva's DUP had been adopted by the municipality on 30 October 2008 and had been published in the official gazette. The report states that the initial design proposed by Atlas would need to be redesigned. The Atlas design proposed a hotel that was 19 storeys high, but the DUP limited the height of buildings to ground plus mezzanine plus 9 storeys. The report also noted that Budva's water, sewerage, and electricity infrastructure was inadequate to cater for the proposed development. The existing water supply system was worn-out, had pumping stations with big losses, and there was insufficient reservoir capacity (for there to be a stable water supply, additional reservoir capacity of 5000m$^3$ was required). The sewage system had "badly built manhole pumping stations which are flooded during the big rains", and there was no wastewater purification plant. As regards electricity, the Budva DUP envisaged a need to construct an additional 17 transformer stations. The Vector report states that

> In order to cover planned development […] infrastructure must be significantly upgraded and strengthened

71. The strategic programme envisaged by Vector in its report showed the design phase continuing until October 2009, with construction commencing in late 2009 or early 2010. The report states that to achieve this programme, the agreement to purchase the shares in the land-owning company would need to be signed before 31 December 2008.

72. On 2 December 2008, Mr Levy and Mr Kennedy had a meeting with Atlas at their offices in Belgrade to discuss the parcelling of the site between the hotel, residential, and trade fair elements, and the issues involving the yellow strip. Broad agreement was reached that the site would be acquired from Atlas for €55m.

73. On 5 December 2008, CB Richard Ellis in Serbia were engaged to undertake a market research study relating to hotels and luxury residential property development in Montenegro. A draft of the report was sent to Mr Young by CB Richard Ellis on 16 December, and Mr Young responds with detailed comments on the drafting on 19 December. Amongst the many detailed drafting comments made by Mr Young, one set of comments is that the term "Worse Case" should be replaced by "Low Case", and "Best Case" replaced by "High Case". Mr Young asks CB Richard Ellis to recalculate the high case projections using a range of €8,000 to €10,000. A copy of the draft report was not provided in evidence, but it is clear (and Mr Levy agreed) that CB Richard Ellis were being asked to change the figures in their original draft, and it seems likely (and I find) that the top of the high case range would have been greater than the top of the "best case" range in the original draft.

74. The report states that the Government of Montenegro was "determined in its orientation towards high-end tourism and development of luxury hotels and residential complexes able to meet the needs of demanding foreign guests". Mr. Levy's evidence was that he considered that this showed support in principle at the level of the national government for developments such as Project Adriatic. He believed that the federal government would therefore provide support for Project Adriatic to steer it through any municipal planning and regulatory hurdles.

75. Mr Levy emails Mr Young on 20 December saying that

> The truth is that there is probably little property changing hands. I'd like the report to include a statement such as "in the current financial climate, with the absence of gearing for international buyers and the reliance this project has on that market, it is hard to imagine that the residential units could be sold at any price. Clearly it is hoped that this will not continue to be the case once economic conditions recover." In Bold!

Mr Levy explained that since Montenegro became independent of Serbia, there had been a boom and a bust, and that FCP were hoping for another boom.

76. It is not clear when the final report was issued. The date on the final report is 16 December 2008 (the date of the initial draft) and has not been changed to reflect the passage of time between the draft and the final version. The "Low Case" scenario set out in the final report is based on a sale price of €2,000-€2,500/$m^2$, the base case scenario is based on a sale price of €3,000-€3,500/$m^2$, and the "High Case" scenario is based on a sale price of €8,000-€10,000/$m^2$. The report sets out for each of the scenarios the factors that would need to be met to support the scenario. For the high case scenario these include recovery of the property market and an increase in the interest of foreign buyers for residential projects in Budva, the positioning of the project as the new Budva "hot spot", and strong synergistic effect with the InterContinental Hotel giving "exquisite tone" to the entire development.

77. On 16 December 2008 Management Services resigned as a partner in Foundation and was replaced as the "Founding Corporate Partner" by FDBS.

78. On 19 December 2008, Peter Young emailed David Comyn at Savills (an international property consultancy, and a competitor to both Knight Frank and CB Richard Ellis) to arrange a meeting to review the Project Adriatic plans, with a view to Savills advising on the residential element. The email noted that the co-venture parties would be meeting in Montenegro around 22-24 January, and that it would be worthwhile for Mr Comyn to be at the meeting. Mr Comyn emailed Mr Levy on 5 January 2009 setting out Savills' fees and other terms for providing consultancy services and noted that there was to be a meeting with Mr Young on 12 January. Ultimately Future Design and Build Services Limited ("Future Design" – a company within the Future Group and of which Mr Levy is a director) engaged Savills, and Future Design supplied Foundation with the benefit of Savills' services. The fee payable to Savills was £200,000 at financial close, £100,000 per annum thereafter, and a performance fee linked to revenues generated by the project (up to a maximum of 2% of revenues).

79. Mr Comyn's email of 5 January states that his expertise is to assist his clients in securing a successful project outcome, and that the scope of the consultancy services that he provides will vary depending on the project, but areas of advice include: helping to finalise the project masterplan (the mix between office, residential and hotel to maximise value on a risk adjusted basis, input on the selection of the core professional team, advice on financial appraisals to support the financial targets), and further advice as the project progresses (including reviewing value assumptions in the light of market conditions, advice on raising new capital, advice on disposal of let buildings, advice on leasing and sales strategy, advice on in-principle decisions regarding use and appearance of individual buildings prior to finalisation of design, attendance at meetings), and for some projects changing the professional team in response to changes in the market, setting new project financial hurdles for the professional team as markets change, and input on programming in the light of new economic parameters.

80. These services are embodied in the contract eventually agreed with Savills that is set out in an undated letter to Savills from Future Design. There are some differences between the services listed in Mr Comyn's email and the letter agreement. I note that a "mark up" of a draft of the letter agreement sent by Mr Levy to Mr Young amends the draft, by deleting the provision that Savills will act as advisors to Foundation and inserting provisions that Savills will assist Future Design with the performance of its (Future Design's) services to Foundation. In particular the letter provides that Savills' advice will also include input relating to the acquisition of the site and the development programme, investor marketing, and debt advisory services. The impression given by the description of the services in both the email and the letter agreement is that Savills advice is "high level" strategic advice aimed at maximising the profit to be generated from Project Adriatic (with a focus on values that can be achieved from selling or letting the completed building, marketing the project to potential investors, and obtaining debt finance) – rather than dealing with the detailed "nitty gritty" of designing and constructing the building.

81. There was a conference call on 2 January 2009 between the co-venturers, Atlas, and their lawyers to discuss the purchase arrangements for the site. On 12 January 2009, Atlas's lawyers emailed the co-venturers with updated drafts of the heads of agreement and the stake purchase agreement (for the acquisition of the shares in the land-owning companies). The parties had agreed that Atlas (or a special purchase entity) would acquire the "yellow strip" land and would remove Piraeus's mortgages. It was envisaged that the trade fair would be the first stage of the development to be completed (as it was anticipated that this would be a condition of any planning consent given for the project), and that the new fair building would be completed by June 2010.

82. An outline financial projection spreadsheet is exhibited to Mr Levy's witness statement. It is not wholly clear by whom the spreadsheet was originally prepared, but it was as probably prepared by Boka on 7 January 2009. The spreadsheet shows the co-venturers and their respective investments into the different aspects of Project Adriatic (the trade fair, the residential apartments, and the hotel). The co-venturers are shown as being FCP, La Cite, Atlas and "Investor X". Mr Levy explained that a new investor (Investor X) needed to be found to replace the gap in the funding caused by Shedlin's withdrawal from the project. The spreadsheet shows that FCP's contribution to the line items relating to the residential aspect is either 45% or 50% of the anticipated costs (depending on the item) and its participation in the proceeds of sale of the residential element is 45%. FCP's contribution to the costs of the hotel element is zero, but it is entitled to 22% of any proceeds of sale and 22% of the operating income.

83. Because of the withdrawal of Shedlin, and the inability to find an "Investor X" as a replacement, the project is later reduced in scope to only one of the two plots shown in Vector's report of 17 October 2008. In consequence, FCP's share (through BPHS) of the sale proceeds of the residential element is increased to 100%, of which 90% is allocated by BPHS to Foundation through the fee arrangement.

84. On 7 January there is an exchange of emails between the co-venturers about a presentation prepared by Boka and a spreadsheet (probably the one discussed above), and a discussion about whether Boka are described in the presentation as "investment manager". Mr Levy comments that this will be confusing, and that Boka's role is advisory. Mr Kennedy of Boka responds as follows:

> OK, but if we are presented as having an advisory rather than a critical role, how will you present the [Boka] retained interest and management fees if we are on the other hand simply advisors?
>
> I am not also clear that all the investing parties have the same risk? The new investors with pure equity will have the greatest risk, future requires risk to make this a good deal. It is the principal commodity of the deal. As I understood it a zero return or worse will not represent a catastrophe.
>
> La Cite's risk is different still, they are hoping to use borrowed capital which will need to be covered by the hotel equity value. We do not know if they will raise this capital, which is dependent on Intercontinental Hotel's commitment. That will follow our detailed plan and their own market analysis etc.
>
> Therefore I do not think that there should now be a fundamental change in [Boka's] status at this stage.

Mr Levy responds immediately with the following email:

> can you pls delete this email – everyone who received it – otherwise we will have to withdraw from the deal due to its content

Mr Levy was questioned about his email:

> Q. John Kennedy is not an idiot, is he, so what he is getting at is that you are covered by the perceived tax relief that the partners will get if there is a zero return or worse.
>
> A. John's understanding of how Foundation was going to work would have been very limited. He had no tax expertise, to the best of my knowledge. He was not familiar with UK tax structuring, to the best of my knowledge. And he was reaching conclusions with limited knowledge, which were very typical of the way that John would behave. So, I was frustrated dealing with

> him, and I wanted to make it very clear that these were inappropriate types of communication to be sending, which is what my one and a half liner above indicates.
>
> Q. What I would suggest is that obviously Mr Kennedy and [Boka] were part of the commercial counterparty mix, if I can put it that way, and this is his commercial take on the deal that is being done and his perception of why things are being structured as they are, is it not?
>
> A. I accept that.
>
> Q. That is why he is saying this in the terms that he is, because this is unlike a commercial deal, where he is facing a party which actively wants to have as much risk as it can get its hands on, is it not?
>
> A. I accept that this is a reflection of his take on the transaction, yes.
>
> Q. Because of that, third party commercial perception was in your view extremely unhelpful, in particular if the Revenue would ever get its hands on. That is why you are encouraging everyone to delete the email, is it not?
>
> A. Yes.

85. On 12 January 2009 there is a discussion by email between the various co-venture parties on "project dynamics", and the need to phase the project. Mr Levy refers to a recommendation by Mr Comyn that the hotel plot is purchased first, with an option to buy the residential plot the following year (at a fixed price). But, ultimately, the project proceeds on the basis that only one of the plots is acquired, and both the hotel and residential elements are built on that single plot.

86. Comments on the project's step plan and planning issues are set out in a memorandum on 14 January 2009. In the memorandum, La Cite commented on the price to be paid for the sites if only one of the plots (UP 26.1) is to be purchased initially:

> […] They [Atlas] state that there is 100,000 sq meters for sale at a price of 55 million euro. We are purchasing 35,000 sq meters which is 35% of the total meters available to build which equals 19,250,000 euro. They can't look at ground massing for the urban parcels and use the physical dirt as their way of calculation because the returns are based off buildable FAR (floor area ratio). At this point in the discussion, you can tell them you understand what they are trying to do is retire their debt of 20,000,000 euro, but the only way we can pay a larger sum for 35% of the deal at this time would be to have a longer term option to purchase the remainder of the land hence purchasing an option.
>
> This will allow the group time to find more cash for the land and it will also allow them to pay of their debt […]

87. There is a comment labelled "PY Question to Vector" (it is not clear whom PY is – perhaps Mr Young):

> One question I had, would it be possible from a planning perspective to just acquire SPV2 [this is a reference to UP 26.1] and then move ahead to design and build on the existing hotel site to build a hotel and suite of residential condominiums?

To which Vector respond:

> There may be this possibility, but it would need to be handled carefully with the Planners.

> Whilst we have not been told to proceed with this work, we have already started considering an issue which is linked to your question. This is the "demisability" of the scheme as we knew this issue would soon be raised. In a perfect world, each building would sit on its own demised site with its own basement car park, vehicular access, infrastructure, and programme, which would allow the developer to build and sell the building in isolation without encumbrance. To maximise the built area, it is likely that there may need to be common car parks as well as a common podium of retail units or similar. It is also likely that access and infrastructure may need to be shared. This makes for a more complicated investment, design and programme. We also need to remember the trade-offs that will need to be negotiated between each of the buildings – they cannot all have a sea frontage and green space – if the Hotel has prime position then the Condos/Aptmts may in part be compromised. The problem, I assume, we all face, at the moment is that we do not know what conditions are attached to the Planning Consent.
>
> The process requires a layout drawing to be prepared and presented to the Planners against which they will respond with the 'Urban Conditions'. My understanding is that it is only at this point that we will understand what constraints will be placed upon the development beyond the height and gross floor area we already know and what infrastructure can be made available. These of course could be significant issues and may preclude the ability to develop only part of the site as well as the number and position of the buildings, whether they are linked or separate, road access, appearance, public areas, service connections etc.
>
> Whist it may be possible to protect yourselves in the SPA against unforeseen significant Planning conditions, I believe many of the above issues would be deemed part of the technical DD any purchaser would be expected to commission and would be very prudent to have at least explored these and other related issues in part before people start signing.
>
> In short, 'the devil is in the detail' and unfortunately until we are formally told to proceed with this work, we cannot approach the Municipality and, without an agreed brief, would run the risk of compromising your other work streams on the acquisition.

88. The "terms of the deal" are also discussed in the memorandum – "to build over 350,000 sq ft of land, with 200,000 sq ft to be allotted to the hotel piece and the remainder 150,000 sq ft for residential condominiums." The memorandum states:

> Foundation to cede €20-25 for the acquisition price paid for SPV 2
>
> Foundation to be entitled to the entire share of the resi-condo sales and 22% share of the hotel revenue
>
> Future Capital Partners to hold the entire legal and beneficial interest of SPV 2 until such time the various contingent piece of the deal is ready to be executed. Relevantly this includes when bank finance and security package on the finance is to be provided to bank.

Mr Young confirmed that the reference to Future Capital Partners should be read as a reference to BPHS, and SPV2 was to be read as a reference to Lenley.

89. The memorandum then discusses "Foundation Tax Structure"

> Incorporate a Future Jersey Corporate to hold the shares in Cyprus SPV 2 that will hold the underlying hotel/resi condo asset – 31 Jan 2009
>
> Incorporate various Montenegro companies – Montenegro Hold Co and Montenegro Subcontract Co – BOKA: WHO CAN ASSIST?

> Enter into design and build commercial contracts with Montenegro Hold Co and Montenegro Sub-contractor Co – 28 Feb 2009
>
> Ener into banking day light facility arrangements – have term sheet arrangements in place 15 March 2009
>
> Enter into Partnership Consultancy Agreement relevant liquidated damages between Future Jersey Corporate in lieu of disposal of SPV 2 in the event that the deal does not go ahead in the form agreeable to Foundation Partners (GP) – 15 March 2009
>
> Detailed design and build model to construct the hotel and resi-condo. For now, can I obtain a quick analysis on:
>
> > Gross Revenue from 150,000 sq ft of residential condo
> >
> > Design and construction costs of BOTH the hotel and hotel condo.

It is worth noting that the memorandum anticipates that the consultancy agreement is to contain a "liquidated damages" provision – in other words Foundation would be entitled to financial compensation if the project did not proceed.

90. On 14 January 2009 Mr Young emails Ms Hotson-Moore and Ms Clarke, who are partners at Mazars, a firm of chartered accountants. He asks whether Mazars can provide an accounting opinion for Foundation's first financial statements and whether they can act as auditors of Foundation. Attached to the email are copies of a draft accounting paper for Foundation and a financial model, CB Richard Ellis's market report, and examples of accounting opinions previously provided by PwC and KPMG – including a copy of an opinion given by KPMG relating to the aborted Shard transaction. The financial model assumes an apartment average sale price of €200/sq ft (which is equivalent to €2153/m$^2$).

91. On 19 January 2009, Mr Young emailed the co-venturers and the professional team with his comments on the latest draft of the heads of agreement with Atlas. One of his recommendations was that there should be a provision allowing the buyers the option to purchase only that part of the site relating to the hotel development (without having to acquire the residential part), for a consideration of €25m (the purchase price for both the hotel and residential elements was to be €55 million), which would be paid no later than 27 March 2009. On 20 January, Mr Young emailed Vector explaining that he wanted two choices to be available – either the acquisition of both the residential and hotel parts of the site for €55m, or the acquisition of only the hotel part for €25m. In his email, Mr Young said:

> To do the original deal, we will need to source an additional €30m for the land acquisition. This is still very much contingent and we may end up exercising the election to just acquire the hotel SPV for 25m.
>
> For now, we are progressing the deal over the next month assuming that we continue to do pursue [sic] the original deal. The election to acquire just the Hotel SPV will need to be made before 1 March.

The email then went on to set out the scope of Vector's work for the next two to three months, which included working with the lawyers to "cover off" land ownership issues, the preparation of a due diligence report, which would address planning consent analysis, pre-construction, initial design, and steps to design and build phase, and the need for geotechnical and environmental surveys to be tendered, if not commissioned and managed.

92. Mr Bacon, of Vector, responded on 21 January saying that they would need to liaise with Atlas's technical manager to make progress on planning, and would need their consent for topographical and geotechnical surveys. Mr Bacon stated that by April there would be a formal agreement "with the site secured and scope fully understood". Vector wrote to

Foundation Partners on 4 February setting out their terms of reference, service scope, and fees, and this letter was countersigned by Mr Levy on behalf of Foundation on 17 March 2009.

93. Mr Levy confirmed in his oral evidence that at this stage the co-venturers were still considering two possible deals – the original (larger) deal, and a smaller deal involving the purchase of just one of the plots – and the smaller deal was the more feasible in the absence of an "Investor X" to replace Shedlin. Mr Levy's oral evidence was:

> Q. If we go back to Mr Young's memo: the role of Shedlin and the role of Future/Foundation was the same: you were both being asked to put in equity financing, in return for a share of the residential and the hotel. Shedlin was in no different a position to Foundation Partners?
>
> A. Big picture in terms of how this project was going to get funded overall: ultimately, it was going to be La Cite providing the debt and equity for the hotel, Foundation enabling the developer to buy the land because of the way the funds flowed and Shedlin or a replacement providing the other funding needed to build out the resi. Mechanistically, how things worked in terms of how the transaction documents fitted together and how funds flowed, as you know, were different. So, yes, IPCS was going to take the money that it had been provided with by Foundation and was going to use the majority of it to make an intercompany loan to BPHS. BPHS expected to be able to repay those intercompany loans to IPCS, enabling IPCS to build the project by way of funding provided by La Cite and Shedlin's replacement. So, we're not disagreeing with each other. I'm just saying over here on the left is Yes, ultimately how the project was being funded, but over here on the right was how the legal documents worked and how the funds flowed. They were different.
>
> Q. And they were different because one was the commercial reality and the other one was the arrangement you had to present in order to get the tax deductions?
>
> A. No, they were both commercial realities. They were just different.
>
> […]
>
> Q. In reality, what I suggest is that the deal just was not ready to be done at the end of March, you had to park, or crystallize a tax event at the end and you were just going to sort out the commercial deal later, and that is why this is just a closed loop, entirely within Future's control as at the end of March?
>
> A. As I said to you before, there were a lot of problems that the project had as at the end of March 2009, and the solutions to those problems we believed were available, and we were all working to resolve them in different capacities. I have to acknowledge that there were big problems at that point in time.
>
> Q. And then you also say, well, BPHS might have, might have received further investment from, for example, La Cite, and it might have been able to repay the loan to Integrated.
>
> A. Yes.
>
> Q. But as things stood at the end of March/beginning of April, there was no certainty as to that, was there?
>
> A. Correct.
>
> Q. And Integrated had only contracted with the partnership on the basis of the funds that were actually raised.

> A. Yes.
>
> Q. And the loan to [BPHS] of 30 million odd reflected that?
>
> A. Yes.
>
> Q. So, even if BPHS had repaid that loan ...
>
> A. IPCS still wouldn't have had sufficient funding to build the entire project.

94. There was an exchange of emails over the period from 20 to 22 January 2009 between Mr Levy, Atlas's lawyers, and Mr Kennedy about the risks of the project, and Mr Levy's concern that the financial risks being assumed by Foundation were not matched by the financial risks being assumed by the other parties.

95. There was a meeting of the partners of Foundation on 30 January 2009, at which it was noted that the final capital raised was likely to be in the region of £50m to £70m, and that if further capital was raised, it would probably be through a separate partnership. The partnership resolved to take out "wrongful acts" and "E&O" insurance.

96. At some point in January 2009, FCP prepared an investor update setting out the commercial structure. The intention was that the money borrowed by FDBS (to fund its equity contribution to Foundation) would be refinanced. Mr Levy's witness statement states that the refinancing would be by way of equity funding from Shedlin and La Cite, along with project debt finance. But I note that Shedlin had withdrawn from the project prior to the signature of the Teaming Agreement.

97. At the beginning of February 2009, Vector write to Foundation recommending that their engagement is extended for three months, and Mr Levy's countersignature of their engagement letter (now with Foundation as Vector's client) is dated 17 March 2009.

98. On 6 February 2009, BPHS was incorporated in Jersey, and its two issued shares were issued to nominees for Mr Levy.

99. Around this time negotiations continue between the co-venturers and Atlas – one of the issues being the risk of a change in tax law. This is brought up in an email from Mr Young to senior management at Atlas dated 11 February 2009 which it titled "Change of Tax Law Risk". The email states:

> This is a key point for us. Investors in our UK partnership will not be the owner of the land but will be providing design and build services and are able under current UK tax law to offset their share of the losses in the partnership essentially, part of the construction costs against any other UK income they have earned in the last three years – BUT only if they spend 260 hours actively in the Partnership's business over a 6 month period. This is a key reason why we are able to raise equity in the UK market now. If the government were to change this law BEFORE we close our deal (and not after 31st March 2009) then our investors would have to have the right to withdraw.

It was put to Mr Levy during cross-examination that he was having to correct a misapprehension on the part of Atlas that the partnership was acquiring the land:

> Q. Mr Levy, […] I am talking about why things were structured so that the partnership was not going to be acquiring the land, which would have been the natural, I would suggest, way of doing this if this was purely a commercial deal.

> A. It was a structure that we created, we created it from some years back for the Shard and it was a structure that we thought was most appropriate for the project.

100. On 26 February 2009 Vector circulated to the co-venturers and their advisors' drawings of the proposed development prepared by Atlas's architects. There was then an exchange of emails between Mr Levy and Mr Bythewood of La Cite, in which Mr Bythewood stated that (in essence) it was not possible to build a 5-star hotel to InterContinental's specifications within constraints of the plot proposed by Atlas and the height restrictions imposed by the DUP. Mr Bythewood wrote:

> Due to the height restriction of 11 stories, in order to achieve the full 40,000m$^2$ we would need to construct a large, bulky structure, which would create masses of unusable internal space, and would not provide the necessary light, air, and views to create a successful design.

Mr Levy's response is that Savills have informed him that it is exceptionally unlikely that a 17-storey building would receive planning consent, and that Vector are of the same view – and he therefore asks about whether the project is viable, since Foundation is not going to indirectly fund the purchase of the site, only to find subsequently that the development cannot work.

101. Dated on 9 July 2008 (the same date as deed originally establishing Foundation as a partnership), are a “Takeover Agreement” between Foundation and FCP, and a "Partnership Consultancy Agreement" between Foundation and Future Design. Both agreements are dated 9 July 2008, and Mr Levy's original witness statement referred to them being executed on that date. However, in a subsequent statement Mr Levy admitted that both agreements had been backdated. There is an exchange of emails between Mr Levy and Mr Young on 18 February 2009 to which a draft of the Takeover Agreement is attached, and it appears likely (and I find) that both agreements must have been executed after the date of those emails, and so were executed in February or March 2009, and not on 9 July 2008. As the July date is set out in the name of the folder attached to the email, the backdating appears to have been deliberate. Mr Levy was cross-examined about the backdating, but could not recollect why these agreements were backdated, but I agree with Mr Yates that the most likely explanation is that the agreements would have a better appearance of "commerciality" if they were dated when Foundation was established, rather than in February or March 2009.

102. The Takeover Agreement recited that FCP (described in the agreement as the "Project Originators") had developed a "business concept" of ways of raising finance from UK tax resident investors to allow for the tax efficient application of capital in the provision of design and build services. It recited that Foundation wanted to acquire this business concept and the Project Adriatic opportunity (in order to exploit the business concept). The agreement provided for FCP to transfer to Foundation the right to exploit the business concept and the Project Adriatic opportunity until such time as the Partnership was wound-up (or upon an event of default occurring after 6 April 2009).

103. The only provision in the agreement relating to consideration is that FCP will be paid a fee for the provision of "Market Advisory Services". "Market Advisory Services" is not defined in the agreement, and there is no obligation in the agreement for FCP to provide any services, other than the transfer of the business concept and the Project Adriatic opportunity and making their staff and representatives available for the purpose of fulfilling their obligations under the agreement. Schedule 1 is entitled "Scope of Right to exploit business concept and commercial opportunity" and sets out six bullet points. The first is providing the use of the business concept for the purposes of Foundation's business. The other bullet points relate to the provision of help and support to Foundation to enable it to exploit the business

concept and the commercial opportunity. However, there is nothing in the body of the agreement that links the meaning of "Market Advisory Services" to any of the bullet points in Schedule 1 or otherwise incorporates Schedule 1 into the agreement or obligates FCP to provide the services listed in Schedule 1.

104. The fee payable to FCP is 1.5% of the "Total Capital Contribution" on the closing of the fundraising (Total Capital Contribution was defined to be the aggregate capital contributed to Foundation by its partners).

105. The Partnership Consultancy Agreement provided for Future Design to provide building construction and design services to Foundation for a fee equal to 3.5% of the Total Capital Contributions on the closing, plus up to 4% of Foundation's total gross partnership income received in each accounting period, plus all reasonable expenses incurred by Future Design in connection with the project. The agreement goes on to provide that its termination will not bring to an end the payment of the profit share, which will continue for Foundation's life. Schedule 1 to the agreement defines the services to be provided, which are set out in some detail over three pages. These include working with Foundation to assemble the professional team, undertaking a feasibility study, leading the project (to include the provision of a detailed short-term management plan), developing a project execution plan, managing the design process, advising on risk management, preparing a detailed cost plan and managing expenditure, managing a master project programme, advising on contract procurement, and monitoring construction.

106. Mr Levy was also asked about the termination provisions:

> Q. […] So Future Design could be in flagrant breach of this contract and yet it still gets to have up to four per cent of the Partnership's gross income.
>
> A. Mm-hm.
>
> Q. Why on earth would the Partnership negotiate that?
>
> A. I do not recollect why that term was in there.

107. Mr Levy was questioned about the reasons for the fees payable under the Takeover Agreement and the Partnership Consultancy Agreement.:

> A. But is your question that at this point in time as we're evolving the product and thinking about its structuring that I had in my mind that there was a fee level that we would need to receive from the Partnership, taking into account the costs I was aware of? Is that what your question is? Because the answer to that is yes, of course. I was running a business. Future Capital Partners was my day-to-day structuring business. So yes, I had in mind what it was going to cost to raise the capital, and I had in mind what it was going to cost to provide services to the Partnership, and therefore I had in mind the sort of fee levels that would need to be charged. And I was imparting that in my communications with Peter Young.
>
> Q. So you have got a mixture of things in that fee, including the costs of raising capital.
>
> A. Yes.
>
> Q. And what you are trying to do, and this is plain on the face of that email, with the Takeover Agreement and the Consultancy Agreement is package that up in a way which looks more commercial to the Partnership.
>
> A. Well I think I did mention yesterday that we had spent a lot of time and money evolving the structure, aspects of the structure in the Shard deal. So, I didn't think it was unreasonable that the Partnership was going to pay for

> that expertise that it effectively was getting the benefit of. We had spent probably a year on the Shard deal. We had spent a lot of money on taking professional advice on it. We had learned a lot about how to structure the deal.
>
> Q. So in your view the Partnership was paying for a structure and you were entitled to charge them a price for that.
>
> A. Well, I mean you're talking about a lot of different things here. But I'll agree with these two principles. Number one, I was running a business, and that business was to make a profit. And so, I had a clear idea in my mind of the level of fee we would need to receive to cover our costs and make a profit. 100% agree with you there. Secondly, what were the components of how we broke the fee down into? Ultimately it was the consultancy fee paid to Future Design and Build, and it was the takeover fee. Two different things. Two different sets of services. And do I think that they were both real things? Yes. Do I think that they were both services provided? Yes. Were they priced fairly in the context of the marketplace at that time? Yes.
>
> Q. But standing back, what was ultimately happening was that you were providing a sort of composite service to the Partnership structured finance, liaising with parties, doing all the things that Future did – and what you are proposing here is charging a flat 4% fee for that, which then you try and deconstruct and put into two separate contracts. That is what this email chain suggests.
>
> A. I think that's entirely reasonable. You know, we know the totality of the income we want to generate from the transaction, and we know that we're going to have expenses. And yes, ultimately that ends up being delivered via two contracts. Yes, that's correct.

108. Although there had been references in the 14 January 2009 memorandum, in the Investment Appraisal of 18 March 2009 (described below), and other documents, to the inclusion of a liquidated damages provision in the Partnership Consultancy Agreement, no such arrangement was included. Mr Levy was asked why:

> Q. I think you have already given evidence that you cannot recall how that came to drop out.
>
> A. No, I cannot.
>
> Q. Thank you. As far as you are aware, no individual member of the Partnership had any input in the negotiating of either of these agreements.
>
> A. No, not as far as I am aware. Aside from myself.

109. Mr Levy confirmed also that none of the Foundation partners (apart from himself) had any role in the negotiation of any of the agreements to which Foundation was a party. Mr Yates also put it to Mr Levy that none of the partners were informed about nor understood the risks they were assuming, and Mr Levy did not dissent from this statement (although I note that risk warnings drafted in general terms were included in many of the documents provided to prospective investors).

110. At the end of February and beginning of March, FCP were in correspondence with Bank of Ireland and with Barclays about the provision of loan facilities, and it was agreed that Barclays would provide a daylight loan facility to BPHS that would be repaid later that same day. There was a chain of emails at the beginning of March about the details of the loan facility and the formalities to open bank accounts for the various entities. Mr Levy confirmed during his cross-examination that because (a) Barclays were properly secured, (b) all the accounts were held at Barclays, and (c) Barclays were in control of the way the money

passed, Barclays took negligible risk in terms of its lending of the daylight facility that they were providing. That Barclays took no risk on (and therefore had no interest in) the financial success of Project Adriatic is illustrated by the fact that they undertook no "due diligence" on Project Adriatic and its viability and took no security over any of the development assets (such as the Lenley shares or the construction agreements), nor did the professional team (Vector, ORMS, CB Richard Ellis) provide any assurance to Barclays about their work product. On 12 March 2009, Barclays confirmed to FCP that they had credit approval for the daylight loan.

111. During the period from 6 to 12 March there were further discussions and emails exchanged between the parties. There remained an outstanding concern that any planning consent would limit the height of the development to 11 storeys. In consequence the parties agreed that the price paid to Atlas would depend on the consent given - €18m if permission was given for only 11 storeys but increased to €28m if permission was given for 17 storeys. In addition, there remained outstanding commercial issues to be resolved, including (but not limited to) the removal of Piraeus's charge on the site.

112. On 10 March, Mr Bacon of Vector emails Mr Young about a telephone conversation he (Mr Bacon) had had with CBRE (CB Richard Ellis) about marketing the apartments, and that CBRE's view is that Serbians would pay €2000/$m^2$ for an unfurnished apartment, and "foreigners" would pay €3000/$m^2$ - but CBRE would not commit to these values given market uncertainties.

113. There was a board meeting of BPHS on 10 March, when it was resolved to incorporate IPCS as its subsidiary, and through which Mr Kennedy's services would be provided to Foundation. Mr Levy's evidence was that Mr Kennedy's services would be needed for IPCS to navigate the complexities of doing business in Montenegro.

114. On 12 March 2009, the Master Agreement between Polarisco Mix Limited ("Polarisco" - a company in the Atlas group), Atlas, and BPHS was executed. The Agreement recorded that the Atlas group did not have ownership of all the plots of land necessary for Project Adriatic (referred to as “Final Unit 2”), and that the other plots (namely, the "yellow strip land") were owned by others, including the State of Montenegro and the Budva Municipality. The agreement envisaged that an SPV (which would be Lenley) would be formed which would have ownership of Final Unit 2. The Master Agreement provided for Polarisco to sell to BPHS the shares in Lenley (Lenley having first acquired the yellow strip land). The price for the purchase was €18m, which would be increased by an additional €10m if planning consent was obtained for the construction of a 17-storey building. The agreement provides for BPHS to pay the initial deposit on 23 March 2009. Polarisco is then obliged to undertake the acquisition of the yellow strip land by no later than 27 March. Once this has been done, 20% of the purchase price is deposited by BPHS with an escrow agent, and a transfer of 20% of the shares (carrying 50% of voting rights) is executed. Following this transfer, BPHS are required to pay to the escrow agent the balance of the price, and a transfer of the balance of 80% of the shares must be executed by Polarisco by no later than 5 April 2009. There are then provisions for the release of the funds in escrow to Polarisco in stages. In an email of 13 March, Mr Levy is advised by BPHS's Montenegrin lawyers that BPHS can exit the agreement up until 5 April 2009 merely by not depositing the initial escrow amount, in which case the agreement terminates – and BPHS can withdraw any funds deposited with the escrow agent. But after that date, BPHS becomes committed to the transaction.

115. In the period from 13 to 19 March, Atlas announced an architectural competition for the development, and provided Vector with a copy of the competition design brief. Mr Levy forwarded a copy of the design brief to ORMS (a firm of architects) asking if they would

become involved by submitting a design that reflected the requirements for a 17-storey development. Mr Bythewood told Mr Levy that he was concerned about whether it was possible to prepare a submission for the competition in the time frame available. But they would provide massing models for the hotel component to ORMS, so that massing blocks for both the residential and hotel components can be completed showing size and scale can be used for the planning submission. Mr Levy emailed Atlas telling them of their intention to provide drawings for the purposes of the application for "urban technical conditions" approval for 17 storeys and asking that they jointly review the submission to ensure that it meets the requirements of all parties.

116. On 16 March, Mr Levy sends an email to the sales team at FCP to update them on the progress of Project Adriatic. This was sent in order to encourage the sales team to market the project and provide information that they can give to prospective investors. The email notes that contracts had been exchanged by the developer group (meaning BPHS) to acquire the site, and that the development appraisal is that at the then prevailing values Foundation would break-even on the residential component and make a modest profit on the hotel. Mr Levy goes on to say that he considers that these are pessimistic values, and that the market will improve. The email then states that there will be a liquidated damages payment to Foundation in if construction does not commence within two years:

> Although this will not reverse the original tax treatment and subject to any income already brought into account may be taxable this represents real commercial potential for an investor in a worst case and the quantum of this will not be more than 28 million euros, but that would give investors a pre-tax return of two times equity even though nothing got built.

117. The email also discusses the risk to investors because Foundation is established as a common law partnership where the partners have unlimited liability for Foundation's obligations – and Mr Levy states that Foundation can convert to an LLP after the initial six-month active period. And as construction is not expected to start in this period, this will eliminate risk for the investors.

118. On 18 March, FCP circulate an "Investment Appraisal" to investors and potential investors. At this point in time some of the investors had committed to invest in Foundation, but others were still considering whether to invest. The first page sets out key highlights. These include a statement that there are arrangements to compensate Foundation if construction does not commence in two years through the sale of the site – further details of which are available on request. The document also notes that Foundation is a "general partnership", but could convert to an LLP after six months. The second page is a table showing the potential return to investors, on the assumption that they invest €22 million equity in aggregate. The return for the hotel element is calculated on the basis of the "actual" projected income for the first four years of the hotel's operation, plus the net present value of the projected income from subsequent years – assuming a 30-year operating agreement and a 10% discount rate. Mr Yates cross-examined Mr Levy, suggesting that this was not a terribly good deal. Mr Levy's response was:

> But you're looking at a number which has been massively discounted to take account of a 10% discount rate over 26 years.

119. Mr Yates suggested to Mr Levy that this appraisal showed the "real" commercial deal for investors, as it did not address the Barclays facility:

> Q. […] I would also suggest that, just standing back again, that really is the deal that is on offer in terms of the commercial deal. I know you have talked about the corporate member and the leverage that goes round, but that

leverage does not make any more profits for the partnership, does it, because it goes back to Barclays at the end of day one?

A. Well, it makes the difference between the project happening or not.

Q. How?

A. Well, because if we had not structured the partnership in that way, if we had not had the leverage in there, we couldn't have done the deal at all.

Q. Because you needed the leverage?

A. Because the leverage was essential to make the structure work, both from a tax and commercial point of view.

Q. I can very much understand the tax, albeit it rather assumes the tax in your favour, but tell me about the commercial side?

A. Well, they both went hand in hand. We had to be able to raise the money from investors to allow the deal to work as a whole. I mean, we've talked about how the funds flow, we have talked about how they are used. So, we know that the most important element, or the first step of this transaction was acquiring the land interest, and when we have talked with the other developer parties about how we are going to piece this deal together, we have talked about Foundation being that element which is going to generate the cash that's ultimately going to pay for the land acquisition by BPHS. So, you know, that structure all was absolutely essential to make the whole deal work.

Q. I am finding these answers slightly confusing. I am not trying to be pejorative. But can I just summarise what I think your evidence is, and please correct me if I am wrong? […] You say you needed the Barclays financing as part of the structure to persuade the investors to invest because that would obviously help them from a tax point of view, and that would then make the deal work and would allow essentially the funding of the land, which would then allow other parties to come in at some point to make the whole deal work. I mean, is that basically the gist of it?

A. Yes.

120. I note that a 10% discount rate is also adopted for determining the present value of cash flows in the financial illustrations included in the "Summary of Opportunity" distributed to prospective investors, and in Foundation's "Initial Business Plan".

121. Two meetings of the Foundation partners took place on 20 March 2009. The first meeting was attended by Mr Levy, and three of the investors: Mr A MacIntyre, Mr Ashton, and Mr Walters. The minutes state that the meeting was held to provide the necessary authority to enter into the following documents (copies of which were produced to the meeting):

(1) The principal construction contract ("the Principal Construction Contract") between BAD and Foundation – by which Foundation agreed to execute and complete the works comprising the construction of an 18,000 square metre five star internationally branded hotel and 22,000 square metres of condominium apartments together with associated parking and external works. The consideration was the payment by BAD:

(a) On a six-monthly basis starting from the first sale or lease of a condominium apartment, 90% of net profits derived from the sale of the condominium apartments from the Project or 90% of the net lease or rental income (insofar as the apartments were not sold);

(b) On an annual basis, for a period of 30 years, starting from the date falling twelve months from the formal opening for business of the hotel forming part of the Project, 22% of the revenue generated under the Anticipated Hotel Management Contract (a future contract between the Partnership and an international hotel chain franchisee).

(2) A services agreement ("the Services Contract") with BAD for the marketing of the leisure and hotel complex. No consideration in addition to that payable under the Principal Construction Contract is payable by BAD under the Services Contract.

(3) The construction sub-contract ("the Construction Sub-contract") between Foundation and IPCS – by which IPCS agreed to execute and complete "the Works", which were defined by reference to Foundation's obligations under the Principal Construction Contract. The consideration was a "fixed lump sum payment" of £37,762,650.76 (excluding VAT) "payable on or by 3 April 2009 which shall not be subject to adjustment for any reason whatsoever". The date of completion for the Works was to be 20 May 2013, or such other date as may be extended under the terms of the agreement. The fixed lump sum payment is strangely precise - down to the last 6p. It equates (broadly) to the equity raised by Foundation (including the equity contributed by FDBS – which was ultimately borrowed from Barclays), less fees and a modest reserve to be retained by Foundation.

(4) A charge in favour of Barclays Bank plc ("Barclays") over a cash deposit; and

(5) Payment instructions to Barclays for the transfer of funds from Foundation to IPCS.

122. The terms of the Principal Construction Contract require Foundation to "execute and complete the Works diligently and in a good, workmanlike and substantial manner in accordance with the Contract Documents and the Approved Contractor Design". The "Works" are defined as "the design, construction, testing, commissioning, and preparing ready for occupation and operation of the hotel and condominium apartments, and related installations as described and specified in the Employer's Requirements and includes the design of the Works, as adjusted from time to time in accordance with this Contract […]". The contract includes as an express term a statement that the design of the Project is not fully developed.

123. Part of the consideration payable to Foundation is stated to be 22% of the revenue generated under the Anticipated Hotel Management Contract. Anticipated Hotel Management Contract is defined as meaning:

> The future contract between an international hotel chain franchise likely to be Intercontinental Hotels Group, and the Contractor or his assignees covering the operation of the hotel to be developed as part of the Works

124. The provisions relating to the payment of consideration relating to the hotel's revenue are strange. First, (as I said to Mr Levy during the course of his evidence) the operator of a hotel (such as InterContinental Hotels) charges a fee for managing the hotel – management contracts give rise to costs, not revenues. Second, the definition of Anticipated Hotel Management Contract presumes that it is Foundation that will be entering into the management agreement – even though Foundation has no ownership interest (direct or indirect) in the hotel and so has no basis for entering into a management agreement with an operator. And third, the consideration is expressed as a percentage of the hotel's revenues, not its profits – and Ms Chew confirmed that typically revenue did not have the same meaning as profit (or net profit).

125. The Employer's Requirements are set out in a substantial document. Whilst some parts of the document are drafted specifically for Project Adriatic, other parts (possibly the majority of the document) have the appearance of "boilerplate" lifted from somewhere else, and not tailored to Project Adriatic – indeed Mr Levy acknowledged that "this probably wasn't originally drafted for the purpose". The parts that were specific to Project Adriatic include a site plan, building floor plans, and a computer-generated image of the building. These plans and the images show that the hotel building is 14 storeys above ground. Later in the Employer's Requirement is a section titled "Typical Room Schedule", which sets out the technical requirements for each room/area on each floor of the hotel. This Schedule sets out requirements for a sub-basement, basement, ground floor, mezzanine floor, four bedroom floors and roof plantrooms– in other words seven storeys above ground. A construction timeline anticipates that the construction of the trade fair would start first in mid- 2009 (with the development to be undertaken by a third party – not Foundation – presumably Atlas). This would take 18 months and be completed in Spring 2011. Later in 2009, construction would commence on the hotel and on phase one of the apartments. The hotel construction would take 36 months and would finish in Spring 2013. The apartments would take 30+ months to complete, but the first release would be in Autumn 2012. Phase two of the apartments would be developed by a third party, and this would start in 2010, take 30+ months, but with the first release of phase two occurring in Autumn 2013.

126. Clause 2.1.2 of the Services Contract provides that the parties would "discuss and agree the particulars of the Services to be carried out by the [Partnership] and what the desired outcomes will be. What has been agreed by the Parties and any time estimates for the provision of the Services shall be as set out in appendix 1."

127. Appendix 1 of the Services Contract is as follows:

> The Employer intends that the successful Contractor will take responsibility for the sales and marketing function for the Condominium and Commercial Retail elements of the Development and the consideration under the contract will derived from the successful sales of these elements of the Development.
>
> The contractor is expected to deliver this service with all the due care, skill and technical competence expected of an international real estate agency tasked with fulfilling this function on behalf of the Employer and will be expected to provide professional indemnity insurance to the level of cover contained in the Contract.
>
> The Employer will retain this role for the Hotel.
>
> The Contractor will be expected within 6 months of contract to prepare a marketing strategy and sales plan for the Condominiums and Retail which shall include as a minimum:
>
> 1. accommodation mix
> 2. accommodation quality
> 3. extent of fit out
> 4. sales programme
> 5. sales plan
> 6. financial appraisal update and sale prices
> 7. draft marketing plan, documents and websites etc
> 8. Real Estate Agents scope of service and appointment
> 9. Guarantees and Warranties to Purchasers

> 10. Etc
>
> The Contractor is incentivised to market and sell these elements of the Development in order to receive its consideration under the Contract.

128. Both the Principal Construction Contract (clause 7.1) and the Services Contract (clause 4) provided for the Partnership to be able to sub-contract. The obligations of Foundation under the Principal Construction Contract were sub-contracted to IPCS under the Construction Sub-contract. However, Foundation did not sub-contract out its obligations under the Services Contract.

129. Some of the provisions of the Construction Sub-contract are unusual. Not only is the contract sum a fixed amount for the construction of a development which has not been fully developed, but the contract sum "... shall not be subject to adjustments for any reason whatsoever". Further, "If there is a termination of this contract under any circumstances, the construction subcontractor shall not pay or repay any amounts to the principal contractor." And there are also provisions which state that even if the scope of the works is reduced, there will be no refund of any part of the contract sum. Mr Levy was asked about the rationale for these non-refundable provisions:

> Some of it was absolutely tax motivated, so for our structure to work as we intended, then it necessitated IPCS receiving the whole contract sum, lending that to its parent in an intracompany loan (its parent being BPHS) and BPHS being able to repay the intraday finance that Barclays had provided to it - that it had in turn loaned to Foundation Design and Build, and that Foundation Design and Build had put it into the partnership as capital. So, part of it was that was the structure that we settled on, that was how we needed it to work, and therefore we needed the funds to flow in that way.
>
> Another part of the reason was from an accounting point of view, to get the desired losses in the partnership's first accounting period, then again, we needed to have an absolute irrevocable non-returnable payment.
>
> And then there were considerations about IPCS and its obligations. So, you know, IPCS obviously had no information on the partnership, it wasn't likely to accept an instalment arrangement from a group of individuals that it had never contracted with before - and then it also gave IPCS substance because, although it was a new entity in the Montenegro market, it could announce itself as, "We're a new Montenegrin contractor, we're effectively being run by John Kennedy, who already had an established presence in Montenegro, and we're a company that has received extensive millions in funding to build this project." So, it gave them credibility and substance. So, there were both tax reasons, accounting reasons and commercial reasons why it was structured that way.

