TC08023

Appeal number: **TC/2017/07592; TC/2018/05667**
TC/2018/05670; TC/2018/05672
TC/2018/05673; TC/2018/05674
TC/2018/05675; TC/2018/05677
TC/2018/05678; TC/2018/05679
TC/2018/05680; TC/2018/05681
TC/2018/05683; TC/2018/05684

INCOME TAX – whether amounts were partnership profits – appeals allowed – whether amounts taxable under s687 ITTOIA 2005 – yes – whether discovery stale – no – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

HFFX LLP **Appellants**
STEPHAN ATKINS
YURI BEDNY
PAUL BEREZA
ALEXANDER GERKO
PHILIP HOWSON
RENAT KHABIBULLIN
JOSHUA LEAHY
JACOB METCALFE
ALEX MIGITA
DMITRY SHAKIN
ANDONIS SAKATIS
CHRISTOPHER SHUCKSMITH
EVGENY TANHILEVICH

- and -

ANDREY BADZYAN **Interested Party**

- and -

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

TRIBUNAL: JUDGE ANNE FAIRPO

Sitting in public at London on 18-21 June 2019

Kevin Prosser QC and David Yates QC, instructed by Macfarlanes LLP, for the Appellants

Rory Mullan, Counsel for the Interested Party

Thomas Chacko and James Kirby, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

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Introduction

1. The appellants appeal against a number of assessments, summarised as follows:

   (1) an amendment dated 22 March 2016 to the HFFX LLP partnership return for the year ended 31 March 2012, stated to have been made under s30B Taxes Management Act ("TMA") 1970;

   (2) amendments to the HFFX partnership returns for the years ended 5 April 2013 and 5 April 14, made by closure notices dated 10 August 2017, issued under s28B TMA 1970;

(3) discovery assessments against the Individual Appellants (the appellants other than HFFX LLP) made under s29 TMA 1970 in respect of the tax years 2011/12 and 2013;

(4) amendments made by closure notices to the Individual Appellants' personal tax returns, issued under s28A TMA 1970, for the tax years 2013/14, 2014/15 and 2015/16.

2. The details of the assessments and closures notices are included in Appendix 1 of this decision.

3. In accordance with the Tribunal's directions, the appeals were listed to be heard together by the same Tribunal.

4. An individual member of HFFX, Andrey Badzyan, was given permission to make submissions at the hearing as an interested party in relation to the appeal by HFFX LLP. Mr Badzyan was a former member of HFFX LLP and the amendments made by HMRC in respect of the HFFX LLP partnership return for the tax year ended 31 March 2012 would affect Mr Badzyan's tax position.

5. HMRC contend that amounts allocated to HFFX LLP should have been treated as allocated to individual members of HFFX LLP (Issue 1) or, in the alterative, that amounts of Special Capital received by individual members should have been taxed as miscellaneous income (Issue 2a) or, in the further alternative, such amounts of Special Capital should have been taxed on the basis of the provisions for sale of occupational income (Issue 2b).

6. The appellants contend that the amounts allocated to GSAM were properly allocated to GSAM and that there was no tax charge on the Special Capital amounts received by individual members. The appellants contend that, if HMRC are correct as to Issue 1, then the discovery amendments issued to HFFX is invalid and that discovery assessments issued in respect of the individual members are stale.

7.

Abbreviations used

HFFX - HFFX LLP

AG - Alexander Gerko

PH - Philip Howson

PB - Paul Bereza

AB - Andrey Badzyan

GSAM - GSA Member Ltd, Retention Member of HFFX LLP

GSACP - GSA Capital Partners LLP

GSACS - GSA Capital Services Limited, Corporate Member of HFFX LLP and managing member of GSACP

GSA - the investment management business primarily operated through GSACP

Background

8. The Individual Appellants were initially employed by GSACS to work within the GSA business. They were employed as researchers and developers, in a team established and led by AG after he was employed in June 2009, to design and implement software to be used by GSA funds to undertake foreign exchange trading.

9. In addition to other remuneration, the team were entitled to a share of GSA profits (the "Trader Pay-Out") which was allocated by AG amongst the team. Approximately 30% of the Trader Pay-Out was paid in the form of deferred remuneration, whereby individuals were given restricted shares in a GSA fund which could be realised over a period of time, if certain conditions were met. The Trader Pay-Out was initially 35% of the profits generated through the team's work; it was subsequently increased to 50%, with effect from 31 January 2010, in an agreement between AG and GSACS entered into on 1 July 2010.