130. I asked Mr Levy how the amount for the consideration given in the Construction Sub-contract had been calculated – noting that it was an unusually precise sum, down to the last penny:

> A. So as I recollect, those were figures that Vector produced for us that were based on the then designs that we envisaged. As I recollect again, that was a piece of work that Peter Young did with Vector.

131. However, Mr McGovern's evidence was that he did not recall ever having seen any detailed costings prepared by Vector. The only costings prepared by Vector that were presented in the evidence were the tables in their September 2008 report, which estimated costs at €93m based on an estimated cost /$m^2$ – but which were not based on any detailed

analysis. Given that everyone was working on an assumption that the construction costs would be of the order of €100m (which is not inconsistent with Vector's September 2008 estimate of €93m), I do not believe Mr Levy when he says that Vector produced a figure for construction costs of £37,762,650.76 (excluding VAT). It seems more likely (and I find) that this figure was calculated so as roughly to match the capital raised by Foundation (less fees payable to FCP and Future Design), but leaving a modest reserve in Foundation. This analysis is corroborated by the minutes of the second partners' meeting on 20 March, where Mr Levy describes how the capital raised by Foundation will be utilised, and which is described below.

132. The form of resolution passed by the partners did not expressly approve these documents, nor expressly authorise anyone to execute them on behalf of Foundation, but rather authorised Mr Levy to approve and execute ancillary documents. However, given Mr Levy's status as managing partner, and the terms of Foundation's partnership agreement, it was probably unnecessary for there to be a partnership resolution to approve these documents, and it is not disputed that these documents were executed on behalf of Foundation, and bind the partners.

133. The second meeting was attended by Mr Levy and the same three investors: Mr MacIntyre, Mr Ashton, and Mr Walters. In addition, the following attended the meeting: Mr Young, Mr Nghi, Ms Greenwood, Mr Smith, Mr Jaffray, and Mr Ashurst. At this meeting Mr Levy advised that there were then 16 individuals signed-up as partners, and by the end of the tax year the amount of capital raised would be "in the range of" £15m from individuals. Mr Levy "advised that the construction costs were scalable to account for this range." A capital call would be made following the meeting for the balance of capital due, which would be payable within 5 business days. Mr Levy proposed that meetings would take place on a weekly basis, which would be supplemented by divisional calls. ORMS were appointed as "guiding architects" to produce initial design concepts, Vector's appointment as project manager was ratified, and Geotechnika were appointed to undertake a geotechnical survey. The partners authorised the obtaining of dishonest acts and professional indemnity insurance. The partners approved the "Transaction Documents" and authorised Mr Levy to execute them. Mr Levy explained that at the financial close, 94% of Foundation's capital would be paid irrevocably and unconditionally under the construction services sub-contract (to IPCS), 3.5% would be paid to FCP under a consultancy agreement, and 1.5% would be paid to FCP under the Takeover Agreement. This would leave a reserve of 1% in Foundation.

134. Mr Yates asked Mr Levy about the interrelationship between the Master Agreement and the construction agreements that were subsequently concluded by Foundation:

> Q. … at that point in time you did not have enough money to buy all of the land.
>
> A. Correct.
>
> Q. And in particular you did not have enough money to buy all the land and pay off the Piraeus security.
>
> A. Correct.
>
> Q. So in the worst of all possible worlds BPHS could have pulled the plug, and that was just a possibility which the Partnership just had to live with.
>
> A. Yes.
>
> Q. In the best of all possible worlds, the Partnership was contracting with an entity which at best owned 20% of the economic value of the land.
>
> A. Yes.

Q. And so at that stage was not in a position to actually allow the Partnership to actually build anything on the land.

A. Well I think there's a distinction between the contractual agreement that Foundation had with Boka Adriatic Developments and BPHS. I mean at that point, yes, we had 50% of the voting rights in the… Three weeks later we had 50% of the voting rights in Lenley. So clearly, we couldn't do anything without Atlas's consent. It didn't mean we couldn't do anything. It just needed their consent. So long as they were a partner in the company, we couldn't have done anything without their consent.

Q. It is not just a matter of consent. If in this case the Future entity does not own the land, all of it, it cannot start divvying up profits to the Partnership, can it? Because it cannot give them 90% of the condo because if I am Atlas and I own 50% of the land I will say, "Well I'm terribly sorry but they're not going to get 90%. They're going to get 30."

A. We had obviously always envisaged a situation where BPHS would be in control of its own destiny as far as owning the was concerned, and ultimately as you know that happened only in 2012, and that's when we became 100% owners of Lenley. So, we never contemplated a situation where we would co-venture with Atlas. Our focus as developer was how do we pay off the balance of the land consideration. How do we complete the acquisition of the shares that we don't own? That was our principal focus. That's what we knew we needed to do. So, we never had a discussion with Atlas where we said, "Let's just leave things as they are ownership wise, and we'll carry on with the Partnership moving the project forward and we'll just co-venture on it together." We never had that discussion with them.

[…]

Q. All I am exploring with you is, commercially why has the Partnership contracted with someone who, at the stage we are looking at, does not hold any of the shares, it has obviously got a contract to acquire the shares […][but] has not got any of the rights to the shares at this stage, and for the foreseeable future does not have the resources to complete on 80 per cent of that.

A. I guess part of the answer is I, as managing partner of the Partnership, represented to my fellow partners the confidence that I had that we would be able to raise the balance of the money to pay off the balance of the land consideration owed.

135. Mr Levy was questioned about the Partnership's activities at this time:

Q […] what the Partnership, with its puny 10 million, was doing in April 2009 and the journey that lay ahead. […] The feasibility of what appears on its face to be an isolated and complete commercial contract, which you are contending for is your trade. I am not mistaken about any of that, am I?

A. No, you are absolutely, 100 per cent right. I mean, it has been a nightmarishly difficult journey and one of the things that I misjudged was how acutely difficult it would be raising funding to complete the acquisition of the land and move ahead with the project, and I had misjudged the depth of the financial crisis, and that very severely affected our ability to raise money.

Q. But as things stood at the end of March 2009, the partners must have all been, unless they were certifiable, they must all have known that they were not in a position to carry out the work they are contracted to do.

> A. Why do you say that? I mean, at that point in time - are you making the point about the land ownership or are you making the point about having only raised 40 million out of the 100 million needed?
>
> Q. Both, but I am actually calling it 10 because they cannot really use that 30, for the reasons we have all been going into.
>
> A. We refer to the big numbers, the big numbers are easier to understand, so [ …] as to the land ownership point, I think we have already discussed that it was not absolutely essential for BPHS to own all of the land for the development to happen.
>
> Q. I have not agreed that, Mr Levy, that is your contention, but let us leave it there.
>
> A. Okay. And then secondly, yes, there was a problem. The problem was that a contract had been entered into between BPHS and the Partnership which required the Partnership to deliver a 100-million-euro project and it had only raised 40 million euros, agreed. That was a problem and we did not think about that problem, as you know, until the days after - I mean, we thought about it in terms of knowing we needed to raise more money, we did not think about it in terms of the way the documentation was phrased until shortly after, when Mr Young brought it to my attention.
>
> Q. So who is "we", is that Future or is that Foundation?
>
> A. It is Peter talking to me, and I would have been wearing my hat both as BPHS and my hat as managing partner of Foundation and my hat as a director of IPCS.
>
> Q. So are you saying it had not occurred to any of the partners before signature that what they were contracting to was just not commercially viable?
>
> A. I am sure it occurred to the partners that, given that we needed to raise £100 million and only raised £40 million, we needed to raise significantly more money, absolutely.
>
> Q. So would not the commercial answer have been there to postpone the contract?
>
> A. If we had postponed the contract then almost certainly, we would have lost the opportunity with regard to the project, and as I explained yesterday when I started giving evidence, there was a lot of excitement and interest in the project from investors. So, we thought it was a very commercial project, we thought we could make it work, we thought we could raise the balance of the money and therefore we decided to move ahead.
>
> Q. So you had to move ahead in order to secure the land.
>
> A. We had to move ahead in order to secure the land, correct.

136. On 18 March 2009 Mr Young emails Ms Clarke (at Mazars) about the impact of the proposed liquidated damages arrangements on the treatment of the construction contract in Foundation's accounts:

> The PCA [Partnership Consultancy Agreement] will be structured to obligate and incentivise FDBS to ensure the Montenegrin development is progressed, and ultimately rewards FDBS for contributing to the success of the Partnership's trade. Accordingly, in addition to a one-off fee, FDBS will be entitled to an annual fee (calculated as 5% of the annual gross partnership

> income). Similarly, where certain hurdles are not met, a contingent liquidated damages clause is envisaged.
>
> Relevantly, the contingent liquidated damages clause will be triggered where material design and build has not commenced by a longstop date (say 3 years). A three year longstop date where material, design and build has not commenced usually means the development project will in all probably not go ahead. Moreover, if the Partnership's commercial trade and the Montenegrin development project is deemed not to meet certain performance targets (i.e. having not driven the project successfully resulting in the project being aborted).
>
> When triggered, the liquidated damages clause will require FDBS to pay an amount to FGP equal to the payments that FDBS is entitled to under the PCA. The source of the contingent LD clause will be from a group company of FDBS, who will be a part shareholder of the Developer Group that may be entitled to its share of proceeds from the land sale. The contingent LD will reflect the amount that the FDBS subsidiary may receive in the circumstances.
>
> Does the above commercial arrangement under the PCA change your accounting analysis, in particular the revenue recognition policy set out in your opinion.

Ms Clarke concludes in her reply that

> On this basis we would not envisage an asset in respect of the liquidated damages needing to be recognised in the accounts of the partnership for its first accounting period, which we understand will be the period ending on 5 April 2009[2].

137. There were discussions between Mr Levy, La Cite and Boka between 20 and 22 March about the Atlas's requirement that €500,000 be deposited with Atlas Bank as a condition for the acquisition of the Lenley shares. Mr Levy wanted both Boka and La Cite to contribute to the payment, so that the commercial risk was shared between the three parties. Ultimately the issue about the contributions of the parties to the deposit fell away, as they managed to reach an agreement with Atlas which did not required a deposit to be paid.

138. There were some problems with the commencement of the geotechnical survey on the project site, because of uncertainty of the location of power cables (and the contractor needed to be sure that in drilling test holes it does not drill into power cables). On 22 March 2009 Mr Young emails Mr Bacon of Vector that Foundation needs to be absolutely sure about the geotechnical survey – "we need concrete comfort on this before we proceed." Mr Bacon replies:

> In answering your question, the water table at the site is high, as you expect next to the beach (probably 2 metres down), and I assume the ground is sand and silt, which means a large raft foundation for medium rise buildings so JU would be happy up to the 11 storeys ie the basement box is effectively a massive hollow raft which spreads the building weight over a big footprint. In our case we are building taller with higher point loads so the survey becomes much more important as we will need to pile foundations (columns in the ground) and this can be very expensive in bad ground so we really

[2] In fact the first accounting period ended on 3 April 2009

> need to know what's there as there is a risk that you'll pay for 17 storeys only to find the foundation cost is prohibitively expensive.
>
> The seller appears not to be able to provide proper records for the site and that this is preventing you from confirming that the site is suitable for development, and therefore no adverse change under the Master Agreement. If formal drawings cannot be provided then can their engineers please attend site and provide instructions to our contractor.

139. The survey began towards the end of March 2009 with the drilling of test holes.

140. On 26 March 2009, Mr Levy emailed Atlas with proposals for the payment of the balance of the purchase price for the Lenley shares (after the payment of the initial instalment of €2.5m), in the light of the fact that FCP was unable to find sufficient investors prepared to contribute (in aggregate) the level of capital originally sought.

141. At the end of March 2009, there is an exchange of emails between Mr Levy and the other co-venturers (Mr Kennedy and Mr James of Boka, and Mr Bythewood of La Cite) about the Teaming Agreement, in the light of the changes to Project Adriatic in the period since that agreement was signed in November 2008. Mr Levy seeks to renegotiate some of the terms of that agreement. In an email to La Cite and Boka on 28 March 2009 he says:

> I don't want my partners spending tens of millions of Euros only for La Cite to pull out down the road, or to come up with unacceptable terms, or to materially change what they want. We need to think about what our Partnership is getting for its money and ensure this is fair and equitable.
>
> […]
>
> I am not looking to screw anyone – I am merely ensuring my Partnership is protected properly – especially as we are the only ones laying out real money at this stage!

142. In fact, the Teaming Agreement was never amended. Mr Yates asked Mr Levy about this:

> Q. […] you were highlighting the risk to your partners of spending, as you put it, tens of millions of euros only for La Cite to pull out. […] That's what you are saying.
>
> A. Yes.
>
> Q. What I am saying is that that risk was not resolved prior to the Partnership signing up to all the documents that it did. Clearly it was not, because La Cite did not ever commit, did it?
>
> A. Well, in the end we got rid of La Cite. They did not pull out. We actually kicked them out. […] So that is a different matter.
>
> Q. But they could have pulled out at any time.
>
> A. They could have pulled out, and as we say we removed them eventually.

143. On 30 March 2009 there were two meeting of the partners of Foundation. The first is attended by Mr Levy, Mr A MacIntyre, Mr Ashton and Mr Walters. The second meeting is attended by Mr Levy, Mr Young, Mr Nghi, Ms Greenwood, Mr Walters, Mr MacIntyre, Mr Hannington, Mr Morris, Mr Warnholtz, Mr J MacIntyre, and Mr Platts (Mr Nghi and Ms Greenwood are not partners). The first meeting considered and approved the suite of contractual documents (Principal construction contract, services contract, construction sub-contract, Barclays' charge over cash deposit, Barclays payment instruction and other ancillary documents).

144. The second meeting updated the partners on progress. Mr Levy noted that the capital raised by Foundation was significantly less than the amount originally sought. The minutes of the meeting state that:

> TL[3] reported that the final raise was expected to be in the region of £50-70 million resulting in the partnership paying between £47 million and £65.8 million to the Construction Services Company. The developer has accepted that the numbers are less than the basis for the original deal in turn for a pro rata reduction in the in the (sic) interest the Partnership will have in the project profit shares.
>
> The Partnership has an option, up to the end of September 2009, whereby the partners may elect to allocate further capital to the project in return for a corresponding pro rata increase in thru profit share. The Corporate member has also indicated that it would be prepared to amend the profit sharing ratios in the second Partnership accounting period. A Member raised the issue of this being problematic for risk exposure purposes and Peter Young (PY) advised that he would be evaluating the logistics of further inputs of equity and that the use of a separate Partnership was more likely.

Mr Levy described the utilisation of the capital raised by Foundation. There was also a discussion and approval of the purchase of "wrongful acts" and E&O insurance.

145. Mr Levy was asked why there were two separate meetings on each of 20th and 30th March – the first meeting with only a small number of partners to review and approve contractual documents, and a second meeting with a larger number of attendees, and he did not know why this happened.

146. It appears that the forms of agreement produced to the meetings of the partners of Foundation were in their final form, and Mr Levy's evidence was that none of the partners (other than himself) had any involvement in their negotiation or had seen earlier drafts. Mr Hannington's evidence was that he had not seen any of the earlier drafts – he does say that he discussed the drafts with Mr MacIntyre (one of the other partners), whom he believed had an earlier involvement with the partnership, but there is nothing in the documentary evidence to suggest Mr MacIntyre became a partner in Foundation materially prior to Mr Hannington, or that Mr MacIntyre had any earlier involvement with the partnership or in the drafting of the documents.

147. There was a meeting of the board of directors of BPHS that same day, at which the terms of a loan facility for £75 million with Barclays Commercial Bank (a division of Barclays) were approved. I note that although the Barclays facility letter is dated 2 April, a draft of the facility letter was produced at the board meeting. The facility was for an overdraft of up to £75 million, and the terms of the facility letter required the facility to be advanced to BPHS's account by no later than 11am on the drawdown date. The facility was repayable on demand, and in any event no later than 5pm on the drawdown date. In other words, this was a "daylight" facility, with the loan being advanced and repaid on the same day. The conditions precedent to the provision of the facility included: the provision of certified copies of the "Transaction Documents" (being the Principal Construction Contract and the Construction Sub-contract described below), Barclays and its solicitors being satisfied with the proposed structure of the transactions, and the provision of security. The security arrangements are extensive and comprehensive and are summarised in an Appendix to this decision. One of the conditions to the advancement of the funds under the Barclays facility was the requirement

[3] Tim Levy

that each of BPHS, FDBS, Foundation and IPCS must provide an account mandate in respect of bank accounts held in their names at Barclays. I find that the effect of the mandates and the security arrangements is that (a) BPHS, FDBS, Foundation, and IPCS had no discretion as to how to apply the funds that were advanced by Barclays – the funds had to follow the circular path laid out in the mandates; and (b) the funds advanced by Barclays at the beginning of the working day would be repaid to Barclays by no later than the end of that same working day.

148. A Further Amended and Restated Partnership Deed dated 30 March 2009 ("the Partnership Deed") was executed by Mr Levy (in his capacity as managing partner of Foundation) and by FDBS (as corporate partner). It is unclear why this Deed was not also signed (or at least approved) by the other partners. The relevant operative provisions of the deed are described in the appendix. Of particular relevance are the provisions of clause 5. Whilst the drafting of clause 5 is not entirely clear (indeed, the same can be said for much of the Partnership Deed), it appears to be accepted by Foundation and FDBS that the effect of these provisions (when taken together with the definition of "Capital Contribution") is that FDBS is obliged to contribute £3 of capital for every £1 contributed by the other partners.

149. On 31 March 2009: BPHS offered to lend £30,266,250 to FDBS, the loan to bear interest at 5.1%, and to be repayable on demand. The letter setting out the offer was accepted and countersigned by FDBS on 2 April 2009. Also, on 31 March 2009, IPCS offered to lend £30,266,250 to BPHS, the loan to bear interest at 5.2% and to be repayable on demand. The letter setting out the offer was accepted and countersigned by BPHS on 2 April 2009.

150. The Principal Construction Contract, the Construction Sub-contract, and the Services Contract were all executed on 1 April 2009.

151. Barclays' facility letter with BPHS, its drawdown letter (requesting Barclays to advance the loan under its facility), and the various security documents required under the facility were all dated 2 April 2009. However, these documents were reviewed and approved by the various entities prior to this date. For example, the minutes of the partners' meeting of Foundation on 30 March 2009 records that the terms of the charge in favour of Barclays over its cash deposit, and the terms of the payment instructions to Barclays were (amongst other documents) all duly and carefully considered. I infer (and find) that these documents must have been drafted and final (or near final) drafts must have been presented to those present at this meeting (and the meetings of the other entities which approved these documents). Indeed, the facility letter requires that BPHS must have provided to Barclays and its solicitors with a long list of documents, and that Barclays and its solicitors must be satisfied with the structure, money laundering compliance, and various other matters (including BPHS having obtained legal opinions on the enforceability of the security arrangements from counsel in Jersey and Montenegro), before Barclays would advance the loan under the facility. This could not all have been done on 2 April between the facility agreement being signed, and the loan being advanced. I find that Barclays and its solicitors must have been satisfied that these "conditions precedent" had all been met in advance of 2 April – and it follows, and I find, that it is likely the form of the facility agreement and the associated security documents were settled no later than 30 March 2009, when the directors of BPHS approved the terms of the facility and the Foundation partners approved the security.

152. Vector's report on property technical due diligence states on its front page that it was prepared on 29 March 2009 and approved by Mr Bacon on 2 April 2009. There is an email dated 2 April 2009 from Mr Bacon to Mr Young (and copied to Mr Levy) saying that he is concerned that report may be too big to be emailed. I find, in the light of the dates on the front page and Mr Bacon's email, that Vector's report would not have been available to be read by anyone at Foundation (or BPHS) before 2 April at the earliest.

153. The 2 April email states:

> Importantly the geotechnical report does not look good – lab tests are still being done, but it is becoming clear that a high rise building will be technically very difficult especially at this level of seismic zoning and on such poor ground. Of course there is always a solution but in this case it may well prove very expensive. Our advice is to have this fully checked before you commit fully so you know just what impact it has on the appraisal.
>
> The utilities investigation is underway and correspondence is now being received but irrespective of this we still have the uncertainty of delivery – lots of promises but nothing certain.
>
> The third main issue as always is the Planning, and we have again noted that the site only has consent for 5 levels and some 26,000m$^2$.

154. The report is substantial, and makes the following points (amongst others):

(1) The DUP does not allow the client to develop 40,000 square metres as described in the Land Purchase Agreement, as FLU2 is designated under the DUP to have only 5-story consent, which would restrict the GBA. Before completion of the land purchase, the client is recommended to insist that "the DUP is adjusted for FLU2 to achieve at least 11 storeys." The report also states that "Additionally the client has also requested that DUP be further adjusted to 17 storeys." The report states that under the DUP only 5 levels are permitted at the Project Adriatic site, and although there is some ambiguity to allow for a tower zone, this should not be relied upon. Mr Levy confirmed in his evidence that the reference to the Land Purchase Agreement was to the Master Agreement of 12 March, the reference to FLU2 was to the plot beneficially owned by Lenley on which the hotel and apartments were to be built, and that GBA means "gross [building] area".

(2) As regards geotechnical matters the report notes that a geological survey is in progress and laboratory tests have yet to be performed, but it says that based on the preliminary report "the subsoil condition is very poor. As no solid rock had been found to a depth of 25 to 30 metres and not expected before the depth of 50m only friction piles would be possible to apply for foundations." It goes on to say (in bold) "On this basis and given the seismic zoning the ability to build high-rise, especially to 17 levels, would be very restricted and potentially more expensive than anticipated.". The report notes that the construction would require friction piles of significant length, and that "Vector would propose a more detailed structural analysis as there is a significant risk that high-rise buildings over 13 storeys may not be possible due to high seismic zoning without significant additional cost." The report gives by comparison a 5-storey office building 500m from the coast, which required piles 17m deep – and that for a high-rise building, extraordinarily long piles would be needed.

(3) In bold the report states "Client is advised not to fully commit to the investment until confirmation is received that at least 11 levels will be permitted and further engineering analysis has been undertaken".

155. Mr Young forwards the report and Vector's email to Mr Levy on 14 April 2009. Mr Young says:

> IMPORTANT: You may want to read this and decide whether this should go to the investors? This report addresses all the core issues in a transparent manner.
>
> In an ordinary deal, one would not go ahead with payment for the land.

> Let me have your thoughts. This has an impact on the work scope of some of the business units (ie construction and civils).

Mr Levy replies:

> I will read and respond to this and other stuff later today.
>
> I guess that the issue is that we must make sure that the tax works – and it is much easier to do this owning some or all of the land than owning none.
>
> However let me read and consider – as we need to also consider the impact on the commercial fundamentals as well as on La Cite.

To which Mr Young responds:

> Yes. My assumption always is we have to acquire the land, given where we are.
>
> I have subsequently given more thought on the communication channel, what scope of the report apply to the partnership and how this should be taken forward (see my email to John Bacon this morning from my FGP account).
>
> Yep – perhaps we can have a quick call later tonight (say 10-11pm UK time) for a quick stock take, as the step plan will (hopefully) be in meatier shape.

156. Mr Levy was questioned about whether he had read the report prior to Foundation signing the various construction and other contracts:

> Q. Did you in your capacity as a managing partner of the partnership have a chance to read and digest this prior to signing the documents?
>
> A. I don't recollect.
>
> Q. Because what I suggest is that it would have been bizarre for you not to have had a chance to read this before committing the partnership to, for example, pay irredeemably £25 million to Integrated. You would agree with that.
>
> A. Firstly I don't recollect, and secondly, as you know there had been a massive amount of correspondence and exchange of information about the views of Vector, Savills, Atlas and other parties about the site, the possibilities with the site, the problems and challenges with the site. So, I very much doubt that this included anything that was a surprise that we didn't already know about, that we weren't already thinking about. But I absolutely don't recollect whether I saw this before or after the partnership entered into the transaction documents.

Although Mr Levy in cross-examination said that he did not recall whether he had read the report prior to Foundation signing the contracts, it is clear from his email to Mr Young of 14 April that he had not read the report. I therefore find that Mr Levy had not read the Vector report prior to 14 April 2009. And the tone of Mr Young's email to Mr Levy about the content of the report suggests (and I find) that Mr Young had only just completed his review of the report on (or very shortly before) 14 April.

157. Mr Levy was questioned about the concerns Vector raised about the limitations in the DUP on the height of the development:

> Q. So what he is saying there is that it is not even certain that you will have 11 [storeys] at this stage. […] And that you needed to get that sorted out before you committed. It is unclear who Mr Bacon (of Vector) at this stage thinks his client is, because it appears to be addressed to BPHS.

A. Yes.

Q. But what I would suggest he is saying there about needing to insist that it is changed must apply just as much for the partnership as it does for BPHS.

A. Well I fully accept what Mr Bacon's view was at the time, and I know that he and his firm were very concerned about what the DUP did or didn't allow. Obviously as you know BPHS had already entered into the exchange contract earlier in March. So, it was committed, though not irrevocably so, as you pointed out. My view was that the person who I considered by far and away the most influential of everyone who was involved in this transaction was Dusko Knezevic at Atlas, and he was adamant in telling me that, given his relationships with the Prime Minister and the President, given the status of himself and his companies in Montenegro, and given the way that Montenegro worked, (a) the DUP did allow 17 storeys, and (b) we were going to be given planning permission for 17 storeys. To me that was the most important thing.

Q. But presumably Dusko was not a geotechnical engineer and he could not alter the law of physics. So, when we go down, in addition to the planning issues Mr Bacon was also highlighting that the subsoil condition is very poor.

A. Yes.

Q. Pointing out that no laboratory tests have been performed yet.

A. Yes.

Q. So that still has to be done.

A. Yes.

Q. But he says: "No solid rock has been found to the depth of 25 to 30 metres", and then in bold says, "On this basis and given the seismic zoning the ability to build high rise, especially to 17 levels, would be very restricted and potentially more expensive than anticipated."

A. Yes. We knew that was a risk. We knew there were issues around the geotechnical surveys. It subsequently turned out, as I told you, we had a very thorough geotechnical examination, granted, I accept, after the land had been acquired and after the partnership has entered into the transaction documents which established that it was possible to build 17 storeys.

Q. Okay, but the partnership did not know that at the time. This is the best advice it had. Did the partnership try and price in the extra cost of having to do deep piling before it committed to the contract?

A. It was a consideration. I don't know how the partnership would have priced that in.

Q. No. But after all it was in theory accepting the entire construction cost.

A. It was.

Q. And I do not believe we have seen any attempt to try and price in that possibility.

A. No. And indeed, subsequently it has turned out that actually there is not a significant marginal cost involved, but I accept that wasn't known to the partnership at that time.

[…]

Q. I suggest to you that it was remarkably uncommercial of the partnership against that backdrop to commit to the construction contract as it did at the time.

A. And my response to you is the most important thing in my consideration was what I was being told by Dusko, and given his influence and given his connections and given my understanding of the way Montenegro worked, if he was telling me we were going to get planning permission for 17 floors, we were going to get planning permission for 17 floors. He was massively incentivised to do so. As far as the geotechnical surveys were concerned, I don't think anyone was saying it was impossible to build at that height, just that it may be more expensive to do so.

Q. Yes, and the partnership, as far as we know, did not look into the additional cost of that and try and price it in.

JUDGE ALEKSANDER: Sorry, is that true or not?

A. The deal wasn't amended to reflect the potential additional cost that could have been involved in deeper pilings.

Q. That is not quite the question. Did anyone do any investigation as to what that additional cost might be?

A. Subsequently, your Honour, not before.

158. Mr Levy was asked why he took the decision to proceed with the project, even though it was clear that at the end of March 2009 Foundation had not raised enough money to fund the projected construction costs:

Q. […] all I am suggesting is, at that [the end of March], knowing that you did not have enough money to even pay lip-service to the fact that you were constructing this hotel, you entered into this contract to try and just secure that position at that point, get the tax relief you needed for the signed up partners with a view to then having a second fund raising later and to try and make commercial sense of it at a later date?

A. Well, there's no question that an enormous amount of time and effort, both by us and by others, had been put into the project by that point in time, and it was clear from our discussions with investors that there was a lot of commercial interest in Montenegro - and I know you are speaking to Mr Hannington later, and I am sure he will testify about that. And so, we did think it was an excellent opportunity, this project, we were very committed to it, we didn't want to walk away from it, we wanted to make it happen. The investors who had signed up also wanted to make it happen. And, yes, there were also tax reasons for wanting to make it happen. I mean, I'm not going to gloss over those. I have accepted throughout that tax was a very important part of this transaction, and I accept that this contract had an error in it that had to be rectified, and I accept that subsequently the partnership had to enter into other co venturing agreements with other partnerships under which it had to pay away a proportion of its entitlement to income to try and make the project viable overall. All of those things are true, but to just refer to it as this was just about parking tax relief by the end of the tax year, I don't think that's a fair statement.

159. During re-examination by Mr Rivett, Mr Levy was asked why he took such a different view as compared with the professional advice that he received:

Q. You also had a line of questions put to you regarding your interactions with the professional advice that you received at the time.

A. Yes.

Q. How many deals have you done over the course of your lifetime, Mr Levy?

A. Over 600 structured investments, totalling more than £8 billion in total transaction values.

Q. To what extent do you rely upon empirical evidence and reports and advice in entering into transactions and businesses?

A. Certainly they are a factor, but I understand that risk is very difficult to measure by conventional means and often transactions such as this are more an art than a science.

Q. Can you explain that in any more detail?

A. We were dealing in a difficult area of the world, few of the advisers had any depth of expertise in dealing with that marketplace. There were, as I am sure both of the other witnesses will comment on, you know, we were mainly used to dealing with a world where there was a lot of certainty, so you had certain rules, you had to abide by that rule, there was a process that had to be followed. You know, as you say, it was a fairly empirical way of working. In Montenegro things did not work that way. The rules of the game were different, and I was the one who had to be the most sensitised to that, to deeply understand that getting things done in Montenegro was about far more than just what appeared to be the rules.

[…]

160. But Mr Levy later acknowledged that this deal was the first real-estate transaction that he had undertaken (other than the Shard – which had aborted, and was very different, as FCP's entity was not involved (for example) in site assembly, building design, or the need for planning and building consents):

JUDGE ALEKSANDER: So, Mr Rivett was saying to you: well, because of your experience in doing transactions you had considerable experience in judgment and were therefore able to understand where your professional advisers perhaps might be overly cautious. But actually […], you had not any previous experience.

A. Yes. […] I accept that.

161. Mr Hannington – like Mr Levy – was also very bullish about the feasibility of obtaining planning consent, notwithstanding the professional advice received by Foundation (although Mr Hannington has admitted that he had not read any of that advice prior to making his investment):

A. We had a meeting on September 11th in Montenegro with the government, with the federal government - it is in my notes - and they said: "We will cooperate with you, we want to cooperate with you because this is an incredibly important site for the country." We are talking about a small country the size of Leeds. They knew that it was a really, really important site. So, on face value I accepted that actually we could make a lot of money out of this. They then got into a spat with the local authority. It seems to me inconceivable that they could have actually got into a situation where the local authority under their existing DUP could prevent this from happening at a time when the government was trying to raise money in tourism.

Q. Mr Hannington, you did not understand the details of the Montenegrin planning system and, what is more, you did not understand the detail of the

> structure you were committing yourself to. So, all your general statements about how bullish you were feeling, they were basically on a hope and a prayer, were they not, because without the detail it is all at risk, is it not?
>
> A. I think you made a point that the federal government were encouraging us to do this.
>
> Q. Yes, well –
>
> A. I do not call a hope and a prayer.

162. Although Mr Levy said that he was the person most sensitised to, and "deeply understood", the different ways things worked in Montenegro - implying that the professional advisors did not have any depth of expertise in dealing with the Montenegrin marketplace - in fact both Savills and Vector had local offices in Serbia (from which Montenegro had recently become independent), and had considerable expertise in dealing with real estate transactions in the region – I assume that was one of the reasons why they had been selected to act as professional advisors. Indeed, Mr Hannington's evidence was that Savills had an office in Budva, and that he highly valued their advice in relation to the opportunity to invest in a project in Montenegro. But Mr Levy subsequently admitted that he had no previous experience, and I do not find Mr Levy's evidence remotely credible that his understanding and judgment of Montenegro was deeper than that of his professional advisors, or that he was more sensitised to the Montenegrin way of doing things than his professional advisors.

**Fundraising**

163. In parallel with the joint venture negotiations, FCP sought investors in Foundation. FCP's objective was to raise £25m from investors. Fundraising was undertaken in the first quarter of 2008, which Mr Levy described as the start of the financial crisis. FCP had a lot of initial investor interest, but one-by-one they dropped out. As noted above, on 30 March 2009 there was a meeting at which FCP said that they expected to raise between £50m and £70m (to include the capital contributed by FDBS) – but in the end the capital raised from investors was only £40m.

164. Mr Hannington had been introduced to Project Adriatic during 2008 by his financial advisors, and he attended a presentation given by FCP to potential investors on 3 December 2008. The presentation was given by Mr Levy, Mr Kennedy (Boka), Nenad Susic (head of valuations at CB Richard Ellis (Serbia)), John Bacon (Vector), and Justine Linehann (La Cite). A copy of the presentation slides was included in the bundles. The first substantive slide in the deck was as follows:

> Welcome – Foundation Global Partners
>
> - A unique property services trade in the emerging market of Montenegro
>
> - Suitable partners to bring capital, expertise, and active participation to the property services business
>
> - Partnership that will provide construction design and build services to a 5* hotel and luxury residential development
>
> - Investors are expected to generate pre-tax commercial return of between 1.5-3 times initial investment
>
> - Over and above the commercial return, an initial downside tax protection in year one, likely to most benefit UK resident high rate tax payer

165. A subsequent slide, titled "Key Highlights" refers to a "pre-tax anticipated return of between 1.5 and 3* equity over 3-4 years", and that the "worse case post tax return should be 1.6* equity regardless of commercial success for someone active in the business".

166. Mr Hannington was taken to these slides and asked about the financial return he had expected to make from his investment in Project Adriatic:

> Q. You want to understand what the pre-tax return would be in terms of any commercial upside, and you want to know what your situation tax-wise is going to be in terms of downside. You are not seriously suggesting you did not understand that before you went into those partnerships?
>
> A. No, my anticipation was that the upside would be considerably more than this. I mean, that's his summation but that wasn't mine.
>
> Q. This is not produced by Ward, this is produced by Future.
>
> A. Either way. My expectation was it would be a great deal more than that.

167. Included in the bundles of documentary evidence is an email dated 8 January 2009 from James Smith (a manager in FCP's sales team) to Premier Group (a firm of financial advisors), promoting Project Adriatic as a "tax planning opportunity". The email provides a summary of projected financial returns which are similar to those given in the 3 December 2008 presentation – namely a pre-tax return of 1.5 to 3 times investment and a post-tax anticipated worst case return over three years of 1.6 times the initial investment. The email goes on to refer to a base case return of approximately 2.5 times investment– something not mentioned in the 3 December 2008 presentation. The email states that the base case assumes an average sale price for the apartments of €500/sq ft, and that a fire sale at €200/sq ft would realise a return of 1.7 times investment on a post-tax basis.

168. Mr Hannington's financial advisors arranged for him to meet Mr Levy on 27 January 2009. Also present at the meeting was David Comyn of Savills. Mr Hannington describes Savills as being hugely regarded, and as having an office in Budva, and he was therefore very interested in their views. During his oral evidence, Mr Hannington stated that he had telephoned Mr Comyn, whom he had met on a previous occasion and whom he knew was involved in Project Adriatic, prior to attending the seminar. But this cannot have been correct, as Mr Comyn was first approached about Project Adriatic on 19 December (after the seminar).

169. In his witness statement Mr Hannington exhibits a copy of a development consultancy report that he says was tabled at the meeting, together with other draft documents. However, the document exhibited was dated September 2009, and could not have been tabled at the meeting. Mr Hannington's explanation was that the report tabled must have been an earlier draft – but there is no evidence that an earlier draft was ever available in January 2009 (or indeed that an earlier draft ever existed).

170. On 3 February 2009, Mr Hannington attended a further meeting with his financial advisors, together with other potential investors. On 9 February, Mr Hannington had another meeting with Mr Ward. Mr Hannington visited Montenegro on 11 and 12 March 2009 to inspect the site.

171. He then met Mr Ward again on 17 March 2009 when he signed the various agreements pursuant to which he agreed to adhere to the Foundation partnership agreement and invest £250,000 in Foundation (being an initial capital contribution of £25,000 and a further capital contribution of £225,000).

172. The suite of documents provided to prospective investors included a Business Plan and a Partners Manual. The Business Plan stated that the founder members of Foundation (Mr Levy and FDBS) were targeting a pre-tax return on equity from the development for individual members of between 1.5 and 3 times their investment over a 3-year period, which would be derived under a hotel operating contract (which could be with InterContinental

Hotels) together with the sale of luxury residential units on the site (which were intended to represent the greater share of the returns). It stated that on a post-tax basis the founder members considered there to be an anticipated worst case return over three years of 1.6 times the initial investment (but without factoring in the time cost of the investors' involvement in the project) and a base case return of approximately 2.5 times investment. The Business Plan stated that due to the nature of Foundation's transactions it was likely that a trading loss would arise in its first accounting period, and that to the extent that that occurred it was likely that there would be a tax advantage for those investors who were active partners. The investors were warned that the amount, timing, and availability of tax relief should be considered to be subject to variation. The Partners Manual was a detailed guide as to how it was intended that Foundation would carry on business, and how individual investors would be involved in the conduct of the business.

173. It is not wholly clear when Mr Hannington was admitted as a partner in Foundation – but it must have been at some point between 17 March 2009 (when he signed his application) and 30 March 2009, when he is recorded as attending a meeting of Foundation as a partner.

174. On 11 March 2009 there are email exchanges between Mr Levy and Mr Hughes, a financial advisor at Westminster Wealth about the possibility of their clients investing in Foundation. Mr Hughes has several questions about Project Adriatic, and the following is one of his questions and the corresponding answer:

> What options have been considered if there is no buyer found for the hotel and insufficient buyers for the apartments/condos
>
>> I would answer this more generally by highlighting that the product offering provides both tax downside protection which wraps up an exciting but risky investment opportunity. As a worst case, the downside protection of this opportunity should be 1.6* return on equity. This outcome is without regard to the ultimate performance of the investment opportunity.
>>
>> The nature of the investment opportunity is without doubt risky, and for this high risk reason, the 1.6 ROE return is made possible through the tax structuring is possible
>>
>> More specific to your question, our market consultant CBRE is of the view that in 2 years time the market will be appropriate for both a hotel/condo concept. Moreover, with the 5-star branded hotel proposed, this will very likely set the development project apart and will be seen to be a landmark development in Budva. Where there is ultimately no buyer the land itself will have value and the partners will be afforded some risk capital protection through the land interest held by the developer group. The partnership will have in place a commercial arrangement to have access to land proceeds consideration where ultimate the project is aborted or the market appetite for the hotel/condo is weak.

Mr Levy explained that the reference to a "commercial arrangement" was to a liquidated damages provision in the Partnership Consultancy Agreement that would compensate Foundation in the event that the project did not proceed in a certain timeframe or other eventualities. Mr Levy was asked why, in the end, those commercial arrangements were not implemented:

> Q. That was all within your gift, was it not, because whether you gave them that right, that liquidated damages clause, that was a matter entirely controlled by Future, and I suggest ultimately you.
>
> A. Yes.

[…]

Q. Why did you not have that clause in the Partnership Consultancy Agreement?

A. I can't recollect very clearly, but I suspect that it was something to do with an accounting issue.

Q. Because what I infer from that answer is that commercially having such a liquidated damages clause would have been quite helpful to the Partnership because –

A. It would have been desirable for the Partnership, not particularly desirable for Future Design and Build.

Q. You are telling an IFA that that is going to be in the deal.

A. Yes.

Q. By way of commercial protection.

A. Yes.

Q. I believe your answer has just been that the reason it was not included was because it would disturb the write-down from a GAAP point of view.

A. Or could have an effect on it, yes.

Q. So is that not really just letting tax wag whatever commercial deal you are trying to do here?

A. You know, I don't recall all the circumstances at the time and I'm just giving you my best recollection of why it was or wasn't in there.

Q. Because if the Partnership knew that that was on the table and been offered, it would be uncommercial for it to have turned down that opportunity, would it not?

A. But it wasn't on the table in the end, because when we provided the consultancy agreement it obviously didn't include any liquidated damages provision.

Q. Was that negotiated at all?

A. Between me and me?

Q. Yes.

A. Yes. I mean, it's quite difficult to negotiate with yourself unless you're a schizophrenic.

Q. But it is slightly difficult, is it not, because you owed duties to your fellow partners. How did you reconcile that conflict?

A. I don't think that we had ever finalised this point, and so this was something that was tentative at this point, and obviously it didn't make it in the end.

Q. Due to tax reasons.

A. That's my recollection. Accounting reasons.

Q. Well, you say accounting, but the only import that accounting has here is tax, is it not?

A. Accounting/tax.

175. But, as can be seen from the email exchange with Mazars mentioned above at paragraph 136, there was no accounting reason for excluding the liquidated damages provision, and when Mr Levy was reminded of Mazars' advice, he then said that he could not recollect why the provision disappeared.

176. A copy of the 18 March 2009 Investment Appraisal document was emailed by Mr Comyn to Mr Crossland (with a copy to - amongst others - Mr Levy). Mr Crossland subsequently invested in Foundation. In the covering message, Mr Comyn notes that the "tax structure" of the project will generate an "independent profit" of £110,000 on an investment of £250,000. If the condominiums are sold at €3500/m$^2$, then the total profit (including the "tax structure returns") is £360,000, and if they are sold at €4000/m$^2$, then the total profits are £500,000. He then goes on to say:

> The [Montenegrin] market has collapsed from 8-10000m$^2$ in 2007/8 but the model is based on the sales taking place in four and five years time, in 2013 and 2014 and less than half these levels.
>
> It is planned that apartments will benefit from hotel room, spa, pool and rental services, making this a very special residential proposition.
>
> Please check out Portomontenegro.com where units are to be offered shortly we understand at around 4500m$^2$. This is a high class residential proposition but it is not Budva.
>
> All unit prices in euros and profits in sterling, based on appraisals by Vector Management Ltd; these are indicative and preliminary based on standard assumptions as there is no actual scheme to appraise.
>
> The hotel assumption is for 57% stabilised occupancy for the 30 year lease; this is extraordinarily pessimistic; as occupancy levels rise further profits will flow to investors.

Mr Levy was questioned on what Mr Comyn must have meant in using the phrase "but it is not Budva" when comparing Project Adriatic to Porto Montenegro:

> Q. And he says: "This is a high-class development, but it is not Budva." It's unclear what he means by that. I would suggest that Porto Montenegro was a higher-class resort, or perceived to be, because of the superyacht development.
>
> A. I think it's a totally different type of thing, but yes.

177. Mr Hannington was asked about the Investment Appraisal document of 18 March 2009, and he confirmed that it was in a form he recognised. He was then asked about the liquidated damages provisions described in the key highlights page:

> Q. You will see […] it is said that "In the event that construction does not commence within two years of financial close, arrangements are in place to compensate the partnership through the sale of the land by the developer." […] Do you recall that at the time as being something which you knew about?
>
> A. I don't specifically recall that.
>
> Q. If you had known about it and you knew that was on offer and it was set out in a formal document like this to the partners, would you have been disappointed or, indeed, maybe angry that that just disappeared in the final drafting without any explanation?
>
> A. Well, it seems to be taking something away, yes.
>
> Q. Yes, it is giving you quite considerable protection, is it not?

A. Yes, it would have done.

Q. And can you recall whether any partner ever quibbled that at the time?

A. Not in my knowledge, no, but then there's no reason why they would have done. They would have made those comments directly, I guess, to Tim Levy.

[…]

Q. And no-one ever said, "Oh, did you remember that bit about us having essentially a fail-safe mechanism where we can force the developer to sell"?

A. No-one ever told me that, no. We never discussed that.

Q. And no-one ever complained about that?

A. It was never discussed with me.

[…]

Q. ... you do not believe anyone has ever complained about the fact that they have had this financial safety net taken away from them, despite it being essentially promised in a document such as this?

A. No, fair point.

178. Mr Hannington was closely questioned about the analysis of Project Adriatic that he had undertaken prior to committing to invest. Mr Hannington compared the potential for a development at Budva, with the development at Porto Montenegro:

> Q. Well, you are trying, I would say, to draw a false comparison between Porto Montenegro and Budva, in circumstances where you are promising big but in reality, at the end of the period we are looking at, which is 5th April 2009, the only resources the partnership have are the resources which the group of you put together, and that, after fees, amounted to £7 million. That was all the real money that was going into this. […] What did you do with the 7 million quid?
>
> A. The 7 million was going to go towards fees. […]
>
> Q. You knew that. You knew that the 7 million quid was all going to go into fees?
>
> A. Well, I certainly knew that we needed to assemble a really world-class team of experts to make this happen. […] Because even though the site might be fantastic - and we will no doubt come on to the Montenegro site in a minute - you need to make it happen. So, if you go, "Location, Location, Location", which is what the property is all about, it isn't really going to make any money - you've got to apply capital to it to make it happen. And in this case we needed to assemble a team, some of whom were already there, the architects who came in, the hotel guys - I mean, the Brady people who came in with InterContinental were not good architects, they came as a sort of package, so the package was La Cite, who were supposed to be investing in the investment, and they didn't, the InterContinental Hotel, who had specifications that were impossible to comply with in respect of the size of the hotel - and they wanted to put a casino in the building, to start with, which was simply not going to work. And then an architect who sort of put this thing together. So, when they were replaced eventually by the main architect, Nick Jacobs of Jacobs Webber, in reality they were the architects for the whole scheme. They were even making suggestions as to what the Adriatic fair behind should do in order to be part of the holistic development of the flats and the hotel and the trade fair. The trade fair had been there for

41 years. It was absolutely fundamental to the country's tourism and commerce that this site was developed. And, you know, coming on to, why would you invest in this thing? It was something which was going to be really very good, and will be very good when it's constructed, and very fundamental to Montenegro. I mean, I don't know whether we talked about the tourist numbers, but the whole population of Montenegro is 600,000, right? That's the population of Leeds. But during the year 1.2 million people visit, so you can see how important tourism is. So, the obvious thing is, if you can build a hotel on the best beach in the country, which is connected to a commercial trade fair and convention centre, that should do very well.

Q. What I am going to be suggesting, Mr Hannington, regrettably, is that all of that evidence is completely divorced from reality. The deal you were apparently knowingly committing yourself to, because you knew that your 7 million quid collectively was just going to go into fees, was to commit to a project where no costings had been carried out, the partnership's legal advisor was telling you, "You probably can't build what you need to build", the person who was responsible for the InterContinental Hotel Group was telling you, "You need 17 storeys and, without that, you can't have the hotel", and without the hotel, we have heard that you cannot have a feasible condominium development. What you are trying to tell the tribunal seems to be completely divorced from what was actually going on, on the ground?

A. Well, you couldn't have a 17-storey hotel with InterContinental because what they needed wasn't possible. You most certainly could have had a Wyndham hotel, which would have been perfectly satisfactory.

Q. Not until years later. You could not, I would respectfully suggest to you ...

A. But we did not know ...

Q. ... Mr Hannington - this is all hindsight which you are now trying to cram into an incredibly dense period of time, between you first being brought in as a partner on the 30th of March and the end of the tax year on the 5th of April 2009. You cannot remotely have been discussing all of this because not even Future were envisaging this, in terms of the organisers of this partnership?

A. No, but I knew ...

Q. I suggest to you that your evidence is completely unrealistic?

A. I knew what you had to do to create a development, because I'd spent quite a lot of time in my career doing it.

Q. In Montenegro?

A. No.

Q. Did you know the plan?

A. Yes.

Q. You knew the planning regime in Montenegro?

A. Yes.

Q. You did?

A. Well, I ...

Q. I am suggesting that that cannot possibly be true at that stage in time.

A. I knew - no, hang on a minute - I knew that there was a planning regime, but I knew also that the government was likely to adjust it.

Q. Had you read the Vector report at the time?

A. Yes.

Q. You had read the Vector report?

A. I read the fact of what the DUP was, absolutely.

Q. No, had you read the Vector report? […] In terms of the geotechnical and the planning?

A. Well, four bore holes had been put into the site, one of which had diesel in it, in the top foot, which ...

Q. When did you know this?

[…]

A. Well, certainly before I committed.

Q. Really?

A. Yes, I had seen the bore hole report, yes.

Q. Right, the one dated the 2nd of April?

A. I can't remember when it was dated. When was the one that they did originally? There was an original report that Vector had done.

Q. Yes, let's go to it. I am suggesting that you are either deeply confused or ...

A. Well, I don't think so. I know that there's four bore holes done prior to ...

[Mr Hannington was then taken to the Vector report dated 29 March 2009]

Q. So, this is the property technical due diligence report dated the 29th, finalised on the 2nd. We see it is emailed to Future on the 2nd - we have already seen that this morning.

A. This is not the report I'm talking about.

[…]

JUDGE ALEKSANDER: Sorry, can I just pause? Did you ever see this report?

[Mr Hannington is then taken to Vector's email to Mr Young of 21 April]

Q. This appears to be the first bore hole test, okay? This only gets sent to the Partnership, Peter Young, on 21 April, with the express comment that "we are not going to tell the partners about it."

A. Okay, maybe it was after the date. […] I saw - there is quite a - it is a coloured document. It has got four bore holes and it shows the content of what was in those bore holes. They were concerned at that time, in the report I saw, was the fact there was some diesel, which turned out to be a spillage from the truck that had done the bore hole. So, you know, no-one has ever struck …

JUDGE ALEKSANDER: Sorry, we can see, if you like, from the heading at the top of the page that there were seven attachments that we do not have to this email.

A. I see. Whether I saw one of the attachments or - I do not know.

MR YATES: There seems to be four bore holes here, because

A. Does it talk about four?

Q. Yes, if we go to page 7039, we have B1, B2, B3 and B4. Okay?

A. Okay, yes. So, I suspect that I saw one of the attachments.

Q. Right. But you cannot have seen that before you signed up.

A. No, no, I did not say - I do not think I said –

Q. I think you did actually.

A. I am sorry. I said I had seen a bore hole. Sorry.

Q. […] I am just trying to suggest that whatever evidence you are giving is deeply confused and in reality the scope of what you were able to appraise, either in the lead up to you becoming a partner or between 30 March and 5 April, could not have really amounted to very much indeed because you just were not in a position to have all the facts or the knowledge, because you did not even have the documents.

A. My recollection was that I actually had a prospectus - it may have been draft - before I went on holiday to Sydney in December. […] so, I had seen the prospectus. […] And I looked at it.

Q. But it did not have bore hole data in it

A. No, it did not, absolutely not. The prospectus dealt with Montenegro and the site.

Q. I understand from your evidence that prior to those documents being signed you did not go through the principal contract or the subcontract. What you mentioned was you had a word with your friend Mr MacIntyre about it.

A. I did, correct.

Q. Did you understand that after you had signed up, or maybe I will frame it differently. When did you understand after you had signed up that the Partnership had (a) committed to build the hotel, and (b) irrevocably paid the amount paid to Integrated, so the 7 million of real cash and plus the 30 million or so financing?

A. I did not, I did not appreciate that from my conversations with Andrew, no.

Q. No. When you did discover, bearing in mind you were in an unlimited partnership, that you and your fellow partners had committed to build a 100 million Euro hotel and residential complex, what was your reaction to that?

A. As I say, I did not realise that […] there was an irrevocable contract to pay to build the hotel.

MR YATES: There was an irrevocable contract to build the hotel and then what had happened was, simultaneously, you had then instructed Integrated to build it and paid money irrevocably to them, in circumstances where the money that was paid to Integrated, which was about £37 million-odd obviously was not enough to build the hotel.

A. Correct.

Q. So you had primary liability, vis-à-vis BAD or BPHS, and then you had to try to subcontract that but obviously had not given the subcontractor enough money to do the job.

A. No.

[…]

> JUDGE ALEKSANDER: I think the point that is being made by Mr Yates is: if you are Knight Frank at the time, you are a partner in a partnership with unlimited liability. You have liability for all, jointly and severally […] for all the liabilities of the Partnership, and you have an agreement, you have agreed personally to build a €100 million hotel and you have no money. What is your thought?
>
> A. If I had seen it in that way, I would have been focused on it but actually I thought we would raise the money, […]

179. Mr Hannington was later taken to one of the exhibits to his witness statement, which was a translation provided by Vector of an extract from the geotechnical report, and from reading the translation, it seems likely that it was the one mentioned in Mr Bacon's email of 21 April 2009. The report has the date 30th April 09 in manuscript at the top. Mr Hannington confirmed that this was the bore hole report that he was referring to – and that he had not seen it prior to committing to invest in Foundation.

180. Mr Hannington's evidence was that he invested in Foundation because of its potential to deliver a strong financial return – and not because of the tax shelter that it offered – and that he was also attracted to investing in Foundation because of the opportunity it offered for him to bring his own expertise in property investment to influence the commercial outcome of Project Adriatic. The financial returns shown in the December 2008 investment memorandum produced by FCP states Project Adriatic will deliver an anticipated pre-tax return of 1.5 times to 3 times over three to four years and a worst-case post-tax return of 1.6 times equity. But Mr Hannington's evidence was that he believed (at the time) that the upside would be significantly greater – based on his research on Montenegro and his visit to the site.

181. I asked Mr Hannington if his investment motivation was the potential of obtaining a strong financial return, why did he invest in an entity whose return (it was intended) would be taxed as trading income, rather than as a capital gain? Although Mr Hannington's answer was "yes" – that he was happy to invest in something whose return was income (rather than capital gain), and so taxed at a much greater marginal rate – his initial reaction to my question did indicate some surprise that his share of Foundation's profits would have been treated as income.

182. I asked Mr Hannington, in the light of the issues identified in Vector's report of 2 April, whether, as an experienced property investment advisor, whether he would advise someone to invest in Project Adriatic, and his response was that he would not have advised the BBC Pension Fund to buy it. Mr Rivett asked him whether – knowing what he now knows - would he have still made the same decision to invest. To which Mr Hannington's response was "I am not sure".

183. Between July 2008 and March 2009, the following individuals were recruited to be the investors (and therefore partners) in Foundation in addition to FDBS, Mr Levy and Mr Hannington. The individuals were: Mr N Andine, Mr D Asthon, Mr G Cook, Mr T Cross, Mr D Crossland, Mr J Dickson, Mr A Goldstein, Mr B Grant, Ms L Hampson, Mr H Kenner, Mr G Mason, Mr A McIntyre, Mr J McIntyre, Mr C Morris, Mr C Newberry, Mr A Oliver-Watkins, Mr S Platts, Mr B Pontifex, Mr A Walters, Mr T Warnholtz, Mr S Waterfield, and Mr A Welham. There was in addition one company that invested in Foundation, being Sir Jacob Behrens & Sons Limited.

184. Some of the investors had experience in property, business, or financial investments.

185. Mr Hannington was, as described above, a former proprietary partner in Knight Frank and was also a director of property companies. Mr Ashton was the largest investor in Foundation and was described by Mr Levy as an experienced businessman, Mr A McIntyre

was a partner with Ernst & Young, Mr J McIntyre was an investment banker, Mr Kenner was the manager of an alternative investment fund, and Mr Newberry was a planning lawyer.

186. Whilst some of the partners may have had business or financial experience, and others may have had some experience of real-estate transactions, I find that none of the partners had any experience of implementing and managing a design and construction project. Only two had direct professional experience of property development in its widest sense: Mr Hannington and Mr Newberry. Although Mr Hannington had advised clients about investing in property development projects, he said that he was not a "building surveyor" and did not, himself, take responsibility for the management and implementation of any construction programmes (his evidence was that when his clients had invested in a property development project, colleagues in the Knight Frank's project management division would have reported to him about the project). Mr Newberry was a planning lawyer, but he was admitted in one of the UK jurisdictions, and the evidence before me was that the planning laws in Montenegro were very different from those in the UK – indeed the evidence before me from Mr Hannington and Mr Levy (which is described below) was that the existence of an "elite" in Montenegro meant that the ways of obtaining consents for development (including planning consents) was very different from that in the UK.

187. The first meeting of the partners attended by Mr Hannington took place telephonically on 30 March 2009. Partnership telephone calls and meetings were then held on a weekly basis. Minutes of some of these meetings, and copies of Mr Hannington's notes were included in the bundles. In his witness statement Mr Hannington says that, as discussed at this meeting, the operating divisions and work streams to be undertaken by the Partnership were subsequently put into place, and Mr Hannington was allocated to the Civils and Construction area. He goes on to say that his appointment to the Civils and Construction business division is detailed in the partnership meeting on 9 April 2009. However, the minutes of the partnership meeting of 9 April set out that Mr Levy and Mr Young are to be the team heads, but do not record beyond that which partners are allocated to which divisions. Mr Hannington, when cross-examined on this point said that he knew he had been allocated to the Civils and Construction stream, but he conceded that did not know when this occurred.

**Cash movements**

188. At "closing" Foundation had raised capital of £10,888,750, of which £1,250,000 had been contributed by Mr Levy.

189. On 2 April 2009 various of the parties provided Barclays Bank PLC with irrevocable instructions:

> (1) BPHS instructed Barclays that it wished to draw down the amount of £30,266,250 from the Barclays facility and instructed Barclays that (a) the sum of £30,266,250 should be credited to an account in the name of BPHS with account number 23661024 and sort code 207898; and that (b) immediately on receipt, the sum of £30,266,250 should be paid to a Barclays account in the name of FDBS with account number 03767825 and sort code 207898;
>
> (2) FDBS instructed Barclays that on receipt of the sum of £30,266,250 in its account number 03767825 sort code 207898 the sum of £30,266,250 should be paid to a Barclays account in the name of Foundation with account number 13020371 and sort code 207898;
>
> (3) Foundation instructed Barclays that on receipt of the sum of £30,266,250 in its account number 13020371 sort code 207898 the sum of £30,266,250 should be paid to

a Barclays account in the name of IPCS with account number 23876713 and sort code 207898;

(4) IPCS instructed Barclays that on receipt of the sum of £30,266,250 in its account number 23876713 sort code 207898 the sum of £30,266,250 should be paid to a Barclays account in the name of BPHS with account number 23661024 and sort code 207898.

190. On 3 April 2009 IPCS presented Foundation with an invoice for the contract sum payable by Foundation under the terms of the Construction Sub-contract in the amount of £37,762,650.96. Foundation was directed (a) to pay the amount of £30,266,250 into a bank account in the name of IPCS with Barclays with account number 23876713 and sort code 207 898; and (b) to pay the amount of £7,496,400.96 into a bank account in the name of IPCS with Barclays with account number 93278212 and sort code 207898.

191. The following cash movements then took place on that same day:

(1) BPHS drew down the amount of £30,266,250 under the Barclays facility which was paid into its Barclays account number 23661024 and sort code 207898;

(2) FDBS drew down the amount of £30,266,250 under the terms of the loan agreement between FDBS and BPHS dated 31 March 2009 which was paid into its Barclays account number 03767825 and sort code 207898;

(3) FDBS paid the amount of £30,266,250 into Foundation's bank account with the number 13020371 sort code 207898 by way of capital contribution under the terms of the Restated and Amended Partnership Deed;

(4) Foundation paid to IPCS the full contract sum due under the terms of the IPCS invoice in respect of the Construction Sub-contract in the amount of £37,762,650.96 of which the sum of £30,266,250 was into a Barclays account in the name of IPCS with account number 23876713 and sort code 207898 and the sum of £7,496,400.96 into a bank account in the name of IPCS with Barclays Bank with account number 93278212 and sort code 207898.

(5) IPCS paid two tranches to BPHS by way of inter-company loan. The first tranche was £30,266,250, and BPHS used these funds to repay the amount it had borrowed from Barclays at the beginning of the day. The second tranche was £7,146,400.96, and BPHS was then in funds to be able to purchase the shares in Lenley.

(6) Foundation paid £2,367,750 to FCP, of which £350,000 was treated as a loan to Future Design, and the balance was in respect of payments due under the Takeover Agreement (£605,325) and the Consultancy Agreement (£1,412,425). No explanation was given as to why amounts due to Future Design (such as the consultancy agreement fee or the loan) were paid to FCP.

192. At the end of the day all the funds that had been borrowed by BPHS from Barclays had been repaid, leaving inter-company loans outstanding between FDBS and BPHS, and between BPHS and IPCS. In addition, FDBS had contributed £30,266,250 by way of capital to Foundation.

193. In addition to the amounts paid to IPCS by Foundation, Foundation also paid £605,325 under the Takeover Agreement, and £1,412,425 under the Partnership Consultancy Agreement.

## On and after 5 April

194. Other than attending the partnership meetings described previously, none of the individual partners undertook any work for Foundation before 5 April 2009.

195. On 26 April 2009 Mr Nghi emails Mr Young about the model he is preparing for the future financial arrangements for the project, and he sends Mr Young a draft of an email that he proposes to send Mr Harrison. It is apparent from his message that Mr Nghi is struggling with the preparation of the model:

> My working the model is just taking too long and is probably best to sit with him [Mr Harrison] to discuss and let him work the spreadsheet. The main problem I am encountering is on a conceptual level. You mentioned that we cannot do two different models (ie one for the accounting and one for commercial) but rather prepare a commercial model and implement the appropriate risk weighting.
>
> However Gavin [Harrison] model thus far does use the low sell range for flats to work out the projected income and loss for the first year.
>
> Also, I have no idea where the anticipated hotel revenue figures come from – was this something provided by La Cite? Also it appears to stop after 10 years. We will need yrs 11 to 30 to fully comprehend the NPV. To me they seem very high and I can't sensibly work the COC to where we need to be.

196. He goes on to note (in his draft email to Mr Harrison):

> The apartments will be luxury apartments geared towards the top end of the market. In this regard the CBRE report indicates a likely sale range between 8000 -10,000/sq m. There is also the low case around €2000 sqm but also at this stage, CBRE says that the current market is not active at all – zero sales prices.
>
> […]
>
> [Foundation] will be entitled to 90% of the total income from the sale of the apartments. HOWEVER this is based on the total project build cost. If you recall [Foundation] only funded £40m of build cost in this raise. Total build cost is a fluid number. Where we are today, given that we are doing a smaller project, total build cost for both the hotel and the apartments is going to be around £110m-120m (ie 70m for hotel and 40-50m for apartments) without any contingency. If you recall we were building 80000sqm in total, now it is only 40000sqm. Using current metric of total raise of £10m, we yielded €6.75m (ie circa £6m) to the developer. Therefore, we may need total build cost to be around £140m-£150m to yield the developer the total €28m.

197. It is worth noting that on 1 April 2009 (the date on which the construction agreements were signed), Mr Smith (a sales manager at FCP) emails a Mr Sherlock at Ernst & Young about one of his clients who is interested in investing in Project Adriatic, notifying him that there will be a second tranche of funding that will be closed in September. This further round of fundraising was also mentioned in a letter that Foundation sent to its investors on 8 April 2009:

> I am pleased to inform you that subsequent to our last Partnership meeting, where we detailed the various agreements, that we financially closed our arrangements with the Developer and Construction Services Company on Thursday last week. Thus we are officially in business! In the final reckoning we raised capital of £40,355,000 for our business and paid £37,762,650 to the Construction Services Company under the Construction

> Subcontract. This was lower than anticipated as some prospective Members did not realise income or gains they had anticipated and thus had to scale back their commitments to the business. As a result, Future has approached the Developer to propose that a further Partnership be formed, to undertake a similar trade, with the intention of financially closing similar agreements (in order to co venture with Foundation) by the end of September 2009. This Partnership will be known as Opus Design and Build Partners. Please let us know if you are interested in also becoming a Member of that Partnership.

198. The evidence before me was that there were several further rounds of funding for Project Adriatic – but all of the additional funding was introduced into the project through "parallel" structures – none of the further funding was introduced through Foundation.

199. On 5 April, Atlas telephoned Peter Young to tell him that they had received consent for 17 floors. But as the €28 million originally agreed as payment for the site was not available, it was proposed that €7 million would be deposited for a 7/28th interest in Lenley – with the balance of €21 million to be paid in September 2009.

200. On 7 April 2009, Mr Bacon of Vector emails Mr Young to say that there is "still no clarity on 11 levels let alone 17. There is still a possibility that there may be a revised Planning drawing with the 11 levels shown but nothing in the text."

201. On 9 April 2009, there is a meeting of the Foundation partners. The minutes record that PY (Mr Young) reported that Foundation "financially closed" on 2 April 2009, with "just over £40 million having incurred to the Construction Service Company and key Partnership Advisory fees". One of the partners questioned the final raise "as it was expected to be significantly higher". Mr Young responds by saying that the "raise did not cause any issues to the Partnership, in particular, in respect of the expenditure incurred to the Construction Services Company. The cost incurred represented a scalable commercial arrangement and moreover the Partnership's interest in the underlying commercial arrangement had not been diluted." Mr Young also reported that "the design and planning of the project had been progressing over the last month. The initial drawings competition for the complex plans had now closed and the Partnership had been advised that the 17 floor development is likely to be approved."

202. This last comment by Mr Young is peculiar, particularly in the light of Vector's report (and the associated emails) that was sent to him on 2 April, and the subsequent email on 7 April.

203. On 21 April 2009, Mr Bacon of Vector emails Mr Young to say that he has a detailed report in Serbian regarding the soil on the site. In summary, the report states that the soil is variable and will need to be piled, and it will be important to establish just where consistent bearing strata can be found – the strata can best be explained as an irregular staircase dropping down towards the sea. Mr Bacon says that he is reluctant to issue the report to Foundation until his own engineers have interpreted it, as he is concerned that the Foundation partners will get their friends to review it and "it will probably set a whole process moving before we can respond".

204. On 22 April 2009, Atlas agreed to a variation in the Master Agreement for the acquisition of the land to reflect the agreement reached on the changes in the payment dates. On 29 April 2009 BPHS acquires 24.1% of the Lenley shares (carrying 50% of the voting rights). The Master Agreement is further amended on 11 December 2009. It is only on 31 July 2012 that BPHS acquires the balance of the Lenley shares and complete (indirect) ownership of the site.

### Introduction of Manly as development manager

205. In June 2009, Manly were engaged as development managers.

206. Mr McGovern was introduced to Project Adriatic in early 2009 by Mr Comyn of Savills. Mr McGovern knew Mr Comyn professionally prior to his involvement with Project Adriatic. Mr McGovern was invited to join a trip to Montenegro in 2009 (prior to being formally instructed) – Mr McGovern's evidence was that this trip was after the April "closing", but before writing Manly's fee proposal dated 22 June 2009. Mr McGovern understood that the primary role of Manly (at least initially) was to take forward the "Detailed Planning Application" for the project. Manly's Development Status Report dated 17 July 2009 describes their key role as being to

> develop and coordinate the professional team to generate the emergence of a coherent real estate strategy which comfortably allows and enhances the co-existence of the Trade Fair, the hotel and the residential apartments. This will include acting as the design interface for all three elements of the development to ensure the following issues are addressed:
>
> - Architectural language across the three built forms
> - Public realm/space across entire land parcel
> - Coherent and workable car parking strategy – given different peaks and troughs of parking patterns across the three building usages
> - Underground servicing i.e. refuse, deliveries etc.
> - Coherent fire strategy for entire site
> - Potential economies of scale logic. E.g. excavate entire site to 2 levels and produce one common deck for the three superstructures
> - Agree timetable for informal liaison with Planning Authority and ultimate formal planning submission
> - Assist with the progressive financial modelling of the residential units. This would particularly centre on sales revenues less construction costs etc.

207. Manly's first action following their appointment in June 2009 was to select a firm of architects to act as lead designer. Five architectural practices were shortlisted and invited to an interview. The briefing paper provided to the shortlisted practices stated that

> The chosen designer will need to work closely with the hotel and trade centre designers in order to co-ordinate interfaces at podium level if appropriate and to establish a complementary design aesthetic which will deliver a comprehensive high-quality development.

208. Originally, the appointed architects were to design just the residential part of the development – and it was assumed that whoever was appointed to operate the hotel (envisaged to be InterContinental because of their relationship with La Cite) would be responsible for the design of the hotel part – notwithstanding the fact that Foundation's construction agreement with BAD was to build both the residential and hotel elements. Mr McGovern's evidence was that there was no possibility of the residential accommodation being built without the hotel – and there had to be an interface with the trade fair, because of the common basement and services.

209. However, within a relatively short period (around 6 months according to Mr McGovern) the brief of the chosen architects (Jacobs Webber) was extended to the hotel part as well. Mr McGovern's evidence was that it quickly became obvious that the operational

needs of InterContinental could not be met – not only in relation to their requirements for the height of the hotel (17 storeys), but also their "individual product requirements" for their rooms (having taken account of what Manly considered could be obtained as a rack rate for the hotel). Mr McGovern described a progressive level of disenchantment between Mr Levy's team and La Cite, which led to substantive discussions with other hotel operators, such as Wyndham Group and Swissôtel.

210. In addition to selecting the lead design firm, Manly recommended the appointment of Arup as the structural engineers. Manly's 17 July 2009 report stated that:

> Montenegro is a seismically active area and it is therefore imperative to retain a suitably qualified structural engineer at concept stage.

211. Mr McGovern was asked about both ORMS and Vector. Mr McGovern describe ORMS as "concept architects" who produce "early doors concepts" but that other people then have to be engaged to try to make those concepts work. Mr McGovern's evidence was that ORMS had "little visibility" once Manly had been appointed. And Vector's continuing engagement did not last long after Manly's appointment.

212. The appointment of Jacobs Webber and of Arup is mentioned in Manly's July 2009 report. The report also refers to the need to make other professional appointments in due course. The report briefly mentions that Savills are producing a development feasibility report and are progressing with the geotechnical survey. Mr McGovern's evidence was that Savills would not have had oversight of the geotechnical survey, but they had made recommendations about possible local contractors – Mr McGovern said:

> It's important to understand that, whatever that work was, the ultimate brief for that work would have been written by Arups out of Belgrade because they can only inform their design by setting certain criteria for that geotechnical survey in terms of how many boreholes, to what depth, what diameter, and so on. So this survey work would only ever have been paid for and commissioned when it had been signed off by Arups because they are the principal recipient of the data that would come out of the survey.

213. Although some boreholes had been dug under the supervision of Vector, the geotechnical survey was not completed until the early part of 2010. Mr McGovern recalled that because Atlas's permission was required for access to the old trade fair building (at a time when there was no exhibition happening) to get in the drilling rigs to do the boreholes, the geotechnical survey was not completed until Spring 2010.

214. And Mr McGovern's evidence was that there was uncertainty as to the height that could be achieved:

> I think that there was a certain nervousness on behalf of Arups, who were led by a lady who was a world-renowned expert in her field in Belgrade in dealing with these things. But overall Arups felt it was within the realms of their engineering capability and also physical execution that the work could be done to support an 11-storey plus hotel and residential block.
>
> Q. An 11-storey.
>
> A. At that stage, yes.
>
> Q. But no higher.
>
> A. Well, I'm not going to be categoric about whether the scope was there, but I believe the initial brief would have been to that level, initially.
>
> Q. And presumably with that you would still have required some significant amount of piling.

> […]
>
> A. Yes, there's all sorts of different technologies in use, but it's not just the question whether it's friction piling, it's how many piles, what diameter and what depth that determines the overall cost.

215. I note that Mr McGovern's recollection was that Arup's initial brief was for an 11-storey building, and not a 17-storey building.

216. In addition to the appointment of Jacobs Webber as lead designers and Arup as structural engineers, Manly were also responsible for the appointment of:

(i) Mechanical, electrical, and plumbing engineers

(ii) Cost consultants

(iii) Construction managers

(iv) Property lawyers

(v) Environmental impact specialists

(vi) Traffic and highways consultants

(vii) Marine specialist

(viii) Cladding specialist

(ix) Marketing vision consultants

(x) Planning specialists.

217. Mr McGovern described each of these appointments being with leaders in their fields. Manly would make recommendations to FCP as to whom to appoint, and FCP invariably accepted Manly's recommendation.

218. In February 2010, for budgeting purposes Manly produced a projected cashflow for the professional fees to be incurred in obtaining preliminary design approval. This amounted to £1.8m in total. Mr McGovern's evidence was that none of the work required to produce this budget had been previously undertaken.

219. In the summer of 2010, Mace were brought on board to provide what Mr McGovern described as "cost and project management advice - buildability".

220. Mr McGovern had worked with Mace on previous projects, and they had been the primary contractor for the delivery of Porto Montenegro, and therefore had considerable experience of delivering high quality projects in the region. Mr McGovern's evidence was that no detailed assessment of the construction costs had been undertaken prior to Mace's involvement.

> Q. Was that the first time that someone has tried to make a detailed assessment?
>
> A. To the best of my knowledge, yes, and don't forget that had the validity, because there had been some detailed design done. We talked earlier about when do you put initial cost per square metre against something, you move away from cost per square metre and you get into the granular detail of actually measuring the elements and a more intelligent estimate is then produced.
>
> Q. Just in terms of your experience in terms of the building industry, presumably it would be standard practice if you are going to agree to a fixed

> price as contractor to do that detailed costing before you commit, rather than a price per square metre.
>
> A. Correct.
>
> […]
>
> JUDGE ALEKSANDER: We heard from Mr Levy about the price in the original construction contract, which is a very precise price, and he said that was based on work that Vector had done. Had you seen any of that?
>
> A. No. I mean—
>
> Q. Had you reviewed any of Vector's work before?
>
> A. Hardly any that I can recall, and I would have remembered any detailed costings, because I am a quantity surveyor myself by background, and it would have been a natural curiosity to me. And it would have become an initial benchmark that I would have challenged as to its accuracy. And then compared it with the emerging cost plan from Mace, and that did not happen.

221. Mr McGovern's evidence was that it was standard practice in the construction industry for a contractor only to agree to a fixed price after having undertaken a detailed costing exercise – and not to agree to a fixed cost contract based on an estimate of cost based on a price per square metre.

222. Manly did not have an office in Montenegro, and therefore worked closely with a local firm – Art Projekt – in the preparation of the application. Although not dated, the receipt of the planning authority is dated 3 August 2011, so the preliminary application would have been submitted shortly before then – probably in July 2011. The preliminary application had to be reviewed and approved by the JU Institute. The JU Institute is part of the University of Montenegro and was engaged by the Montenegro planning authorities to review and vet all planning applications against the technical requirements of the country's planning laws. The JU Institute's certificate (confirming that the preliminary application conforms to the technical requirements of Montenegrin planning laws) was dated 30 December 2011. However, this certificate did not authorise the commencement of construction work. Before the development could start, various prescribed conditions had to be met and a building permit had to be issued by the relevant Montenegrin ministry.

223. Mr McGovern's evidence was that the requirement in the Budva DUP that limited the height of new buildings

> were pretty hard and fast and, frankly, […] they were lower than we were seeking to ultimately obtain consent for. However, there was, as there often is, a conflict between the purity of planning objectives and the wider commercial needs of the country. And I witnessed myself first-hand the business agenda of wanting to […] regenerate and bring a town like Budva on, versus the somewhat more modest aspirations of the DUP.
>
> […]
>
> To put it mildly, we were testing the envelope of the DUP in submitting what we submitted, but it received the validation it did ultimately, two and a half years later from when we started.

224. One of the reasons for the height limitation in the DUP was because Budva was in a seismic zone, and buildings higher than 11 storeys were without precedent in Montenegro. And the seismic activity had an impact on the design of the building. Mr McGovern's evidence was that there was an obvious impact on the piling needed to support the building:

> Well piling is the obvious one, but in addition there were other things that we had to do in terms of expansion joints throughout the building to allow a level of movement should there be, one hopes, only modest seismic tremors. So, the influence of the seismic area was not just confined to the piling; it had an impact on the way in which the rest of the design would develop, for example it has become more typical now to put toilet pods into schemes where you have bathrooms made up and you literally put them onto site – what we call "Plug-and-play", they're ready to go. That was not considered to be a good idea here, because you're just going to get a little movement and there is no tolerance in those pods. So, we had to go back ironically to traditional construction which would allow a little bit of play as you move up through the building.

225. Mr McGovern also commented on the state of Budva's infrastructure:

> Again, you are talking about Budva as a town, it increases 10 or 15-fold in the summer in terms of the number of people there, and the infrastructure could not cope and there were contributions that we would have to get into to the main drains and IT and so on, in terms of substantial infrastructure upgrade, because the town as it existed could not cope with that. And that had to be addressed in the application too.

226. The preliminary application is a substantial document, of about 150 pages. The evidence was that Manly were given a budget of about €5 million to obtain the necessary consents, of which €3 million was spent on professional fees of some 25 firms of specialist consultants, including architects, engineers, environmental specialists, and other consultants (including Manly) engaged in the design of the building.

**INVOLVEMENT OF INVESTORS**

227. A large part of Mr Hannington's witness statement and oral evidence related to his involvement in Project Adriatic after 5 April 2009.

228. At some point in early April, the partners in Foundation Partners were divided between individual business streams based on any relevant expertise they might have. Foundation rented premises at 28 Grosvenor Street, London W1K 4QR and engaged administrative staff. Their involvement in Foundation's activities (other than attending the first few partners' meetings) occurred after 5 April 2009 and was therefore after the tax year under appeal.

229. The investors met (mainly on conference telephone calls) on a regular basis. To begin with, telephone conference calls with all partners were held on Monday afternoons and additional business unit calls were held on Thursdays and Fridays. The minutes of the meetings and calls held between April and October 2009 suggest that the partners were involved in a wide range of activity in relation to Project Adriatic.

230. Mr Hannington was asked about the work undertaken by the partners:

> Q. So quite a lot of the work the partners were doing in terms of their timesheet commitments were participating in those calls, as it were, in addition to some trips as well. But the weekly calls were a major element of—
>
> A. Well the weekly calls were requiring the partners to make decisions. So, the whole purpose of the call was to talk about what had happened in the preceding week and update partners and ask whether there were any changes, or you know what was required, which was, you know, pretty onerous actually.
>
> Q. But when it actually came to doing substantive work, doing reports, doing surveys, or anything like that, that was all outsourced, as we have heard.

> A. Absolutely. The partners were involved in selecting some of those consultants. […]
>
> Q. Leaving aside labels of trade, which are not a matter for me to talk to you about, but what I would suggest is that what you were doing could just have well have happened if this was an investment opportunity, because people who invest and just want someone else to get on with it no doubt are very careful in terms of the due diligence they do. People do not just throw their money away at projects.
>
> A. Correct.
>
> Q. And they will interview, and they will spend a lot of their time. But it does not necessarily mean in this instance for example that they are actually actively doing something which changes on a week- week basis. This was long-term planning for equity which you were putting in, is it not?
>
> A. I think your point about investments and developments is an interesting one, because if there is an investment and it is let for 30 years with 5-year rent reviews there's not much to do unless the tenant stops paying the rent. Here it was completely different. I mean here there were daily decisions being made as to what should be done in this far-off development. And as Mr McGovern described it, it was third world. A lot of stuff was being done around the edge of that which was very valuable.

231. In addition to the regular meetings, there were also occasional visits by the individual investors to Montenegro. Mr Hannington referred, in the course of his evidence, to various trips he made to Montenegro and to attending various meetings whilst he was there. Mr McGovern in his evidence stated that during the time that he was involved with Project Adriatic, he made around twenty trips to Montenegro. He distinguished between the trips that were "totally professional", and others made with some of the individual investors, which he agreed were "a mixture of business and pleasure".

232. But Mr McGovern was not impressed with the work done by the partners, and it is clear from his evidence that in essence, he started the project work again – largely discarding any work previously undertaken either by the previous professional team (such as Vector), or the individual partners. When he was asked about the extent to which any of the work his firm was undertaking – such as the appointment of specialist consultants – had been undertaken prior to Manly's appointment, his answer was "Absolutely not." As regards to the involvement of the partners with the appointment of the professional team Mr McGovern said:

> Q. So, you didn't just leave it to the partners to try and make do?
>
> A. No chance.
>
> Q. And why was that?
>
> A. Um, too many cooks. You know, there were some robust discussions, you know, principally around the architect, I remember, which was fair enough, because that was about setting the vision and the tone. But I wouldn't expect one of the partners to be advising us on who they thought the best cladding specialist should be.

233. Manly reported on a weekly basis to the investors, but Mr McGovern's evidence was that in terms of the decision makers - the persons from whom he took instructions, and to whom he was accountable:

> […] we were going into one place and dealing with one person, primarily Peter [Young] but also Tim [Levy] as well.

234. In the light of Mr McGovern's evidence, I find that whilst the investors may have been interested in how Project Adriatic was progressing, any work undertaken by the investors was predominantly "make-work", and something of a "fifth wheel" on a car – undertaken primarily for the purpose of seeking to avoid the limitation on loss relief imposed by Finance Act 2008, by demonstrating that the investor was spending at least ten hours per week working in the business for whose losses he (or she) seeks tax relief.

235. In relation to the work of the previous professional advisors, Mr McGovern's evidence was that he recalled having a couple of meetings with Vector, but he did not recall receiving anything substantive from them that would represent a "kicking off point" for the project. He described ORMS as a firm producing "early doors concepts" which other people then have to try to make work. They had done some initial work for Vector but had "little visibility" after Manly's appointment.

236. In 2011 Foundation was "converted" into a limited liability partnership incorporated under English law. Mr Hannington's evidence was that this was done at his suggestion. But I find that it was always the intention of Mr Levy that Foundation be converted into an LLP, as a conversion from unincorporated partnership to LLP had formed part of the structure planned for the Shard. There is also a reference to the conversion of the partnership into an LLP in the email Mr Levy circulates to his sales team on 16 March 2009 and in the Investment Appraisal of 18 March 2009.

237. Mr Hannington was asked about the conversion of Foundation into an LLP, and Mr Hannington discussed the conversion of Knight Frank from a common law partnership into an LLP:

> It may be my fault that [Foundation] became an LLP. Knight Frank had been an unlimited liability partnership since its inception nearly 100 years before, and it was a time when you could do the transfers into an LLP from an unlimited liability partnership. And KPMG came along and spoke to us as the partners, there were only about 25 of us, and explained why it was a good thing to be an LLP in terms of future liabilities. […] And the only disadvantage appeared to be that you had to tell somebody what you earned.
>
> […]
>
> MR YATES: I think you are probably flattering yourself, because the idea of incorporating the partnership into an LLP was being bandied around well before you were a partner.
>
> A. But we were working here in an ex-warzone, this development. [Mr McGovern] spoke about it just now. And so, there were sort of risks that we couldn't perhaps conceive that might arise, which we thought would be a good way to protect ourselves from it, and I don't think anyone had really thought about it before.
>
> Q. So, I mean, the odd thing is that all that was clear before you all signed up, but you all signed up merrily as an unlimited partnership and, for reasons I have explored with Mr Levy, that seems to be purely for tax reasons, and then once the tax requirements were satisfied, it was thought it would be a jolly good idea to become an LLP and then limit your liability for the reasons we have already discussed?
>
> A. Well, that wasn't how I recall it.
>
> Q. No.
>
> A. And, indeed, the transfer idea was certainly mine.
>
> Q. The transfer to the LLP?

> A. Yes. […] Because of the experience that I'd had at Knight Frank.
>
> Q. But all of the promotional material we have had, before you came on board, was already highlighting this possibility, Mr Hannington, but we can go to that.
>
> A. Well, I don't recall it being a particular issue, but that's why we did it.

**SUBSEQUENTLY**

238. In 2012 BPHS completed the acquisition of the balance of Lenley's share capital that it did not already own. As at the hearing date, Piraeus's security interest continues to be in place (albeit now in respect of a much-reduced debt balance of €3.1m).

239. On 14 October 2013 FDBS and BPHS entered into a "Deed of Rectification" which purported to rectify the interest rate set out in the loan facility of 31 March 2009. The deed recites that the interest rate of 5.1% per annum set out in the 31 March 2009 facility letter did not reflect the "true agreement" reached between the parties. The deed goes on the rectify and amend the interest rate to 1% with effect from 31 March 2009 and gives FDBS the facility of compounding any interest due (rather than having to pay interest as it arises). Mr Yates questioned Mr Levy as to whether there was an error in the original agreement:

> Q. Now, the Revenue don't accept that there was an error in relation to the first agreement. What we would suggest is that this was essentially, the interest rate originally agreed was found to be problematic and it was thought convenient to attempt to retrospectively alter it to a lower rate. Why would Future want to do that?
>
> A. Well, HMRC can have its view, which it is perfectly entitled to. Again, in reviewing my emails I tried to look at the history of this. My recollection is when we were gathering all of the documentation to submit to HMRC as part of our responses to their inquiry, it became evident to me that there had been an error in these documents, and it didn't reflect what was intended to happen at the time. This is my recollection of what happened in 2013 when this amendment was entered into. And obviously that at that time was based on my recollection of events in 2009. There's nothing more to say than that.

240. I do not believe Mr Levy when he says that there was an error in the original agreement. There is nothing in the documentary evidence which indicates that FDBS and BPHS intended that a rate of 1% was to be charged. I agree with Mr Yates submission, and find, that the original interest rate was found to be problematic, and the purported "rectification" was perceived to be a convenient way of reducing the rate retrospectively.

241. In mid-2017 BPHS commenced negotiations with a Turkish consortium to finance Project Adriatic – however the basis on which revenues from the project will be split have yet to be agreed.

242. The DUP has become a significant issue in the politics of the Budva municipality. Following municipal elections in 2018, there are two main parties represented in the municipal government. The political parties representing the majority of the local council (including the mayor) support further real estate development in Budva. However, the minority party wants to cancel the DUP, which would mean that no construction development could occur in Budva. The municipal architect is drawn from the minority party, and objects to the grant of the final concept design approval ("CDA") for Project Adriatic – being the last stage of the planning process requiring approval by the municipality. An application for CDA was made in September 2018 and refused in June 2019. The application was resubmitted in September 2019 to take account of the municipal architect's objections (for example to make the facades more "Mediterranean looking"), and a further rejection was issued on 11

November 2019. However, following a successful appeal against the decision of the municipal architect, the CDA was finally awarded on 25 December 2019 – over ten years from the date on which Foundation entered into the Principal Construction Contract and the Construction Sub-contract.

243. This story does not have a happy ending. On 22 October 2019, Cocoon Wealth Management LLP ("Cocoon"- an entity controlled by Mr Levy) wrote to all the partners in Foundation to state that on 5 April 2020, with the expiry of the Cocoon service agreement, it will terminate its services, and the services of the designated members of the LLP that succeeded to Foundation. In consequence, the investors would themselves become responsible for the administration of the LLP. Cocoon informed the investors that there is no ongoing benefit in remaining a partner as the debt burden of the entity owning the site is such that it is entirely unrealistic to expect there to be any surplus profit available to be distributed to investors. To allow the individuals to exit the LLP in an orderly manner, Cocoon offered to acquire the interests of partners who wished to leave – charging a fee of 2.5% of the partner's investment (subject to a minimum of £1000, plus VAT).

244. Mr Levy was asked whether this illustrated the foolhardiness of committing the Foundation irrevocably to pay money without having any control or any certainty as to what other third parties, including the landowner, will do?

> A. With the benefit of hindsight, it certainly looks like it was a project which was very risky and where there are a lot of things that could go wrong, and some of them indeed did, but that is with the benefit of hindsight.
>
> Q. Sure, but obviously businessmen take risks, but they also try their utmost to reduce risks, and one cannot foresee how, for example, the buying market will behave in relation to an offering, but one can hold off for example, committing to an irrevocable payment until you are ready to do so - that type of risk, I would suggest, is a controllable risk and one which the partnership chose not to control?
>
> A. We understood it to be a risky project. The partnership and the partners understood it to be a risky project, and there was an appetite to assume that risk in large part because of the potential upside and in large part because of the way the transaction had been structured for tax purposes, and the downside protection that partners were anticipating from the tax treatment of the transaction.

**COMMERCIALITY**

245. Mr Levy was cross examined about the commercial purpose of Foundation – given that the financing "just gets washed through a variety of Future entities and [Foundation] does not serve any commercial purpose whatsoever." Mr Levy's response was:

> A. We came into a project where there were other parties involved, and those parties certainly in the early days of discussions we thought were going to put up the equity and debt required to finance the construction of the hotel and any equity required to construct the residences. So, my thought process at the time, if I cast myself back to that, was that we needed to be able to fund the land acquisition, and the land acquisition give or take ended up being somewhere close to that £25 million figure, as you know. So what I thought that commercial structure achieved was it allowed the developer to fund the acquisition of the land, and it allowed the intercompany loans, or should have allowed the intercompany loans from Integrated to BPHS to have been repaid by the funding which La Cite and originally Shedlin were expected to put in. So essentially it was a way of funding an extremely high-risk project where there were other partners in place to provide the balance

of the funding. So, I would say it served a very commercial purpose, which is to allow the development actually to go ahead by using the knowledge that we had about structuring in a UK tax environment to put in very risky money into a very risky project, but a project where we thought there were very attractive returns to be made.

Q. With respect, Mr Levy, it did not allow anything to happen, because it was back in Barclays Bank by the end of the day. All it did was set up a series of indebtedness as between Future companies as controlled entirely by you.

A. No. As you have already accepted, not all of the money went to Barclays Bank. Only that money which had been loaned to BPHS and onwards to Foundation Design and Build ended up back in Barclays.

Q. Let us just focus on that money, because that is what I am talking about at the moment. What commercial purpose did that money have if it is not being loaned to anyone?

A. Well the commercial purpose that money had was that that allowed our structure to work. And our structure was designed around using tax as a risk mitigation technique for investors. And I think we've always accepted that that has been a key part of the structure.

Q. I could put it another way, Mr Levy, and I do not think we are actually at cross-purposes now. If for some reason the UK had a more generous tax loss relief regime, there would not have been any need to have this loan at all. It was purely there for tax purposes and to raise money from the partners.

A. No, there were commercial purposes as well. Obviously, Foundation Design and Build, as you rightly say, had a significant interest in the Partnership, and stood to make significant money from its interest in the Partnership, which it then would have had to use to repay BPHS, which was owned in the Future Group. So, there was a commercial purpose for Future in that structure, in that there may have been profits that it could have made through that methodology of structuring.