10. Following negotiations over the position of AG and the team within GSA, GSA proposed that the team be restructured. Certain members of the team became members of a new LLP (HFFX) and were seconded to GSA, continuing to undertake the same work as they were doing as employees. AG was appointed as the Managing Member of HFFX. HFFX also had two corporate members; GSACS and GSAM.

11. GSAM was owned by a Cayman Islands company, which owned GSAM as trustee of the GSA Member Limited Star Trust, a Cayman Island Star Trust. A Star Trust is a purpose trust with no beneficiaries. The purpose of the GSA Member Limited Star Trust was stated to be to own GSAM to promote the business of GSACP and HFFX. GSAM had a single director, who was not otherwise connected with HFFX.

12. HFFX was set up and became a member of GSACP in October 2010. It was entitled to a share of GSACP profits, including the HFFX Trader Pay-Out. This was an amount calculated as a percentage of the profits generated by the "HFFX Trader Group" business conducted by GSA. The relevant percentage was stated to be 35% for profits to the period to 31 January 2010, and 50% thereafter, as HFFX was entitled to the HFFX Trader Pay-Out for the entire financial year of GSACP in which it became a member of GSACP.

13. The arrangements further involved the implementation of a Capital Allocation Plan (the "CAP"). In brief, the CAP required the payment of a proportion of the HFFX Trader Pay-Out to GSAM. This amount was based on amounts calculated by the HFFX managing member. The HFFX managing member would also recommend how the amounts paid to GSAM should be dealt with. The recommendations to GSAM would be that GSAM should in future allocate amounts between the

individual members in specified percentages. The recommendations in respect of the individual members could be amended.

14. GSAM invested the amounts (after deduction of corporation tax and other liabilities) in GSA funds. On the first, second and third anniversaries of the recommendation being made, GSAM would sell one third of the investment and contribute the amount to HFFX as "Special Capital". GSACS, as Corporate Member of HFFX, could require that amounts held as Special Capital by GSAM could be used to pay any liabilities incurred by GSA arising from fraud, negligence, breach of contract or breach of statutory duty by any member of HFFX or an employee of the HFFX Trader Group. Subject to this, GSAM could then decide whether to reallocate the Special Capital amount held by it to individual members of HFFX. Following reallocation, the individual members of HFFX were then able to withdraw these amounts on demand.

15. Individual members who were removed from or retired from HFFX as "bad leavers" were no longer members of HFFX and were not able to be allocated amounts of Special Capital by GSAM. Individual members who wished to leave and were not bad leavers became a "Restricted Member" of HFFX and continued to be able to be allocated amounts of Special Capital by GSAM.

Appellants' evidence

16. As the appellants' evidence is relevant to several of the issues to be considered, I have set out it out here before considering those issues.

17. Three of the individual members provided witness statements and gave evidence as follows:

Alexander Gerko

18. AG was the Managing Member of HFFX from its inception and is the co-CEO of the successor business created by the exit of HFFX from GSA in 2015. With an academic background in mathematics and economics, he was engaged by GSA in June 2009 as a senior strategist to create and implement (with a team of researchers and developers) high frequency trading strategies to be used in the foreign exchange markets by funds managed by GSACP. His role included research as well as management activities although the proportion varied over time: although he had started by spending most of his time directing research and undertaking research, AG estimated that by 2012 less than 50% of his time was spent on research. By 2014, he did not undertake any research work as he was spending all of his time negotiating with GSA over the exit of the HFFX business from GSA.

19. When engaged by GSA, AG received a basic salary and the team received a pay-out of approximately 35% of profits generated by the team. AG stated that he was assured on joining that the trader pay-out would be increased to 50% if a particular threshold was reached. AG had discretion as to the distribution of the trader pay-out amongst the team members. 30% of the pay-out was subject to deferral and was

required to be used to purchase restricted fund shares. These could only be realised by a trader in later years, subject to specified conditions being met, including a requirement that the trader had not left as a "bad leaver".

20. AG stated that one of his reasons for joining GSA and accepting a lower pay-out than he considered he could obtain elsewhere was that they agreed that he could retain ownership of any intellectual property developed by the team. He had therefore retained ownership of all of the code developed by the team, both for developing strategies or live code used for executing those strategies. GSA also agreed to fund higher start-up costs than other businesses that AG had spoken with, so that a larger research team could be engaged, and appropriate infrastructure implemented more quickly.

21. The team exceeded the threshold for the 50% trader pay-out by February 2010. AG stated that GSA then disagreed that such a pay-out had been offered. After discussions, GSA agreed to increase the pay-out but required that AG become a member of GSACP. AG's evidence was that he had some concerns about that, including the exposure to potential losses in GSA and his doubts about the profitability of other parts of the business. GSA were also not prepared to make all of the team members of GSACP.