Q. But if I were one of these partners […] I see this other party coming into my partnership and they are offering to contribute money which the Partnership cannot ever use because it has to go back to Barclays. I can quite see why from your personal point of view it is a great way of essentially sucking profits out of the Partnership, because you get to have 25 and then 75 per cent. But leaving aside Futures' economic interest, in terms of what is actually going on with this project and the trade the Partnership is actually trying to carry on, it does not really have any commercial function. It has two functions. It allows the partners to have larger than otherwise claims for tax relief and, secondly, if there is a commercial success it allows those profits to go to Future.

A. There may have been other ways that the Partnership could have been structured, but in the tax environment that existed at the time to achieve the commercial purposes that we wanted, then we viewed it as the optimal structure.

246. Mr Levy was also asked why BPHS acquired the shares in Lenley, and not Foundation:

Q. So [BPHS] was going to acquire some of the shares in Lenley. […] What was the logic of that? Surely it would have made more sense for the Partnership to acquire the land and then do the development like a conventional property developer.

> A. Going back to the point I made earlier, we had the structure that we had. We developed it from the Shard. The Shard was the same principle. We wouldn't have owned any real estate in the Shard transaction, and it suited our financing approach and our risk management techniques to structure the deal in the way that we did.
>
> Q. Can I suggest that the reason why you did not want to acquire the land is that it would have been a lot harder to write-off all the value of the land on day one in comparison to the onerous contract which we see arises in relation to Integrated.
>
> A. That may well have been a point. There may well have been other points as well.
>
> Q. Not to spoil the surprise, but what I am going to be suggesting is that what happens here is that you have a property development venture arguably which then gets distorted to carve out the land so as to maximise tax losses for the partners. Would you like to comment on that? That is the case, is it not?
>
> A. Certainly the structure was designed so as to be as tax efficient as we could make it within the confines the law as it stood at that time, and as you know we took significant advice both from accountants and lawyers and a tax QC. So yes, it was meant to be very tax efficient. Yes, it was meant to protect investors about downside commercial risk. Yes, it was meant to make it more attractive and yes, the idea was that it would encourage investors to take risks they otherwise would not take. All of the above are true.

247. In his witness statement, Mr Levy says after the construction agreements had been signed, Mr Young identified that there was a "flaw" in the contracts – namely a mismatch between the contract sum paid by Foundation to IPCS under the Construction Sub-contract and the anticipated cost of the works to which Foundation had committed under the Principal Construction Contract – which Mr Levy said was expected at the time to be more than €100m. But because Foundation had not been able to raise sufficient funds to be able to commit to the full expected costs of the development, the contract sum in the Principal Construction Contract "should have reflected the proportionate cost commitment for the completion of the works". Mr Levy explains that this "error" arose because Foundation had originally expected to raise £100m, and the construction agreements were drafted on this basis.

248. During cross-examination, Mr Levy was asked to explain the nature of the flaw: in essence, if Foundation had raised £25m as originally anticipated, the Principal Construction Contract would have been signed as drafted. But because Foundation had only raised 40% of that amount, the contract needed to be adjusted. Mr Levy was asked about the adjustment that should have been made to the contract.

> Q. But what we are having to consider is, as at the date of this contract, what is the partnership doing? I suggest it is absurd that it is purporting to build 40 per cent of the hotel. In reality what it is doing is agreeing to fund 40 per cent of the hotel at this stage, or 40 per cent of the project, because you cannot agree to part-build something, logically.
>
> […]
>
> A. I think I leave that to the tax and legal analysis. I am really here just as a witness of fact to explain what was going on at the time and trying to do that to the best of my ability.

249. The Principal Construction Contract was never "adjusted" to reflect the fact that Foundation only raised 40% of its original target. Indeed, it is difficult to imagine how it could have been adjusted – it is not as if Foundation (as contractor) could have committed to construct just 40% of the hotel and the apartments, and then stop when its money ran out. In reality, all it could do was commit to funding 40% of the construction costs.

250. Mr Levy referred in his evidence to a discussion with Mr Young about the options open to Foundation to address this "flaw" – and two were considered. The first was that Foundation raise additional capital from a further "closing", which would have the effect of introducing new partners into the partnership. This option was problematic, as there would be conflicts between the partners depending upon when they introduced capital into the partnership, and each partner would have different profit-sharing entitlements for different periods. The second option (which was eventually adopted) was to create additional "parallel" partnerships, which would raise capital themselves, and enter into co-venture agreements with Foundation. But this is to look to the future (at least as far as the issues that need to be considered in this decision are concerned). For the purposes of this decision, I need to consider the obligations of Foundation under the Principal Construction Contract from its execution until the time that Foundation wrote-off the value of work-in-progress. And these obligations were to design and build the entire development project (hotel and condominium apartments), even though it had raised only 40% of its target fundraising. And at that point in time, the prospect of additional "parallel" partnerships was something of a hope.

251. Indeed, as Mr Levy acknowledged during his evidence, on 3 and on 5 April 2009, after the contracts were concluded, IPCS was in no position to fulfil its obligations to Foundation to build out the project, and Foundation must have known this (given Mr Levy's role as managing partner of Foundation and as a deputy executive director of IPCS):

> Q. But if we are going to treat the partnership as a commercial entity, which, as you know, the Revenue do not accept, standing at the end of the tax year, it was contracting with an SPV, which it knew was going to pay all the money out for other purposes ...
>
> A. Most of the money.
>
> Q. Let's not quibble. Let's say 95%, okay? On no view did it have the funds to build the hotel and whilst there may have been all sorts of warm noises by other parties about committing, no-one else had committed to fund [IPCS], had they, or indeed inject capital into any other entity in this chain?
>
> A. That is all fair comment.
>
> Q. So, what the partnership was doing was irrevocably committing to pay the sum of money under the subcontract, knowing full well that [IPCS] could not build the hotel and with no comfort that there would be any other source of funding?
>
> A. Knowing full well that it required additional funding to allow the build to go ahead, yes.
>
> Q. And if the build could not go ahead, it would not get its money back at all?
>
> A. That's correct. I mean, I'm not a lawyer, again I don't know if it could sue for non-performance, but obviously IPCS would have little in the way of assets against which to enforce.

252. Of course, subsequently additional funds were raised by IPCS to be able to continue to fund the project. But at the end of the 2008/09 tax year, Foundation had contracted with IPCS

to undertake the construction of Project Adriatic in circumstances where it was aware that IPCS had paid out virtually all of its money for other purposes.

253. In the period since the signing of the Construction Sub-contract, IPCS (with its parent BPHS) have engaged the services of over 25 different consultants and contractors (including Manly) and have expended approximately €10m on these services.

254. One of the themes in Mr Levy's and Mr Hannington's evidence was that doing business in Montenegro was not like doing business in the UK. Mr Levy described it as being ruled by "an elite" – and that Atlas was the largest business in Montenegro and was close to – if not part of – that elite:

> An elite – a small number of individuals who essentially controlled everything in the country, whether we like that or not. And it didn't work the way that necessarily the professional advisers advised us that things worked. The professional advisers were all professional firms who were very competent at what they did, and they advised on things as they saw them. My understanding of the way that Montenegro worked was quite different from the way that the professional advisers were advising us. Peter [Young] was a prudent individual. The professional advisers were prudent individuals, and they were giving us advice as they saw things. I had to take into account what I understood to be the case at a far more subtle and complex level as regards the way things worked in Montenegro. So, there was a distinction between the way Peter might have seen things and the way I might have seen things. And Peter might not have always got that.

And because of their view of the way in which the elite worked, because of the desire of the federal government to encourage tourism, and because Atlas was heavily incentivised under the terms of the Master Agreement to facilitate the grant of planning consent for a 17-storey building, both Mr Levy and Mr Hannington were confident that planning consent would be granted for a 17-storey building, irrespective of the views of the local Budva municipality, and irrespective of terms of the DUP. And it turns out that their confidence may not have been entirely misplaced, as the CDA was eventually granted on 25 December 2019 – although not for the project as originally envisaged, more than ten years after the construction agreements were signed, and in circumstances where it seems highly likely that the investors in Foundation will have lost the entirety of their investment.

255. But even if Mr Levy's and Mr Hannington's view about the Montenegrin elite turned out to be correct, the difficulty with this line of argument is that, irrespective of the influence of the elite on the operation of Montenegro's planning laws, following the geotechnical survey in March 2009, the professional advice given to Foundation and to BPHS was that it was not possible to construct a 17-storey building on the site without using very long friction piles, which would be very expensive. And no account of the cost of friction piling had been taken into account in the costings used in pricing the construction contracts, indeed Mr Levy confirmed that no attempt to determine the possible additional costs was made until much later.

**3 April 2009 Financial Statements**

256. Foundation prepared its first financial statements for the period commencing on its establishment on 9 July 2008 until 3 April 2009 ("the Accounts").

257. Foundation prepared its Accounts on the basis that it was carrying out a trade on a commercial basis with a view to making a profit, and that its payments were incurred for the purposes of its trade.

## Foundation's accounting policies

258. There are no statutory provisions requiring partnerships established under the Partnership Act 1890 (such as Foundation) to prepare their financial statements in accordance with any particular accounting standards. Clause 8.1 of Foundation's Partnership Deed required Foundation to prepare its accounts in accordance with the principles agreed with its auditors, and clause 8.3 gives Mr Levy (as managing partner) discretion to vary the accounting policies (with the consent of the auditors).

259. However, s25 Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") provides that:

> The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes.

260. Section 997 ITA 2007 defines generally accepted accounting practice to mean either generally accepted accounting practice in relation to accounts that are intended to give a true and fair view ("GAAP"), or generally accepted accounting practice in relation to accounts prepared in accordance with international accounting standards ("IAS").

261. For this reason, in practice, most English partnerships that are liable to UK tax on their trading profits will prepare accounts in accordance with either GAAP or IAS.

262. Foundation's Accounts include at Note 1 a statement of accounting policies, which include the following:

> **1.1 Accounting convention**
>
> The financial information is compiled on an agreed accounting basis that
>
> - enables profits to be calculated such as to meet the requirements of Section 42 of the Finance Act 1998, as amended by the Finance Act 2002; and
>
> - provides sufficient and relevant information to enable the completion of a tax return”
>
> **1.2 Compliance with accounting standards**
>
> The financial statements are prepared in accordance with applicable accounting standards, which have been applied consistently
>
> **1.4 Stocks and work-in-progress**
>
> Long term contract balances are stated at cost incurred, net of amounts transferred to cost of sales, after deducting foreseeable losses, less any applicable payments on account. The asset is only recognised to the extent that the future economic benefits that the partnership will receive can be reliably estimated.
>
> The estimate of the future economic benefits attributed to the long-term contract balance for stock is the estimated present value of the future cash-flows that the partnership will receive as a result of the long-term contract costs incurred, discounted at an appropriate discount rate reflecting the risk of those cash-flows, and the time value of money. The valuation is based on forecasts created by third parties who are experts in the market to which the long-term contract relates.
>
> The underlying assumptions to which the estimate is sensitive are the discount rate used, and the assumptions regarding the level of future revenues that will accrue to the partnership as consideration for their work done.

> The amount recorded as turnover in respect of long-term contracts is ascertained by reference to the value of the work carried out to date. Attributable profit is recognised as the difference between recorded turnover and related costs.

263. In addition a footnote to the profit and loss account states that it has been prepared on the basis that all operations are continuing operations – in other words on a "going concern" basis.

264. The provisions of s42 Finance Act 1998 and Finance Act 2002 were repealed and replaced by s25 ITTOIA with effect from the tax year 2005/06. The differences between s42 FA 1998 (as amended) and s25 ITTOIA are immaterial as far as this appeal is concerned.

265. Although the statement of accounting policies does not say so in terms, both Ms Chew and Mr Bach agree that the "agreed accounting basis" to which note 1.1 refers is GAAP. In order to comply with GAAP, the accounts must be prepared in accordance with the core mandatory accounting standards which are set out in the Statements of Standard Accounting Practice (“SSAPs”), Financial Reporting Standards (“FRSs”) and Urgent Issue Task Force Abstracts (“UITFs”); these the "applicable accounting standards" to which note 1.2 refers.

**Accounting standards**

266. Both Ms Chew and Mr Bach agree that the following accounting standards are applicable to the Accounts:

(1) SSAP 9 – stocks and long-term contracts

(2) FRS 5 – Reporting the substance of transactions

(3) FRS 5, Application Note G – Revenue recognition

(4) FRS 12 – Provisions, contingent liabilities, and contingent assets

(5) FRS 18 – Accounting Policies

(6) FRS 21 – Events after the balance sheet date

(7) FRS 25 – Financial instruments: presentation

In addition, both Ms Chew and Mr Bach agree that FRS 10 (Goodwill and intangible assets) may be relevant depending on my findings as to the nature of the consideration given under the Takeover Agreement.

267. FRS 18 "Accounting Policies" sets out the conceptual background and objectives that must be considered in choosing an entity’s accounting policies so that its financial statements provide a true and fair view. The policies adopted in preparing the Accounts have to achieve FRS 18’s objectives of making them relevant, reliable, comparable and understandable. FRS 18 details the various elements that must be considered in order to achieve these stated objectives of which two are crucial to relevance and reliability, being the concepts of materiality and accrual. FRS 18 also details the concept of prudence, which needs to be considered in relation to the impairment exercise that Foundation conducted at its year end.

268. FRS 18 requires accounts to be prepared on the accrual basis of accounting. The “accruals” concept is based on the principle that an entity should, in preparing its accounts, include all the amounts which it is entitled to receive or pay as a result of providing or receiving goods and services in the accounting period. FRS 18 provides that the accruals basis reflects an “asset and liability” approach – it is not driven by revenue or expenditure. Thus, an entity cannot defer the inclusion of costs on the basis that they are not assets or do not have corresponding revenue to be recognised in its accounts. Conversely, it cannot recognise revenue to which it has not yet become entitled just because the corresponding

costs have been included in its accounts. FRS 12 "Provisions, Contingent Liabilities and Contingent Assets" provides further guidance in that an asset or liability should only be recognised when

> an entity has a present obligation […] as a result of a past event, and it is probable that a transfer of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The burden of proof to recognising an asset is higher than for recognising a liability. FRS 18 paragraph 37 explains that, where there is judgemental uncertainty as to the "existence of assets, liabilities, gains, losses and changes to shareholders' funds, or about the amount at which they should be measured", then a prudent approach to recognition should be taken. Specifically, a higher standard of proof is required for the entity to recognise an asset or gain than to recognise a liability or loss. However, if an accounting choice is to be made, the concepts of materiality and accrual take precedence over prudence.

269. Both Mr Bach and Ms Chew referred to the "matching principle", that expenditure has to be matched to the economic benefits derived from that expenditure – in other words the Accounts must consider the amounts paid (or to be paid) by Foundation, and the economic value derived from that expenditure. Both Mr Bach and Ms Chew agreed that the expenditure incurred by Foundation under the Construction Sub-contract needed to be matched to the economic benefits derived from that contract (which would be the future cash-flows generated under the Principal Construction Contract). However, they disagreed about how that matching was to be achieved in the Accounts.

270. GAAP also addresses the narrative disclosure that explains or justifies the inclusion of the figures set out in accounts, and guidance is given to the level and detail of disclosure that is required in financial statements in order that they provide a true and fair view.

271. FRS 5 "Reporting the Substance of Transactions" addresses how and whether transactions should be recorded in the financial statements. FRS 5 applies to all transactions of an entity whose financial statements are intended to give a true and fair view. The starting point is that in order

> to determine the substance of a transaction it is necessary to identify whether the transaction has given rise to new assets or liabilities for the reporting entity and whether it has changed the entity's existing assets or liabilities

272. The key definitions used in FRS 5 are the following:

(1) "Assets" are defined as "rights or other access to future economic benefits controlled by an entity as a result of past transactions or events"

(2) "Control in the context of an asset" is defined as "the ability to obtain the future economic benefits relating to an asset and to restrict the access of others to those benefits"

(3) "Liabilities" are defined as "an entity's obligations to transfer economic benefits as a result of past transactions or events"

(4) "Transaction" includes both a single transaction or arrangement and also a group or series of transactions that achieves or is designed to achieve an overall commercial effect.

273. The Statement of Principles at paragraph 4.13 states that the "Capacity to obtain future economic benefits is the essence of an asset and is common to all assets irrespective of their form."

274. The following paragraphs are extracted from FRS 5:

**General**

**The substance of transactions**

14. A reporting entity's financial statements should report the substance of the transactions into which it has entered. In determining the substance of a transaction, all its aspects and implications should be identified and greater weight given to those more likely to have a commercial effect in practice. A group or series of transactions that achieves or is designed to achieve an overall commercial effect should be viewed as a whole.

**The substance of transactions**

**Identifying assets and liabilities**

16. To determine the substance of a transaction it is necessary to identify whether the transaction has given rise to new assets or liabilities for the reporting entity and whether it has changed the entity's existing assets or liabilities.

**Assessing commercial effect by considering the position of other parties**

51. Whatever the substance of a transaction, it will normally have commercial logic for each of the parties to it. If a transaction appears to lack such logic from the point of view of one or more parties, this may indicate that not all related parts of the transaction have been identified or that the commercial effect of some element of the transaction has been incorrectly assessed.

52. It follows that in assessing the commercial effect of a transaction, it will be important to consider the position of all of the parties to it, including their apparent expectations and motives for agreeing to its various terms. In particular, where one party to the transaction receives a lender's return but no more (comprising interest on its investment perhaps together with a relatively small fee), this indicates that the substance of the transaction is that of a financing. This is because the party that receives a lender's return is not compensated for assuming any significant exposure to loss other than that associated with the credit worthiness of the other party, nor is the other party compensated for giving up any significant potential for gain.

275. FRS 21 "Events after the balance sheet date" addresses the extent to which events occurring after the balance sheet date (but before the date on which the accounts are finalised) need to be reflected in accounts. FRS 21 distinguishes between "adjusting" and "non-adjusting" events, the former being events that require the amounts to be included in the accounts, and the latter to require only disclosure and not adjustment. An adjusting event is one where there is evidence that the conditions giving rise to the event existed at the balance sheet date.

276. SSAP 9 "Stock and Long Term Contracts" addresses the accounting requirements for situations where “a contract [is] entered into for the design, manufacture or construction of a single substantial asset or the provision of a service (or of a combination of assets or services which together constitute a single project” and spans more than one accounting period. If the outcome of a long-term contract can be assessed with reasonable certainty prior to its conclusion, then SSAP 9 requires that the appropriate proportion of contract value that reflects the stage completion of the project should be recognised as turnover. Conversely, if a loss can be assessed with reasonable certainty, then the full extent of that loss – the “foreseeable loss” – should be recognised as soon as it is foreseen. Any excess of foreseeable

losses over and above costs incurred (after the transfer of any costs to cost of sales) should be included within “provisions for liabilities and charges”.

277. SSAP 9 requires that, as a general principle, stock should be shown at the lower of cost and net realisable value, and paragraph 11 provides that the foreseeable loss should be deducted from the work in progress figure, thus reducing it to net realisable value. I note that the requirement is to write-down stock to take account of the foreseeable loss, not the worst possible outcome.

**Write down of stock and work-in-progress**

278. The figure for stock given in Foundation's balance sheet as at 3 April 2009 is £3,685,896, despite Foundation having incurred construction costs of £37,762,650.96 in the accounting period. In other words, stock had been written down by £34,076,754.96. This was taken through Foundation's profit and loss account for the period ended 3 April 2009 and treated as a trading expense.

279. The impairment in the value of Foundation's stock was made in order to comply with accounting policy 1.4, on the basis that £3,685,896 was the net realisable value of the stock represented by the construction contracts as at 3 April 2009.

280. The experts' joint report sets out the basis under which it was acceptable for a construction business to write-off construction costs. They both agreed that for such a write-off to be acceptable, an impairment event must have occurred. In addition, for Foundation to recognise a write-off in its Accounts, either:

(a) The impairment event must have occurred on or prior to 3 April 2009; or

(b) There must be evidence that the conditions giving rise to the impairment event were in existence as at 3 April 2009.

The experts were also in agreement that it was a finding of fact for the Tribunal as to whether an impairment event had occurred, and if so, the timing of any impairment event – a matter on which they were unable to reach agreement. They did agree that, on the basis that the valuation of Project Adriatic's long-term balance is correctly stated at £3.7 million by the date of the Accounts being finalised, timing of the impairment event is determinative for accounting purposes. If the event occurred on or before 3 April, then the impairment should be expensed in the Accounts. However, if the impairment occurred after 3 April, then the impairment should not be expensed.

281. Ms Chew in her evidence described this as follows:

> JUDGE ALEKSANDER: So they paid £37 million for something that is only worth £3.6.
>
> A. They contracted for £37 million. They had the expense of £37 million. They carry it forward in their accounts, and then at the year-end date—
>
> Q. Which is only a few days later.
>
> A. A few days later. At the year-end date they undertook an impairment review. And they took the balance, the £2 in my …
>
> Q. So they paid £37 million for something only worth £3 million.
>
> A. Yes.

282. The net realisable value of the stock was calculated by reference to the net present value of the future cashflows payable to Foundation under the Principal Construction Contract using a discount rate of 37%. The spreadsheet setting out the basis of this calculation was sent to HMRC under cover of an email dated 11 October 2011. Although the

spreadsheet had not been reviewed by Mr Bach, he agreed with Ms Chew that discounting cash flow to determine the net present value of an item of stock was an acceptable method of ascertaining its net realisable value. The arithmetical accuracy of the calculations shown in this spreadsheet are not challenged.

283. The cash-flows used for the purposes of the impairment analysis was, I find, inconsistent with the March 2009 financial analysis that was presented to prospective investors. The position presented to prospective investors recognised hotel profits from 2011 onwards, whereas the analysis used for the Accounts does not show any hotel profit until 2031. The experts agreed that the allocation of the partnership's share in the profits from the development used in the accounting analysis was wrong, as a 37.8% reduction was incorrectly applied to Foundation's entitlement (as the spreadsheet allocated net profits after construction costs), whereas its entitlement under the Principal Construction Contract was to 90% of the residential profits and 22% of the hotel revenue. In other words, under the impairment analysis, Foundation suffered the construction costs twice, first as it incurred those costs itself, and second as the payment by BAD under the Principal Construction Contract was determined after taking account of the construction costs.

284. Both Ms Chew and Mr Bach stated that their expertise did not extend to an analysis of the basis on which the discount rate of 37% was chosen, and that property valuations were also outside the scope of their expertise.

285. Mr Levy was asked how the discount rate of 37% was determined:

> A. So, my recollection, bearing in mind that this is now ten years ago, and I think that goes to the point that is made in the letter, was that I expected that the projected income stream which we would have used, I believe, the CBRE appraisal as the basis for in our business plan, then was adjusted to take into account an appropriate risk adjusted discount rate. And I had discussed this with David Comyn, who was adviser to Future Design and Build, which was the partnership consultant, and David had said, well, the starting point is if we were working on a UK development project, we would probably use a discount rate of 25 per cent at Savills, because that's where David was partner. […] I as managing partner thought the most appropriate basis was to take what David was saying to me about the discount rate that they would use if they were looking at a UK project and then add a bit more to reflect the additional risks inherent in Montenegro, political risk, country risk, difficulty in financing risk, and so forth. And that is where the figure of [37] per cent came from.

286. There is no documentary or other evidence to corroborate Savills' use of a 25% discount rate when appraising projects in the UK. I asked Mr Levy the basis for Savills starting point of 25%, to which Mr Levy replied that this was just the figure that Mr Comyn gave him. I also contrast Mr Levy's evidence as to the discount rate used in the impairment analysis with his evidence in relation to the March 2009 investment appraisal, where he said that the use of a 10% discount rate meant that the return shown to investors was "massively discounted".

**Fees payable to other FCP entities**

287. A fee of £605,325 was invoiced to Foundation on 1 April 2009 under the Takeover Agreement and charged in full to Foundation's profit and loss account for the period ended 3 April 2009. Consultancy fees of £1,412,425 are charged in the profit and loss account in respect of fees payable under the Partnership Consultancy Agreement with Future Design.

### Expert evidence

288. Ms Chew and Mr Bach both prepared reports on the Accounts. Following the filing of their reports, they met and prepared a joint report. Ms Chew also prepared a supplementary report.

289. As a result of the meeting, Mr Bach and Ms Chew agreed that there were various issues on which they were agreed. But they also identified were several issues which they were unable to resolve, not because they disagreed, but because these issues were either outside their expertise or were matters of fact for the Tribunal to resolve.

290. The first of these was whether any relevant impairment event had occurred prior to 3 April (or whether the conditions giving rise to an impairment event had occurred before 3 April). It was agreed that if no impairment event (or no conditions giving rise to the event) had occurred on or before 3 April, then no impairment should be reflected in the Accounts.

291. Both experts agreed that the fees of £1,412,425 paid to Future Design under the Partnership Consultancy Agreement can be categorised as an indirect cost of production and could therefore be treated as stock under GAAP. They also agreed that if Project Adriatic had "failed" on or before 3 April 2009, the consultancy fee should be written-off as part of the stock impairment provision. It follows that if no relevant impairment event (or no conditions giving rise to the event) occurred on or before 3 April, the write-off of the amounts payable under the Partnership Consultancy Agreement should not have been recognised in the Accounts. There is a separate point in relation to this fee as to whether the amount of £25,000 per member is a non-refundable advance and should be expensed in the Accounts in any event (irrespective of the timing of any impairment), on which the experts are not in agreement.

292. Whilst Ms Chew and Mr Bach agree on these principles relating to the recognition of impairment events in the Accounts, they do not agree on the timing of any impairment event that occurred.

293. Secondly whilst both experts agree that a discounted cash flow ("DCF") analysis is an acceptable method of ascertaining the value of stock under GAAP, the valuation of property and the determination of the discount rate used in the fair valuation exercise was outside the scope of their expertise.

294. Both experts were unclear about the nature of the amount payable under the Takeover Agreement, and whether (or not) it was for the right to exploit a business concept, and therefore was for the acquisition of an intangible asset under FRS 10. The experts agreed that this was a matter of fact for the Tribunal to determine. If the payment was for the acquisition of an intangible asset, they were agreed that the cost should be carried forward in the Accounts as a fixed asset and amortised over its expected life (or written-off entirely if the project had failed on or before 3 April 2009). However, if the payment is a fee for services provided to Foundation, it should be treated as a revenue item and expensed in the periods to which it relates.

### Ms Chew's expert evidence

295. Ms Chew's opinion was that the Accounts complied with GAAP and provided a "true and fair view".

#### *Construction Sub-contract*

296. In her opinion, Foundation's involvement with Project Adriatic is a long-term contract for the purposes of SSAP 9. As noted above, SSAP 9 paragraph 11 provides that any foreseeable loss should be deducted from the work in progress figure, thus reducing it to net realisable value. Ms Chew notes that this appears to have been the accounting treatment taken

by Foundation in that the stock figure is only £3,685,896 despite incurring costs under the Construction Sub-contract of £37,762,650.96 in the accounting period, suggesting a write-down of £34,076,754.96. Under Foundation's accounting policy note 1.4, net realisable value is determined by reference to the net present value of future cashflows arising from the amounts invested. In Ms Chew's opinion, the policy set out in note 1.4 is an acceptable basis of valuing net realisable value. This is because FRS 5 Application Note G paragraph G18 says that the right to consideration and, therefore, turnover, under a long-term contract should be ascertained by reference to the total fair value of the contract. In her view, this treatment is consistent with UK GAAP and, more specifically, SSAP 9.

297. Ms Chew considered that the amount expended by Foundation on the Construction Sub-contract was an "asset" for accounting purposes. This was because IPCS were legally obliged to provide a service to Foundation (providing its partners with a right to a future economic benefit) via a contract signed and invoiced prior to 3 April 2009 (prior to the balance sheet date). The "control" element was therefore present through those contractual obligations. In consequence the amount payable to IPCS by Foundation needed to be recognised in Foundation's balance sheet as an asset.

298. Ms Chew believed the asset in respect of the Construction Sub-contract was to be treated as "stock" and not a "pre-payment". Under SSAP 9 stock comprises the "expenditure … incurred in the normal course of business in bringing the product or service to its present location and condition" and includes costs of purchase and conversion. As the contract sum payable under the Construction Sub-contract is neither subject to any adjustment nor is repayable, Ms Chew considered that the contract was stock rather than a pre-payment.

299. Ms Chew believed the consultancy fees payable by Foundation to Future Design should be charged to the profit and loss account in the period in which the services provided under the Partnership Consultancy Agreement are performed. To the extent that the consultancy fees are accrued in advance, then they should be carried forward in the balance sheet as pre-payments until such time as the services to which they relate are delivered, at which point the amounts paid should be recognised in the profit and loss account. In the light of the contractual clause prohibiting repayment of the fee, Ms Chew considered that the amount should not be treated as a debtor (and therefore a pre-payment) in the Accounts, as Foundation had no recourse to claim back the amount paid. Instead, the fee should be expensed in its entirety in the period in which it was paid.

300. As regards the write-down of the value attributable to the Construction Sub-contract, Ms Chew considered that there were two steps that needed to be addressed. The first, was whether the unadjusted value of £37,762,650.96 correctly represented the value of the stock as at 3 April 2009 in the context of Foundation's circumstances as at that date. The second was the application of SSAP 9's accounting requirements for foreseeable losses on long-term contracts.

301. Foundation's right to income under the Principal Construction Contract would only arise on completion of construction of the hotel or sales of the condominium apartments. Given the uncertainties relating to Project Adriatic as at 3 April 2009, neither of these outcomes could, in Ms Chew's opinion, be reasonably ascertained. In addition, the uncertainty as to whether the hotel would be an 11-storey or 17-storey building contributed to her conclusion that income, and thereby return on the project, had a high degree of uncertainty.

302. On that basis, Ms Chew considered that GAAP requirements, and the concept of prudence, required Foundation to undertake an exercise to determine the fair value of amounts held as stock in its balance sheet at 3 April 2009.

303. Ms Chew's understanding was that the fair value included in the Accounts utilised a discount rate determined by Tim Levy, who was “an experienced investor”, and the net cashflows used in the calculation were backed by:

> estimates provided by Vector Management International Limited … the initial project managers, of the design and construction costs associated with the development of the residential apartments, estimates provided by La Cite of the design and construction costs associated with the development of the hotel and of the future operating profits of the hotel, and took into account the market valuation report provided by CB Richard Ellis [dated December 2008] which estimated the price per square footage at which the apartments might be sold in future.

304. In her report, Ms Chew states that she has not audited the assumptions backing the calculations, nor verified the calculations. But in her opinion, the basis of preparation seems reasonably robust and in line with industry practice. The discount rate, while high, is, in her view, backed up by explanations. She also noted that the Accounts were subject to a statutory audit process and she therefore assumed that the methodology and calculation were verified as part of that process.

305. Ms Chew's opinion was that it was "in line with UK GAAP" for Foundation to reduce the value of its stock (being the amount attributable to the Construction Sub-contract) in its balance sheet to the net realisable value shown.

***Takeover Agreement***

306. Ms Chew noted that under the Takeover Agreement, Foundation is given the right to exploit the "Business Concept". A fee of £605,325 was invoiced to Foundation on 1 April 2009 and charged in full to Foundation's profit and loss account for the period ended 3 April 2009. On the basis that the fee payable under the Takeover Agreement is dependent upon the capital raised by Foundation from investors prior to 3 April 2009, she concludes that the fee was paid for services rendered in the accounting period ended on 3 April 209. It was therefore "in line with UK GAAP" for the fee to be recognised in full in the profit and loss account.

307. However, in the experts' joint report, she and Mr Bach agreed that the provisions of the Takeover Agreement were not clear, and it was for the Tribunal to make findings of fact as to the nature of the fee payable under this agreement. They agreed that if the fee was payable for the acquisition of the right to exploit the business concept, it falls within the definition of an intangible asset under FRS 10. It should then have been capitalised and the cost spread over a suitable period or written-off entirely if the project has failed. The experts agreed that if the fee was payable for services provided to Foundation, then it should be treated as a revenue item and expensed in the periods to which it relates.

***Partnership Consultancy Agreement***

308. Consultancy fees of £1,412,425 are shown in the profit and loss account – these are attributable wholly to fees payable under the Partnership Consultancy Agreement with Future Design.

309. In her original report, Ms Chew considered that it is "arguable" that these fees should be treated as cost of production and accounted for as "stock", subject to the following two points.

310. The first relates to £25,000 per investor payable as a non-refundable deposit against part of the consultancy fee. As the deposit is non-refundable, she considered that it was

reasonable to write-off £650,000 (being the non-refundable element of the fee) to the profit and loss account.

311. She then considered that the balance of the fee (being £762,425) should be written off as part of the fair valuation exercise for work-in-progress.

312. Therefore, Ms Chew considered that it was appropriate for the whole of this fee to be expended in the profit and loss account.

313. In the joint report, Mr Bach agreed that the fee can be treated as an indirect cost of production and could therefore be treated as stock under GAAP. In addition, there was agreement between the experts that if Project Adriatic had failed as at 3 April, the fee would be written off as part of the stock impairment provision – but if the project had not failed, it would be carried forward.

***Income recognition***

314. Ms Chew considered that it was correct that Foundation did not recognise any income in the Accounts. SSAP 9 requires entities to recognise profit which reflects "the proportion of work carried out by the accounting date", by including "an appropriate proportion of total contract value as turnover in the profit and loss account as the contract activity progresses". But profit should only be recognised where the outcome of the contract can be assessed "with reasonable certainty". Given the uncertainty of outcome over Project Adriatic as at 3 April 2009, Ms Chew considered that it was correct that Foundation did not impute any attributable profits in its accounts.

315. She considered that it was correct that the cash inflows from the partners should be treated as equity under FRS 25, and remain on the balance sheet.

***Substance over form***

316. Ms Chew's initial instructions from Foundation did not include the analysis of IPCS's invoice to Foundation, and the use to which the funds paid to IPCS were put. And, prior to her meeting with Mr Bach, Ms Chew was not aware (amongst other things) of the Barclays' daylight facility. As a result of her attention being drawn to that loan facility, she prepared a supplementary report. Her supplemental report addresses the application of both FRS 5 (Reporting the Substance of Transactions) and FRS 25 (Financial Instruments: Presentation) to the payment by FDBS to Foundation of its capital contribution, and the payment by Foundation to IPCS under the Construction Sub-contract.

317. In essence, her view was that the contribution by FDBS to Foundation should be recognised as equity, as it is paid under a legal obligation under the Partnership Deed, there is evidence that the contribution exists, and the amount of the contribution can be reliably measured.

318. As regards fact that the funds were held in a "blocked" account at Barclays, her view was that the payment cannot be disregarded merely because Foundation's control of the funds was restricted:

> In my experience, it is common, in large complex financing transactions involving different legal entities, for the financing institution to impose physical controls over the flow of funds between the entities. This is done for a number of reasons, including security. At each stage in the transaction, the financing institution will have in place its checks to ensure that the next stage of the transaction is in accordance with their understanding and agreed purpose. For practical purposes, the financing institution will require all the paperwork to be completed before the transaction occurs, providing a safeguard against any entity in the chain from diverting the funds contrary to

> the agreed transaction. For example, where the security given by the borrowing entity comprises a charge over equity, the financing entity will require a signed share transfer form to be delivered as a pre-condition for the facility being provided. This does not mean that ownership transfers to the financing institution on delivery of the signed share transfer form; however, in practical terms, the financing institution will have assured itself that it will be able to act swiftly in case of default.

319. Ms Chew reconsidered in her supplemental report whether the amounts invoiced by IPCS were accounted for in accordance with GAAP and whether her views on the impairment exercise needed to be revised, but concluded that her opinion on the accounting treatment was unchanged.

320. During cross-examination, she was questioned about the circularity of the Barclays' financing – and in particular about the security arrangements that ensured that the funds they advanced were returned by the end of the day:

> what I understand from Mr Bach's explanation is that bank accounts were set up by Barclays for each individual entity in the trail of transactions, so the monies did pass through, however briefly, to the individual entities, it was held by them, albeit all within Barclays, but the name on the bank account was, for this one, Foundation Partnership, if you like, Foundation - it is Foundation Design, Foundation Partners to IPCS. In terms of whether it is normal for it to go around, the only thing I can say is in my experience what I have seen is that in transactions of this size, this magnitude, just in terms of millions of pounds rather than just hundreds and thousands of pounds: (a) the bank will have done their due diligence, they will have understood, they will have had to have understood the basis of the transactions. But the other thing is that they will hedge the risk that they are exposed to at every step of the way. So, for example, I have seen in a series of acquisitions where the charge is over, for example, the shares of the companies that are being acquired. Now, what the bank will do is they will require, as part of the completion documents, signed stock transfer forms, not dated but signed, and those have to be delivered to them. In the event of anything happening then they have all the legal documents within their possession in order to carry through whatever the agreement is. So, is it unusual? I cannot say. I have not seen so many transactions that I would say that it absolutely does not happen, but I have seen that banks do maintain tight controls and they try to make sure that they hedge their risk and exposure on such large transactions.

321. During cross-examination, she was asked about the impact the Teaming Agreement had on her opinion, and she stated that she had not previously seen this agreement, and that her reports had not taken this agreement into account. She was then asked to read the Teaming Agreement and was cross-examined about the inter-relationship between the various parties in the light of their obligations under the Teaming Agreement. Ms Chew's evidence was that she had not been asked for her opinion on the accounting treatment when considered from this wider perspective. During lengthy questioning by Mr Yates, Ms Chew avoided giving direct answers about the applicability of paragraph 51 of FRS 5 to the Accounts, and the need to consider whether there was a wider transaction. Eventually she could avoid this no longer:

> Q. … you have avoided answering my question, which is the prior question of whether para 51 [of FRS 5] appears to be engaged on the facts here because it does appear to require you to look and consider a wider transaction? You would agree with that, would you not?
>
> A. Yes.

322. It also became clear during her cross-examination that she was unaware of the degree of control that Mr Levy had over the affairs of the various entities – in particular that Mr Levy was both a director and the ultimate controlling shareholder of IPCS and was also the managing partner of Foundation.

323. She was then asked to consider the application of paragraph 51 in the light of the fact that IPCS was paid £37 million in respect of a contract which would cost IPCS €100 million to implement, and whether this may indicate that not all of the related parts of the contract have been identified:

> A. Okay. It's an interesting one. FRS 5 requires that you look outside the legal form of a transaction and reflect the commercial substance behind that transaction. So, if you were to see an agreement for an amount which is less than the total construction cost, then you would ask the question: why is this agreement in place for an amount for less than the projected construction cost? Commercial logic. I agree with the statement that, in terms of assessing the substance of a transaction, you will need to assess whether that transaction has commercial logic in order to be able to assess whether it's inclusion or exclusion in the accounts gives a true and fair view. The next statement, "If a transaction appears to lack such logic from the point of view of one or more of the parties it may indicate ..." - yes, it may indicate, and that is the point at which you would go back to Foundation Partners, in this sense, and the straightforward question would be: "You've got a construction projection that says a hundred million pounds..." -I'm taking your word for it that it says a hundred million pounds -" ... but you have subcontracted the cost for £37 million. Why would you have done so?" I wouldn't automatically have said - two things. If I were the auditors of the accounts, it may not be that I have access to IPCS. In this circumstance, maybe, if I had asked for it, I would have been given the IPCS agreement. Is it automatically the case that I would then disregard the ...
>
> JUDGE ALEKSANDER: That is not the question that you are being asked.
>
> A. Yes.
>
> Q. You are merely being asked ...
>
> A. Should you look beyond this immediate contract?
>
> Q. Yes.
>
> A. Then, yes, the answer is you should look beyond.

324. Mr Yates then went on to question Ms Chew about the consequences of looking beyond the immediate contract:

> And we have already then discussed what happens when you look beyond. We say that you have to take into account the circular financing. I appreciate that you somehow disagree that you can ignore that as a matter of commercial substance, and we have already had that discussion. I think you have also raised the question of, "Well, isn't it a debtor? Isn't Foundation Design going to be a debtor if you ignore it?" - yes?
>
> A. Yes.
>
> Q. And surely the answer to that question is twofold: the first is, no, it is not a debtor because it has discharged its very superficial obligation to pass the money around in a circular way -point 1. Point 2: even if you did view it as having an undischarged liability, assume that Foundation Design had no assets: so, surely you would not recognise it as a debtor in your accounts, would you, because you would not have any enforceable, realistic

> enforceable recovery from that partner in the accounts? If you owe me an obligation to pay me and you have no assets, I do not recognise that in my accounts, do I?
>
> A. You would recognise it in your accounts and then you would assess the debtor and the ability of the debtor to pay and then you would write it off in your accounts as an expense. […] So, the 30 million would go into the profit and loss account as a bad debt.
>
> Q. Yes, it would, but it would not be a trade debt, it would just be that someone has defaulted on their contribution?
>
> A. Right.
>
> Q. You agree with that? It would not be a trading expense, it would just be a bad debt from a contribution?
>
> A. If Foundation Design didn't have the means to make good on its debt, then you would write it off as a bad debt, as long as you...
>
> Q. But it would not be - what expense line would you put it in there?
>
> A. It's not a trade debt.

325. Ms Chew was also questioned about her opinion that payments to IPCS could not be treated as a pre-payment because of the inclusion of an express provision in the Construction Sub-contract that the fee paid to IPCS was not refundable. She accepted that there was no reason why the payment made to IPCS could not be a pre-payment if (a) Foundation could require IPCS to perform its obligations under the Construction Sub-contract or recover money from them (as damages) in the event that they failed to perform those obligations. She was clear that if the contract was silent as regards refunds – in other words there were no provisions of any kind relating to repayments – then the payment to the sub-contractor would be treated as a pre-payment.

326. During her cross-examination in relation to the provision in the Construction Sub-contract relating to refunds, Ms Chew acknowledged that an express prohibition on refunds was unusual. She was asked whether this was an indication that the transaction lacked commercial logic:

> Q. … did that not make you think this all lacks commercial logic and therefore paragraph 51 is engaged when you are preparing your report?
>
> A. I am an accountant, […] I'm not involved in the construction industry. There are unusual terms. Not all contracts are standard. I didn't put myself in a position, when I was doing the reports, I didn't put myself in the position of an overall expert of all things construction or development.
>
> Q. I accept that, but FRS 5 does require you to consider whether the transactions have commercial logic. So, you cannot just sit in your ivory tower and say, "Well, I know nothing about the machinations of the construction contracts." You are going to have to question, at least at a high level, whether what you are looking at has commercial logic, surely?
>
> A. Yes, but that wasn't the remit of my report. The remit of my report was to say, was to opine on whether or not, given the documentation that I am asked to review, how should they be reflected in the financial statements? And this is how they would be reflected in the financial statements.
>
> Q. But that presupposes that you have not even, as it were, prodded the commercial logic of what you are being asked to examine, contrary to what FRS 5 requires?

> A. I don't think that is - okay, you look at the partnership deed, you look at the various contracts that were in place at 1st of April 2009, 3rd of April 2009, and then you follow through the accounting entries to those. Then you look to see whether the circumstances around the accounting reference date was such as to be reflected in the accounts for the year. Do you then sit and say, "Are these contracts on an arm's length basis?" You don't have to conclude that they are on an arm's length basis, and contracts do not have to be on an arm's length basis. The fact that a contractual term is unusual does not necessarily make it uncommercial.

327. Ms Chew was asked how Foundation's accounts should appear if the true nature of the transaction was the financing by Foundation of an investment in land:

> A. So you are saying that Foundation Partners has lent money to somebody to purchase land on which it is going to fulfil its construction obligations. […] Does it get a return on that investment?
>
> Q. Yes, let's assume it is the return the Partnership actually gets under the construction contract, namely 90 per cent of the condominiums and 22 per cent of the hotel profits.
>
> A. And this is stated. So what they are saying is: "I am going to lend you the money and in return for that you are going to let me have the 90 per cent, and this is all per the agreements." […] Then in that case it would - well, it is a loan, is it not? It could be an investment; it could be perceived to be an investment.
>
> JUDGE ALEKSANDER: I think rather than describe it as a loan, perhaps describe it as a financing transaction.
>
> […]
>
> A. Okay. In which case it would be either a current or fixed asset investment depending on what you intended to do with it.

328. Ms Chew was also asked to compare the summary financial analysis presented to the Foundation investors and prospective investors, which was prepared on 18 March 2009, with the discounted cash flow analysis used for the purpose of the fair valuation exercise relating to Foundation's stock in the accounts as at 3 April 2009. Her attention was drawn to the fact that the March 2009 financial analysis used a discount rate of 10%, whereas a discount rate of 37% was used for the fair valuation exercise. She confirmed that there was a lack of logic in the use of two different discount rates in these cash flows, providing nothing had changed between 18 March and 3 April, and that there was nothing in existence between these dates that only crystallised after 3 April. She also agreed that the two sets of cash flows were inconsistent in the timing of cash-flow from the hotel and the 37.8% reduction in Foundation's entitlement to its share of revenues and profits.

### Mr Bach's expert evidence

#### *Substance over form*

329. Mr Bach's opinion on the accounting treatment that ought to have been adopted by Foundation depends upon whether the £30,266,250 capital contribution by FDBS represents "monies ultimately available to" Foundation. The phrase "monies ultimately available to" is defined by Mr Bach as meaning that Foundation had an overall benefit from the relevant funds, even if they were not under Foundation's formal control – for example because the funds are available to settle costs incurred by Foundation on Project Adriatic.

330. Mr Bach also commented in his report on the timing of any impairment. If the loss recognised in Foundation's accounts arose due to circumstances that occurred in the period up

to 1 April 2009 (the date on which the Construction Sub-contract was signed), or in the period between signature and the balance sheet date, then (if it was proper to recognise a loss), that loss was correctly recognised in the accounts for the period ended 3 April 2009. However, if the circumstances giving rise to any loss arose after 3 April, then it would have been wrong for Foundation to recognise the loss in its accounts. In this regard, he and Ms Chew were in agreement.

331. Mr Bach concludes that it would only be correct for Foundation to recognise a write-down of £34,076,754.96 in respect of the fair valuation of its stock if (a) the £30,266,250 capital contribution by FDBS represents monies ultimately available to Foundation, and (b) the circumstances giving rise to the impairment arose on or before 3 April 2009. The aggregate loss to be recognised in other circumstances would be either £994,973 or £6,117,015 – depending on the timing and whether FDBS's capital contribution represented monies ultimately available to Foundation.

332. Mr Bach noted three matters which in his view caused paragraph 14 of FRS 5 to be engaged. These were:

(a) the circularity of the daylight facility provided by Barclays, and the security given to Barclays by the various entities, which ensured that the entirety of the Barclays loan would be repaid by the end of the day,

(b) that the fair value of the stock represented by the Construction Sub-contract had been reduced by £34,076,755 in the three days between the payment of the construction fee on 1 April, and its valuation as at 3 April, and

(c) the "mismatch" between the amount paid to IPCS under the Construction Sub-contract (£37m), and the anticipated costs of those works for IPCS (€100m = approx. £83m), and in his witness statement, he says that one of the primary commercial purposes for an up-front payment was to enable BPHS to acquire the site.

He regarded the combination as unusual, and therefore required (in accordance with FRS 5) a consideration of the overall substance of the transactions.

333. Mr Bach believed, in the light of the overall substance of the transactions, the £30,266,250 paid to Foundation as a capital contribution by FDBS never came under Foundation's formal control, as Foundation had granted entire control to Barclays over the bank account into which these funds had been deposited. As these funds were not used to settle costs incurred on the development project – but were returned to Barclays in a circular transaction, Mr Bach believed these funds were not ultimately available to Foundation.

334. Mr Bach states in his report that FDBS's capital contribution should not be recognised as equity in the Accounts, but his report did not address the obligations arising under Foundation's Partnership Deed in respect of FDBS's capital contribution. The definition of "Capital Contribution" in the Partnership Deed provides that the capital contribution of FDBS "shall be a sum equal to approximately 75% of the Total Capital Contributions", and clause 5.6 of the Partnership Deed makes provision in the event that a Partner (which includes FDBS) fails to provide its Capital Contribution. Mr Bach was asked whether the Accounts should therefore show FDBS's liability to make its capital contribution as outstanding (in other words as a debtor) if its payment in respect of its capital contribution was not recognised in Foundation's balance sheet.

335. When questioned about this, Mr Bach acknowledged that he did not fully consider this issue and that it was a flaw in his original report, but he pointed out that he did consider the issue in the joint report. His opinion is that the contribution made by FDBS never came under

the control of Foundation (and therefore should not be recognised in the Accounts under GAAP). He would in these circumstances have expected the Accounts to show a debtor in respect of the unsatisfied obligation that FDBS owed to Foundation to make a capital contribution. But as it appeared that all the Foundation partners considered that FDBS had satisfied its obligation to make its capital contribution (as they had not taken any action to require FDBS to make a further payment), which is why no debtor was shown.

336. In the experts' joint report, Ms Chew says in relation to this point:

> As Individual Partners contributed £10.1 million, the Foundation Corporate Partner was required, under the Partnership Deed, to contribute £30.3 million. If one disregards the cash inflows from Foundation Design, as Mr Bach suggests, then the 2009 Accounts would show the Foundation Corporate Partner as a debtor as at 3 April 2009 – its capital contribution would remain as an outstanding amount due to the Partnership. However, Ms Chew does not agree that the capital contribution is outstanding as at 3 April 2009.

337. As regards the payments to IPCS, in his view only £7,496,401 (namely the amount funded from the equity provided by the individual partners represents) should be recognised in the Accounts. This is because the commercial substance of the transactions was that Foundation's obligations to IPCS had been settled in full, with the settlement of the balance (£30,266,250) having been funded from the monies not recognised in the Accounts. In addition, this amount should be treated as a pre-payment, and not as stock. Clause 11 of the Construction Sub-contract provides:

> The contract sum for proper performance and completion of the works is a fixed lump sum payable on or by the 3rd of April 2009 which shall not be subject to adjustment for any reason whatsoever.

338. Mr Bach acknowledged that there was a liability of Foundation to pay the lump sum due under the contract. In cross-examination he stated that as at 3 April, this liability had been extinguished as a result of the £30.3 million payment made by Foundation. Mr Bach was asked to specify the double entries that ought to have been made by Foundation in respect of the payment:

> A. So, there is an obligation to pay the 30 million, which in effect - so, it's debit ... actually, debit pre-payments initially because it's a payment in advance, as we heard this morning. So, it's debit pre-payments, credit ...
>
> Q. Well, Ms Chew thinks it is not pre-payment, she thinks it is stock.
>
> A. Yes. No, I respectfully disagreed with that.
>
> MR RIVETT: Why do you disagree, out of interest?
>
> A. Because it's a payment in advance of services; the services were to be provided into the future.
>
> Q. Yes, we will have a look at them in a minute.
>
> A. So, in effect, the initial - based on the documentation, the contract, there is a payment there, but that payment or that obligation is actually extinguished by the 1st of April, to my understanding, and ...
>
> JUDGE ALEKSANDER: By the 1st of April?
>
> A. By the 3rd of April, sorry. Thank you, sir. Because the payment has been made out of assets that never actually qualified for recognition in the partnership, the 30 million that went through the bank accounts but never were under the control of the partnership. So, in effect, that whole

transaction extinguishes the obligation and in reality, that obligation was settled for nil cost to the partnership, or nil cost incurred by the partnership, so in effect we reverse 30 million of the deemed obligation, because ...

Q. I understand, I think I understand what you are saying in relation to the discharge of the obligation - it is the double entry, I think, that we are focused on.

A. Yes, so the initial entry was debit pre-payments, credit creditors 37 million. The extinguishment of it - 7 million was extinguished by the actual payments. So, the payment was credit bank account - sorry, I'm getting myself confused here.

Q. Take a glass of water.

A. I'll take a moment and ... Right, the contract sum is payable as services rendered that's where I'm getting myself confused.

MR RIVETT: Sorry, where do you get that from?

A. So ...

Q. It is not payable as services are rendered?

A. Sorry, the contract sum is payable upfront, so that's 4758, so that's the 3rd of April, by the 3rd of April, so the contract sum is a fixed lump sum payable upfront, in advance. So, there is no obligation - the entry at that stage therefore is credit bank account, debit pre-payments, with the amount that is paid in advance of the services. So, for the 7 million, it's credit bank account, because that's a bank account of the partnership, debit pre-payment 7 million.

JUDGE ALEKSANDER: But what happens with the - but then in the bank account is 30 million odd?

A. But the other 30 million is a bank account that was never in the partnership's control at all, so the bank account never qualified for recognition as an asset on the balance sheet.

Q. Are you saying that there remains a creditor in the balance sheet for the rest of the contract sum?

A. No, I have got myself completely confused there, and I do apologise.

339. Mr Bach's confusion continued. But eventually his evidence does become somewhat less confused

A. That's right, so on the 3rd of April, as you have said, 37 million in two bits has gone from the partnership to Integrated. So, the double entry on the 7 million is fairly straightforward. There was an asset in the balance sheet, so suddenly the bank account is empty, let's say.

Q. Yes.

A. So, it's credit bank account, debit pre-payment 7 million. Now, the confusion and the difficulty - and what is odd about this […] is the payment of 30 million - one might, being simplistic, want to put an entry of 30 million in, in the bank account, but there was a bank account in the name of the partnership for 30 million, represented in the balance sheet, I would say, as zero ...

Q. I understand that, yes.

A. So, although the transaction occurs, there is no accounting entry to make for that 30 million because that never existed in, it was never recognised in

> the partnership bank account. It's the converse of when it came in, it was, the, I would say the account entry, when the 30 million hit the bank account, should have been credit equity zero, debit, asset bank account zero, because there was never a bank account asset that qualified for recognition.
>
> Q. You are saying that was not under the control of the partnership.
>
> A. Because it was never under the control ...

340. Mr Bach's answers to questions were prolix and never straightforward, and it is not easy to make sense of them. But in essence his opinion appears to be that the capital contribution made by FDBS should not be recognised in Foundation's accounts, as the amount paid by FDBS to Foundation never came under Foundation's control (because of the nature of Barclays' loan arrangements), and the amount paid was therefore not an "asset" for the purposes of GAAP. And because these funds were never recognised as an asset in Foundation's accounts, the onward payment of these funds to IPCS is not recognised either.

341. Further, Mr Bach was of the opinion that Foundation's expectation as at 3 April 2009 was that it (or FDBS) would be able to raise additional funding to enable the balance of the Lenley shares to be acquired, and for Project Adriatic to proceed, and that it was the failure to raise this additional funding that caused the impairment of the project – as it was not possible to acquire clear title to the site (free of Piraeus's security) and commence construction. Any impairment (and the consequential loss) therefore only arose after 3 April 2009.

***Takeover Agreement and Partnership Consultancy Agreement***

342. Subject to the Tribunal's findings of fact about the nature and meaning of the Takeover Agreement and the Partnership Consultancy Agreement, there was substantial agreement between the experts on the treatment of the fees payable under these agreements, which is addressed above in relation to Ms Chew's evidence.

343. The principal difference relates to the treatment of the £25,000 per investor payable under the Partnership Consultancy Agreement. Whilst Ms Chew considered that the payment is a non-refundable advance (recognised as an expense in the profit and loss account). Mr Bach considered that the non-refundable advance should be treated as an inseparable component of the fee – and its accounting treatment should be in line with the rest of the fee.

***Accounting treatment***

344. Mr Bach's opinion was that the profit and loss account for the period ended 3 April 2009 should have shown:

(a) £nil turnover (as it in fact did)

(b) £nil profit/loss in respect of the Construction Sub-contract (rather than a loss of £34,076,755)

(c) £nil expense in respect of "takeover fees" (rather than £605,325), on the basis that this was consideration for the acquisition of an intangible asset, and there was no amortisation or impairment as at 3 April 2009

(d) £706,231 expense in respect of "consultancy fees" (rather than £1,412,425), on the basis that only half of the fees relate to services performed prior to 3 April, and the balance relate to services to be performed after that date

(e) £288,760 expense in respect of sundry net costs (as shown in the Accounts)

345. In consequence, Mr Bach concluded that Foundation's financial statements for the period ended 3 April should have only reported a loss of £994,973 and not £36,383,265.

346. As regards Foundation's balance sheet, this should have shown:

(a) £17,111 as sundry amounts due to partners (as shown in the Accounts)

(b) £10,088,750 as partners' capital classified as equity (not £40,355,000), on the basis that the contribution made by FDBS never represented an asset under the control of Foundation and should not be recognised in Foundation's Accounts.

(c) A debt of £994,973 as partners' accumulated losses (not £36,383,265).

(d) The payment to IPCS to be shown as a debtor (prepaid contract fee) of £7,496,401, and not £37,762,651 of stock (long term contract balances).

347. In consequence, Mr Bach concluded that Foundation's net assets available to its partners was £9,110,888, and not £3,988,846.

**ISSUES FOR DETERMINATION**

348. The issues that arise in this appeal concern the availability of relief in respect of losses incurred by Foundation - a common law partnership governed by the Partnership Act 1890. The relevant legislation provides for the individual partners to claim loss relief against any income generated from the partnership. In addition, in certain circumstances those partners can claim relief in respect of losses incurred by Foundation against their other income under the provisions now contained within s64 ITA 2007 – "sideways loss relief". For that relief to be available, the taxpayers will need to demonstrate that the trade carried on by Foundation is "commercial" within the meaning of s66(1) ITA 2007 – namely that the trade was carried out on a "commercial basis" and "with a view to the realisation of profits of the trade" (s66(2) ITA 2007).

349. I first need to determine whether Foundation was carrying on a trade, and if it was, whether that trade had commenced in the tax year 2008/09.

350. If it had commenced in 2008/09, I then need to determine whether

(1) the amount of £37,762,650.96 paid under the Construction Sub-contract was "incurred wholly and exclusively" for the purposes of the Foundation's trade such that the condition in s34 ITTOIA was satisfied;

(2) the amount of £37,762,650.96 paid under the Construction Sub-contract was capital in nature such that the condition in s33 ITTOIA was satisfied;

(3) any part of the payments under the Takeover Agreement and the Partnership Consultancy Agreements were capital in nature, and if so to what extent, and if any part of the payments were not capital in nature but were revenue payments, whether those revenue payments were incurred wholly and exclusively for the purposes of the Foundation's trade such that the condition in s34 ITTOIA was satisfied; and

(4) Foundation's accounts for the period ended 3 April 2009 were produced in accordance with GAAP such that the provisions of ss25-26 ITTOIA were satisfied.

351. For the purposes of this hearing, I do not need to consider how any trading losses incurred by Foundation are allocated between its partners.

352. I note that Foundation was not a limited partnership registered under the Limited Partnerships Act 1907, nor was it a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000. In consequence several provisions which limit the ability of partners or members of such entities to claim loss relief are not relevant to this appeal. In particular, s863(1) ITTOIA (which requires the entity to be carrying on a trade, profession, or business "with a view to profit") is not relevant. Nor, for the purposes of this appeal do I need to determine whether any trade carried on by Foundation was "commercial"

for the purposes of s66 ITA 2007, as that provision only bites on a claim by a partner for sideways loss relief (which is not an aspect of this appeal).

353. However, in determining whether Foundation's activities amount to a trade, I will need to consider the "commerciality" of Foundation's business activities, and any assessment of commerciality may inevitably have to consider whether the arrangements have any prospect of eventually realising a profit. And I would also note that if the partners were not carrying on business with a view of profit, Foundation would not be a partnership for the purposes of the s1(1) Partnership Act 1890.

**Trading**

354. Section 989 ITA 2007 provides that "trade" for the purposes of the Income Tax Acts "includes any venture in the nature of trade". "Trade" and "venture in the nature of a trade" are given no further statutory definition.

355. The meanings of "trade" and "venture in the nature of trade" have been considered in several decisions of the courts. One of the classic descriptions of what amounts to a trade was given by Lord Wilberforce in *Ransom v Higgs* (1974) 50 TC 1(HL):

> As the above summary demonstrates, we are concerned with some sophisticated transactions, evidently the product of expert intellects in the tax avoidance business. To resolve the problems which they create, we are not called on, as has usually happened since 1965, to apply correspondingly sophisticated tools of legislation. We have rather to apply to the facts the legal concept of trade' (Income Tax Act 1952, ss 122, 123 and 526(1)). This may be called a concept of common law. Trade has for centuries been, and still is, part of the national way of life; everyone is supposed to know what 'trade' means; so Parliament, which wrote it into the law of income tax in 1799, has wisely abstained from defining it and has left it to the courts to say what it does or does not include.
>
> Trade is infinitely varied; so we often find applied to it the cliché that its categories are not closed. Of course they are not; but this does not mean that the concept of trade is without limits so that any activity which yields an advantage, however indirect, can be brought within the net of tax. Some systems tax in general terms all profits or income arising from personal exertion; some also tax the produce of any profit making enterprise; but English law does not do this. It names the commonest and most recognisable forms of personal exertions or enterprise in Schs D and E of the code and, apart from special provisions which are not invoked here, each case must be brought within one of them.
>
> "Trade" cannot be precisely defined, but certain characteristics can be identified which trade normally has. Equally some indicia can be found which prevent a profit from being regarded as the profit of a trade. Sometimes the question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, of organisation, even of intention, and in such cases it is for the fact finding body to decide on the evidence whether a line is passed. The present is not such a case: it involves the question as one of recognition whether the characteristics of trade are sufficiently present. I do not think that we need here to get enmeshed in the intricacies—I am tempted to say sophistries—of primary or secondary facts or inferences. We are clearly in the realm of principle and of law.
>
> Trade involves, normally, the exchange of goods, or of services, for reward, not of all service, since some qualify as a profession, or employment, or vocation, but there must be something which the trade offers to provide by

> way of business. Trade, moreover, presupposes a customer (to this too there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral—you must trade with someone. The "mutuality" cases are based in part at least on this principle, and it was the existence of it that made *Sharkey v Wernher* an interesting problem: could Lady Zia trade with herself?
>
> Then there are elements or characteristics which prevent a trade being found, even though a profit has been made—the realisation of a capital asset, the isolated transaction (which may yet be a trade). In recent years a transaction, even one of property dealing, which amounts to no more than a planned raid on the revenue (see *FA & A B Ltd v Lupton*) has been held not to be by way of trade - a sophistication which I do not reject, but which must be carefully watched for illegitimate extension. Although these are general characteristics which one cannot state in terms of essential prerequisites, they are useful benchmarks, so when one is faced with a novel set of facts, as we are here, the best one can do is to apply them as tests in order to see how near to, or far from, the norm these facts are. I attach no importance to the fact that, if there was trade, there is a difficulty in knowing what to call it. Christening normally follows some time after birth, and if Mr Higgs's activities were found to be trading activities, a description would soon be found.

356. A recent summary of its meaning was given (in the context of partnership tax schemes) by the Court of Appeal in *Eclipse 35 v HMRC* [2015] STC 1429 (CA) at [111] to [112]:

> [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 (at 960c) 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 (at 955h) 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 [...] trade includes every trade, manufacture, adventure or concern in the nature of trade [...] 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 […]. It is a matter of law whether some particular factual characteristic is capable of being an indicator of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not in 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.

357. The Court of Appeal discussed its decision in *Eclipse* in *R (on the application of Samarkand Film Partnership No3 and Another) v HMRC* [2017] EWCA Civ 77:

> 59. […] 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].

358. Lord Reid in his speech in *Ransom v Higgs* said that for a business activity to constitute trading, the activity must have a commercial character.

> The Income Tax Acts have never defined trade or trading farther than to provide that trade includes every trade, manufacture, adventure or concern in the nature of trade. Leaving aside obsolete or rare usage [trade] is sometimes used to denote any mercantile operation, but is commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services.
>
> The contexts in which the word "trade" has been used in the Income Tax Acts appear to me to indicate that operations of that kind are what the legislature had primarily in mind.

359. The Upper Tribunal in the case of *Ingenious Games LLP and Others v Revenue and Customs*: [2019] UKUT 226 (TCC) considered the requirement for a trade to have a commercial character in the context of a film business:

> 257.As has been repeatedly said in the authorities, it is necessary to look carefully at the facts found, standing back and looking at the whole picture. Once the activities carried out by Ingenious that the FTT found could not be attributed to the LLPs are stripped out, and account is taken of the reality of the insignificance of the LLPs' ownership rights of the films, what is left is negotiation of and entry into a series of speculative investment in financial assets, and little serious ongoing involvement in the production of the films.
>
> 258.There are a number of findings of the FTT that support that conclusion, as follows:
>
> > (1) at [356] which describes the activity as buying an income stream in a complex way;
> >
> > (2) at [405] which describes the activity as the exchange of a sum of money paid to one party for a potential future financial reward from another;
> >
> > (3) at [418] which describes the structure as not one for dealing in a film but one for the acquisition of an interest in the proceeds of exploitation of a film;
> >
> > (4) at [428] which states that in reality the right acquired was the right to income and the LLP did not intend to dispose of it;
> >
> > (5) at [453] which describes the transaction as a 30% investment for a 30% share of GDI; and
> >
> > (6) at [39] of the Further Decision, which summarised the trade as financial, namely the speculative activity of choosing and laying out money on rights in the hope of monetary receipts.

360. The appellants in the *Eclipse 35* and the *Ingenious* decisions were limited liability partnerships, and so the claim for loss relief in those appeals was subject to the provisions in

s863 ITTOIA which required the LLPs to be carrying on a trade, profession, or business with a view to profit. But the analysis in the paragraphs I have cited relate to whether the LLP was trading in the first place (irrespective of whether the trade was carried on with a view to profit) – and these aspects of its decision are therefore of potential relevance to this appeal.

### Calculation of profits

361. The profits and losses of a partnership trade are calculated and taxed as follows:

(1) Where the partnership has a UK resident partner liable to income tax, the profits and losses of the trade are calculated as if the partnership were a UK resident individual (s849 ITTOIA);

(2) Each partner's share of profits or losses or the trade are determined for income tax purposes in accordance with the firm's profit-sharing arrangements (s850(1) ITTOIA);

(3) These profits or losses are treated as the profits or losses of a trade carried on by each partner alone (s852(1) ITTOIA);

(4) As noted above, the profits and losses of a trade are to be calculated in accordance with generally accepted accounting principles subject only to any adjustment required or authorised by law (ss25-26 ITTOIA); and

(5) One such adjustment is the disallowance of expenses not incurred "wholly and exclusively" for the purposes of the trade (s34 ITTOIA for years before 2009/10). This does not, however, prohibit a deduction for any identifiable part or proportion of the expense that is incurred wholly and exclusively for the purposes of the trade (s34(2) ITTOIA).

362. The law was amended with effect from the tax year 2009/10 to limit the losses allocated to a partner to the amounts that the partner might be called on to contribute to the partnership's debts: ss850A-850D ITTOIA. But these limitation provisions do not apply in the periods under appeal: see *Reed v Young* [1986] STC 285.

363. Section 33 ITTOIA provides that no deduction is allowed in calculating the profits of a trade for items of a capital nature.

364. Section 34 ITTOIA provides:

> **34 Expenses not wholly and exclusively for trade and unconnected losses**
>
> (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.

## REVIEW OF FACTUAL EVIDENCE

### Mr Levy's evidence

365. I found Mr Levy to be straightforward and credible as to the underlying factual background of the matters under appeal. However, I did not find his evidence as to his intentions or motivations to be credible – particularly his statement that his intention in structuring Project Adriatic to provide sideways loss relief for investors, was to provide a

level of commercial protection against a risky commercial proposition. I make this finding in the light of the fact that, for example, the after-tax returns to investors on a worst-case basis were better (based on Foundation's own projections distributed in March 2009) than if Project Adriatic's outturn fell within the middle of the ranges of the projections.

366. I find also that he was unreasonably optimistic about the commercial prospects of Project Adriatic in Spring 2009, when these prospects were (on any reasonable view) very weak indeed. This optimism may well have been coloured by his evident desire to "close" Foundation's financing in 2008/09 in order to lock-in the sideways loss relief for investors and to generate fees for the Future Group.

367. Mr Levy admitted that he had no previous experience in property construction or development, nor in marketing and selling a hotel/apartment project such as Project Adriatic, and I so find. Although there was some evidence that Mr Levy was familiar with the Balkans and had visited the area with his then wife (who was a Croatian national), there was no evidence before me that indicated that Mr Levy had any previous experience of doing business in Montenegro, and I find that Mr Levy had no previous experience of doing business in Montenegro.

368. I also find that no one else at FCP had any experience in property construction or development, nor in marketing and selling a hotel/apartment project such as Project Adriatic, nor in doing business in Montenegro.

**Mr McGovern's evidence**

369. Mr McGovern was a straightforward and credible witness. He is clearly very experienced in managing substantial and complex property development projects. But he had not been involved in Project Adriatic prior to 5 April 2009, and therefore could provide no direct evidence on the issues with which the Tribunal has to contend. However, his evidence was helpful in understanding and interpreting some of the evidence relating to the period prior to his appointment. His evidence relating to the events occurring after his appointment also throws light on the unpreparedness of Foundation prior to his appointment.

370. Mr McGovern's evidence supported the uncommercial nature of Foundation's activities. In particular, his evidence was (and I find) that it was standard practice in the construction industry to contract at a fixed price only in circumstances where the contractor had undertaken a detailed costing analysis (rather than using a price per square metre of the building's size). Mr McGovern confirmed (and I find) that no detailed costings had been undertaken prior to Manly being instructed, and that work on detailed costings only occurred following the instruction of Mace in summer 2010. Mr McGovern also confirmed (and I find) that the fact that the project was located in a seismic zone – as well as the issues relating to the composition of the soil underneath the site – would have complicated the construction (for example because of the length, number, and nature of the piling for the foundations, the need to use expansion joints, and the inability to use "plug-and-play" construction techniques), which would also have added to the cost.

**Mr Hannington's evidence**

371. I did not find Mr Hannington to be a reliable witness. The overall impression that I got from Mr Hannington's evidence was that he was not a "details" person. Although he attended lots of meetings, made lots of notes, and retained lots of files of documents – I doubt the extent to which he engaged with the details. He admitted that he did not read agreements, and he did not look at the details of the "small print". He relied on others (like Mr MacIntyre) to do this work for him. He appears to have made decisions on a highly impressionistic basis - and there is a strong flavour of his decisions being compromised by confirmation bias – that he placed greater weight on information that confirmed his impression that Project Adriatic

was going to be successful, and less weight on the information that suggested that there were problems.

372. His boosterism and confirmation bias may also have infected his recollection of events (and their timing), as his recollection about the timing of events was incorrect on several occasions, so that events happened in his mind either earlier or later in his evidential narrative than they occurred in reality. In particular, his evidence about the timing of events in spring 2009 was poor, and his oral evidence was contradicted by the documentary evidence in various respects. To take just a few examples: he could not give clear oral evidence about meetings he attended (particularly the meeting in early December 2008), even though details of these meetings were set out in his witness statement; he was confused about whether work streams were allocated to partners in meetings on 30 March 2009 and on 9 April 2009, even though he exhibited minutes of those meetings to his witness statement; his statement that he had a telephone conversation with Mr Comyn prior to attending the seminar in December 2008 cannot have been correct (as he subsequently admitted); and his evidence that he was given a copy of Savills' development consultancy report on 27 January 2009 also cannot be correct, as the report was dated September 2009. He was also confused about when he learned of the results of the geotechnical survey of the site at Budva – his initial evidence was that he knew about the results before he committed to invest on 17 March 2009, even though a precis of the results was only sent to Foundation on 21 April (and the copy included in the bundle has the manuscript annotation: "we are not going to tell the partners about it"), and the English translation of the survey can only have been made available to the partners subsequently. Mr Hannington subsequently conceded in cross-examination that he could not have seen this report prior to making his investment decision.

373. Mr Yates suggested to Mr Hannington that not only did he not understand the details of the Montenegrin planning system, but further, that he did not understand the detail of the structure to which he was committing himself. Mr Hannington did not deny this – rather he sought to deflect the question by saying that because the Montenegrin federal government were supportive of Project Adriatic, the project was not just "a hope and a prayer".

374. There were other aspects of his evidence that I did not find credible:

(1) His assertion that the conversion of Foundation to an LLP was his idea, when the evidence indicated that such conversion had always been intended –FCP's structure for the Shard certainly envisaged that the partnership used in that structure would be converted into an LLP at a later stage, and the 18 March 2009 investment appraisal refers to a possible conversion.

(2) His claim that his analysis prior to making his investment decision was that the likely return on his investment would be "considerably more" or "a great deal more" than the returns projected in FCP's presentations. In his witness statement, Mr Hannington says that he had satisfied himself that the viability of the transaction seemed robust. Although Mr Hannington visited Budva and had read about Montenegro, prior to making his investment, he had not seen any of the underlying financial models used by FCP, he had not himself read any of the underlying contracts, and he was unaware of the contractual rights of the different parties to the co-venture.

(3) Whilst Mr Hannington may have believed that the return on his investment would be a great deal more that the projections set out in the investment appraisals published by FCP, his belief is not supported by the underlying financial or contractual documents. During the course of his evidence Mr Hannington said that he had been given a lot of analysis ("analysis paralysis"), but there is no suggestion or evidence that this "analysis" included anything other than FCP's marketing literature, and in

particular did not include any of the detailed financial models. Mr Hannington's evidence was that

> […] there were just figures all over the place as to how this was all going to work. And eventually, you know, one makes a judgment, I guess.

This is not a statement of a professional who has undertaken a serious appraisal of potential investment prospects. In my view, and I find that, Mr Hannington's opinion that Project Adriatic would make "considerably more" or "a great deal more" than the projected returns was just wishful thinking on his part. Mr Hannington's bullish confidence in the likely profitability of Project Adriatic stands in contrast to the balanced advice Mr Comyn had given to Mr Crossland in March 2009.

(4) I do not believe Mr Hannington's evidence that he knew about the Montenegro planning regime prior to his investment – other than that his rather simplistic and generalised statement that he knew there must have been some kind of planning regime in existence. When he was cross examined about his knowledge, he did not deny that he did not have any detailed understanding of the Montenegrin planning system. Any knowledge about the detail of the Montenegrin planning regime can only have come from reading Vector's 2 April 2009 report about the geotechnical and planning issues which addresses planning points in detail. And he was not given a copy of this report until after he had made his investment.

375. I note that Mr Hannington said in the course of his evidence that he had not appreciated the nature of the commitment he had made when he agreed to become a partner in an English "common law" partnership, with unlimited liability for its obligations. His evidence was that he had not himself read either any of the construction contracts, instead he spoke to one of the other partners (Mr MacIntyre – who was an accountant) about them. He confirmed that he had not appreciated in March and April 2009 that he (together with the other partners in Foundation) had an unlimited obligation to construct a hotel and residential complex (estimated at the time to cost €100m), having raised only €7m (disregarding the €30m of Barclays financing, as it was repaid on the same day that it was borrowed).

376. I also note that Mr Hannington could not explain why he had not raised any complaint about the deletion of the liquidated damages provisions in the Partnership Consultancy Agreement (the so-called downside protection), which was described in the marketing literature. But he did say during the course of his evidence that he did not recall the references made to this protection in FCP's marketing literature (which goes to support my finding that Mr Hannington did not read any documents in any detail).

377. I also note that Mr Hannington's involvement in Foundation's business prior to 5 April 2009 was minimal. The documentary evidence is that he attended a partners' meeting on 30 March 2009, where Mr Levy gave an update. He said that he had read some of the documents provided to him and talked to the other partners prior to that meeting. But I find that he did not read documents in any detail, certainly he admitted to not having read any of the contractual documents. And there is no evidence of the involvement of the other individual partners in Foundation's work prior to 5 April beyond attendance at partners' meetings. I find that there was no material engagement with the project by the individual partners during the 2008/09 tax year. I find that any involvement that they had with the project occurred after 6 April.

**Commercial nature of the project**

378. I find that Foundation's involvement in Project Adriatic was artificial and lacked any commercial character.

379. The presentation given on 3 December 2008 (attended by Mr Hannington) and the email to Premier Group projected a pre-tax anticipated return for investors of between 1.5- and 3-times initial investment, and a worst-case post tax return of 1.6 times initial investment "regardless of commercial success". Assuming a marginal rate of tax of 40%, the post-tax return would be between 0.9- and 1.8-times initial investment. The returns made by an investor after tax would therefore be roughly the same – whether the project failed, or whether it succeeded. Indeed, if the outturn fell within the middle of the projected ranges (2.25 times investment), the after-tax return (1.35 times) would be worse than the worst case if the project failed altogether. This indicates to me, and I find, that investors must have been attracted to invest in Foundation primarily because of the tax loss purportedly generated by the project, and not because of the prospect of commercial returns.

380. I do not believe Mr Levy when he says that his intention in structuring Project Adriatic to provide sideways loss relief for investors, was to provide a level of commercial protection against a risky commercial proposition. If Mr Levy really wanted to provide a level of commercial protection to Foundation's investors, why was the liquidated damages provision removed from the final executed version of the Partnership Consultancy Agreement? Mr Levy was not able to provide an answer to this question. In my view, and I find, that this description was "window dressing", intended to misdirect HMRC, rather than being a true description of the deal.

381. I do not believe Mr Hannington when he said he invested in Foundation because of its potential to deliver a strong financial return – and not because of the tax shelter that it offered. Nor do I believe Mr Hannington when he said that he considered that the likely return on his investment would be "a great deal more" than the returns projected in the investment memoranda published by FCP. I have found that this was just wishful thinking on his part.

382. I find that the pre-tax anticipated return of between 1.5- and 3-times initial investment was based on unreasonably optimistic projections of the likely sale prices for residential units (even after recognising that the Montenegrin property market was depressed in 2008/09, and might recover by the time the apartments were ready for sale). Mr Levy's email to his sales team of 16 March states that if the apartments were being sold "today", the project would break even on the residential element. CB Richard Ellis in their telephone call with Vector estimated that likely sale prices would be €2000/m$^2$ to €3000/m$^2$ (admittedly unfurnished), and the financial model sent by FCP to Mazars assumed average sale price of just over €2000/m$^2$. The CB Richard Ellis report of December 2008 uses a base case of €3,000/m$^2$ to €3,500/m$^2$ – and Mr Comyn's email to Mr Crossland suggests sale prices of €3,500/m$^2$ to €4,000/m$^2$ and notes that apartments at Porto Montenegro (which I find to be a much higher-class resort than Budva was ever intended to be) were being marketed at €4,500/m$^2$. Yet the March 2009 investment appraisal gave a range of projected returns based on sale values ranging between €3525/m$^2$ and €5000/m$^2$ so that the "low case" in the March 2009 appraisal falls within the base case range of CB Richard Ellis's report – and all the other scenarios set out in the appraisal use sale figures in excess of CB Richard Ellis's base case.

383. Further, I find that the financial models prepared by FCP prior to 6 April 2009 were not complete and commercial financial models. The email from Mr Nghi to Mr Young of 26 April 2009 shows that the financial modelling of the project was incomplete as at that date. The first financial model that appears to give a complete analysis of costs included within the evidence is dated 2 September 2013. Mr Levy's evidence was that the reason that no final model was produced was:

> I think the reality is that models were constantly being produced and that's why I made a rather flippant comment yesterday that there were probably

> 500 models, because there probably were over the life of the deal, there have probably been 500 different models. And so, they've always been constantly being iterated to reflect new facts, different build costs, different assumptions and so forth.

But I find that this just emphasises the complete uncertainty of Foundation's financial situation as it was not possible to produce a final financial model for the project prior to the investment by the investors (or indeed, within a reasonable period thereafter).

384. Mr Rivett in his submissions referred me to Mr Hannington's evidence that he invested in Foundation to make a profit from property development – but, for the reasons I have given earlier, I do not find his evidence credible.

385. Mr Rivett also submits that the other investors were commercially motivated – Mr Ashton was an experienced businessman, Mr MacIntyre was an experienced accountant, and Mr Kenner was a hedge fund manager and sophisticated investor. But none of these individuals gave evidence, and I do not know on what information they based their investment (beyond the documents that were presented in evidence and which are discussed in this decision). In particular, I do not know the extent to which the potential availability of sideways loss relief motivated their investment. As the post-tax returns (on the mid-level projected outturns) were worse than the post-tax returns on the worst case (at least as presented on 3 December 2008), it is most unlikely that investors were attracted to Project Adriatic because of the potential commercial returns. I find that the other investors were not commercially motivated in making their investment in Foundation.

386. Mr Rivett also referred to the fact that Mr Levy was himself an investor and had experience of undertaking over 600 investments totalling more than £8 billion during his career. But Mr Levy's motivation for investing in Foundation were very different from those of the other investors, as Foundation would generate substantial fees for his business irrespective of its success. And I discount his experience of undertaking over 600 investments, as these would have been wholly or mainly in structures intended to deliver to investors the tax reliefs associated with film production – his evidence was that he had undertaken a strategic shift in FCP's business, and that Foundation represented one of its first projects outside tax-based film production. Mr Levy was not an experienced investor when it came to property development, let alone property development in Montenegro.

387. Mr Levy's 7 January 2009 "pls delete" response to Boka's email demonstrates that the co-venturers were aware that obtaining a commercial return was, for FCP, secondary to allocating as much risk as possible to Foundation – so that Foundation could obtain a tax-deductible write-down for their investors. Mr Levy admitted that he encouraged everyone to delete Boka's message because he considered that it would be "unhelpful" if HMRC ever saw the messages. I find that a commercial business would have sought to mitigate rather than maximise risk, and that FCP's desire to allocate as much risk as possible to Foundation showed that these arrangements were not motivated by any commercial intention.

388. I find that in March and the beginning of April 2009, Project Adriatic was still very much in the very early stages of conception. It was nowhere near the stage at which a construction contract could be put out to tender on a commercial basis. Whilst ORMS had been asked to become involved in mid-March, they were described by Mr McGovern as a firm of "concept architects", who had done some "initial work" – in my view, and I find, such work as was done by ORMS was insufficient to be able to define the work that would need to be done by a design and construction contractor in order to construct the Project Adriatic building.

389. Mr Young emails Vector on 22 March 2009 saying that Foundation needs "concrete comfort" on the geotechnical issues before proceeding, and receives a response that because of the high water table and the ground being sand and silt, the JU Institute would probably be happy with 11 storeys, but that "prohibitively expensive" piles might be required to build to 17 storeys – which is why the geotechnical survey is required. Yet, Foundation enters into the Principal Construction contract and the Construction Sub-contract on 1 April – before FCP receives Vector's due diligence report on 2 April 2009 – notwithstanding Foundation's expressed need for "concrete comfort" on the geotechnical issues. The report also states in bold "Client is advised not to fully commit to the investment until confirmation is received that at least 11 levels will be permitted and further engineering analysis has been undertaken". Even though Mr Young says that Foundation needs to be absolutely sure about the geotechnical survey before proceeding, he does not read Vector's report until shortly before 14 April 2009, and it was not read by Mr Levy until 14 April 2009 at the earliest. I find that this is not the behaviour of a commercial business.

390. In cross-examination, Mr Levy said, "I accept that subsequently the partnership had to enter into other co-venturing agreements with other partnerships under which it had to pay away a proportion of its entitlement to income to try and make the project viable overall", acknowledging that Foundation had entered into the suite of agreements at the end of March/beginning of April 2009, in full knowledge that the project was not then viable. Mr Levy also acknowledged that tax was a "very important part of this transaction", and there were tax reasons for wanting the transaction to happen before the end of the 2008/09 tax year. There was no business reason why the execution of the Principal Construction Contract and the Construction Sub-contract could not have been deferred by a few days to await receipt of Vector's report. I find that the only reason why these agreements were signed on 1 April was to ensure that the investors accrued their purported trading loss in the 2008/09 tax year. I find that a commercial design and construction business would have deferred entering into the Principal Construction Contract and the Construction Sub-contract until after it had received Vector's report, even if that meant pushing execution into the 2009/10 tax year.

391. I find that at the time the Principal Construction Contract and the Construction Sub-contract were signed on 1 April 2009:

(a) The co-venturers believed that it was necessary for the hotel to have 17 storeys, otherwise the hotel would be " a large, bulky structure, which would create masses of unusable internal space, and would not provide the necessary light, air, and views to create a successful design". After La Cite withdrew from the project, hotel operators other than InterContinental were approached about managing the hotel, and it appears that some of the other operators were content to manage a hotel that was less than 17 storeys high – but as at 1 April 2009, everyone engaged in Project Adriatic believed (and had reasonable grounds for that belief) that the hotel had to have 17 storeys;

(b) Insufficient capital had been raised by Foundation, such that BPHS did not have sufficient finance in place in April 2009 to be able to acquire all the Lenley shares;

(c) Neither Boka nor La Cite had committed any finance to the project (indeed La Cite subsequently withdraw from the project);

(d) The DUP provided that construction of only 5 storeys was permitted at the Project Adriatic site, and the DUP would need to be amended to permit a taller building. And even if construction of a taller building were to be permitted, there

was considerable uncertainty about whether planning consent would ever be given to the construction of a building higher than 11 storeys;

(e) There was considerable uncertainty about whether it was feasible (in engineering terms) to construct a building higher than 13 storeys (other than at a prohibitive cost) given the height of the water table, the uncertain nature of the ground under the site, and the fact that Budva was in a seismic zone;

(f) Budva's water, sewerage, and electricity infrastructure was inadequate to cater for the proposed development; and

(g) There had been no detailed exercise to determine the cost of constructing the project.

392. BPHS's funding to purchase the Lenley shares was to have come via the amount paid by Foundation to IPCS. The fact that BPHS had insufficient funds meant that it could not acquire all the Lenley shares. And until it had acquired all the shares, construction could not commence on the site – and until construction had finished, there would be no apartments or hotel generating cash-flow to be paid to Foundation. Although Mr Levy's evidence was that construction could have commenced prior to BPHS acquiring all the Lenley shares, this could only have been with Atlas's consent, and there was no evidence indicating whether Atlas would have consented, and if so, on what terms. I find that a commercially motivated business would not have proceeded without at the very least having determined whether Atlas would consent to construction commencing prior to their shares being purchased, and the terms they would exact for giving that consent, and this was not done. I find that the viability of the construction agreements was dependent on sufficient funds being raised to enable BPHS to acquire the balance of the Lenley shares. And I find that sufficient funds had not been raised by BPHS (whether through the loan arrangements with IPCS, or otherwise) to enable it to acquire all the Lenley shares at the relevant times.

393. I find that if Foundation had been commercially motivated, it would not have entered into the Principal Construction Contract or into the Construction Sub-contract on 1 April 2009 given all these facts and the uncertain state of the project (and its likely cost and feasibility) at that time.

394. I find that the primary reason why Foundation entered into these agreements on 1 April 2009 was to secure the write-down of its stock in the 2008/09 tax year, and the associated purported ability of the Foundation investors to claim sideways loss relief for tax.

395. And because of the uncertain nature of the project, I find that it was not possible to enter into a suite of construction contracts on a commercial basis for a fixed price – as it was not possible to define exactly what it was that was going to be built. And I find that this is one of the reasons (but not the only reason) why the Construction Sub-contract had to be concluded with a related party (namely ICPS, an entity under the ultimate control of Mr Levy), because no unrelated third party would be prepared to enter into a contract whose obligations were as uncertain and uncommercial as the obligations in the Principal Construction Contract (which were mirrored into the Construction Sub-contract) (I address the uncommercial nature of these agreements below).

396. I also note that there was a distinct absence of any concern on the part of Foundation and its partners as to the abandonment of the liquidated damages provisions in the Partnership Consultancy Agreement. And no satisfactory evidence was given as to why this provision was omitted from the final suite of agreements. Although Mr Levy initially said that the omission was due to accounting/tax concerns, this cannot have been the case, given Mazars' advice on exactly this point.

## The Barclays facility

397. I find that there was no commercial purpose for the Barclays facility. Its primary and principal purpose was to allow FDBS to "lever" the amount invested by the various investors through its capital contribution, in order to amplify the amount of sideways loss relief that the investors claimed. Its other purpose was to allow Mr Levy to participate in the profits of Foundation through FDBS's entitlement to share in profits as the corporate partner.

398. The lack of commerciality for the Barclays borrowings is illustrated by the terms of the facility, and the fact that Barclays had no interest in the viability of Project Adriatic, or any of the work undertaken by the professional team at the time (Vector, ORMS, CB Richard Ellis, Savills). The reality is (and I find) that the terms of the loan facility and the security provided to Barclays meant that neither Foundation nor IPCS (as its subcontractor acting on its behalf) were ever free to spend the funds provided by the facility (and contributed to Foundation by FDBS) on the substantive design and construction of the project, because the funds had to be back with Barclays by the end of the day. And it was because Barclays were assured of the return of their funds within the same working day, that they had no need to consider the viability of Project Adriatic, and whether it represented a commercially viable business capable of supporting a bank loan of £30m+.

399. Mr Levy could not provide a reason for the facility – other than it

> allowed our structure to work. And our structure was designed around using tax as a risk mitigation technique for investors.

400. Mr Levy did not dispute that the circular financing arrangement meant that the investors could seek to claim a greater amount by way of sideways loss relief than if no such finance had been in place. In addition, the structure enabled Future to share in the profits of the project if it was successful:

> Q. But can I just summarise what I think your evidence is, and please correct me if I am wrong? […] You say you needed the Barclays financing as part of the structure to persuade the investors to invest because that would obviously help then from a tax point of view, and that would then make the deal work and would allow essentially the funding of the land, which would then allow other parties to come in at some point to make the whole deal work. I mean, is that basically the gist of it?
>
> A. Yes.

## The construction agreements

401. I find that the Principal Construction Contract and the Construction Sub-contract were not concluded on arm's length terms and were wholly uncommercial and artificial for the following reasons.

402. The "employer" under the Principal Construction Contract was BAD. It was never satisfactorily explained why BPHS did not itself engage Foundation, nor why BAD was only 50% owned by BPHS. As BAD had no interest in Lenley or the underlying property, it had no source of revenue from which it would be able to pay Foundation the consideration due under the Principal Construction Contract. Mr Levy could only say that he had been advised by DLA that BPHS should only have a 50% interest in BAD for tax reasons but could offer no justification for this structure. Nor could he explain whether BAD was acting as agent for BPHS in contracting with Foundation – or whether it was intended that ultimately some of the profits derived from the underlying property would be routed through BAD. In my view, and I find that, the only basis on which BAD could have contracted with Foundation was as agent for BPHS.

403. The terms of the Principal Construction Contract relating to the consideration payable in respect of the hotel's income were odd – and would require major redrafting to become workable.

404. The specification for the construction of the building is extremely vague. The drawings included in the Employers Requirements provide for a building that is 14 storeys above ground – this is greater than both the 5 storeys that Vector's report state is designated under the DUP for the Project Adriatic site, and the maximum 11 storeys permitted elsewhere in Budva under the DUP, but is less than the 17 storeys required by La Cite and InterContinental. And the rooms schedule provides for a building of 7 storeys. On any basis, the specification in the Principal Construction Contract is internally inconsistent and is for a building that meets neither the requirements of the DUP nor the requirements (as advised by La Cite) of the intended hotel operator. The plans are dated January 2009, have Atlas's logo printed on them, and Mr Levy described them as having been produced by Atlas. It appears likely – and I find – that these plans were developed by Atlas in January 2009 and these were not updated prior to the drafting of the Principal Construction Contract being finalised. The result is that Foundation (and – because the specifications are mirrored in the Construction Sub-contract – IPCS) is under an obligation to construct a building that is neither permitted under the DUP, nor is desired by BAD/BPHS (as it would not satisfy InterContinental's requirements for appointment as hotel operator). Whilst I recognise that both contracts provided for the specification to be amended, I consider that a court would have implied some limits on the scope of the employer to make amendments – not least in the Construction Sub-contract, given its fixed price.