22. Eventually, by mid-2010, GSA had agreed to increase the trader pay-out to 50% with effect from January 2010 and proposed that the team be spun out into a separate limited liability partnership (HFFX), in which some of the team would be members. AG was told that they would have significant autonomy in operating the business and could make decisions independently from GSA with regard to potential hires and promotions. Nevertheless, GSA retained approval of significant management decisions and, in particular, GSACS was to be appointed a corporate member of HFFX and given the right of veto over matters covering the major activities of HFFX. Once HFFX was established, weekly meetings between AG and GSA were held to discuss HFFX's business. AG was Managing Member of HFFX but could be replaced by GSA if they terminated his secondment from HFFX to GSA.

23. AG was told that this structure could make it easier to enforce non-compete agreements against team members, if they were LLP members rather than employees. AG's evidence was that, despite the greater autonomy and improved pay-out, he remained concerned about GSA's level of effective control and that, as an LLP member, he would also have fewer rights than he would have had as an employee of GSA. However, he considered that he had no choice if he wanted to achieve the higher trader pay-out and concluded that matters balanced to make it worthwhile taking the risk of giving up protection rights. He also considered that, if the business remained profitable, GSA would not be likely to exercise their powers over himself or HFFX.

24. AG noted that GSA had offered him an employment contract in July 2010 with a 50% trader pay-out, which he could not recall well, but thought that it was an interim measure pending HFFX being established. As HFFX was eventually established, the contract became irrelevant.

25. AG stated that the terms for establishing HFFX were discussed between his lawyers and those of GSA between August and October 2010. The team was informed about the position but AG considered that they took their lead from him and had little choice but to join HFFX if they wanted to stay in the team.

26. HFFX was incorporated on 8 October 2010, AG's employment with GSACS was terminated on 27 October 2010 and he became the Managing Member and Designated Member of HFFX on 28 December 2010. Three other individuals, including PH, became members of HFFX on the same day. AB became a member on 1 December 2010, after visa delays. AG also stated that he was unsure whether AB was ready to be made a partner, being the most junior member of the team. Further employees of GSA were made members of HFFX at later dates.

27. The members of HFFX were seconded to GSA, to continue to research and develop strategies for the funds as they had done as employees of GSA. HFFX became a member of GSACP and would receive the 50% trader pay-out that had been agreed, less any reasonable costs incurred by GSA in relation of HFFX.

28. As part of the formation of HFFX, AG stated that GSA required that HFFX operate the CAP as a remuneration deferral mechanism. Under the CAP, a percentage of the amounts received by HFFX from GSACP were allocated to GSAM. AG, after discussion with GSA, would make recommendations as to how these amounts should by applied by GSAM but AG considered that GSA had the final say as to how and whether GSAM would follow the recommendations.

29. AG stated that he had no involvement in the development of the CAP. The reasons for implementing it were explained to him by GSA. The explanation given was that there was perceived pressure from the Financial Services Authority (FSA)[1] after the financial crisis to require businesses to put in place effective risk management and to promote a longer-term approach to conducting businesses. In line with this, businesses were to ensure that those receiving bonuses were more closely aligned with the interests of the business and clients. Although HFFX was not itself regulated, the members of HFFX were seconded to GSA, which was regulated. GSA clearly considered that the FSA remuneration requirements would apply to HFFX.

30. Although GSA had made available a restricted fund shares mechanism as an alternative remuneration deferral mechanism, AG believed that GSA considered that this mechanism was not sufficient to meet FSA requirements. AG said that he was told this during negotiations in 2010, and he thought that GSA had concerns about being able to recover unvested shares. AG also said that he was told by his lawyers that the restricted fund shares mechanism created a risk over the whole payment, because the tax charge would take up the whole of the initial payment under that mechanism and all other amounts would be deferred and at risk. AG said that he did not consider it very attractive to work 60-70 hour weeks and have the entirety of the

[1] The FSA was abolished in April 2013; the relevant FSA responsibilities were taken over by the Financial Conduct Authority. For the sake of simplicity and as the tax position does not depend on which authority was in effect at the time, this decision refers to the FSA throughout.

bonus effectively deferred. He said that he was told that the mechanism did not work in a partnership and that he should take the alternative, the CAP, instead.

31. AG said that GSA also refused to allow the restricted fund shares mechanism to be used other than by US taxpayers who would be subject to an excessive tax burden under the CAP. AG said he would have preferred to be able to use the restricted fund shares mechanism himself in preference to the CAP, but GSA would not allow him to do so.