405. The Construction Sub-contract "piggy backs" off the Principal Construction Contract as regards the specification of the building works to be undertaken by IPCS – and so the problems identified with the Employers Requirements in relation to the Principal Construction Contract apply equally to the Construction Sub-contract.

406. But it is the non-refundable payment mechanism in the Construction Sub-contract that above all else demonstrates its uncommercial and artificial nature. Mr Levy explained that the reason why the consideration was not refundable was tax motivated, allowing Foundation to trigger the writing-down of its stock – and thus giving rise to the tax losses. He also said that IPCS was unlikely to accept an instalment payment arrangement from Foundation – a group of individuals with whom it had never previously contracted. He also said that these provisions gave IPCS "credibility and substance":

> So, there were both tax reasons, accounting reasons and commercial reasons why it was structured that way.

407. I do not agree with Mr Levy that having an up-front non-refundable payment would give IPCS credibility and substance, as virtually all of the payment made to IPCS is immediately paid away and is used to repay the Barclays daylight loan and to fund the purchase of some of the Lenley shares. The explanation that IPCS would not be prepared to contract with Foundation on an instalment payment basis is disingenuous – these are related parties both (in substance) under the control of Mr Levy, and the reasons why IPCS would not contract with Foundation on the basis of instalment payments (lack of substance), are equally good reasons why Foundation ought not to contract with IPCS on the basis of a single up-front payment – especially in circumstance where substantially the whole of the amount paid is on-lent, leaving IPCS with no funds to pay for the construction of Project Adriatic. And Mr Levy confirmed in his oral evidence that everyone was aware that IPCS had not retained sufficient funds to be able to meet its obligations under the Construction Sub-contract. Mr Levy's evidence was that the parties expected further funding to be made

available by commercial partners in the project – but he agreed that no such commitments had been made.

408. And Mr Levy's reasons do not provide a commercial explanation for the payment under the sub-contract being non-refundable – even if the contract is terminated because of a breach by IPCS, or if the scope of works are reduced. No commercial business would have agreed to make an irrevocable payment to IPCS in circumstances where there was no certainty that the project could proceed (not least, because the developer – BHPS – could not afford to buy all the shares in the owner of the development site – and Foundation (by Mr Levy – its managing partner - who was also a director of IPCS) was well aware of these facts).

409. I find that the only reason why the consideration payable under the Construction Sub-contract was paid up-front and was non-refundable was to provide justification for Foundation to be able to write-down its expenditure under the Construction Sub-contract, thus triggering a tax loss that could be utilised by the investors by way of sideways relief. There was no commercial reason for this provision.

410. Also of significance, in relation to both the Principal Construction Contract and the Construction Sub-contract, is the scope of the work to be undertaken – particularly the amount of work to be undertaken in the light of the amount of funding raised. Mr Levy acknowledged in his evidence that Foundation had not raised enough money to be able to meet the then anticipated costs of building out Project Adriatic – at least €100m. In early April 2009 there was recognition that the construction contracts had been drafted (and executed) on the basis that Foundation had raised £100m, and Foundation's minutes of 30 March 2009 note that there would need to be a *pro rata* reduction in Foundation's "profit shares". But this was never done – presumably because the inevitable consequence of a reduction in Foundation's profit share under the Principal Construction Contract would be a corresponding reduction in the amount of its construction work – and it is not realistic or possible to amend the Principal Construction Contract so that Foundation could just stop working when its money ran out.

411. And what is true in relation to Foundation's obligations under the Principal Construction Contract, applies equally in relation to IPCS's obligations under the Construction Sub-contract – as it had committed to build Project Adriatic for £37,762,650.76 when it knew that the cost of the construction was estimated to be €100m.

412. The solution to this conundrum (apparently devised by DLA) was for Foundation to remain obligated under the Principal Construction Contract to construct the entire project, but to enter into a series of parallel arrangements with other entities (including Opus Design and Build Partners (GP) ("Opus")), under which Foundation ceded a proportion of the consideration payable under the Principal Construction Contract, in exchange for the other entity agreeing to take on part of the construction obligation.

413. The arrangements with Opus were documented in (amongst other agreements) a "Deed of rectification and amendment" between Foundation and IPCS, and a "Co-venture agreement" between Opus and Foundation, both dated 19 October 2009. These contracts split the works to be carried out under the Construction Sub-contract as between "FGP Works" and "Opus Works." In return for Opus incurring expenditure of £23,340,000, Opus was to be paid 13.94% of "the Entitlement" (in other words, the amounts payable to Foundation under the Principal Construction Contract). The Co-venture Agreement states that Project Adriatic was now expected to cost £167,398,519, and there were provisions in the agreements for Opus's percentage share of the Entitlement to be adjusted depending upon the actual expenditure incurred by Foundation and Opus.

414. At least twenty other parallel partnerships were subsequently introduced. Of course these parallel entities were all established after 6 April 2009, and it would be wrong to analyse the true meaning of the Principal Construction Contract solely on events that occurred after it had been executed. But these events do shed light on the intentions of the parties at the time they entered into the agreement. It is utterly surreal to contemplate a co-venture arrangement involving some twenty-two parallel entities (including Foundation) in the circumstances of this case as somehow undertaking parallel trades engaged in designing and constructing Project Adriatic, or that these amount to anything other than an arrangement under which the entities contributed equity finance to Project Adriatic.

415. Both the Principal Construction Contract and the Construction Sub-contract included provisions allowing the employer to make changes to the specification without any corresponding adjustment to the consideration payable under the agreement.

416. I find that no business of a commercial character would have entered into an agreement to construct a hotel and apartment complex which it believed would cost €100m to construct, having only raised £10m (approx.) of financing, and with no commitment from other parties to contribute to those costs. Nor would such a business sub-contract those construction obligations to a sub-contractor, in circumstances where (a) the consideration paid under the sub-contract was fixed at £37m, but the estimated construction costs were €100m, (b) knowing that the sub-contractor would immediately pay away the overwhelming majority of the consideration, leaving it with virtually no funds to meet the construction costs, (c) under a contract which provided that none of the consideration was repayable under any circumstances, and (d) where the contract permitted the employer to change the design without there being any adjustment to the consideration. I therefore find that Foundation had no commercial basis for entering into the Principal Construction Contract nor the Construction Sub-contract.

### The Services Contract

417. No consideration (additional to that payable under the Principal Construction Contract) is payable under this agreement to Foundation. This agreement relates to the marketing of the project to customers. CB Richard Ellis did not anticipate that any marketing in relation to the sale of the apartments would occur until May 2010 (on the original construction timeline), and there was no evidence before me that any services were provided by Foundation to BAD (or anyone else) under this agreement at any relevant time.

### The Partnership Consultancy Agreement and the Takeover Agreement

418. It was conceded by Mr Levy that both agreements had been backdated.

419. As regards the Takeover Agreement, as the business concept had been well established in the hands of Foundation by February/March 2009, Mr Yates submitted that there was no real need for Foundation to pay FCP for the "concept". Mr Yates suggested to Mr Levy that the payments made under these agreements were (from the perspective of Foundation in March 2009) therefore purely voluntary:

> Q. Well, there is no need for the partnership to have the permission of Future Capital Partners to continue its existence because it is already fully formed, and it has already signed the agreement?
>
> A. Well, I'm afraid I don't recollect all the details of how and when and why things happened. I'm not sure that there's very much more I can say on that.
>
> Q. And, as we discussed yesterday, that is the reason, I suggest, why it was thought appropriate to backdate it, to avoid that uncomfortable commercial reality - but I think I have already asked you to address that and you have given your answer.

A. Yes.

420. Mr Levy's explanation was that FCP had spent a great deal of money on developing the structure (not least on professional tax and accounting advice), and his "educated hypothesis" was that there had been discussions in 2008 that Foundation should pay to take over the concept, although these arrangements were not formalised until later (which is why the document was backdated to those discussions).

421. Whilst Mr Levy's "educated hypothesis" might provide some basis for the backdating of the Takeover Agreement, it is not a strong reason. And no reason was given by Mr Levy for the backdating of the Partnership Consultancy Agreement. I find that the reason for the backdating of both agreements was to give them a better appearance of "commerciality" by appearing to have been executed when Foundation was established, rather than in February or March 2009.

422. Mr Rivett submits that under the terms of the Partnership Consultancy Agreements Foundation paid for the provision of various services, including providing property advisory services with respect to potential construction and design projects, and advising Foundation whether to undertake, what to do in relation to those projects, and scoping and advising on material aspects of the services to be provided by Foundation to a developer – and referred me to Schedule 1 of the agreement. But it is abundantly clear that Foundation Design did not have the capability of providing the services specified in this agreement – and neither did anyone at FCP have these capabilities. Mr Levy was asked whether Future Design had any particular expertise to provide the services specified in the Partnership Consultancy Agreement. Mr Levy's response was that it had the services of Mr Comyn at Savills. But although Foundation Design engaged Mr Comyn to assist it in advising Foundation, his skill set was advising on marketing the completed development, the likely values to be achieved, and the likely return on investment – his skills did not encompass "building construction and design services", and the terms of the letter agreement between Savills and Future Design did not encompass the provision of advice relating to detailed construction and design beyond the selection of the professional team and high level review of the design considerations. And although Savills may have provided some very general advice on likely construction costs (primarily for the purpose of their assessment of the potential profitability of the project), these were very much "finger in the air" numbers and given at a time when there was no finalised design. No detailed costings were undertaken until 2010 when Mace were instructed to undertake a costings exercise.

423. To the extent that building construction and design services were provided, I find that these services were provided to Foundation by Manly as a sub-contractor to IPCS. And even though Mr Comyn introduced Mr McGovern to Mr Levy, Manly were engaged by IPCS and not as an advisor contracted to Foundation (and the evidence is that it was Manly who advised on the selection of the rest of the professional team, not Savills). Whatever services were provided to Foundation by Foundation Design, I find that they were not the "building construction and design services" specified in the Partnership Consultancy Agreement beyond the selection of the professional team and high-level review of the design considerations.

424. Not all the services provided under the letter agreement between Savills and Future Capital were then supplied onwards to Foundation. Some would have been supplied to BPHS as developer – for example advice relating to the acquisition of the site, and advice relating to the "mix" of the development as between hotel and apartments – these were not matters for Foundation to consider in its role as contractor. The only evidence before me as to the work Mr Comyn did for the benefit of Foundation was his work relating to investor marketing – such as his meeting with Mr Hannington and his correspondence with Mr Crossland. Savills

did produce in September 2009 (after the periods being considered in this appeal) a substantial report on market conditions and development consultancy – but this was a high-level strategic report, rather than anything addressing the details of the design and construction of the building.

425. What Foundation was paying for under the Partnership Consultancy Agreement was the work of the Future Group in providing prospective investors and persuading them to invest capital in Foundation. I further find that the primary benefit provided to Foundation under the terms of this agreement was the capital contributed to it by its partners, which was a long-term advantage of an enduring nature. I therefore find that the fee payable under the Partnership Consultancy Agreement was not incurred wholly and mainly for the purposes of any trade carried on by Foundation.

426. No reason was given why Foundation Design subcontracted the services of David Comyn to Foundation – and why Foundation did not itself contract with Savills for Mr Comyn's services (as appears to have been envisaged in a draft of the letter agreement), saving itself the significant margin between the fee payable under the consultancy agreement, and the fee paid by Future Design to Savills. I appreciate that it was open for Foundation Design to make a margin between the fee paid to Savills and the fee payable by Foundation – but the size of this margin (given Mr Levy's control of both sides of the contract) does suggest a lack of commerciality.

427. Further, the other terms of the Partnership Consultancy Agreement are themselves uncommercial and artificial, in particular the provision that payment under the Partnership Consultancy Agreement will continue for Foundation's life – for which Mr Levy could give no explanation.

428. Mr Rivett also submits that it is not open to me to find that the real purpose of the Partnership Consultancy Agreement was the obtaining of financing for the benefit of Foundation merely from the fact that Foundation Design made a significant margin between what it was paid by Foundation and what it paid to Savills – as Mr Levy may believe his services to be worth considerably more than those of Savills. However, Mr Levy's evidence was that Future Design's only ability to provide the services specified in Schedule 1 was that it had the benefit of Mr Comyn's services, and not that Future Design was also providing Mr Levy's services. Mr Levy's services were being given because of his role as Foundation's managing partner. And I have found that the services provided by Savills (and Mr Comyn) to Foundation Design did not encompass the provision of advice relating to detailed construction and design beyond the selection of the professional team and high-level review of the design considerations. I therefore find that Future Design could not, and did not, provide to Foundation the services specified in Schedule 1 to the Partnership Consultancy Agreement, what it provided was Mr Comyn's services in marketing Foundation to prospective investors.

429. Mr Levy, in his evidence, said that there were two principles behind these two agreements. The first was to generate a fee that covered FCP's costs and made a profit (Mr Levy clearly took the view that because Foundation Design was a Future Group company, its cash assets were available to the rest of the group). The second was the component services used to deliver that fee income, being the takeover fee and the consultancy fee, which he said were "both real things".

430. I accept Mr Levy's first principle, but not the second. The only "real thing" that can be said to be provided by FCP to Foundation is the tax structure it developed. That this is the true substance of the Takeover Agreement is, in my view, reinforced by the drafting. Although the only fee payable under the agreement is for the provision of "Market Advisory

Services", the term "Market Advisory Services" is undefined. I note also that there is no obligation in the agreement for FCP to provide any services, other than the transfer of the business concept and the Project Adriatic opportunity and making their staff and representatives available for the purpose of fulfilling their obligations under the agreement. Although Schedule 1 lists various forms of help and support that Foundation could use to exploit the structure, there is nothing in the body of the agreement which incorporates the schedule or obliges FCP to provide the listed help and support. The sloppy drafting indicates that the parties had no real interest in establishing the scope of the services to be provided to Foundation, and the real purpose of the agreement was as a vehicle to justify the payment of a fee to FCP.

431. There is negligible underlying substance to the Partnership Consultancy Services Agreement. Future Design had no expertise or ability to deliver the services specified, other than to provide Mr Comyn's services to Foundation.

432. Whilst I do not consider that the Partnership Consultancy Agreement was a "sham" in the sense articulated by Diplock J (as he then was) in *Snook v London and West Riding Investments* [1967] 2 QB 786 (CA), I do find that it was "mislabelled" in the sense used by the House of Lords in *AG Securities v Vaughan and others; Antoniades v Villiers and another* [1990] 1 AC 417 (cited in *Ingenious*), and that I am not bound by labels that the parties have chosen to apply where those labels do not reflect the true nature of the legal rights and obligations created pursuant to the contractual arrangements. It is not that the provisions of the Partnership Consultancy Agreement obliging Future Design to provide the Schedule 1 services are dishonest or a sham, but rather they are statements which do not have the legal effect that they purport to have. I find that the services provided by Future Design to Foundation were the services of Mr Comyn, not the services listed in Schedule 1. And whilst Mr Comyn introduced Manly to IPCS, the evidence before me was that his work (insofar as it was provided to and used by Foundation in the periods up to 5 April 2009) was primarily for the purposes of promoting Project Adriatic to prospective investors. The fee paid to Future Design under the Partnership Consultancy Agreement was linked to the capital raised by Foundation and included an element that was payable for Foundation's life – it therefore tracked the commissions payable to financial advisors (including the trail commission).

433. I find that the real reason for both these agreements is given by Mr Levy's first principle: to generate fees that would cover FCP's costs and deliver a profit to it. And FCP's costs were substantial. In addition to its own costs and liability for professional fees, substantial commission as payable to financial advisors – one example given in evidence was of initial commission of 7.5% of equity raised, plus a trail commission of between 7.5% and 12.5% of Foundation's income. Mr Levy confirmed that the trail commission was being met out of the fees payable to Future Design, which passed the funds to other companies in the Future Group which had the obligation to pay the commissions. And the fact that the fee payable under the Partnership Consultancy Agreement is linked to the amount of capital raised by Foundation and continues to be paid for the life of the partnership, means that it tracks FCP's obligation to pay commission to financial advisors – and this supports my conclusion that the fee is in substance a commission payable for Future Group's services of raising capital for Foundation.

434. I find that what Foundation was in fact paying for under these two agreements was (a) the right to use a tax structure and business concept developed by FCP, and (b) Future Group's work in finding prospective investors and persuading them to invest capital in Foundation.

### Teaming Agreement

435. This agreement set out the broad terms of the co-venture that existed between Boka, La Cite, FCP, and Foundation. While I believe Mr Levy's evidence that Boka was agitating to get the Teaming Agreement signed in order to assure their fee, in my view, this was not the sole purpose of the Teaming Agreement, as it sets out in broad terms the roles of the different co-venturers, and gives a broad outline of the structure that is proposed to be adopted for the project. It is not disputed that the Teaming Agreement goes beyond mere heads of terms and creates binding obligations between its parties.

436. Mr Rivett submitted that the Teaming Agreement was superseded and did not reflect the deal that was actually done as Mr Levy's evidence was that the structure that was ultimately used was quite different to the one envisaged in the Teaming Agreement. And this submission is not wholly without merit – La Cite ultimately withdrew from the project, and the site was not parcelled up between entities in the manner set out in the Teaming Agreement.

437. But I also note that the Teaming Agreement was a binding agreement, and La Cite did not withdraw from the project until after the periods under appeal (and there is no evidence that indicated that La Cite's withdrawal was in any way anticipated prior to April 2009). I also note that on 28 March 2009 (after the signing of the Master Agreement), Mr Levy sought to renegotiate the terms of the Teaming Agreement, but without any success. Mr Levy would only have sought to renegotiate the terms of the Teaming Agreement if he believed that it continued to be relevant and bind the parties – notwithstanding the changes to the structure implemented by the Master Agreement. So, although the Teaming Agreement was superseded to some extent by events occurring since its signature (including the changes to the property ownership arrangements as a result of the Master Agreement), I find that it remained legally binding in other respects, and was in force in the periods under appeal.

## REVIEW OF EXPERT EVIDENCE

438. I found the evidence of both expert witnesses to be neither satisfactory nor persuasive.

### Ms Chew's evidence

439. I did not find Ms Chew's reports to be persuasive. Her reports (including her contribution to the experts' joint report and her supplemental report) did not address the underlying substance of the arrangements when taken as a whole, the Teaming Agreement, and the uncommercial nature of the construction agreements. I was also concerned that during her oral evidence she said that she lacked expertise in relation to businesses in the construction industry, and she was therefore unable to make any assessment as to whether the transactions in this Appeal had commercial logic (a necessary exercise for the purpose of determining whether paragraph 51 of FRS 5 is engaged).

440. I found her evidence about the Barclays daylight facility to be extraordinarily naïve - particularly in the light of her purported experience and expertise. Her answers concentrated on the fact that a lender would have undertaken due diligence and would take comprehensive security (such as, for example, when taking security over shares, requiring the shareholder to sign a blank stock transfer form). But in my view, this is to miss the point - she did not consider it unusual that the lender in this case undertook no due diligence, nor the fact that the amount advanced by the lender was repaid later on the day the loan was drawn down.

441. Although she did not consider the circularity of Barclays' financing arrangements in her original report, she did consider it in her supplemental report. Her comment in the joint report is that:

> […] her instructions are to address whether the Partnership's transactions in the period to 3 April 2009 are recorded in accordance with UK GAAP in its 2009 Accounts. She considers that the movement of funds outside of the Partnership is not within the scope of her instructions and therefore has not addressed it in her Report.

But she did not address why paragraph 51 of FRS 5 (which refers to transactions lacking in commercial logic) was not engaged, and appears not to have considered whether the expert declaration that she gave to the Tribunal (as set out in Practice Direction 35 in Part 35 of the Civil Procedure Rules) overrode the limitations on her instructions. It cannot be right for her to ignore the movement of funds outside Foundation (even if those movements are apparently outside the scope of her instructions) where those movements are material to her expert evidence. She was cross-examined at length by Mr Yates on the application of paragraph 51, and eventually did concede that (when addressing the accounting treatment of the substance of the arrangements) it was necessary to look beyond the immediate contracts to which Foundation was a party.

**Mr Bach's evidence**

442. Mr Bach was unable to give straightforward answers to even the simplest question. His answers were extraordinarily prolix – and he even managed to lose and confuse himself in some of his rambling long-winded answers.

443. Mr Bach's report also included what might be described as "pointed" comments on issues on which he had no professional expertise (in particular on the form of IPCS's invoices), which demonstrated a lack of independence and professional detachment on his part.

444. Although Mr Bach is a chartered accountant, it became painfully clear during his oral evidence that he has very little (if any) experience or expertise in dealing with partnership accounts, where the partnership forms part of what might be called a complex "structured" arrangement - such as Foundation. This is perhaps reflective of his experience prior to joining HMRC, which (from the CV annexed to his report) appears to have been either within accountancy firms at sub-partner/director level outside any major financial centre, or within a commercial business.

445. Mr Bach is quite the worst expert witness that I have ever come across in the thirty-five or so years that I have been in practice. I lost all confidence in his alleged expertise during his oral evidence, at least insofar as it relates to accounting for partnerships forming part of a complex structure (such as is the case here). Save to the extent that his evidence was consistent with, and corroborated by, Ms Chew's evidence, I have placed negligible weight upon it.

**Accounts and GAAP**

446. I found Mr Bach's evidence on the accounting treatment of the capital contribution by FDBS into Foundation, and the treatment of the payment by Foundation to IPCS to be unpersuasive. In particular, he had no answer to the question posed by Ms Chew as to why GAAP would not require a debtor to be recognised in the Accounts in respect of FDBS's unsatisfied obligation to make a capital contribution. I was not persuaded by his argument that the fact that the Foundation partners had not taken any action to enforce payment evidenced the obligation as having been met – and that there was therefore no liability to be recognised.

447. I was also unpersuaded by Ms Chew's evidence that the capital contribution and the payment to IPCS can be considered in isolation, without regard to the overall transactions – including the effect of the Teaming Agreement and the circularity of the flow of the funds

advanced under Barclays' daylight facility. However, after lengthy cross-examination, Ms Chew eventually conceded that paragraph 51 of FRS 5 required the broader transactions to be taken into account.

448. Ms Chew also conceded that there was an inconsistency between the financial analysis prepared on 18 March 2009 that was presented to prospective investors, and the cash flow analysis used for the purposes of valuing Foundation's stock as at 3 April 2009. She confirmed that there was a lack of logic in the use of two different discount rates in these cash flows, if nothing had changed between 18 March and 3 April (and that there was nothing in existence between these dates that only crystallised after 3 April). In addition, she agreed that (i) the position presented to the investors and prospective investors recognised hotel profits from 2011 onwards, whereas the analysis used for the accounts does not show any net profit until 2031, and (ii) the allocation of profits used in the accounting analysis was wrong, as it incorrectly applied a reduction of 37.8% (as it allocated the payment of BAD's net profits *after* construction costs in circumstances where Foundation was itself incurring those costs).

449. There was no independent evidence before me as to an appropriate discount rate to be used for a DCF valuation of the future cash flows arising to Foundation from the Principal Construction Contract. There was no evidence which backed up the use of the 10% rate used in the investor presentations, and the only evidence for the 37% rate used in the accounting analysis was Mr Levy's evidence that he was advised by Mr Comyn that Savills used 25% for UK development projects – and he then increased this to reflect the increased risks associated with Project Adriatic. Curiously there is no documentary evidence (such as an email exchange with Mr Comyn) to corroborate Mr Levy's evidence. I do not know what assumptions underpin Savills' usage of a 25% discount rate for UK development projects, and there is no evidence before me to justify why this should be inflated by roughly 50% to address the additional risks of undertaking projects in Montenegro.

450. Ms Chew's evidence was that she did not question the use of 37% as a discount rate as this was the rate determined by Mr Levy, whom she described as "an experienced investor", and she admits that she did not audit any of the assumptions backing the impairment calculation. If she had, she would have quickly realised that Mr Levy had no experience in property transactions, no experience of undertaking projects in Montenegro, and no expertise relevant in determining an appropriate discount rate for Project Adriatic.

451. I therefore have no evidence before me which justifies the use of a discount rate of 10% for the investor presentations, nor the use of 37% for the purposes of the accounting analysis. Should it become necessary, for any reason, to determine the appropriate discount rate that should have been used for accounting purposes, it will be necessary for me to hear evidence from appropriate experts as to what that rate should be.

452. Mr Rivett explained that the reason why there was a difference between the discount rate used in the investor presentations and for the impairment analysis, was because they were different things. Mr Rivett submits that one should be very careful not to confuse what the Accounts require in terms of being brought into account under GAAP, and the commercial expectations of the parties: when it comes to doing the impairment analysis, the accounting standards tell you that the amount which you must bring into account is only that which on a prudent basis is recognisable. But I find that Mr Rivett's submission is not supported by the evidence. What the accounting standard requires is that the Accounts record a realistic valuation – the net realisable value - namely what the asset can be sold for (if this is less than cost). Indeed, the evidence was that SSAP 9 makes it clear that the Accounts must not be "over-prudent", what needs to be brought into account is the foreseeable loss, not the worst possible case – it must be a reasonable estimate. And I note that the investment

appraisals produced for the benefit of investors gave a range of different projections – showing different outcomes in terms of sales. But they all used the same 10% discount rate to determine the net present value of future cash flows. Whilst it might be legitimate for there to be differences between the spreadsheets used to prepare the investor presentation and the impairment analysis to reflect the requirements of accounting standards and tax legislation, the underlying business-related assumptions should be the same – including the discount rate used.

453. However, for the reasons I give below, I have been able to reach my decision without the need to determine what discount rate ought to have been applied, as I can make the following observations and findings:

(1) Both experts agreed that recognition of any impairment of Project Adriatic was only justifiable under GAAP if an impairment event had occurred on or before 3 April (or the circumstances giving rise to the impairment were in existence as at 3 April);

(2) Paragraph 11 of SSAP 9 provides that:

> If it is expected that there will be a loss on a [long-term] contract as a whole, all of the loss should be recognised as soon as it is foreseen …

(3) I find that nothing had occurred on or prior to 3 April such that Foundation had an expectation that it would make a loss on the Principal Construction Contract (nor were there any conditions in existence as at 3 April which would give rise to such an expectation). In other words, I find that nothing had occurred that would give rise to an impairment between 1 April (when Foundation entered into the Principal Construction Contract and the Construction Sub-contract), and 3 April (the balance sheet date). I therefore find that no impairment should have been recognised in the Accounts (nor were there any conditions giving rise to an impairment event that were in existence as at 3 April 2009); and

(4) I find that nothing occurred between 18 March 2009 and 3 April 2009 that would justify a change in the discount rate to be used for the purposes of determining the net present value of future cash flows – nor was there anything in existence between these dates that only crystallised after 3 April.

454. Of course, there is a certain unreality in this analysis, given that the capital raised by Foundation was insufficient to pay for the construction of Project Adriatic. But the Accounts were prepared on a "going concern" basis, presumably on the assumption that additional capital would be raised to complete the project, and I recognise that in April 2009 FCP was already engaged in raising capital for a parallel partnership. So it is possible to envisage circumstance in which Mr Levy (who, under the clause 18.4 of the Partnership Deed, was responsible for approval of the Accounts) might believe that Foundation was a going concern.

455. In any event, I find that:

(1) what is sauce for the goose is sauce for the gander, and if the appropriate discount rate for valuing future cash flows was 37%, then (a) the project was wholly uncommercial and artificial from the outset – and was one that no commercially minded business would have undertaken, and (b) FCP must have deliberately misled its prospective investors by using 10% as the discount rate in its investor materials; and

(2) if the project had truly failed to the extent that it was unviable, then preparation of the Accounts on a going concern basis was incorrect, and Foundation would have either ceased trading (or, more likely, that trade would have never commenced).

456. I also find that the amount paid to IPCS under the Construction Sub-contract should have been treated as a pre-payment and not as stock in the Accounts. Although the fee payable under the Construction Sub-contract is described as non-refundable, IPCS would have been liable to Foundation in damages if it failed to perform its obligations under the contract. It is the opinion of both experts that in these circumstances the fee paid to IPCS is correctly analysed as a pre-payment.

457. As regards the fees paid under the Takeover Agreement and the Partnership Consultancy Agreement, I find that these were in substance paid (a) to acquire the tax structure from FCP, and (b) to remunerate the Foundation Group generally for raising capital from investors.

458. The best characterisation of the fee payable under the Takeover Agreement is, and I find that it is, a payment for a right to exploit a business concept – and is therefore payment for an intangible asset for the purposes of FRS10. It should therefore be capitalised, and the expenditure spread over the anticipated life of the asset.

459. As regards the fee payable under the Partnership Consultancy Agreement, I find that this was (in its entirety – including the £25,000 payable per investor) a fee for the services provided by FCP in raising capital from investors. From a tax perspective, this fee was not wholly and exclusively incurred for the purposes of any trade carried on by Foundation (if indeed Foundation is carrying on a trade – a point I deal with below), and would therefore not be deductible as a trading expense.

**SUBMISSIONS OF THE PARTIES**

460. Mr Rivett submits that Foundation's activities amount to the carrying on of a trade. Mr Rivett bases his submissions on the following grounds, that:

(a) the intrinsic nature of Foundation's activities amounts to a trade;

(b) an entity can trade through the activities of its sub-contractors; and

(c) the activities of an entity are not prevented from amounting to a trade merely because they are motivated by obtaining a tax relief.

461. Mr Yates for HMRC submits that Foundation did not conduct a trade during the 2008/09 tax year for the following reasons: that

(a) the Partnership's activities did not objectively amount to a trade when considering the Partnership's role and function as a matter of reality and having regard to the arrangements as a whole;

(b) the Partnership's activities did not amount to a trade given their lack of commerciality; and

(c) insofar as the Partnership's activities were, in theory, capable of constituting a trade, such a trade did not commence in the period.

462. Mr Yates submits that the reality of what Foundation did was make an equity contribution to a development project in return for a slice of the profits.

**Intrinsic trading nature of activities**

463. Mr Rivett referred me to Lord Reid's and Lord Wilberforce's speeches in *Ransom v Higgs* cited above. Mr Rivett notes that Lord Wilberforce identified the exchange of goods and services for reward as being the essential characteristic of a trade. In the case of Foundation, it was not disputed that it entered into legally binding contracts with BAD to provide services in exchange for a fee. And it was able to provide those services in consequence of the Construction Sub-contract with IPCS. Mr Rivett submits that these are

intrinsically trading transactions. Mr Rivett submits that entering into a contract to provide construction services for speculative reward is intrinsically a trading transaction. Mr Rivett also submits that the form of the consideration payable to Foundation – in essence a share in the profits or revenues arising from the sale of apartments and the operation of the hotel, have a trading character.

464. Mr Rivett also notes that it was the intention of Foundation's partners that Foundation's business amounted to a trade – indeed the desired tax consequence of being able to claim sideways loss relief would not be available to them if it was not engaged in trading. And Lord Wilberforce says that "intention" is one of the indicia of trading.

465. He also took me to the following paragraphs of the speech of Lord Morris in *Ransom v Higgs*:

> Bearing all this in mind the question still arises, what did Mr Higgs do?
>
> […]
>
> All that Mr Higgs did was to pay heed to an idea which was suggested to him, to take advice about it, to understand the purpose of it, though not to comprehend all the details of the scheme which embodied the idea, and then somehow to contrive that his wife and certain limited companies and others would act "at his behest" and play their part in effecting the transactions which the scheme necessitated. But can this in any rational or realistic sense be described as trading or as being an adventure in the nature of trade? Quite lacking are the indicia which are common to so many forms of trading activity. Mr Higgs was not himself concerned in any buying or selling activity. He gave no services. He supplied nothing. Nor, in any real sense, was he introducing anyone or acting as a broker.

466. Mr Rivett contrasts the lack of trading indicia identified by Lord Morris in the case of Mr Higgs, with the activities of the Foundation partners – who were actively concerned with buying and selling, who gave their services, and who supplied things.

467. He further submits that the level of activity by the individual partners (who were actively involved in the management of the partnership and were performing services for it) supports the characterisation of Foundation's business as trading, given that a partnership acts through its partners.

468. And submits Mr Rivett, the judgement of Millet J (as he then was) in *Ensign Tankers* (1989) 64 TC 617 (in the High Court – but upheld in these respects on appeal) takes this further, stating (at p 699)

> It is open to a partnership, like any other trader, to act through agents or independent contractors.

469. In the circumstances of this case, Foundation engaged IPCS as its sub-contractor – and through IPCS indirectly engaged architects, engineers, geotechnical surveyors, and the like. And the activities of these various suppliers can be attributed to Foundation for the purpose of ascertaining whether it is trading.

470. HMRC's Statement of Case describes Foundation as a passive participant in the Project Adriatic Transactions, and that it was

> Merely interposed with a series of entities controlled by Tim Levy and/or Future Capital Partners and/or the Boka Group in circumstances where the partnership's role was that merely of a passive participant.

Mr Rivett submits that because of the activities of its partners and sub-contractors, Foundation cannot be described as a passive entity. Mr Rivett referred me to the activities

carried on by the individual partners, and the engagement of specialist consultants (including Mr McGovern) by IPCS to act on behalf of the partnership.

471. Mr Rivett notes that the Upper Tribunal in the *Ingenious* case did not consider whether the activities of sub-contractors can be attributed to the ultimate principal (that issue is however the subject of an appeal to the Court of Appeal):

> 264. As regards the LLP's submission that the activities of the production services contract can be attributed to the LLP so that it can be regarded as a producer, that analysis was clearly not accepted by the FTT and no appeal is made against that finding.

Mr Rivett's submission is that Foundation trades through the activities of the underlying sub-contractors to IPCS and by the activities of its individual partners, but that the activities of the taxpayer here in question are in fact different from those in *Ingenious* (which, as noted above, is the subject of an outstanding appeal to the Court of Appeal).

472. In any event, says Mr Rivett, the entering into the Partnership Deed, the Principal Construction Contract and the Services Agreement are themselves (both individually and cumulatively) sufficient to constitute a venture in the nature of a trade for the purposes of s989 – and he referred me to the reasoning of the Privy Council in *Kowloon Stock Exchange v Commissioner of Inland Revenue* [1984] UKPC 38, which by analogy indicates the breadth of the concept.

473. Mr Yates submits that the activities of the individual partners of Foundation are irrelevant to an assessment of whether Foundation is trading. He notes that the terms of the Construction Sub-contract mimic the terms of the Principal Construction Contract - all the obligations of Foundation under the Principal Construction Contract are delegated to IPCS under the Construction Sub-contract – indeed that is the whole point of the sub-contract arrangement. So, for example, clause 8 of the Construction Sub-contract provides that:

> The construction subcontractor [IPCS] shall be responsible for developing the design of the works.

Mr Yates submits that the role of Foundation (at least in the tax year under appeal) is minimal. It does have a role, for example, in choosing IPCS as the sub-contractor, but little else. And there is therefore nothing of any materiality for the individual partners to do, it makes no sense that there is anything for the individual partners to do if the terms of the Construction Sub-contract are taken at their face value, because the terms of the Construction Sub-contract provide that everything is going to be done by IPCS. Indeed, the terms of the Construction Sub-contract make no sense anyway, says Mr Yates, because everyone knows that IPCS does not have sufficient funds to finish the design work and construct the building.

474. Mr Yates submits that although some activities cannot ever be a trade as a matter of law, everything else potentially could be a trade. But whether it is a trade can only be determined after considering all relevant facts. In other words, there is nothing that can "intrinsically" amount to a trade. In particular, it is "plainly wrong" that providing a service in return for a payment must be a trade, and he referred me to the former Schedule D Case VI, and to the decisions in *Brocklesby v Merricks* (1934) 18 TC 576, *Bloom v Kinder* (1958) 38 TC 77, *Scott v Ricketts Scott (Inspector of Taxes) v Ricketts* [1967] 2 All ER 1009, and *Manduca v HMRC* [2015] UKUT 262 (TCC). In all these cases, something was provided by way of services in return for payment, and although the income in these cases was held not to be trading income, it was nonetheless held to be within the scope of income tax as miscellaneous income (the old Case VI of Schedule D).

475. Mr Rivett also submits that the trade undertaken by Foundation had commenced well before 5 April 2009, and cites the decision of the Special Commissioners in *Mansell*:

> 93. It seems to me that a trade commences when the taxpayer, having a specific idea in mind of his intended profit making activities, and having set up his business, begins operational activities - and by operational activities I mean dealings with third parties immediately and directly related to the supplies to be made which it is hoped will give rise to the expected profits, and which involve the trader putting money at risk: the acquisition of the goods to sell or to turn into items to be sold, the provision of services, or the entering into a contract to provide goods or services: the kind of activities which contribute to the gross (rather than the net) profit of the enterprise. The restaurant which has bought food which is in its kitchen and opens its doors, the speculator who contracts to sell what he has not bought, the service provider who has started to provide services under an agreement so to do, have all engaged in operational activities in which they have incurred a financial risk, and I would say that all have started to trade.
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> 94. It does not seem to me that carrying on negotiations to enter into the contracts which, when formed, will constitute operational activity is sufficient. At that stage no operational risk has been undertaken: no obligation has been assumed which directly relates to the supplies to be made. Not until those negotiations culminate in such obligations or assets and give rise to a real possibility of loss or gain has an operational activity taken place. Until then, those negotiations may be part of setting up the trade but they do not to my mind betoken its commencement.
>
> *Conclusions*
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> 95. It seems to me that Lord Millet's statement that "it is necessary to identify the venture in order to decide whether the parties have actually embarked upon it, but it is not necessary to attach any particular name to it" is equally applicable to the question as to whether a person has commenced a trade. But it is necessary that there be a fairly specific concept of the type of activity in the mind of the putative trader which is to be carried on, although it does not have to be given, or be capable of being given a simple name.

476. In the case of Foundation, says Mr Rivett, there was also "advanced and detailed analysis of the specific first development project that would be entered into by the partnership". Further, the fact that Foundation entered into the Principal Construction Contract was sufficient to have commenced the trade, because, with effect from the point in time at which it became liable to fulfil the construction requirements under the terms of that contract, they were at risk in the venture, which Special Commissioner Hellier identified as being one of the hallmarks of a trade having commenced.

477. Mr Yates submits that if Foundation was undertaking a trade, it had not commenced by 5 April 2009. Rather the arrangements were an internal loop between parties (all under Mr Levy's control) which were intended to "park" Project Adriatic, a way that would allow the individual partners to claim sideways loss relief in 2008/09 – but park the project pending raising further funds. Although Foundation had entered into contracts with the employer (BAD) and its subcontractor (ICPS) and paid ICPS, everyone knows that the subcontractor is going to lend the payment to BPHS to enable it to buy a part-interest in the site. There is no money available to finalise the design, let alone construct it. Mr Yates says that it is a "failed raise", and that everyone knows that additional funds will need to be raised to be able to get on to do the "real project". Mr Yates says that it is like saying that he has decided to build a skyscraper in Milton Keynes and has entered into a contract with a friend to construct it – but everyone knows that he needs to raise the funds to design and build it. Even where there is a

credible project, Mr Yates submits that a trade cannot have commenced until all the pieces are in place, including the funding.

**Shams, Purposive approach, and commerciality**

478. It is no part of HMRC's case that the agreements entered into by Foundation were "shams", nor is it suggested that the various contracts entered into by Foundation did not give rise to enforceable rights and obligations. I find that none of the agreements were "shams". I also find that the various entities are separate and that their respective personalities (insofar as they are bodies corporate) must be respected.

479. Mr Rivett submits that the arrangements were entirely commercial. He recognises that Foundation may have been reckless, but that recklessness is not relevant to an assessment of whether Foundation is trading. Mr Rivett acknowledges that the site for Project Adriatic may have been sand, but sand can be built on. Mr Levy's unchallenged evidence was that he believed that eventually Project Adriatic would obtain planning permission. And Mr Rivett noted that ultimately Foundation was successful in obtaining consent from the JU Institute to construct the building. Mr Levy also believed that he would be successful in raising the balance of the finance required to construct Project Adriatic. The £37m paid by Foundation to IPCS for the design and construction of a €100m building represented a "bargain" and did not prevent Foundation's activities from amounting to a trade.

480. Mr Rivett submits the "separateness" of the various entities engaged in Project Adriatic must be respected. He further submits that there is nothing under the terms of any of the contractual arrangements that is self-cancelling or interdependent. It is very different from the facts of *Ingenious*, for example, where the obligation to pay out the purchase price to the subcontractor was conditional on receipt of capital. Paragraphs [108] to [110] of the decision of the Upper Tribunal consider inter-related contracts:

> 108. However, where a number of contracts are entered into together, at the very least the existence of the other contracts is part of the factual background known to the parties at or before the date of the contract, as referred to by Lord Neuberger at [10] of *Wood v Capita* (quoted at [79] above) and commonly referred to as the “factual matrix”. The existence of the other contracts is therefore a relevant part of the factual matrix when construing any one of them. Furthermore, where the contracts specifically cross-refer or there are other indications that they are intended to operate only as a package, then that fact will be relevant.
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> 109. Authority for this approach is to be found in Lewison on the Interpretation of Contracts, 6th edition, paragraph 3.03 where it is said:
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>> “Many transactions take place by the entry into a series of contracts…. In such cases, where the transaction is in truth one transaction all the contracts may be read together for the purpose of determining their legal effect. This principle is a more specific example of the general principle that background is admissible in interpreting a written contract. It applies to other documents executed as part of the same transaction, whether they happen to be executed before, at the same time as, or after the document requiring to be interpreted.”
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> 110. Therefore, where there is in truth one transaction, the tribunal is entitled to read the contracts together for the purpose of determining their legal effect. That is not the same as saying that where there is a series of contracts to implement a transaction there is a single composite agreement. As we have said, the “composite agreement” approach is not correct as a matter of contractual construction. However, what must not be done is to adopt blinkers in looking at each agreement. In determining the legal rights and

obligations acquired by the LLPs pursuant to the contractual arrangements, the FTT was entitled and correct to look at the entirety of each set of transaction documents, which it found at [91] were entered into at the same time and as a single package. That set of documents, which we have referred to at [82] above, reflected what was undeniably a single, albeit multi-party, transaction as a commercial matter. Even though it was common ground that none of the documents in question could be regarded as a sham, the absence of any allegation of sham does not prevent the tribunal following the approach outlined above or, for example, examining critically whether the written provisions of the documents had the effect when read together that the LLPs maintained that they did. This is consistent with the principle, illustrated in *Antoniades v Villiers* as discussed above, that the tribunal is not bound by labels that the parties have chosen to apply if those labels do not reflect the true nature of the legal rights and obligations created pursuant to the contractual arrangements.

481. I was referred by Mr Rivett to the decision of the Court of Appeal in *The Brain Disorders Research Ltd Partnership v Revenue and Customs* [2018] EWCA Civ 2348. The case concerned a claim for capital allowances on research expenditure:

> 1. The Appellant, the Brain Disorders Research Limited Partnership ("the Partnership"), was established in March 2007 as part of a scheme promoted by Matrix Securities Limited ("Matrix") that was designed with the twin objectives of allowing substantial capital allowances to be claimed for expenditure on medical research and of obtaining tax relief for the members of the Partnership in respect of some £68.6m of pre-payments of interest included as part of the financing structure of the scheme. At least in its origin the scheme was based on the one considered by the Upper Tribunal (Tax and Chancery Chamber) in *Vaccine Research Limited Partnership* [2014] UKUT 389 (TCC).
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> 2. In order to maximise the claim for capital allowances whilst still enabling the pre-payments of interest to be made, the Partnership capital of £122m (largely made up of bank borrowings) was paid to a captive SPV (Numology Limited) ("Numology") under a Research Agreement which required the SPV to undertake a specified programme of medical research in return for the sum of £122m but permitted the SPV to conduct the medical research through a specified sub-contractor (BRC Operations Pty Limited ("BRC")) at a cost of only £7.67m. […] The balance of the £122m paid to the SPV was used to make the pre-payments of interest, to repay the principal of the bank loans and to pay fees. But the Partnership claimed capital allowances of some £120m on the basis that it had incurred this amount of capital expenditure on research when carrying on a trade.
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> 3. The Appellant is the general partner of the Partnership and its limited partner members are all high net worth individuals who joined the scheme in order to obtain up-front tax relief which could be set against their other sources of income. The transactional arrangements necessary to implement the scheme took effect on 2 April 2007 when both the Research Agreement and the Research Sub-Contract were signed. HMRC refused to allow the Partnership's claim for capital allowances and the claims of the individual partners to interest relief on a number of grounds including that parts of the contractual arrangements in the form of the Research Agreement entered into between the Partnership and Numology were a sham and therefore of no legal effect; as an alternative to the sham argument that a claim for capital allowances could not extend beyond the £7.67m paid to the sub-contractor and used for medical research because the wider contractual arrangements

> (including the bank loans and the Research Agreement with Numology) fall to be treated as a single composite transaction under which the only expenditure incurred on medical research was the £7.67m; but that even this sum was not allowable because the Partnership was not at the time carrying on a trade to which the research and development related so that the expenditure was not qualifying expenditure as defined in s.439 Capital Allowances Act 2001 ("CAA 2001").

482. The parallels in *Brain Disorders* with the factual background in this Appeal are obvious. Although it is not the individuals who are undertaking the borrowings in this case, borrowings are incurred, and these borrowings are (as was the case in *Brain Disorders*) repaid almost immediately through a circular financing arrangement. One further parallel is that the £122m research fee paid by the partnership to the SPV is stated to be non-refundable, and the partnership knows that the research will actually cost £7.67m.

483. The key paragraphs of the decision of the Court of Appeal, dismissing the appeal of the taxpayers that they are entitled to relief on the £7.67m actually expended on research, are the following:

> 31. By contrast, the £7.67m paid to BRC for the research and development in this case was only qualifying expenditure if it was incurred by the taxpayer at a time when he was carrying on a trade in respect of it. Mr Southern's argument about the need to correlate the legal effect of the composite transaction with the question of whether the Partnership was trading assumes that the legal analysis involved has the effect of collapsing the Research Agreement and the Research Agreement Sub-Contract into each other and eliminating Numology in the process. If it does not have this effect then the argument goes nowhere because the only party in the transaction who paid money directly to BRC was Numology and it is, I think, common ground that it did so as a principal and not as an agent for the Partnership. Even if the finding of a sham is correct, it did not displace Numology in respect of its obligation to carry out the research via BRC and the fact that under clause 3.10 of the Research Agreement Numology assigned to the Partnership the benefit of its contract with BRC does not affect this analysis. The issue of trading calls, in my view, for an assessment of the actual arrangements which the parties put in place and the wider context in which the £7.67m came to be paid. It is a different question from what sum was actually expended on research and development for the purposes of s.437(1) and the court is not restricted to considering only those parts of the contractual arrangements which qualify for relief.
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> 32. Neither the FtT nor the Upper Tribunal in this case has decided that on a purposive construction of s.437(1) the Partnership as opposed to Numology has incurred expenditure of £7.67m on research and development by BRC. The case for the Partnership remained throughout that it had spent the £120m it claimed as capital allowances on research and development in the form of the payment it made to Numology under the Research Agreement. It raised serious arguments based on the decisions of the House of Lords and the Supreme Court in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1 and *HMRC v Tower MCashback* [2011] UKSC 19 to the effect that the whole £120m had been expended "on" research. All that the FtT and subsequently the Upper Tribunal have decided (and needed to decide) for the purposes of the quantum issue was that no more than £7.67m could be claimed by way of capital allowances because the £120m paid to Numology under the Research Agreement was not, on analysis, money that was expended on research within the meaning of s.437(1). Although the Ramsay approach to construction has undoubtedly involved the courts in looking at

the commercial realities of the transaction and ignoring financial components of a scheme which are circular or have no purpose other than to produce a tax loss in order to identify whether and, if so, which parts of the transaction engage the relevant tax provisions, it does not enable the courts to fix the taxpayer with a contract which under the scheme it does not have. The actual transactions remain the same.

33. Although the FtT's analysis of whether the £7.67m paid by Numology to BRC could amount to trading by the Partnership takes into account a wide range of factors including the fact that the transactions existed as part of a tax deferral scheme, it seems to me that the FtT did address the real issue in [118] of its Decision where it makes the point that the Partnership incurred no further costs of any trading venture as a result of the fixed royalty payments made by Numology and had no active involvement with BRC which could generate losses. Wider points were taken about the possibility of any return by way of royalties being highly speculative but the core of the reasoning is that the Partnership simply did not engage in any trading activity with BRC. As the Upper Tribunal put it in [56]-[57] of its Decision:

> "[56] …. Although we have found the FTT's reasoning a little difficult to follow in parts, we are satisfied that it took the right approach to answering the question whether the Partnership was trading and reached a conclusion which was supported by the evidence. Had there been a straightforward contract between the Partnership and BRC for the undertaking of research in return for 6, with a sharing of any resulting royalties but without the involvement of Numology and the overlay of guaranteed payments, it might well be possible to reach the conclusion that the Partnership was trading despite the highly speculative nature of the transaction. But the proposition that the vast sum supposedly spent on research, whether that is taken to be 100, 99 or 96, was in reality incurred on trading activity is absurd.
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> [57] … In our judgment the FTT's decision contains no error of approach and reaches a finding which was open to the tribunal on the evidence."

34. I agree with this analysis. The FtT and the Upper Tribunal concentrated on what the Partnership had spent on research as part of a trading activity. It had no direct contractual relationship with BRC other than by way of assignment and no legal control over whether BRC performed its own contract in accordance with its terms. Nor was the relationship one of principal and agent. One can perhaps look at the arrangements in terms of an investment by the Partnership in what BRC was doing but to describe it as a trading relationship between joint venturers is unsupportable on the facts which the FtT found and the contractual structure which the parties put in place. As Mr Prosser QC submitted, the contractual arrangements are inconsistent with this being a trading relationship and, when one takes into account the overall tax purpose of the arrangements, any equivocality is resolved against the taxpayer.

484. Although the taxpayer lost in the *Brain Disorders* case, the point Mr Rivett draws from the Court of Appeal's decision is the sentences at the end of paragraph [32]. The courts (and this Tribunal) cannot fix the parties with contracts that they did not enter into.

485. Mr Rivett noted that there was no contractual interconnection between the terms of the Partnership Deed, the Principal Construction Contract, and the Construction Sub-contract. So, for example, unlike in the *Brain Disorders* case, IPCS was free to enter into sub-contracts with anyone, it was not restricted as to how it could expend the fee paid to it. There was no contractual connection between the Principal Construction Contract and the obligations on

Foundation to perform under that, and any performance or otherwise by IPCS under the Construction Sub-contract. Equally, there was no obligation that Foundation owed to its partners to pay the fee under the Construction Sub-contract using the capital contributed by its partners.

486. I questioned Mr Rivett about the circular nature of the Barclays financing, and the nature of the security package that ensured that Barclays were repaid the money that they had advanced by the end of the day – and even if these transactions were not self-cancelling, they were circular. Mr Rivett's response was that this was not a concern for Foundation: if IPCS is willing to allocate some of its fee to be paid into a particular account from which it can only access the benefit of £8m as opposed to £38m, that is an issue for IPCS, it is not an issue for Foundation. I was referred to Lord Millett's decision (for the majority) in the Privy Council case of *Peterson v. Inland Revenue (New Zealand) [2005] UKPC 5*. *Peterson* was a New Zealand case concerning film financing. Investors borrowed funds on a non-recourse basis from a lender connected with the film production company. They commissioned the film production company to make a film, and paid the production company's upfront fee using the funds they borrowed together with their own funds. Unbeknown to the investors, the film production company did not need all of its fee to make the film, and recycled the excess (corresponding to the amount borrowed by the investors on a non-recourse basis) back to the lender. The investors claimed tax relief on the totality of the fee paid to the production company. Lord Millett's judgement at paragraphs [42] to [45] addresses the extent to which the investors incurred capital expenditure on the whole of the fee, or only in respect of that part that was actually applied in making the film:

> 42. Consistently with the statutory purpose, it is not only necessary but also sufficient that the taxpayer should have incurred capital expenditure in acquiring an asset for the purposes of trade. The focus is on the party who acquires the asset. It does not matter what the party who disposes of the asset does with the money: see ib at p 1395, para 39 per Lord Nicholls. It is therefore quite wrong to suggest that the purpose of the statutory depreciation regime, when invoked by persons who have incurred a liability to pay a capital sum to acquire a film, is not satisfied unless the disponor applies the proceeds in making the film. If the Commissioner had shown that the features on which he relied, singly or in combination, had the effect that the investors, while purporting to incur a liability to pay $x+y to acquire the film, had not suffered the economic burden of such expenditure before tax which Parliament intended to qualify them for a depreciation allowance, then he could invoke section 99 to disallow the deduction.
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> 43. This, however, the Commissioner never succeeded in doing. The inflation of the costs of making the film meant that the production company made a secret profit at the investors' expense; but it did not alter the fact that they incurred a liability to pay $x+y to the production company in accordance with the contract to acquire the film. The costs of making the film were incurred by the production company, and these must not be confused with the costs incurred by the investors, which were the relevant costs in respect of which the deduction was claimed. The fact that the production company made a profit of $y at the expense of the investors did not mean that they did not suffer the economic cost of paying it. As Lord Diplock speaking for the Board said in *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue* [1976] 1 NZLR 546 at p 556:
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> > "Their Lordships' finding that the monies paid by the taxpayer company ... is deductible under section 111 as the actual price paid by the taxpayer company for its stock-in-trade under contracts for the sale of goods

> entered into with Europa Refining … is incompatible with those contracts being liable to avoidance under [the predecessor of section 99]. In respect of those contracts the case is on all fours with *Cecil Bros Pty. Ltd. v Federal Commissioner of Taxation* (1964) 111 CLR in which it was said by the High Court of Australia "it is not for the Court or the commissioner to say how much a taxpayer ought to spend in obtaining his income." (ibid p 434)

> 44. The leverage obtained by use of a non-recourse loan meant that the investors did not sustain an economic loss after the tax deduction is taken into account. Their Lordships suspect that it is this feature of the scheme which has most exercised the Commissioner. But a moment's reflection shows that what Lord Templeman had in mind was expenditure or loss before any tax advantage is taken into account. Tax relief often makes the difference between profit and loss after tax is taken into account; and a transaction does not become tax avoidance merely because it does so. The fact that the investment was funded by a non-recourse loan did not alter the fact that the investors had suffered the economic burden of paying the full amount of $x+y. It was not and could not be suggested that either loan was on terms which meant that it was unlikely ever to be repaid. The investors have repaid one of the loans in whole or in part, albeit out of the film receipts; and they incurred a liability to repay the other if the film generated sufficient receipts, as it was hoped it would.

> 45. The circular movement of money sometimes conceals the fact there is no underlying activity at all. But each of the payments in the circle must be examined in turn to see whether it discharged a genuine liability of the party making the payment. It does not matter whether external funds were introduced into the circle or whether cheques were handed over and duly honoured. If the money movements did not discharge a genuine liability the introduction of external funds will not save it; if they did, their absence will not affect it. In either case the payments are interdependent, in the sense that each of the payments is dependent on the receipt which funds it and each receipt on the payment by which it is funded. On the way in which the Commissioner put his case the relevant payments were those by which the investors received the non-recourse loan and paid it out to the production company. Subsequent payments through the circle of which the investors were unaware and which they could not control or prevent did not alter the fact that they had borrowed $y and used it towards the discharge of their liability to pay $x+y to the production company, thereby suffering the loss or incurring the relevant expenditure for which the depreciation allowance is granted.

487. Mr Yates submits that I need to treat *Peterson* with some care, given the comments made by Lord Hope (with whom Lords Roger, Collins, Kerr, Clarke, and Dyson agreed) in *Revenue & Customs v Tower MCashback LLP 1 & Anor* [2011] UKSC 19 at [92], where he says that the decision in *Peterson* should be confined to its own facts in the light of the facts agreed or found by the New Zealand Taxation Review Authority at an earlier stage of the appeal.

488. Mr Rivett in his submissions says that I cannot just point to money moving in a circle, and saying "you lose" – rather, he submits, I need to answer the question as to what Foundation was doing under the various contracts, which are acknowledged to give rise to real rights and obligations - the method by which obligations are discharged may tell me something about the financing of those obligations, but it does not tell me anything about the obligations themselves. Mr Rivett also notes that under the terms of the Construction Sub-

contract, Foundation has benefited from the services provided by IPCS's sub-contractors, including the benefit of the 25 specialist consultancy firms which were paid many millions of Euros in fees.

489. Mr Rivett also referred me to the decision of the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2004] UKHL 51

> 41. So far as the lessor is concerned, all the requirements of s 24(1) were satisfied. Mr. Boobyer, a director of BMBF, gave unchallenged evidence that from its point of view the purchase and lease back 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.
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> 42. If the lessee chooses to make arrangements, even as a preordained part of the transaction for the sale and lease back, which result in the bulk of the purchase price being irrevocably committed to paying the rent, that is no concern of the lessor. From his point of view, the transaction is exactly the same. No one disputes that BMBF had acquired ownership of the pipeline or that it generated income for BMBF in the course of its trade in the form of rent chargeable to corporation tax. In return it paid £91 million. The circularity of payments which so impressed Park J. and the Special Commissioners arose because BMBF, in the ordinary course of its business, borrowed the money to buy the pipeline from Barclays Bank and Barclays happened to be the bank which provided the cash collateralised guarantee to BMBF for the payment of the rent. But these were happenstances. None of these transactions, whether circular or not, were necessary elements in creating the entitlement to the capital allowances

490. Mr Rivett submits that as there is no allegation of sham that is advanced in relation to the contractual documents in this appeal, clearly the same approach as that taken in *Barclays Mercantile* should be followed here. In other words, I should respect the integrity of the different commercial agreements that were entered into by the parties.

491. Mr Rivett also submits that I review only the arrangements that were entered into by the parties, and not other hypothetical arrangements – such as ones which the parties might have considered, yet rejected. In support of this submission, Mr Rivett referred me to the speech of Lord Millet in the *Ensign Tankers* case, where he states that the Tribunal must look at the actual rights and obligations of the parties – not their economic consequences. Mr Rivett submits that it is for these reasons that the Teaming Agreement is irrelevant to my decision, as it does not reflect the deal that was actually done between the parties.

492. Even though the Teaming Agreement was superseded to some extent (amongst other things) by the changes to the property ownership arrangements as a result of the Master Agreement, I find that it remained legally binding in other respects, and to that extent reflected the arrangements agreed between the parties in the periods under appeal. In particular, I note that La Cite did not withdraw from the project until after the periods under appeal, and for the periods I need to consider, La Cite were an active participant in Project Adriatic.

493. Although Mr Rivett submits that there is nothing in the arrangements that creates a contractual link between the Principal Construction Contract, the Construction Sub-contract, and the Partnership Deed, he neglects to consider the terms of the Barclays facility and the

circumstances in which it was taken out, which, I find, do create a contractual link between these agreements. The terms of the facility, and in particular the security package, require the funds advanced by Barclays to be contributed to Foundation, and then utilised in part payment of IPCS's fee. The terms then require IPCS to lend the money to BPHS so that it can repay the loan. Although the facility letter and the other ancillary documents are dated 2 April 2009 (whereas the Principal Construction Contract, the Construction Sub-contract are dated 1 April), Foundation approved the terms of its security in favour of Barclays on 30 March, at the same meeting that also approved the terms of the Principal Construction Contract and the Construction Sub-contract. BPHS made its offer to lend £30,266,250 to FDBS on 31 March, and it had no funding from which to make that loan other than the Barclays facility. And it is clear that Foundation could not have satisfied its obligation to pay IPCS its fee without the benefit of the funds that were borrowed by FDBS from BPHS and contributed to it – and no one has suggested otherwise. Finally, I note that IPCS's offer to lend money to BPHS was also made on 31 March, and the only source of that funding was the fee paid to it by Foundation (which had as its source as to £30,266,250 the Barclays facility).

494. Further, the terms of the Barclays facility include as a condition precedent to drawdown a requirement that the "Transaction Documents" (defined to include the Principal Construction Contract and the Construction Sub-contract) must have been duly executed. It was therefore a term of the Barclays facility that Foundation had entered into these agreements before BPHS could draw down the loan. And the nature of the security package was that once the loan had been drawn down, the money must circulate in the pre-defined circle and end up back where it started – with Barclays.

495. I find that these are all an interlocking and interconditional set of agreements the terms of which must have been agreed by the parties on or prior to 30 March, even if they were not all finally signed until 2 April.

496. Mr Yates referred me to the decision of Lord Walker in *Tower MCashback* in the Supreme Court:

> 70. All those points would arise even in the absence of the last-minute change when it was decided to sell the software rights 'in bits'. The Special Commissioner speculated as to which bits, if any, remained unsold (see para 103: his reference to a retained interest in 87% of the clearance fees seems to have overlooked that the LLPs' 13% was a gross figure). A confidential report dated 5 July 2004 made by Mr John Heap, an IT expert, suggests that the four systems allocated to the four LLPs (Code Generation, Reporting Module, Customer Support Interface and Call Centre Interface) were the essential parts of the system. But the report (though written more than three months after the SLAs were entered into) reports a different allocation (LLP1 Customer Support Interface; LLP2 Call Centre Interface; LLP3 Reporting Module; LLP4 Code Generation). Both sides accept that that is wrong, and that Mr Heap must have been misled by his instructions. Mr Brewer's valuation does not specify the categories of software to which it apportions the total valuation of £145m to £150m, nor does it explain the basis on which the apportionment has been made.
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> 71. The fact that these errors and omissions were made and apparently caused no concern emphasises the extreme unreality of selling the software rights 'in bits', when they were parts of a closely-integrated system designed for a specialised task. To my mind it is only a little less unreal than for a syndicate which owns a racehorse in undivided shares to decide, 48 hours before the big race, to partition the animal so that one member takes the head and neck, and another the off-hind leg, and so on. A further indication of

> how little practical importance seems to have been attached to the division of the software rights, and what they were to earn, is that the reader of the information memorandum relating to LLP3 has to get to p 42, if he gets that far, before learning that the rights in the Call Centre Interface (itself mentioned on p 12) are to earn 4.16% of the clearing fees.

Mr Yates submits that there is an analogy between the unreality in the *Tower MCashback* case of software being purportedly sold "in bits", and the arrangements in this appeal as Foundation cannot afford to construct the whole development, it can only fund a "bit" of the construction costs.

497. Mr Yates acknowledges that he cannot merely refer to the circularity of the funding to justify HMRC's case. Rather he points to the distinction being drawn by Lord Walker in *Tower MCashback* between the facts in that case and those in *Barclays Mercantile*:

> 77. One of the lessons of *BMBF* is that it is not enough for HMRC, in attacking a scheme of this sort, to point to the money going round in a circle. Closer analysis is required. In *BMBF* the whole £91m was borrowed by Barclays Finance from Barclays Bank on fully commercial terms (though they were companies in the same group) and Barclays Finance's acquisition of the pipeline was on fully commercial terms. BGE had the whole £91m at its disposal, and though it was disposed of at once under further pre-arranged transactions, those transactions were entirely for the benefit of BGE. BGE had no pressing need for upfront finance (which is not, contrary to what Park J supposed, an essential feature of a leasing scheme capable of generating capital allowances). In the present case, by contrast, the borrowed money did not go to MCashback, even temporarily; it passed, in accordance with a solicitor's undertaking, straight to R & D where it produced no economic activity (except a minimal spread for the two Guernsey banks) until clearing fees began to flow from MCashback to the LLPs (in an arrangement comparable, though not closely similar, to the arrangements between LPI and VP in *Ensign*).

Although the *Tower MCashback* case was about capital allowances, the fundamental point as to whether expenditure was "incurred" (in this case "incurred" wholly and exclusively for the purposes of a trade) remains the same. Mr Yates submits that the facts in this case are even worse than those in *Tower MCashback*. In the case of *Tower MCashback*, the circular finance at least sat with another entity where it generated income in the form of interest. In this case, it did not even sit with IPCS for more than an instant, as the mandates in force at the commencement of the day provided that the funds had to be transferred to BPHS and back to Barclays. Mr Yates submits that the facts in this case are the cleanest example that you can find where the element funded by the daylight facility was not expenditure that had been incurred. Mr Yates also referred me to the last sentence of paragraph [34] of the decision of the Court of Appeal in *Brain Disorders*, where the court says

> […] the contractual arrangements are inconsistent with this being a trading relationship and, when one takes into account the overall tax purpose of the arrangements, any equivocality is resolved against the taxpayer

498. Mr Yates also referred me to the decision of the Court of Appeal in *Eclipse* and to *Ransom v Higgs*. He submits that there is a distinction to be drawn between collapsing arrangements and looking through to the end result and considering the totality of the transactions viewed as a whole. As can be seen, he says from paragraph [111] of the decision in *Eclipse* (which cites *Ransom*), in appraising whether an activity amounts to a trade, you need to stand back and look at everything in the round. This approach is, he says, endorsed by the Upper Tribunal in *Ingenious*, and although the Tribunal (at paragraph 110 of its decision)

rejects an interpretative approach that considers the elements as a single composite transaction, the Tribunal should consider everything as a totality – as the Upper Tribunal did at paragraphs 257 and 258 (cited earlier).

499. Mr Yates submits that £30m of payment made by Foundation to IPCS was made in circumstances where everyone knew that IPCS had to transfer the amount onwards to repay the Barclays daylight loan. He referred me to the facts in *Acornwood LLP and others v Revenue and Customs Commissioners* [2016] UKUT 361 (TCC):

> 38. I entirely accept that the question whether a transaction which is designed to have a particular tax consequence does or does not achieve that consequence is to be determined by whether the relevant taxation provision applies to it or does not. But I do not think that it follows, as Mr Peacock suggested, that the question whether a transaction was designed to take advantage of a provision in a taxing statute so as to avoid or mitigate or defer tax, is always irrelevant to the assessment of what the transaction does. In normal circumstances, if A enters into an arm's length transaction with B under which A agrees to pay £5m to B for certain services, that would, in the absence of any other indication, tend to suggest that the value of those services to A was £5m and that the reason A paid the £5m was to secure those services. But it is a feature of transactions designed to have particular tax consequences that they may contain provisions which are not designed to reflect any true commercial reality, but are designed to obtain the benefit of the desired tax advantages. If therefore in a transaction which is designed to have beneficial tax consequences A agrees to pay B £5m ostensibly for some services, but in circumstances where A has borrowed £4m, where it is known to A that the £4m is not going to be used by B for providing those services, where B does not want the £4m for those services and regards the receipt of the £4m as a nuisance, and where B, to the knowledge of A, is immediately going to put the £4m in a blocked account the sole purpose of which is to repay A's borrowing, it is not surprising if a tribunal regards it as far from self-evident that the £5m is really being paid for services. That is not to invoke some spooky jurisprudence under which s. 34 of ITTOIA can be used to strike down transactions which are found to have an aim of avoiding tax; it is to take account of the motive of avoiding tax in considering the question that s. 34 does require to be answered, namely whether the whole of the £5m is truly paid wholly and exclusively for the purposes of the trade, or in this case for the exploitation services. I see nothing inappropriate in such an exercise or impermissible in such reasoning.

500. Mr Yates says that in the case of IPCS, it was not even as if it had to put up with the nuisance of having the £30m out of its total fee, because it was not going to hold on to it for even a day; it had to go back to Barclays. And in circumstances where everyone knew that IPCS was not actually going to be able to carry out the services which it was contracting to do. He says that *Acornwood* shows why £30m of IPCS's fee cannot be deducted by Foundation as a trading expense under s34.

501. Mr Yates submits that the activities of Foundation do not amount to a trade for two reasons. The first is that the "real deal" was the provision by Foundation of equity finance to Project Adriatic, and that this does not amount to a trade. The second is because the arrangements are wholly uncommercial.

502. Mr Yates grounds his submission that Foundation was providing equity finance in three ways. The first is on an analysis of the interconnecting web of agreements that were concluded at the end of March and beginning of April 2009. The second is by looking at the

history of those agreements, in particular the terms of the Teaming Agreement which provides on its face that Foundation and FCP will be providing equity to the project, but that the precise structure and basis through which this equity will be provided will be determined later. And the third way is Mr Levy's own evidence that Foundation was providing a cost commitment, and that the Principal Construction Contract cannot operate as a construction contract. Mr Yates drew an analogy between the facts in this case and the factual finding of the First-tier Tribunal in *Ingenious* (referred to by the Upper Tribunal at paragraphs 546 and 547) that the business of the LLPs was "financial" in the sense of it being a "speculative activity of choosing and laying out money on rights in the hope of monetary receipts from them". Mr Yates submitted that as Foundation had subcontracted all its obligations under the Principal Construction Contract to IPCS, it had nothing further to do.

503. As regards the uncommerciality of the arrangements, Mr Yates refers to the terms of the Principal Construction Contract and the Construction Sub-contract. His submission is based first on the terms of those agreements – that the Construction Sub-contract is a fixed-price non-refundable contract in circumstances where the building work has not been finally scoped, let alone costed. Secondly that the basis on which the terms of these agreements were settled was wholly uncommercial. And thirdly, the parties entered into those agreements prematurely, given the uncertainties that existed given the surrounding circumstances. Mr Yates submits that the uncommerciality of the arrangements is an essential element in determining whether Foundation is trading – it is wrong to consider hypothetically whether Foundation is trading, and then consider commerciality as a subsequent step - commerciality is part of the process of determining whether Foundation is trading.

504. Mr Yates also criticises Mr Levy's evidence that his original intention was that one of the corporate co-venturers would have provided the loan to BPHS (and not Barclays). It would not have made any economic sense, submits Mr Yates, for La Cite (or any other co-venturer) to have injected funding into BPHS, and for its share in the profits of the project to be paid out through a share of Foundation's profits, because Foundation's entitlement to share in the project's returns has already been allocated under the terms of the Principal Construction Contract with BAD. La Cite's entitlement to 78% of the hotel's profits (as set out in the Teaming Agreement) can never come through Foundation, it must come via a separate agreement with BPHS or as part of some other arrangement. I have some doubts about the strength of this submission, as I could envisage that a third party might agree to refinance the Barclays debt as part of an overall "deal" by which it also invests equity (and possibly debt) either as a separate arrangement with BPHS or as part of some other arrangement.

**Allocation of amounts paid to IPCS**

505. One of the issues that I need to address arises if I determine that Foundation is carrying on a trade is whether: (a) the whole of the payment made to IPCS is expenditure incurred wholly and exclusively for the purposes of that trade, or (b) only part of the payment, or (c) none of it?

506. Mr Rivett submits that the answer to this question is that the whole of the payment was incurred for the purposes of Foundation's trade. This is because there was obligation under the terms of the subcontract to pay £37,362,650.96, and this amount was actually paid. There is nothing in the contract that makes this obligation conditional or contingent in any way.

507. Mr Rivett submits that there is no requirement for there to be any symmetry between the amount paid under the contract, and the economic benefits derived from the payment.

508. The real issue in this case is whether the whole (or any part) of the payment can be identified as being paid out for a duality of purpose. Mr Rivett referred me to the passage in

the decision of the House of Lords in *Barclays Mercantile* cited previously. The purpose of the payment made to IPCS was to secure the provision of its services to Foundation. What IPCS then does with the funds is irrelevant to the analysis. Mr Rivett acknowledges that the conditions precedent to the Barclays facility included the transfer instructions and security arrangements that ensured that the money it advanced went around in the circle and was repaid at the end of the day. However, he submits that this is irrelevant to the analysis of the purpose for which Foundation incurred the expenditure – it incurred the expenditure to benefit from IPCS's services. In his submission, although the cases he cited deal with capital allowances, their approach to what to do about questions when there is circularity of payments is as true here. He submits that I must look at the legal obligations that are created, not the means by which those obligations are discharged (or not discharged, as the case may be). In looking at what the purpose of paying out this sum was for, he submits that it was to procure services under IPCS. He submits that it was no part of the Barclays facility that Foundation was required to enter into a contract for services with its counterparty, the subcontractor.

**Capital or Income**

509. On the basis that Foundation is carrying on a trade, Mr Rivett submits that the amounts paid to IPCS were of a revenue, and not a capital, nature.

510. Mr Rivett referred me to the judgment of Dyson LJ in *IRC v John Lewis Properties* (2002) 75 TC 131 at [73] where he quotes with approval from a judgment of Dixon J that the characterisation of a payment as income or capital depends on the practical application of business common-sense, rather than, if different, a juristic classification of any legal rights secured, employed, or exhausted in the process. The *John Lewis Properties* case concerned the hypothecation of rental payments, where John Lewis assigned its rights to receive 15 years of rents in consideration for a lump sum. The lump sum was held to be capital in John Lewis's hands.

511. Mr Rivett's first submission in support of this assertion is that Foundation was originally established to undertake multiple construction projects, of which Project Adriatic was intended to be just the first.

512. Second, Mr Rivett submits that the payment made to IPCS was recurrent in nature – notwithstanding that it was a single "bullet" payment. His reasons are that as Foundation was established to undertake multiple projects, the payment to IPCS was just the first of what would be many payments to construction companies for many building projects. Second, the underlying nature of the services provided through the Construction Sub-contract were the kind of services that would need to be incurred again and again throughout its trading lifetime. Mr Rivett submits that it is the kind of expenditure that was discussed in *Vallambrosa Rubber Co Ltd v Farmer* (1910) 5 TC 529, where the Lord President described capital expenditure as being “a thing that is going to be spent once for all” and revenue expenditure as being “a thing that is going to recur every year”.

513. Third, Mr Rivett submits that there was no change in the nature of Foundation's business as a result of the purchase of services from IPCS. Foundation did not, for example, acquire a right to undertake business it was not currently engaged in (for example in a different geographic area, or a different kind of business altogether). Nor submits Mr Rivett, did Foundation acquire a capital asset in exchange for the payment to IPCS.

514. Mr Yates referred me to the decision of the Upper Tribunal in *Ingenious* at paragraphs 550 to 553, which considered the period of time over which the profits of the LLPs activities accrued, and noted that the FTT had observed

> 553. […] that the rights extended over too large a tract of time to escape from the idea that profits are "annual" and the idea that things which last a long time must be capital. In reaching this conclusion the FTT had commented that it would not have regarded an asset which lasted for only five years as capital, but in this case receipts were possible over a much longer period. Although the majority of the income was expected to come in over five years and the LLPs were marketed as five-year vehicles, the rights should be regarded as having a life of more than five years (see in particular [50], [53], [69] and [74]).

The Upper Tribunal also referred at [554] to the following factors considered by the First Tier Tribunal to be relevant to the determination that the expenditure was capital:

> (i) the advantage sought by the LLPs from the rights under the relevant agreements was the receipt of future income, and whether or not this was an enduring benefit depended upon how long a shadow the nature of the business cast;
>
> (ii) the payments did not have recurrent nature in the sense of being continuously demanded by the business;
>
> (iii) the rights had a length which could not escape from the primitive concept that revenue items had an annual or at least a short term nature;
>
> (iv) ordinary commercial accounting principles would nowadays require deduction of part of the cost from the profit and loss account, and
>
> (v) the monies were not expended on, and the rights were not part of the structure of the business.

The reference to five years in [553] refers back to the *John Lewis* decision. But I note in this case that Foundation's entitlement to share in the profits from the proposed hotel stretch over 30 years, and on the GAAP impairment analysis, were recognised only from 2031 (although in the presentation given to investors, that element of Foundation's income is brought in at a much earlier time).

515. I doubt that this was ever a realistic intention or desire of Foundation to engage in multiple construction projects – even at the outset of Foundation's existence. Although several of the documents presented to potential investors make this statement, little emphasis is given to these statements in the documents – and they have the appearance of "window dressing". All the financial projections provided to prospective investors relate solely to Project Adriatic, and to nothing else. The financial projections all assume that any revenue generated from Project Adriatic would be distributed to investors, and that Foundation would not retain any funds to be used for other projects. Certainly, by March 2009, Foundation had not been able to raise sufficient funds to proceed with Project Adriatic – and there is discussion of having to undertake further rounds of fundraising through parallel entities. I find that at the time Foundation entered into the construction contracts with BAD and IPCS there was no realistic prospect of it ever being able to enter into other construction projects.

516. As regards the payments made under the Partnership Consultancy Agreement and the Takeover Agreement, Mr Rivett submits that these are also of a revenue nature, and not capital.

517. As regards the Partnership Consultancy Agreement, he submits that the payments were made in consideration for the provision of the consultancy advice and services specified in Schedule 1. He submits that these services were being supplied to Foundation, and they had a trading nature, and that no long-term capital asset was acquired nor any enduring long-term advantage. But the evidence is clear, and I find, that the services being provided to

Foundation by Future Design under this agreement were the services of Mr Comyn, and these were not the services listed in Schedule 1. I find that if anyone provided the services listed in Schedule 1 to Foundation, it was Manly – who provided these services for the benefit of Foundation under the terms of its contract with IPCS.

518. Mr Rivett recognised in his submissions that the trading nature of the Takeover Agreement was "more difficult". He submitted that the payment under the agreement was for the acquisition for two things: first for the acquisition of a right to exploit a business concept that had been produced by FCP throughout the term of the agreement, but secondly for services to be provided by FCP to allow Foundation to exploit that concept, as particularised in schedule 1 to that agreement. He acknowledges that insofar as that payment under the agreement is for the acquisition of a structure, he is in trouble in arguing that the payment has a revenue character. But he submits that when you look at the terms of the agreement and Mr Levy's evidence, it is clear that payments under the Takeover Agreement are similar in nature to those payable under the Partnership Consultancy Agreement, just without the structure. On that basis, if the Partnership Consultancy Agreement fees are revenue, then as the Takeover Agreement fee is paid for similar services, that should also be revenue. However, he accepts, that as it was a single payment paid, I might take the view that it was impossible to distinguish between the two aspects for which it was paid, namely part capital, part services.

519. The other troublesome issue as regards the Takeover Agreement is its potentially voluntary nature. As Mr Yates put it to Mr Levy during cross-examination – there was no need for Foundation to enter into the Takeover Agreement because, at the time it executed the agreement, it was already fully-formed, and was already using the structure developed by FCP. Mr Rivett's submission is that even if the payments were not enforceable, that did not prevent them from being a deductible trading expense.

**Tax motivation**

520. Mr Rivett submits that it is improper to consider motive in analysing the legal substance of the transactions. The fact that the partners in Foundation may have been motivated to make their investment because of the possibility of benefitting from sideways tax loss relief is not relevant to my analysis. Mr Yates considers that the tax motivation of the parties is one aspect of determining whether the transactions are commercial and therefore whether Foundation is trading.

521. I was referred to the speech of Lord Morris in *Lupton (H M Inspector of Taxes) v F A & A B Ltd* (1971) 47 TC 580 at 620

> If, therefore, as in my view is clear, the presence of a motive of securing tax recovery does not cause a trading transaction to cease to be one, then reliance on motive must disappear. And if reliance on motive is either voluntarily or reluctantly but compulsively jettisoned it is not saved even if the language of rhetoric is used to characterise it.
>
> It is manifest that some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction. The result will be, not that a trading transaction with unusual features is revealed, but that there is an arrangement or scheme which cannot fairly be regarded as being a transaction in the trade of dealing in shares.
>
> […]
>
> If upon analysis it is found that the greater part of the transaction consists of elements for which there is some trading purpose or explanation (whether ordinary or extraordinary), then the presence of what I may call "fiscal

elements", inserted solely or mainly for the purpose of producing a fiscal benefit, may not suffice to deprive the transaction of its trading status. The question is whether, viewed as a whole, the transaction is one which can fairly be regarded as a trading transaction. If it is, then it will not be denatured merely because it was entered into with motives of reaping a fiscal advantage. Neither fiscal elements nor fiscal motives will prevent what in substance is a trading transaction from ranking as such. On the other hand, if the greater part of the transaction is explicable only on fiscal grounds, the mere presence of elements of trading will not suffice to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an artificial structure, remote from trading and fashioned so as to secure a tax advantage, the mere presence in that structure of certain elements which by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure. In speaking of the greater part of the transaction I am not, of course, referring to mere bulk. A long document, like a long speech, may do and say remarkably little. What seems to me to be of particular importance is the relative extent of the significant provisions which are made.

> One may look at matters in a slightly different way. I think that some assistance might be gained from considering the comment which a hypothetical, sapient and impartial trader in shares would make when confronted with the details of a transaction. Is he to be imagined as saying: "That's obviously share trading", or perhaps: "What an unusual but interesting way of share trading", or would he exclaim: "Whatever that is, it is not share trading"? If he were to be endowed with the qualities of a professional accountant as well, perhaps the answers might be rephrased as: "That's an adventure or concern in the nature of trade", on the one hand, and on the other: "If this can be called an adventure or concern at all, its nature is a tax-recovery device remote from trade".

522. The case of *Ensign Tankers (Leasing) Ltd v Stokes (H M Inspector of Taxes)* 64 TC 617 related to the Victory Partnership, a limited partnership, and the tax benefits that would accrue to it and its partners (which included the appellant), Millett J (in the High Court, and upheld on appeal) decided that even though the structure adopted in the *Ensign* case was intended to provide an "initial fiscal advantage", that did not mean that the partnership was not carrying on a trade:

> In purely financial terms, Victory Partnership was in effect a sleeping partner with a minority interest. It was putting up 25 per cent. of the cost and taking a 25 per cent. equity participation. LPI was putting up the remaining 75 per cent. of the cost and its associated company was retaining a 75 per cent. participation. In legal terms, however, LPI was not an equity participant, for it was making its contribution by way of loan. But a loan creditor would normally expect to be repaid before equity participants recovered any part of their capital, whereas LPI's advance was recoverable only out of film receipts and was repayable pari passu with instead of ahead of Victory Partnership's capital investment.

> […]

> Whatever may have been the substance of the transaction in financial terms, however, this was not the way in which it was structured. Victory Partnership was not in fact a sleeping partner with a minority interest in a joint venture. It did not acquire merely a 25 per cent. interest in the venture; nor did it pay only 25 per cent. of the cost. It would not have suited the purpose of those from whom it was obtaining its finance for it to do so.

Instead it acquired a 100 per cent. interest in the venture, and it paid 100 per cent. of the total budgeted cost, though it did so with the assistance of a 75 per cent. loan from a creditor whose associated company took a 75 per cent. equity participation in view of the unfavourable terms of repayment.

[…]

This had two consequences. In the first place, it meant that as a loan creditor LPI would expect to recover its loan with interest before Victory Partnership recovered any part of its capital. The terms actually offered by LPI were more favourable to Victory Partnership than that. LPI was to recover its loan capital pari passu with instead of ahead of Victory Partnership (just as if Victory Partnership were an equity participant) and interest on its loan only after Victory Partnership had recovered its capital. In the second place, it provided Victory Partnership with the element of "gearing" necessary to achieve the fiscal advantages the limited partners were seeking. By borrowing 75 per cent. of the capital cost of the film, it was able to spend four times its own capital in the provision of "plant"--and obtain first-year allowances of an amount equal to that expenditure.

[…]

It is important to bear in mind that the initial fiscal advantages which Mr. Whitfield sought to achieve, like the later fiscal disadvantages which could not be avoided, derived from the "gearing" effect obtained by the use of borrowed money to acquire assets for which first-year allowances were available in the course of a business where expenditure normally preceded the receipt of income by two or three years. The non-recourse nature of the borrowing and the use of a limited partnership (either of which would have been sufficient without the other) provided a desirable degree of protection for participants but were not necessary to the securing of the tax advantages sought to be obtained.

[…]

At one stage of the argument before me, the Crown submitted that the limited partnerships were not trading at all but merely investing in films to be made and distributed by others. This was not an argument which was addressed to or considered by the Commissioners, and if there were any substance in it the case would have to be remitted to them.

The submission appears promising at first sight, but as an independent point it breaks down on close examination. As I have pointed out more than once, in purely financial terms each partnership was in effect a sleeping partner with a minority interest in a joint venture undertaken by others. But any such joint venture was a trading venture, and a corporate partner in a joint trading venture is by force of s155 treated as carrying on a separate trade of its own. As the Crown pointed out, however, the partnership did not in fact acquire an interest in an existing venture, but a film; and that was not trading unless the partnership intended to trade with it. But the subject-matter of the purchase was an uncompleted film, and the partnership arranged for it to be completed on its behalf with a view to its commercial exploitation. The returns were incapable of calculation; the film might have yielded substantial profits, or no net receipts at all. Once fully exploited, the film would have negligible residual value. The transaction had all the characteristics of a typical though speculative trading transaction, and none of the characteristics of an investment.

523. Mr Rivett acknowledges that the factual background in the *Ensign* case is very different to the factual background in this appeal, but he submits that the general principles set out by Millett J apply to Foundation – and that the transactions in this appeal (as with those in the case of *Ensign*) have "all the characteristics of a typical though speculative trading transaction, and none of the characteristics of an investment".

524. Mr Rivett referred me to the evidence of Mr Hannington, that he would have invested in Foundation irrespective of the tax benefits. He also referred to the evidence of Mr Levy, that the tax benefits were a form of "downside protection". But, for the reasons previously given, I do not believe these statements.

525. I was referred by Mr Rivett to the decision of the Upper Tribunal in *Cobalt Data Centre 2 LLP and Cobalt Data Centre 3 LLP v Revenue and Customs* [2019] UKUT 342 (TCC), where the Upper Tribunal concluded that while the principal purpose of the appellant entities was to obtain the benefit of capital allowances for their members, they had a subsidiary purpose of carrying on a business with a view to profit (for the purposes of s863(1) ITTOIA). One of the aspects of the structures used in the *Cobalt* case was that the consideration paid by the entities was funded as to 30% by contributions from their members, and as to the balance by a loan. The loan proceeds were "cash collateralised" by means of a complicated network of security arrangements, which meant that the bank advancing the loan took little, if any, credit risk. The Upper Tribunal rejected HMRC's submissions that the loan's only or main purpose was to inflate the capital allowance claim, and that on a "realistic and pragmatic" approach, only something less than 30% of the consideration was paid for the capital allowance asset. The Upper Tribunal's decision was based on a "proper analysis of the contractual arrangements". In other words, says Mr Rivett, the fact that the principal purpose of the entities was to obtain a tax advantage did not negate whether the entities were undertaking a business that was respected for tax purposes. The fact that the investors (and Foundation) were aware of the existence of a tax relief when they entered into the transactions discussed in this Appeal is not a good reason why Foundation's activities cannot amount to a trade.

526. Mr Yates accepts that if something is undoubtedly a trading transaction, the fact that the taxpayer has a fiscal motive for entering into the transaction does not prevent it from being a trading transaction. Mr Yates submits that *Lupton* is not a case about starting off with a trade and then denaturing it. Rather *Lupton* sets out a principle that if something has the appearance of being a trade, but it is distorted by tax considerations or tax structuring, then its activities might (although not automatically) not amount to a trade - because they are so distorted by tax considerations, they start to break down as a credible trading proposition.

527. This can be seen in the judgment of Mann J in *Clavis Liberty Fund 1 LP (acting through Cowen) v Revenue and Customs Commissioners* [2017] UKUT 418 (TCC) where he said:

> [42] The FTT clearly applied what was set out by the House of Lords in *Lupton* (see paragraph 102) in arriving at its conclusion in paragraph 103. It was entitled (and obliged) to do so. It equally plainly had *Ensign Tankers* and *New Angel Court* in mind - see the closing words of paragraph 103 and the recording of submissions on those cases in paragraphs 86 and 96. I do not consider that its decision contravened the principles in either case. Although paragraph 103 refers to the motivation (and was entirely correct, as a matter of fact, in that conclusion) it did not reason that the motive was tax avoidance and therefore the transaction was not a trading transaction. The reasoning is shortly expressed but that is not what it is saying. The FTT were saying that the transaction was artificial and therefore not a trading

> transaction. That is demonstrated by the example that it gives (the late payment of the consideration). The FTT is illustrating artificiality there, not tax avoidance. Its consideration of all the circumstances of the transaction inevitably required it to note, at the very least, the taxation motive, and it was justified in doing so, but it did not go on to elevate that factor to some impermissible status. It was doing what *Lupton* required and justified.

528. The distinction drawn by Mann J is that the fact that a transaction may be motivated by tax avoidance does not mean that the business in question is not trading. However, the fact that a transaction is artificial may give that result. And this conclusion is, in my view, entirely consistent with the decision of the House of Lords in *Lupton* and in *Ensign*.

529. Mr Yates also referred me to the decision of the Upper Tribunal in *Scotts Atlantic Management Ltd* [2015] UKUT 66 (TCC), where the Upper Tribunal drew a distinction between a company choosing to reward its directors using a tax efficient mechanism, and having tax minimisation as the object of its adoption of a mechanism. Mr Yates submits that if, tax minimisation is actually the object of the original expenditure, instead of the purpose of tax minimisation being behind the selection of the means, then that taints it for s.34 purposes.

**Accounts**

530. Mr Rivett submits that I should prefer the evidence of Ms Chew to that of Mr Bach.

531. Mr Rivett's submission was that Ms Chew's evidence was that from a GAAP perspective the appropriate treatment is to look at each entity separately. This is because FRS 18 focus on assets and liabilities – and therefore the balance sheet of the individual entity. There was an express legal obligation on the part of the FDBS to contribute its capital to Foundation, and an express legal obligation on the part of Foundation to pay IPCS for the services it acquired under the Construction Sub-contract. Mr Rivett submits that Ms Chew's evidence supports his contention that the proper approach is to treat that expense as work-in-progress or stock for the purposes of SSAP 9, and then to ascertain the value of that work by reference to the economic benefits flow from it. Ms Chew's evidence is that the Partnership was right to seek to analyse that by reference to its realisable value rather than its cost. As regards the payments made under the Partnership Consultancy Agreement and the Takeover Agreement, Ms Chew's evidence was that if these were payments for the provision of services (a matter of law to be determined by the Tribunal), then the payments made under those agreements were correctly recognised as expenditure incurred in the period ended on 3 April 2009.

532. Mr Rivett also submitted that Ms Chew had considered the circularity of the payments derived from the Barclays facility but did not consider that this affected the accounting analysis. Further, Ms Chew had also considered the fact that the various entities were under Mr Levy's control and considered that the existence of common control also did not affect the accounting treatment.

533. Mr Rivett criticised the evidence of Mr Bach, and his use of FRS 5 to "undertake a roving investigation of all sorts of other entities' accounts" in drawing up Foundation's Accounts, which he submits is not right. He also criticises Mr Bach's evidence as being muddled – not least in respect of the treatment of the capital contribution made by FDBS, and his view that the payment made by FDBS need not be recognised in Foundation's accounts. Mr Rivett described it as "bonkers" that Mr Bach could write an opinion saying that this all turns upon the amounts of funds that are available but then not have addressed up front the question of the fact that the Partnership Deed not only obliges the corporate member to put the funds in, but then also in the same report to recognise that that obligation was actually

satisfied, slightly differently – and I have to say that I agree with Mr Rivett's criticism of Mr Bach's report. Mr Rivett submits that he would be worried if he opened a set of partnership accounts and knew that the partnership had accepted that £30 million of capital had been contributed, but, on the basis of Mr Bach's evidence, the contribution is not recognised anywhere in the accounts – and I agree.