32. The LLP Deed stated that a minimum of 30% of amounts received by HFFX would be allocated to GSAM. GSA required from the start that at least 50% be so allocated, notwithstanding the terms of the Deed. AG's evidence was that he wanted to limit the allocation to 30%, as in the Deed, but GSA refused to allow this. AG considered that this was a further attempt by GSA to control the members of HFFX and demonstrated the influence that GSA had over the process.

33. AG considered that the CAP was to operate as a retention and incentivisation tool, to encourage good behaviour with the prospect of being reallocated amounts in future and also to punish 'bad' behaviour as, in those circumstances, a member would not be reallocated any amount. Members would also be incentivised to carry out trading with a long-term view and sustaining performance over a number of years.

34. The CAP also allowed for investment in new opportunities, to support partnership capital for regulatory purposes and also to provide protection against a downturn in business. AG said that GSA refused to allow any such investment, although AG had identified specific opportunities to do so.

35. AG explained that the LLP Deed provided that the CAP could also be used against potential regulatory fines or against losses incurred. This was not only a theoretical risk, as a competitor business had lost $400m in the space of 45 minutes as a result of a problem with their equivalent software. Had such a mistake been made by HFFX, AG considered that GSA would have clawed back the losses from the amounts held by GSAM.

36. Fines incurred could also be clawed back, and a fine of $100,000 had been clawed back by GSA: in the event, it was clawed back from the regular bonus as the fine arose close to year end and so there was no need to claw back from the amounts allocated to GSAM. AG considered that the LLP Deed allowed GSAM discretion to use the CAP for any legitimate business reason that might arise.

37. AG disputed HMRC's assertion that the CAP was put in place to create a tax benefit. He stated that tax was only a factor to the extent that he had been advised that the alternative restricted fund shares arrangements could create a deeply unfair tax position, creating a tax charge on amounts never received. The problem was not the amount of tax but the timing of tax payments. AG was not interested in obtaining a tax benefit and would have preferred greater certainty over the amounts to be received, less control by GSA and a smaller deferral. He stated that he would actually have preferred no deferral at all, but that GSA would not allow this. He took no

advice as to the tax aspects of the CAP; he took only commercial law advice. GSA did not suggest to him that the CAP arrangements were prompted by tax avoidance.

38. AG's view was that the CAP provided much less certainty over provisional awards than he had had as an employee. His view was that he would have no recourse if GSA recommended that amounts should not be reallocated. If things did not go well or his relationship with GSA deteriorated and he needed to leave, he would not receive anything from the CAP arrangements. The CAP process was run by GSA; contact with GSAM was primarily through GSA; GSA had approval rights over how GSAM applied amounts allocated to it. GSA could prevent awards being made where it had incurred a liability as a result of any breach or negligence on the part of HFFX members.

39. AG explained that his lawyer had advised that there was much less certainty over payments than was the case when AG was an employee, even though the trader pay-out allocated to HFFX was higher. AG's evidence was that he approached the CAP on the basis that he might never see the deferred amounts, and could not count them, and that he had advised his team accordingly.

40. AG described the operation of the CAP as follows:

(1) A trader pay-out of 50% of profits generated for GSACP was allocated to HFFX, after deduction of expenses relating to HFFX.

(2) The LLP Deed provided for specific allocations, after which AG had the right to allocate the reminder subject to the approval of GSA.

(3) GSA insisted that 50% of the amounts available for distribution always had to be allocated to GSAM.

(4) After this allocation to GSAM, the remainder was allocated between the individual members in percentages determined by AG with the approval of GSA. As AG was the team manager, he was best placed to make this assessment. The proposed allocation was confirmed with GSA in early January after receipt of the profit share by HFFX from GSACP and after discussions about the performance of the team and HFFX. AG's view was that, if GSA had disagreed with his recommendations, he would have needed to change them.

(5) The percentage recommended was based on the cumulative performance of each member and so would increase over the first few years with the team. An increase in the percentage recommendation for one team member naturally required a corresponding reduction in the percentage recommendation for others.

(6) In practice, the percentage recommended for a member was reasonably stable, unless others joined, once they had been with the team for a few years as in general the performance of the members remained strong.

(7) AG would make provisional recommendations for the reallocation of amounts allocated to GSAM, although his evidence was that GSA ultimately had discretion as to how the amounts allocated to GSAM were to be applied.

AG agreed that it was fair to say he had a broad discretion. GSA would be likely to be aware of any problems relating to a developer as it would be obvious from the performance of the software; however, they would need information from AG if there were a problem with a researcher.

(8) The provisional recommendations had to be agreed with GSA and AG's evidence was that he would be required to accept any changes which GSA made, although he did not expect them to interfere as a matter of routine as the team was operating well. GSA assisted with the calculation of the recommendations and provided the explanation for the recommendations to GSAM. The recommendations largely followed the percentages used to allocate the remainder as there was no reason to do otherwise at that stage. The provisional amount was, however, within a band rather than being a specific number.

(9) Recommendations could be, and were, subsequently changed and could be ignored by GSAM. Multiple updated recommendations were made by AG for 2010 and 2011, to propose provisional awards for new members joining HFFX and to reflect the departure of AB and other individual members who left HFFX.

(10) AG would then write to the individual members to advise them of the amounts allocated to them and that they had been recommended for a provisional award within a particular financial band. No explanation was given as to how the recommendation had been reached, and the specific percentages were not set out in the letters. AG's view was that individual members would not be able to determine the percentages as eventual receipts would reflect the performance of the funds in which GSAM invested. The letters also confirmed that the amounts were not guaranteed and that specific criteria would need to be met for amounts to be paid, and that payment was at the discretion of GSAM. AG's evidence was that he did not provide members with any assurances as to the amount, if any, that would be received. He stated that, on the contrary, the message he gave the team was that these awards might never be received.

(11) GSAM paid corporation tax on the amounts allocated to it and the amounts remaining post-tax were invested by GSAM in the GSA main fund.

(12) On the first, second and third anniversary of each allocation to it, GSAM would redeem one third of the relevant investment in the GSA main fund and contribute that amount to HFFX as Special Capital. At the same time, AG again updated the recommendations, subject to the approval of GSA.

(13) GSAM would then consider whether to reallocate any of the Special Capital in accordance with the recommendations. GSAM would advise AG of its decisions and AG would inform the individual members accordingly. The director of GSAM was not involved directly with HFFX and would review AG's recommendations and would discuss the awards with GSA, who provided the relevant documentation as to the recommendations and had practical control of the process. AG's primary contact with the GSAM director was through GSA although he did meet the director each year to provide explanations for recommendations made. Where recommendations were changed, GSA would

provide the GSAM director with an explanation for the changes. AG's evidence was that he would have expected the GSAM director to have refused to follow a recommendation that did not have an adequate explanation, and he considered the director to be a genuine independent check on the reallocations recommended.

41. AG explained that the departure of AB demonstrated how the CAP operated to deny benefits to retiring members who were not "good leavers". AB had left HFFX abruptly in 2012 and AG's evidence was that HFFX had determined that he had left to join a competitor firm and that it was believed that he would be using HFFX IP at that firm. AG explained that GSA considered that there was insufficient evidence to bring a claim against AB and that, in discussing how to stop AB from competing, it had been suggested that some of the GSAM funds provisionally recommended for AG should be used to increase the proportion provisionally recommended to AB, as it was thought that AB might not compete if offered more. AG thought that this offer may have been made and had not been accepted. Subsequently, AG considered that the belief that AB would compete was confirmed when AB joined that competitor twelve months later and began trading immediately without preparation and that his actions reduced HFFX revenue. Nevertheless, GSA were reluctant to enter into what AG considered would have been a long and expensive claim process.

42. However, as AB had no entitlement to amounts allocated to GSAM, AG's evidence was that it was straightforward to ensure that he did not receive any further funds from HFFX. AG was able to recommend to GSAM that AB's entire provisional award be reallocated. AG's recommendation was that the amount should be reallocated to himself (AG); AG's evidence was that GSA agreed that the amount should be reallocated but refused to approve the recommendation that it be reallocated to AG. Instead, GSAM proposed that it be left unallocated and used to fund any legal action taken against AB and the competitor firm. AG's evidence was that he accepted that GSA had the final decision and so recommenced that GSAM leave the amounts unallocated. The discussion with regard to this also involved the GSAM director, who AG considered was concerned about the value of the IP which AB had apparently taken and the potential damage that could be caused to HFFX's business.

43. GSAM agreed that AB should not receive any amounts under the CAP and AG's evidence was that AB did not challenge this. Some of the amounts were used to fund legal action, although the action taken was limited.

44. Following AB's departure, to increase the protection for the firm's IP, the notice period to be given by retiring members was increased to 24 months on 13 September 2012. AG's view was that such a long non-compete period would have been impossible to enforce against an employee. AG's evidence was that the effectiveness of a long notice period was increased by the existence of the CAP, as it would give him greater bargaining power regarding the future conduct of members who did choose to leave.