534. Mr Yates submits that Ms Chew eventually conceded that paragraph 51 of FRS 5 was engaged, but criticises her evidence because she does not state the impact that its engagement would have on the Accounts. Mr Rivett submits that Ms Chew considered paragraph 51 in her supplementary report but reached the conclusion that it did not change her analysis. This is not the interpretation that I place on her oral evidence. The position taken by her in her original report, in the joint report, and in her supplemental report, was that Foundation need not look beyond the "immediate contract", namely the Construction Sub-contract with IPCS. It also became clear during her cross-examination that she was not aware of the existence of the Teaming Agreement and was not aware of the degree of control that Mr Levy had over the various entities engaged in Project Adriatic – including BPHS, Foundation, Foundation Design, FDBS, FCP, and IPCS. She also admitted that she had not been instructed to give an opinion on the accounting treatment when viewed from this wider perspective. I therefore place no weight on the opinion expressed in her supplemental report about the impact of paragraph 51, as that opinion was given based on incomplete information.

535. Mr Yates also submits that no explanation was given by Ms Chew as to why the £30m contributed by FDBS to Foundation could be recognised as an asset, given that it could not control the economic benefits flowing from the contribution, as everyone knew it was going to have to go back to Barclays by the end of the day.

536. Mr Yates noted that Ms Chew's evidence was that – absent some intervening event – there was no reason why the discount rate used in the March 2009 investment appraisal should not also have been used for the purposes of any impairment analysis as at 3 April 2009. And he submitted that there was no intervening event.

537. Mr Yates also submitted that the discounted cash flow analysis used for the impairment exercise was flawed in any event as the hotel income is recognised in an inconsistent way and Foundation is treated as only entitled to 37.6 per cent, whereas the Principal Construction Contract did not "*pro rata* it down".

**DISCUSSION**

## Was Foundation trading?

538. The circumstances in which Foundation found itself at the end of March 2009 were not as Mr Levy had planned – his business, FCP, had sought to raise £25m from investors, but had only succeeded in raising less than 40% of that amount. This was a failed capital raise. Yet Mr Levy decided that the project should proceed. And this distinguishes the facts in this appeal from the facts in many of the cases cited to me. In many (perhaps virtually all) of the other cases which consider tax-advantaged arrangements (to use Mr Levy's term), such as *Eclipse, Ingenious*, *Ensign, Brain Disorders, Peterson, Tower MCashback, Cobalt,* and *Clavis,* the relevant entities had successfully raised all the funds they needed for their respective projects. And in those cases, the various contracts were concluded, and the payments made under those agreements, in the manner that had always been intended by the promotors. In those cases, the various parties were able to fulfil their contractual obligations (however artificial those obligations might be). They had been paid enough to be able to meet those obligations, and those obligations were (in most cases) sufficiently defined and constrained so as to be capable of fulfilment. But this was not the case for Project Adriatic.

539. And the other set of factors that distinguish this case from the facts in those other cases is that at the time Foundation entered into the Principal Construction Contract, the Construction Sub-contract, the Takeover Agreement and the Partnership Consultancy Agreement, Project Adriatic was (to put it at its best) only half-baked. At the time those agreements were signed, it appeared highly unlikely that Project Adriatic could be implemented at a cost that reflected the funds that FCP, La Cite, and Boka had anticipated would be needed to be raised, or at all:

(1) La Cite (who were still actively involved at that time) advised that the viability of the project depended on the hotel being at least 17 storeys (and there is no evidence to suggest that – as things stood in March/April 2009 – anyone disagreed with this advice), yet the local development planning provisions (the DUP) limited buildings in Budva to 11 storeys, and to 5 storeys in the beachside location where Project Adriatic was located;

(2) The site of the project was sand and silt, with a high water table, which might require very expensive foundations;

(3) Budva was in a seismic zone, which potentially placed constraints on the height of the building – and would increase construction costs as the building would need to accommodate movement due to seismic tremors;

(4) Atlas (the seller of the site) did not have title to the whole site – and needed to acquire land at the perimeter of the site (the "yellow land");

(5) The infrastructure in Budva (such as the electricity supply, the fresh water supply, sewerage) was inadequate to support the proposed development;

(6) Only an outline concept design had been prepared (described as "early doors") and no detailed design work had been undertaken; and

(7) A geotechnical survey, which might provide some clarity to points (2) and (3), had not reported, but the report was due to be provided in just a few days.

540. And finally, the terms on which Foundation entered into contracts with its counterparties were artificial and had no commercial logic.

(1) The design specification included in the Principal Construction Contract (which was mirrored into the Construction Sub-contract) was internally inconsistent, and the drawings included in the specification were for a building that met neither the requirements of the DUP nor the requirements (as advised by La Cite) of the preferred hotel operator;

(2) Foundation had agreed a fixed price contract with IPCS for the design and construction of the project, with the fee being non-refundable in all circumstances. Construction costs had been estimated at €100m, significantly more that the fee payable under the Construction Sub-contract. And the €100m had been estimated based on a price per $m^2$ of gross floor area – which did not take into account the particular requirements for the construction of Project Adriatic – such as the likely complexity of the foundations (given the geotechnical characteristics of the site) or the fact that Budva was in a seismic zone. Although the geotechnical survey had not been completed at the time the contracts were concluded, it had been commissioned in the knowledge that there were potential problems with the geotechnical characteristics of the site, and Mr Young had stated that it was essential that Vector report on the results of the survey before contracts could be signed;

(3) The funds raised were not sufficient to enable BPHS to purchase all the shares in Lenley, the company which owned the site, and clear the charge that Piraeus had over the site; and

(4) Even if Project Adriatic were to end up costing only €100m to design and build, the funds raised were insufficient to cover even this cost.

541. I find that the arrangements into which Foundation entered in March and April 2009 made no sense.

542. Why would Foundation irrevocably commit on its face to pay £37 million to IPCS with no right of refund if it knew that there was a serious possibility that the envisaged project might not be buildable – or at least buildable to the standards required by the co-venturers within the anticipated budget? Why did it not wait a few days for Vector's report?

543. And moreover, Foundation knew (through Mr Levy, its managing partner) that IPCS would disburse virtually all of its fee, leaving it with insufficient money to actually design and build Project Adriatic. And Foundation would have been aware that BHPS did not own the construction site, and the funds being passed to it by IPCS were insufficient for it to buy the whole site and clear Piraeus's charge. So, there was a very real risk that the project might not go ahead.

544. I find that no commercially motivated business would have entered into the suite of agreements in these circumstances.

545. The only answer as to why Foundation entered into the various agreements can be (and I find) that it was to "lock-in" a tax loss for individual investors for the tax year 2008/09, as any delay would defer the benefit of the tax loss until the following tax year. And I have no doubt that Mr Levy was anxious that Foundation Design and FCP were paid their fees given that his businesses had "spent a lot of time and money evolving the structure", had spent a lot of money on professional fees, and needed to receive a fee to cover their costs and make a profit.

546. But even if I consider Project Adriatic on its own terms – and assume that it had been successful in its fund raising – there are aspects of the project and the arrangements for its implementation that stand out as being artificial and strange.

547. First, it is bizarre that its own financial projections show a better post-tax result for investors if the project is unsuccessful than if it succeeds (other than in the most optimistic of projected results). This suggests, and I find, that this project was uncommercial from the "get go" – and would have been uncommercial even if Mr Levy had been successful in raising £25m from investors. I find that Project Adriatic (and Foundation) was never really intended to generate commercial profits for its investors. Project Adriatic was – to use Mr Young's expressive term – a "tax shagger", notwithstanding Mr Levy's entreaties that the tax relief inherent in the structure was merely providing commercial downside protection. This was never a risky commercial project, with tax relief providing commercial downside protection – rather it was (as described by Mr Harrison in his email exchange with Mr Levy) a tax project, with some potential commercial upside if things went really well.

548. Second, why did the proposed liquidated damages provision disappear from the Partnership Consultancy Agreement? If Mr Levy really wanted to provide commercial protection to the investors, this would have done it – and it had been promised in the marketing literature.

549. Third, there was no satisfactory explanation of why the Takeover Agreement and the Partnership Consultancy Agreement had been backdated.

550. I find that the artificiality and utter lack of any commerciality in the contracts concluded by Foundation for Project Adriatic means that Foundation was never trading or undertaking a venture in the nature of a trade. I find that its operations did not have a "commercial character" of the kind described by Lord Reid in *Ransom v Higgs*. Rather Foundation made a speculative investment in circumstances where it had little serious involvement in the actual design and construction of Project Adriatic (and never intended to have any such serious involvement).

551. I make this finding based on the absence of any commerciality in its activities, and not because of any perceived tax advantages in its structure. The fact that Project Adriatic may be a "tax shagger" does not, of itself, prevent Foundation from trading. The fact that tax avoidance may have been a motive for Foundation (or its partners) entering into various contracts and transactions does not prevent Foundation's activities from being treated as a trade – rather this is one of those cases where the arrangements are so distorted by tax considerations, that they break down as a credible trading proposition.

552. I find that the transaction undertaken by Foundation was a partial financing of the Project Adriatic construction project. I reach this conclusion without finding that any of the agreements were shams, but I do find that they were mislabelled in the sense used by the House of Lords in *Antoniades*. It is wholly artificial to treat the Principal Construction Contract as an agreement to design and construct a building in circumstances where everyone knew that (a) the building would cost at least €100m to design and construct (and in fact probably considerably more); (b) only £10,088,750 had been raised from investors (although FDBS contributed £30,266,250 of capital to Foundation, most of this was borrowed from Barclays and had to be repaid later on the day that it was borrowed), (c) not even enough money had been raised to enable BPHS to acquire all of the shares in Lenley (the owner of the site) – and unless BPHS controlled the ownership of the site, no construction work could commence.

553. And the fact that Mr Levy and Mr Hannington were confident that the balance of the capital required could be raised in the future cannot negate my finding that the Principal Construction Contract is in reality a financing arrangement. The Principal Construction Contract was never amended to limit Foundation's obligations – so that it could stop work once its money ran out. To do so would be artificial and impossible. Nor was it possible for Foundation to raise additional capital itself. It could not introduce additional partnership capital, as that would create tensions between the existing and the new partners as to the allocation of profits. Any additional capital had to be raised through parallel partnerships – as in fact happened - with Foundation ceding part of its entitlement to consideration from BAD to the parallel partnerships. And although the agreements between Foundation and the parallel partnerships on their face purport to allocate different elements of the design and construction process between Foundation and the parallel partnerships, I find that this purported allocation is artificial and unreal.

554. I find that the Principal Construction Contract can only be interpreted as a cost contribution arrangement – in other words a financing.

555. There is a reference in Mr Levy's first witness statement to the fact that Foundation had raised significantly less than it had planned:

> 72. All parties recognised that as Foundation Partners had not itself raised sufficient funding to commit the full expected costs of the development it could fund only a proportion of the total development costs, with further funding to be forthcoming from La Cite through equity and development debt funding. On that basis the Principal Construction Contract between BADM and Foundation Partners should have reflected the proportionate cost

> commitment for completion of the Works, as had been correctly reflected in the Construction Subcontract between Foundation Partners and IPCS.

I note that Mr Levy refers to Foundation "funding only a proportion of the total development costs ..." not to Foundation only constructing a part of the building. And my finding is also supported by the terms of the Teaming Agreement (which refers to Foundation providing €25m of equity financing) - I agree with Mr Yates that the Teaming Agreement sets out the "real deal" agreed between the co-venturers.

556. For completeness, I also find that the activities of the individual investors are not indicia of any trade being carried on by Foundation. Any activity that they undertook was after 5 April 2009, and therefore not relevant to whether Foundation was trading in 2008/09. In any event I have found that their activities were "make-work", undertaken primarily for the purpose of attempting to avoid the limitation on loss relief imposed by Finance Act 2008, and did not make any material contribution to Foundation's purported trade. Mr McGovern's evidence was that he did not take any account of their work (other than discussions with them about the appointment of the architect) nor took instructions from them. And in any event, as Foundation had delegated virtually all of its functions to IPCS, there was nothing left for the individual investors to do.

**What if Foundation was trading?**

557. In case this decision is subject to an appeal, I have considered what my decision would have been, if Foundation was found to be conducting a trade.

***Commencement of trade***

558. First, I would find that the trade had not commenced on or before 5 April 2009. The transactions that occurred at the end of March and beginning of April 2009 merely served to "park" Foundation's activities pending raising further capital. Mr Yates, in the course of his submissions, gave a hypothetical example of him deciding to build a skyscraper in Milton Keynes – and that he entered into a contract with a friend or relative to construct the building – everyone knowing that neither he nor the contractor had the resources to undertake the construction work. He submits that merely entering into a contract with a sub-contractor is not enough for the trade to commence.

559. I am not sure that Mr Yates' submission would be right in all circumstances, but I agree that it is correct in this case. Not only was Foundation woefully underfunded to undertake the work required under the Principal Construction Contract, but Project Adriatic had not yet reached the stage when it would be appropriate to engage a prime contractor (such as Foundation), given that there were considerable uncertainties as to whether it would even be possible to construct a building meeting the requirements of the co-venturers in the first place: neither BAD nor BPHS owned the entirely of the site, there were no proper plans or designs for the project (and the specification included in the Principal Construction Contract was muddled to put it at its mildest), the geotechnical characteristics of the site (sand and silt, high water table, seismic area) made construction difficult and potentially extremely expensive, and the DUP prohibited building a hotel that would meet the chosen operator's requirements.

560. In these particular circumstances, I would find that no trade could have commenced on or before 5 April 2009.

***Amounts paid to Foundation Design and FCP under the Partnership Consultancy Agreement and the Takeover Agreement***

561. I have found that the amount paid by Foundation to FCP under the Takeover Agreement was for the right to use FCP's tax structure and business concept and is therefore capital in nature.

562. I have found that the amount paid by Foundation to Foundation Design under the Partnership Consultancy Agreement was as consideration for Future Group's work in finding prospective investors and persuading them to invest capital in Foundation. It is therefore capital in nature too.

563. I would therefore have found that the payments under both agreements would be:

(a) items of a capital nature for the purposes of s33 ITTOIA, and

(b) expenses not incurred wholly and exclusively for the purposes of a trade for the purposes of s34 ITTOIA.

***Amounts paid to IPCS under the Construction Sub-contract***

564. Mr Rivett says that the circular nature of the Barclays finance should be ignored, as it is of no concern to Foundation what IPCS does with its money. Mr Rivett says that I cannot just point to the fact that money is moving in a circle and say, "You lose". Rather, the question I need to consider is the purpose of Foundation's payment to IPCS, which Mr Rivett submits is made to procure the provision of IPCS's services under the Construction Sub-contract.

565. Mr Levy was cross examined on the purpose of the Barclays daylight facility and the circularity in its repayment. Mr Levy's response was that the commercial purpose of the payment to IPCS was "that it allowed our structure to work", and that the structuring was designed around "using tax as a risk mitigation technique". It was put to him by Mr Yates that the reason for the payment of £30,266,250 of IPCS's fee (financed through the Barclays facility) was to allow the investors to have larger than otherwise claims for tax relief and, secondly, if there is a commercial success it allows those profits to go to FDBS. Mr Levy's response was that there might have been other ways of structuring the partnership, but that he viewed this as being the most optimal structure in the tax environment that existed in 2008/09 – in other words he did not deny that the main purpose of these arrangements was to inflate the tax relief that was intended to be claimed by investors.

566. I find that it would be artificial to separate the different steps inherent in the terms of the Barclays facility – and to consider that what happened on 1 and 2 April were completely independent. For the reason I have given above, I have found that the financing and construction documents were an interlocking and interconditional suite of arrangements, the terms of which were agreed by all the parties (including Foundation) on or prior to 31 March, even though they were not all finally signed until 2 April – the suite of documents and arrangements included the Principal Construction Contract, the Construction Sub-contract, the Takeover Agreement, the Partnership Consultancy Agreement, the Barclays facility letter (and associated security documents and mandates), the BPHS-FDBS loan agreement letter, the IPCS-BPHS loan agreement letter, and the FDBS capital contribution to Foundation.

567. I have found that the Construction Sub-contract is contractually interlinked with the circular nature of the Barclays daylight facility. Foundation, in making its payment to IPCS, knew that £30,266,250 of the capital contributed to it by FDBS was originally borrowed by BPHS from Barclays, and that IPCS would be paying this same amount to BPHS to enable it to repay that loan. And because of the terms of the mandates and security that Foundation (and the others) had given to Barclays, I find that these cash movements were contractually

bound to happen, and that the construction agreements and the financing agreements were conditional and contingent on one another.

568. I find that one of the purposes of Foundation's payment to IPCS (indeed, the main purpose) was to enable IPCS to make its loan to BPHS (as it was contractually bound to do), and the reasons for that loan was to enable BPHS (a) to repay the Barclays facility, and (b) to purchase some of the Lenley shares. Very little of the amount paid to IPCS by Foundation was available to IPCS to provide services to Foundation under the Construction Sub-contract.

569. Whilst obtaining the benefit of the services of IPCS may appear to have been one of the consequences of the Construction Sub-contract and the payment made under it, that was not the purpose of the payment made by Foundation. This follows from the fact that Foundation was aware that virtually all of the amount paid to IPCS would be on-lent to BPHS, and IPCS would therefore be unable to provide any services to Foundation, as it would not have sufficient cash to provide those services.

570. I find that the £30,266,250 cannot have been expenditure incurred by Foundation since:

(1) it could never have been used for the purposes of Foundation's purported trade;

(2) it was artificial and had no commercial purpose;

(3) it made no difference to Foundation's ultimate share of the profits;

571. The real purpose of £30,266,250 of the payment was to inflate the claims to be made by investors for sideways loss relief, and to provide a mechanism for FDBS to share in Foundation's profits (if Project Adriatic turned out to be highly successful). Most of the balance was used to pay for the acquisition by BPHS of some of the Lenley shares.

572. In these circumstances I would find that the sum paid by Foundation to IPCS was not incurred wholly and exclusively for the purpose of obtaining the services of IPCS (or its sub-contractors) and therefore could not be incurred wholly and exclusively for the purposes of Foundation's trade. If Foundation was held to be trading, I would find that the amount of £37,762,650.96 paid under the Construction Sub-contract was not incurred wholly and exclusively for the purposes of the Foundation's trade within the meaning of s34 ITTOIA.

573. In taking this approach, I am not "collapsing" arrangements and looking at the end results (following a *"Ramsay approach"*[4]), nor am I invoking some "spooky jurisprudence" to strike down tax avoidance arrangements. Rather (per Nugee J in *Acornwood*) I am taking account of the motive of avoiding tax in considering whether the whole of the £37,762,650.96 paid to IPCS was truly paid wholly and exclusively for the purposes of Foundation's trade. In doing so, I have considered the totality of the transaction to determine whether the amounts paid by Foundation were truly incurred wholly and exclusively for the purposes of its trade. And I find that they were not.

574. I also note the decision in *Scotts Atlantic*, where the Upper Tribunal drew a distinction between a company choosing to reward its directors using a tax efficient mechanism, and having tax minimisation as the object of its adoption of a mechanism. I find that those circumstances are mirrored in this case. Foundation's structure was adopted with tax minimisation as its objective, rather than Foundation choosing to manage its business in a way that minimised its tax liability. And this is another reason why the £37,762,650.96 paid to IPCS was not expended wholly and exclusively for the purposes of Foundation's trade.

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[4] *Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300

575. Mr Rivett cited the decision of the Privy Council in *Peterson* in support of his submissions, but this was held by the Supreme Court to be restricted to its own particular facts.

576. My finding is none of the £37,762,650.96 was incurred wholly and exclusively for the purposes of Foundation's trade. This is because it is not possible to split the payment into different elements, and identify some part of the payment which is not tainted with duality of purpose (see by analogy the decision of the First Tier Tribunal in *The Vaccine Research Ltd Partnership and another v HMRC* [2013] UKFTT 073 (TC) at [89] which was upheld on appeal by the Upper Tribunal)

577. I find also that the £37,762,650.96 paid to IPCS was capital in nature and satisfied the condition in s33 ITTOIA. This is because the amount paid to IPCS was a single lump sum paid to generate an income stream for Foundation.

578. Although Mr Rivett has submitted that Foundation was created with the purpose of constructing many buildings, I found this statement in its marketing literature to be "window dressing", and that (certainly by the time it entered into the construction contracts) it had no intention of undertaking any project other than Project Adriatic. I note that the 18 March 2009 investment appraisal shows Foundation's entitlement to share in the profits from the proposed hotel to stretch over 30 years, and on the GAAP impairment analysis, hotel profits were recognised only from 2031. I find that:

(1) the advantage sought by Foundation from the rights under the Principal Construction Contract was the receipt of future income which was anticipated to stretch over 30 years;

(2) the payment made to IPCS under the Construction Sub-contract was a single lump sum which did not have a recurrent nature in the sense of being continuously demanded by the business; and

(3) the rights to payments under the Principal Construction Contract had a length which could not escape from the primitive concept that revenue items had an annual or at least a short-term nature.

579. I find 30 years is far too long a tract of time to suggest that the profits generated by Foundation's expenditure are revenue in nature. I note that in the *Ingenious* case, most of that entity's income was anticipated to be generated within five years (and in the case of Project Adriatic, the March 2009 investment appraisal shows that profits from the sale of condominium apartments was expected to be generated within 5 years of completion of the building). Yet the Upper Tribunal in *Ingenious* upheld the FTT's finding that the payments were capital in nature.

580. I also find that as the payment is not severable, the whole of the amount paid is capital in nature.

***Accounting treatment***

581. For the reasons I have given, I find that as there was neither

(a) an impairment event that occurred on or prior to 3 April 2009; nor

(b) any evidence that the conditions giving rise to an impairment event were in existence as at 3 April 2009,

it was wrong for Foundation to write down the value of its stock in its 3 April 2009 balance sheet. For the purposes of GAAP, no such write-off should have occurred. I therefore find that the provisions of ss25-26 ITTOIA were not satisfied in respect of the Accounts.

582. But more critically, I find that paragraph 51 of FRS 5 should have been applied to the treatment of the payments made to IPCS. Even if Foundation was trading for tax purposes, GAAP would require all the wider circumstances to be considered to reflect the commercial substance behind the transaction and take into account the circular financing. I find that the operation of paragraph 51 requires that the payment to IPCS should be treated as a current or fixed asset investment, rather than as an expense - irrespective of the fact that Foundation may have been conducting some kind of construction trade for tax purposes.

583. As I have found that the amount paid under the Takeover Agreement was for the right to exploit a business concept, it should be treated as a payment for an intangible asset, and the payment should have been capitalised, and the cost spread over a suitable period (or written-off if the project fails entirely).

584. The experts analysed the payments under the Partnership Consulting Agreement on the basis that Foundation Design had provided the services stated on the face of the agreement. However, I have found that the reality was that it had not provided those building and construction services, but rather had provided services of promoting Foundation to prospective investors and raising capital for Foundation. The accounting treatment would need to follow this corrected analysis, and the amount paid is therefore not deductible as a trading expense (even assuming Foundation was trading).

**CONCLUSION**

585. I have found that Foundation was not trading.

586. I have also found that if, on an appeal, it was held that Foundation was trading, then its trade had not commenced in the tax year 2008/09.

587. I have found that the payment made under the Construction Sub-contract was capital in nature and was not incurred wholly and exclusively for the purposes of any trade carried on by Foundation.

588. Further, the amounts treated as stock in Foundation's balance sheet were not correctly accounted for under GAAP. Paragraph 51 of FRS 5 should have been applied to treat the amounts paid to IPCS as fixed or current asset investments. In any event, no impairment event had occurred which would justify the writing-off of stock on its balance sheet as at 3 April 2009.

589. Finally, I have found that the amounts paid under the Takeover Agreement and the Partnership Consultancy Agreement were capital in nature, and not incurred wholly and exclusively for the purposes of any trade carried on by Foundation.

**DISPOSITION**

590. The appeal is dismissed.

591. This appeal was allocated to the Complex case category. However, Foundation elected under Rule 10(1)(c)(ii) of the Tribunal's procedure rules for the proceedings to be excluded from potential liability for costs. Accordingly, I make no order in respect of costs.

**RIGHT TO APPLY FOR PERMISSION TO APPEAL**

592. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

**NICHOLAS ALEKSANDER**
**TRIBUNAL JUDGE**

**RELEASE DATE: 26 JANUARY 2021**

**Cased mentioned in skeletons but not discussed in this Decision:**

*Arnold v Britton* [2015] UKSC 36

*B. P. Australia Ltd v Commissioner of taxation* [1966] AC 224

*CCE v Faith Construction Limited [1989] STC 539*

*Daarasp LLP v HMRC* [2018] UKFTT 548 (TC)

*Degorce v HMRC* [2017] STC 2226

*Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 (High Court of Australia)

*Hancock v General Reversionary and Investment Company Limited* [1918] 1 KB 25

*HMRC v William Grant & Sons* [2007] STC 680

*Iswera v Commissioner of Inland Revenue* [1965] 1 WLR 663

*MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6

*Marathon Oil UK LLC v HMRC* [2018] SFTD 597

*New Angel Court v Adams* [2004] STC 779

*Rangers 2012 plc (in liquidation) v Advocate General for Scotland* [2017] UKSC 45

*Sun Newspapers Ltd and anor v Federal Commissioner of Taxation* (1938) 61 CLR 337 (High Court of Australia)

*Temple Legal Protection Ltd v QBE Insurance (Europe) Ltd* [2008] EWHC 843 (Comm)

*UBS AG v HMRC* [2016] UKSC 13

*Vodafone Cellular Limited v Shaw* [1995] STC 353

*Wood v Capita Insurance Services Ltd* [2017] UKSC 24

## APPENDIX ONE

**THE FURTHER AMENDED AND RESTATED PARTNERSHIP DEED DATED 30 MARCH 2009**

The Partnership Deed is made between Tim Levy (defined as the "Managing Partner") and FDBS (defined as the "Foundation Corporate Partner"). Mr Levy and FDBS are together defined as the "Founding Partners"). It further amends and restates the partnership deed dated 10 February 2009.

Relevant provisions of the Partnership Deed are set out below:

### 1. Definitions

In this Deed, unless the context otherwise requires, the following words and expressions have the meanings shown:

| | |
|---|---|
| Accounting Date | means 3 April 2009 and 5 April in each year thereafter or such other date as the Managing Partner may resolve and notify to the other Partners or (in the case of the final Accounting Period of the Partnership) the date when the Partnership is ultimately wound up |
| Accounting Period | means the period ending 3 April 2009 and in the second period commencing on 4 April 2009 and ending on 5 April 2010 and thereafter commencing on 6 April each year and ending on 5 April of the next year or such other dates as the Managing Partner may determine and notify to the other Partners or (in the case of the final Accounting Period) the date when the Partnership is ultimately wound up |
| Act | means the Partnership Act 1890, as amended or replaced from time to time |
| Affiliate | means with respect to any entity, any other entity that directly or indirectly controls, is controlled by, or is under direct or indirect common control with, such entity. For the purposes of this definition, "controls" and "controlled" mean the power, directly or indirectly, to direct or cause the direction of the management and policies of such other entity, whether through the ownership of voting securities, by contract or otherwise |
| Annual Accounts | means accounts prepared in accordance with clause 8.1 |
| Build and Design Services Agreement | means an agreement between the Partnership and the Developer to provide build and design services in return for a share of revenue associated with the build and design project |
| Build and Design Services Subcontractor Agreement | means an irrevocable agreement between the Partnership and the Subcontractor to provide build and design services |
| Business | means: |

| | |
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| | i. engaging in an integrated property services trade, including, but not limited to, the provision of build construction and design services; and |
| | ii. conducting activities associated with the Partnership's property services contracts, making appointments and receiving or providing services in pursuance of the Business and incidental or consequent on the Business. |
| Capital Contribution | means in relation to a Partner the amount contributed by such Partner to the capital of the Partnership from time to time comprising the Initial Contribution and the Further Contribution. The Capital Contribution of the Foundation Corporate Partner shall be in a sum equal to approximately 75% the Total Capital Contributions. The aggregate Capital Contributions of the Individual Partners, Corporate Partners and the Founder Partners apart from the Foundation Corporate Partner shall be in a sum equal to approximately 25% of the Total Capital Contributions. |
| Capital Gain | means the amount (if any) by which the proceeds on disposal of any capital asset, (after deduction of expenses of the Partnership associated with the disposal) exceed the acquisition cost thereof |
| Capital Loss | means the amount (if any) by which the acquisition cost of a capital asset exceeds the proceeds on disposal after deduction of expenses of the Partnership associated with the disposal |
| Capital Proceeds | means amounts determined by the Managing Partner to be in the nature of capital proceeds and available for distribution by the Partnership |
| Consultant | means Future Design and Build Services Limited, who is appointed as property advisors to the Partnership further to the Partnership Consultancy Agreement, or any other consultant that the Partnership may appoint from time to time |
| Corporate Partner | means any Partner apart from the Founder Partners and Individual Partners, that is admitted to the Partnership |
| Deed of Adherence | means the deed of adherence dated November 2008 included as part of the Initial Business Plan |
| Developer | means an entity that will directly or indirectly own the development project |
| Economic Entitlement | means any share in the income, capital gains and other Profits of the Partnership |
| Equity Multiplier Threshold | means the point at which the Income received by the Individual Partners, the Corporate Partner and the Managing Partner is equal to twice the Capital Contribution (including the Further Contribution) made by |

| | |
|---|---|
| | those partners to the Partnership |
| Financial Close | means the date on which the Partnership and the Build & Design Services Subcontractor Agreement becomes irrevocable and unconditional |
| Foundation Corporate Partner | means Future Design and Build Services (Jersey) Limited, a Jersey incorporated and tax resident company that is admitted to the Partnership |
| Founder Partners | Mr Tim Levy and the Foundation Corporate Partner |
| Further Contribution | means such further amount of Capital Contribution specified in each Individual or Corporate Partner's Deed of Adherence and due from such Individual or Corporate Partner as set out in this Deed |
| Income | means any and all income and any and all amounts determined by the Managing Partner on behalf of the Partnership as being income proceeds and available for distribution by the Partnership |
| Initial Business Plan | means the initial business plan issued by the Managing Partner describing the opportunity to participate in the Partnership |
| Initial Contribution | means the initial Capital Contribution in the sum of £25,000 to be paid by each Subscriber before admittance into the Partnership as a Partner |
| Interest | means the interest of a Partner in the Partnership and all other rights which it has in the Partnership |
| Individual Partner | means any partner, apart from the Founder Partners and Corporate Partners, that is admitted to the Partnership |
| Net Income | means the amount greater than zero which results when the gross income excluding Capital Gains of the Partnership has been reduced by expenses of the Partnership (other than Capital Losses) |
| Net Loss | means the resultant loss where the expenses of the Partnership (other than Capital Losses) exceed the gross income of the Partnership |
| Outstanding Investment | means in relation to a Partner, the amount of its Capital Contribution which, at the relevant time, has been contributed to the Partnership and not withdrawn |
| Partner Majority | means the written consent of the Founder Partners and Foundation Corporate Partner together with the written consent of all those Individual Partners and Corporate Partner who are in attendance at the relevant Partnership meeting, in the aggregate, represent 75% or more of the aggregate Capital Contributions of the Partners. For the purposes of any Partnership vote, the Foundation Corporate Partner will be restricted to representing 50% of the aggregate Total Capital Contribution and the remaining |

50% shall be pro-rata allocated

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| Partner Percentage Contribution | means the Founder Partner's and each Individual Partner's and Corporate Partners Capital Contribution expressed as a proportion of the total aggregate Capital Contributions of Partners |
| Partners | means the Founder Partners and the Individual Partners and Corporate Partners that are admitted to the Partnership as a Partner in accordance with the terms of this Deed including any Substitute Partner who acquires rights and obligations in succession to a Partner (for the term during which that Partner or Substitute Partner is a Partner of the Partnership) provided that any such Partner is resident in the United Kingdom for income or corporation tax purposes for the term during which that Partner is a Partner of the Partnership |
| Partnership | means Foundation Partners GP, being the general partnership formed pursuant to this Deed under the provisions of the Act |
| Partnership Assets | means all or any of the assets of the Partnership |
| Partnership Consultancy Agreement | means the agreement made between the Partnership and the Consultant |
| Profits | means profits of the Partnership after payment of all fees, costs and expenses as shown in the annual accounts of the Partnership |
| Profit Sharing Participation | means the allocation of the Net Income, Net Losses, Capital Gains and Capital Losses for a particular Accounting Period, such allocation to be determined in accordance with the following order of priority (at the discretion of the Managing Partner acting on behalf of the Partnership): |

(A) The Partnership's Capital Gains and Capital Losses shall be allocated between the Partners in accordance with their respective entitlements on a winding-up set out in clause 13.2(a)

(B) The Partnership's Net Income shall be allocated for the purposes of Taxation and the Annual Accounts as follows:

(a) Subject to the Equity Multiplier Threshold not having been met, in all Accounting Periods:

(i) an amount equal to 75% of the Net Income shall be allocated to the

Individual Partners, Corporate Partners and the Managing Partner pro-rata and;

(ii) an amount equal to 25% of the Net Income shall be allocated to the Foundation Corporate Partner

(b) Once the Equity Multiplier Threshold has been met, in all Accounting Periods:

(i) an amount equal to 25% of the Net Income shall be allocated to the Individual Partners, Corporate and the Managing Partner aggregate) pro-rata and;

(ii) an amount equal to 75% of the Net Income shall be allocated to the Foundation Corporate Partner

provided that if the date on which Equity Multiplier Threshold is met (the "trigger date") occurs during any particular Accounting Period the ratios set out in sub-paragraphs (a) and (b) above shall be applied pro rata to the periods before and after the trigger date respectively.

(c) An amount equal to 99% of the Partnership's Net Losses shall be allocated for the purposes of Taxation to the Individual Partners, Corporate Partners and the Managing Partner pro-rata and the residual 1% to the Foundation Corporate Partner

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| Sub-Contractor | means an entity that will be subcontracted by the Partnership to provide property services, which may include, but not limited to build and design services |
| Sub-contractor Agreement | means an agreement between the Partnership and the Subcontractor for property services, which may include, but not limited to build and design services |
| Subscriber | means a prospective Partner who executes a Deed of Adherence and any Substitute Partner who acquires rights and assumes obligations in succession to such person (for the term during which the person or Substitute Partner is a Partner of the Partnership) |
| Substitute Partner | means a person admitted pursuant to clause 11.3 as a Partner as the successor to all, or part of, the rights and |

| | |
|---|---|
| | liabilities of a Partner, in respect of such Partner's Interest |
| Total Capital Contribution | means the aggregate amount of all the Capital Contributions |
| Transaction Documents | means certain documents to be entered into by the Partnership including but not limited to the Build and Design Services Agreement, Subcontractor Agreement or any other commercial arrangements that is considered as relevant to the Partnership's Business by the Managing Partner, which may include, but not limited to Partnership employment contracts. |
| Transfer | has the meaning given in clause 11 |

1.7 Where the consent, approval or discretion is required of the Partners, such consent, approval or discretion shall be given by Partner Majority unless any other majority is required by this Deed.

## 2 Nature of Partnership

The Partnership is a general partnership and has been formed pursuant to the Act.

## 3 Purpose and Business of Partnership

3.1 The purpose of the Partnership shall be to carry on the Business and in particular but without limitation the business of the Partnership shall include:

(a) to enter into relevant Transaction Documents associated with the Business of the Partnership;

(b) to engage the Services Providers to provide certain services to the Partnership in respect of the Business;

(c) to enter into agreements with other persons in order to acquire jointly and otherwise deal with rights in property where necessary or desirable to maximise the scope and profitability of the Partnership's trade;

(d) to enter into suitable property services activities including, but not limited, to those activities as set out in the Initial Business Plan;

(e) to execute, deliver and perform all contracts, deeds and other undertakings and engage in all activities and transactions necessary or advisable in order to carry out the foregoing purposes and objectives, subject to and in accordance with the provisions of this Deed and in particular where necessary or desirable in order to most effectively carry on the Business to appoint third parties to carry out functions approved by the Partnership pursuant to this Deed;

(f) to employ such persons, engage such consultants, lease such offices and or facilities as in the opinion of the Managing Partner, may be reasonably required from time to time, for the conduct of the Business; and

(g) any other related activities as the Partnership may decide.

## 4. Managing Partner

4.1 The Managing Partner shall be Tim Levy of […], London, United Kingdom

4.2 The Managing Partner may only be removed by unanimous vote of all other Partners

4.3 The Managing Partner shall receive an annual fee, to be paid quarterly in advance, with first payment due on the date of Financial Close, equal to 0.125% of Partnership Capital

4.4 The Managing Partner also be entitled to, in addition to his proportionate share of income or capital profits, an additional 0.5% of all Partnership profits, payable annually

4.5 The Managing Partner is entitled to incur expenditure up to £250,000 in any one Accounting Period without requiring Partners consent.

## 5. Capital Contribution

*Partners*

5.1 Additional Subscribers may be admitted as Partners at any time and from time to time provided that each such person executes and delivers to the Managing Partner a Deed of Adherence. Upon acceptance of such Deed of Adherence by the Managing Partner, the additional Subscribers shall be admitted to the Partnership.

*Capital Contribution and Interest*

5.2 Each Subscriber hereby agrees that it shall contribute its Initial Contribution of £25,000 referred to in its Deed of Adherence on or before its admission as a Partner.

5.3 Each Subscriber may contribute its Further Contribution specified in its Deed of Adherence before the time prescribed in clause 4.4. In this event, the Individual Partner will be entitled to interest payment on the Further Contribution earned from the relevant deposit account up to the time the Managing Partner notifies that the Further Contribution is due for payment.

5.4 Each Partner hereby agrees that it will pay its Further Contribution specified in its •Deed of Adherence within 7 Business Days of the Managing Partner notifying the Partner that such payment is due.

5.11 The Foundation Corporate Partner acknowledges that the Managing Partner has made its Initial Contribution and the Managing Partner acknowledges that the Foundation Corporate Partner has made its Initial Contribution on or about the date hereof.

## 6. Management and operation of the Partnership

*Appointment of the Consultant*

6.1 The Managing Partner shall have full discretion and authority to appoint a person to act as Consultant pursuant to the terms of the Partnership Consultant Agreement and to terminate such appointment and appoint a different Consultant in its place. The Consultant currently appointed is Future Design and Build Services Limited.

*General Management of Partnership*

6.2 Other than the specified authority of the Managing Partner, any agreement or approvals required by this Deed to be made or given by the Partners, which shall include the decision to enter into the first set of Transaction Documents, shall be decided by a Partner Majority. gave

that the following decisions or approvals shall be required to be decided by the unanimous consent of all the Partners:

(a) any decisions requiring the Partnership to incur expenditure or liabilities in excess of £25,000, save that any decisions requiring the Partnership to incur such expenditure or liabilities before the date on which it has been resolved by the Partners to enter into the first set of Transaction Documents shall be decided at the sole discretion of the Managing Partner;

(b) any decision requiring the Partnership to enter into any further transactions that are not provided for under the Transaction Documents; and

(c) any amendment to clause 17 of this Deed.

6.3 The Managing Partner shall have sole authority to determine those matters which are stated in this Deed as requiring only its approval, consent or determination (as the case may be).

6.4 The Founder Partners shall have full power and authority to execute so as to bind the Partnership any deed or document or do any other act or thing which the Partners may direct the Partnership to execute or do under the provisions of this clause 6 or any other provision of this Deed.

6.5 Save as set out in this clause 6 or any other provision of this Deed, no Partner has authority to bind another Partner and/or the Partnership and no Partner shall (deliberately or otherwise) hold himself out as the agent of the Partnership or another Partner of the Partnership. Without prejudice to the generality of the foregoing, no Partner shall, or shall purport to, pledge the credit of the Partnership or any other Partner.

*Authority and Powers of the Partnership*

6.7 The Founder Partners shall be treated for all purposes to be acting under the direction of the Partners, shall have full power and authority:

(a) to sign the Partnership Consultancy Agreement on the Partnership's behalf and so as to bind it and thereby appoint the Consultant (and to do likewise in relation to each succeeding consultant).

## 8. Partnership Accounts and other information

*Preparation of Annual Accounts*

8.1 The Partnership shall prepare accounts for each Accounting Period in accordance with the principles agreed with the Auditors from time to time, including a balance sheet and a profit and loss account. The Managing Partner shall cause such accounts to be audited by the Auditors. A copy of the audited accounts together with the Auditor's report and a statement of accounting policies shall be dispatched by post, email or facsimile or other acceptable means of communication to each Partner not later than ninety (90) days following each Accounting Date.

*Partners' Accounts*

8.2 Each Partner shall have an income account and a capital account which will be operated so that the Net Income, Net Losses, Capital Gains and Capital Losses allocated to each Partner pursuant to clause 10 shall be credited or debited as the case may be to that Partners income account or capital account; distributions to each Partner pursuant to clause 8 shall be

debited to that Partner's income account or capital account; no interest will accrue on amounts outstanding on any Partner's capital account.

*Variation of Accounts*

8.3 The Managing Partner on behalf of the Partnership may with the approval of the Auditors, vary the accounting policies of the Partnership and shall accordingly determine or vary the allocation of any item to reflect properly the intention of the Partners as stated in this Deed (including any variation arising from a Partner becoming a Ceasing Partner) provided that no such variation shall affect the distributions payable to the Partners pursuant to clause 8 (other than in respect of a Ceasing Partner).

*Report*

8.4 The Managing Partner shall use reasonable endeavours to ensure that the relevant Employees or the relevant Partners prepare and send by post, email or facsimile to each Partner within 120 days of the end of each Accounting Period a report comprising a statement of the Partnership Assets and a commentary of the progress of the Business of the Partnership for the relevant period.

## 10 Allocation of Profits and Losses and Distributions of Capital Proceeds

*Allocations*

10.1 Subject to the other provisions this Deed all Net Income, Net Losses, Capital Gains and Capital Losses shall be allocated to the Partners in proportion to the Profit Sharing Participation.

*Distribution of Income*

10.2 Subject to the provisions of this clause 9.2 Income of the Partnership shall be distributed in accordance with clause 9.1, annually within 120 days of the Accounting Date.

*Limitations on Distributions*

10.3 The Partnership shall not make any distribution pursuant to this clause:

(a) unless there is sufficient cash available for that purpose;

(b) which would render the Partnership insolvent; or

(c) which would or might leave the Partnership with insufficient funds or profits to meet any future contemplated obligations, liabilities or contingencies.

## 12 Meetings of Partners of the Partnership

*Chairman*

12.4 The Managing Partner shall preside as chairman of every meeting of the Partnership or if he is not present or is unwilling to act an officer of the Foundation Corporate Partner shall be or he is not present or is unwilling to act, the Partnership shall nominate an officer of one other Partner to be chairman of the meeting.

*Voting*

12.5 At any meeting of the Partners, a resolution put to the vote of the meeting shall be validly adopted if approved by a Partner Majority save that, if pursuant to any provision of this Deed a resolution requires a vote of the meeting to obtain the unanimous approval of the

Partners, then the vote shall only be validly adopted if approved by the unanimous vote of the Partners.

12.6 For the purposes of any resolution put to vote of the meeting, the Foundation Corporate Partner shall represent 50% of the Total Capital Contribution.

12.7 Only a resolution in writing signed by all the Partners in person, shall be effective as if the same was passed at a duly convened meeting.

12.8 If any vote for any resolution at any meeting is undecided, the vote of the Managing Partner shall act as the casting vote.

## 13 Winding-up

*Partners to cause winding-up*

13.1 On that date which is thirty five (35) years from the date of this Deed or a date which is earlier if deemed appropriate by a Partner Majority, the Partners shall cause the Partnership to be wound-up, and for this purpose shall designate the Managing Partner (failing whom some other appropriately qualified person) as liquidator of the Partnership (the "Liquidator").

13.2 The life of the Partnership may be extended if agreed by a Partner Majority.

*Distribution of remaining assets*

(a) Upon a winding-up of the Partnership, the Liquidator will be responsible for selling all of the assets of the Partnership. All remaining assets of the Partnership after the satisfaction of all obligations to creditors of the Partnership shall be distributed to the Partners in proportion to their respective Capital Contributions.

13.3 If pursuant to the terms of this Deed, any Partner has been allocated a Capital Loss or a Net Loss in excess of its Capital Contribution to the Partnership, such excess shall not be treated as a debt owed to and thus an asset of, the Partnership upon a winding-up of the Partnership.

## 18. Auditors and Accounts

*Approval of Accounts*

18.4 The Managing Partner on behalf of the Partnership shall be responsible for approving the accounts of the Partnership prior to their distribution to the Partners.

## APPENDIX TWO

**SECURITY GIVEN TO BARCLAYS IN RESPECT OF THEIR FACILITY**

All dated 2 April 2009:

Mr Levy and JTC Securities Ltd: Security Interest over BPHS shares;

Mr Levy and JTC Corporate Services Ltd: Security Interest over BPHS shares

Mr Levy and JTC Securities Ltd: Security Interest over FDBS shares

Mr Levy and JTC Corporate Services Ltd: Security Interest over FDBS shares

BPHS: Charge Over Cash Deposit

BPHS: Deed of Assignment

BPHS: Stake Pledge

FDBS: Charge Over Cash Deposit

FDBS: Deed of Assignment and Charge

Foundation: Charge Over Cash Deposit

IPCS: Charge Over Cash Deposit

IPCS: Deed of Assignment