45. AG stated that GSAM subsequently agreed that part of the amounts no longer allocated to AB should be allocated to new members of HFFX, partly in recognition

of the longer notice period and the loss of their employment rights on becoming partners.

46. AG's evidence was that the provisions of the CAP influenced the behaviour of other members who left the firm. One member, who left in 2012 after AB, agreed to a three-year non-compete agreement in exchange for HFFX recommending to GSAM that he receive the amounts provisionally recommended to him over that three year period in quarterly instalments, subject to confirmation each quarter that the non-compete provisions had been complied with. AG stated that the retiring member insisted on HFFX guaranteeing the payments if GSAM refused to make the allocations.

47. AG wished to use the same arrangements for another member, who resigned in January 2017, but GSA refused as the recommendations for this member were of relatively small amounts and AG's understanding was that GSA did not want the administrative burden of dealing with quarterly payments. It was instead agreed that the recommended amount would be paid in a single payment in April 2019 subject to confirmation that the non-compete provisions had been complied with in the interim.

48. AG explained that GSA's control over matters was also evident in the early stages of HMRC's enquiry in this matter as GSA had coordinated discussions. Once the retiring members had left HFFX, GSA began to fund the costs of responding to the enquiry from the CAP. AG had disputed the amounts and whether they should be funded from the CAP. His evidence was that GSA had ignored his comments and had required GSAM to pay half of their costs from the CAP amounts held by GSAM.

49. AG further explained that GSA had used the CAP as a bargaining mechanism when AG was discussing and negotiating a separation of HFFX from GSA; he considered that GSA was pursuing more passive investment strategies than those developed by HFFX and were gradually withdrawing support for HFFX's cost base. AG was keen to expand HFFX and considered that in order to grow HFFX required its own infrastructure and that separation from GSA would give the business full access to the profits generated. AG's view was that, if he was unable to agree a deal with GSA, GSA would take over as Managing Member and would recommend that all potential awards be removed from the team. AG stated that during negotiations, GSA shut down HFFX's trading systems for a few hours in order to pressure the team.

50. AG stated that, when he indicated he might simply resign and use the two year non-compete period to build new infrastructure to launch a competing business when the non-compete expired, GSA made it clear that amounts in the CAP would be reallocated away from AG and the other HFFX members even if they were not formally in breach of covenants. AG stated that he believed that this was not a bluff and that, as he would cease to be the managing member, would have no powers to challenge the position. It was eventually agreed that HFFX would be allowed to spin out from GSA on the basis that GSA members would be allowed to invest in the new business. The shares given to GSA later turned out to be much more valuable than the CAP amounts but, at the time, it was not clear what the value of the new business

would be and so it was considered worthwhile to allow the GSA holding in order to be able to access the CAP amounts. AG's evidence was that he would not have agreed to GSA members becoming shareholders in the new business if it was not for the amounts held in the CAP.

Philip Howson

51. PH is a member of HFFX, as well as a member of the successor business, although he is no longer working for the successor business. His role was that of software developer, having specialised in programming automated trading systems since he left university. He joined GSA in June 2009 and was one of the original four team members working for AG. His role was primarily to develop the programs to implement the models and algorithms developed by others in the team, although he also assisted in developing tools for the researchers and other ancillary functions. He stated that his original employment contract provided for a salary and bonuses, of which up to 30% could be subject to deferral. He understood that some of this could be clawed back in certain circumstances, including leaving, and his recollection was that AG was concerned that it would not have much effect on retaining staff or protecting IP by preventing staff from leaving and competing.

52. PH stated that he was informed by AG in 2010 that the team was being spun out into the HFFX partnership. PH said that he was not part of the discussions about this and so did not know whether the idea was that of AG or GSA, or someone else. He understood from the information provided by AG that the move to HFFX was to protect IP by making it financially undesirable for someone to leave and use the IP to compete with HFFX, as becoming a partner in HFFX meant being subject to more restrictive non-compete provisions than as an employee and losing employee protections.

53. PH considered that, although HFFX would have more independence as a separate unit and AG would be primarily responsible for the direction of the team, GSA still had substantial control over HFFX as the team were reliant on GSA's capital and equipment.

54. PH stated that he was not given any formal confirmation of the total amount that HFFX could expect to receive from GSA and believed that, for HFFX, only AG was involved in negotiations with GSA on the point. PH understood that he would receive drawings similar to his salary as an employee but that he could receive a discretionary payment which could be substantially larger than his base salary.

55. PH said that he was advised that the deferral arrangements in HFFX were to be different to those in GSA whilst he was an employee. He understood that AG would continue to be responsible for deciding the amount of any potential discretionary payment made immediately, and that he could recommend that PH receive further payments in future. PH stated that future amounts were not guaranteed at all. His understanding was that, under the CAP, he would receive a lower discretionary payment immediately than he had done previously. However, as HFFX's profits

increased substantially, his immediate discretionary payment as a member of HFFX was actually more than he had received as an employee.

56. PH stated that he was not aware of the specific money flows between GSA and HFFX but he understood that part of the profits generated by HFFX would be paid to a "retention member" and that he (PH) would then be notified as to the provisional recommendation which had been made in respect of him, and that he would only be eligible to receive it if he met certain conditions. He understood that the retention member could decide to withhold the amount. He understood that the funds would belong to the retention member and would be invested in a GSA fund. Decisions as to whether to pay any recommended amounts would be taken in future years.

57. PH stated that AG had made it clear to him that the CAP was designed so that members had no rights or legal recourse to amounts held by the retention member, and that members would not be able to demand payment of amounts recommended. He said that it was explained to him that this was to ensure that it was possible to refuse to pay deferred amounts on a member leaving HFFX.

58. PH said that he did not fully understand the full interactions between GSA and HFFX regarding the CAP. He expected that AG would still be the main person responsible for making recommendations, although some parts of the CAP were administered by GSA staff. He expected that, if GSA disagreed with AG's recommendations about him (PH), he would not have received any amounts under the CAP.

59. PH said that AG had explained that there would be tax benefits to using the CAP because, as he had no rights to the amounts held by the retention member, these amounts would be subject to corporate tax rather than income tax. The commercial consequences were a substantially larger part of the explanation provided to PH for the structure. He stated that he would have preferred to have greater certainty and lower amounts upfront, given the risks involved in this type of trading, and that he was not interested in a tax benefit when he did not know whether he would ever receive any money. He did not consider that there was a significant tax saving in any case, as he thought that the overall tax rate would be 33% rather than 50%. When it was pointed out that the tax rate would be 28%, he suggested that this showed he was not particularly focussed on the tax saving.

60. PH stated that his understanding was that he would have to become a partner in HFFX and be subject to the CAP if he wanted to continue working within the team. No other option was presented. He considered that the fixed remuneration and immediate discretionary payments were more than he could earn elsewhere and that, as he wanted to remain with the team, he believed he had no choice but to accept the new structure and CAP. He had forgotten that the LLP Deed contained a mechanism for restricted fund shares.

61. PH stated that he received a substantial increase in payments over the years but did not know whether part of this was as a result of the HFFX structure. He was never sure how much he could expect to receive in any one year, given market fluctuations

and changes to the total number of members at HFFX. He understood that the introduction of new members would mean that he was entitled to a smaller proportion of HFFX's profits although the new members were expected to contribute to an increase in profits overall.

62. PH was not aware of any relationship between what he was actually paid and what he might receive in future under the CAP and did not know how much was allocated to GSAM. He did not know how any potential award was calculated. He believed that if he did a god job and there were no mistakes by the team such as the software problem which had cost $400m at a competitor, there would be no reason for him not to be given the award originally recommended. He considered that there would be very little he could do if amounts were not allocated to him. PH did not consider that the potential awards were guaranteed and did not make any decisions on the assumption that amounts would be paid to him.

63. PH did not know how GSAM made its decisions: he was aware of the LLP Deed provisions but did not know what would have happened in the case of a disagreement, although he assumed that GSA would prevail as they were the bigger party and the team were reliant on GSA's infrastructure, equipment and other employees. He was aware that GSA had 'kill switch' software which would enable GSA staff to stop HFFX trading, as this was good practice in case of emergency situations.

64. PH moved with AG to the new trading structure when the HFFX operations separated from GSA in 2015, but remained a partner in HFFX. PH later left the new trading structure in order to pursue other interests but considered that the future discretionary payments which had been deferred under the CAP acted as collateral to ensure that he did not compete with the business. PH stated that before resigning he did not know whether AG would recommend that no future payments under the CAP should be made to him.

65. PH explained that his resignation was ultimately amicable and that he received payments under the CAP on a quarterly basis as he ensured that he did not undertake competing activities. He understood the payments were made quarterly to ensure that there was less risk of him breaching non-compete obligations. PH stated that the payments were not guaranteed.

Paul Bereza

66. PB is a partner in HFFX and a partner in the successor business. He leads a team of software developers. He did not work in the financial services sector before joining the HFFX team within the GSA business in March 2011. His work involved developing software to execute trading strategies. He was originally engaged as an employee of GSA and paid a salary and discretionary bonus.

67. PB understood that HFFX was set up to provide control over sensitive business data, so that it would be more difficult for individuals to compete with HFFX. In particular, he understood that members of HFFX could be subject to longer notice

periods than those which could be applied to employees. A longer notice period meant that any relevant knowledge would be out of date and of little use to a competitor by the time the period ended.

68. PB had initially been engaged as an employee and would have preferred to remain as an employee but did not consider that there was an option of not joining HFFX if he wanted to progress. He had not expected his overall compensation package to change significantly as a result of joining HFFX.

69. PB stated that the details of the HFFX arrangements were explained to him by GSA's general counsel. PB did not recall any significant discussion of tax, although he was told that the CAP structure was tax efficient and had been investigated and "found to be okay" by a tax QC. He did not realise that the LLP Deed gave any option to ask to use the restricted fund shares mechanism in place of the CAP.

70. PB said that the tax information provided to him related to the need to complete tax returns as a self-employed partner. He was advised to use a particular firm of accountants as they had the CAP information. He paid whatever tax the accountants advised him to pay.

71. GSA's general counsel also explained the CAP to him, and all the documentation provided to PB came from GSA. PB's understanding was that GSA were in charge of the operation of the CAP as they dealt with back office functions and that any distributions were at the discretion of GSAM, and these were not guaranteed to be paid. PB did not know how provisional awards were determined and did not know how much had been recommended as the information provided specified only a range, although he understood that AG made the recommendations to GSAM. When payments were made, he could not relate these to the original recommendations as the payments would include amounts from investment gains.

72. PB understood the purpose of the CAP to be a form of control to make it difficult to leave, as well as to incentivise partners. He would have preferred not to have taken part in the CAP but was not given the option of joining HFFX without joining the CAP.

73. Although PB had subsequently joined the successor business to HFFX, he was still a restricted member of HFFX. He said that he had no knowledge of whether there had been any changes to the way in which HFFX and the CAP had been operated since the HFFX business was separated from GSA in 2015.

Issue 1 – whether amounts taxable as partnership profits

Whether amounts paid to GSAM under the CAP should be treated as allocated to the individual members of HFFX in the 2011/12 tax year (including AB) for the purposes of s850 ITTOIA 2005 and are therefore taxable as partnership profits of those individual members for the 2011-12 tax year.

74. s850 ITTOIA states, as relevant:

> "(1) For any period of account a partner's share of a profit or loss of a trade carried on by a firm is determined for income tax purposes in accordance with the firm's profit-sharing arrangements during that period.
>
> This is subject to sections 850A and 850B.
>
> (2) In this section and sections 850A and 850B "profit-sharing arrangements" means the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade."

Appellants' submissions

75. The appellants submitted that the term "profit sharing arrangements" used in s850 ITTOIA is defined in s850(2) and so cannot take the broad meaning of "arrangements" used elsewhere. The rights referred to in s850(2) are those relating to the allocation of profits amongst partners and not the distribution or application of assets representing profits, given that the profits measured between partners may differ from the profits measured for income tax purposes where, for example, expenses are disallowed as a deduction for tax purposes or amounts are used to pay annuities to retired partners.

76. It was submitted that HMRC's argument that the right to be considered for deferred distribution of profit is relevant to the interpretation of s850 has confused an irrelevant right (the right to be considered) with the relevant right, being that arising from the determination of allocated profits. It was submitted that a "right to be considered for distribution" cannot be a relevant right for the purposes of s850 as it is not possible to determine the amount of a profit share "in accordance with" such rights. s850 can only apply to the rights arising in consequence of the decision as to allocation of profits. Similarly, the right to request that profits be applied to the purchase of restricted fund shares under clause 11.10(A) of the LLP Deed is not a right which is relevant for s850.

77. Further, it was submitted that the term "arrangements" is concerned with the legal rights of partners (and thus LLP members) inter se and, construed purposively, does not include any non-binding arrangements even if such arrangements could be predicted with practical certainty.

78. Accordingly, where profits are allocated to partners, the subsequent use to which a partner puts the assets representing such profits is not relevant for the purposes of determining the profit sharing arrangements referred to in s850 ITTOIA.

79. It was also submitted that the profit sharing arrangements to be considered by s850 are those which are in force during the relevant periods of account, as the statute refers to amounts being determined for tax purposes in accordance with the profit-sharing arrangements "during that period". As such, any variation in rights after the relevant period cannot affect the tax position for the relevant period and HMRC's

submission that the members' rights should not be considered only at a particular point in time is incorrect.

80. It was submitted therefore that HMRC's contention that GSAM had no genuine entitlement to enjoy the profits of HFFX is accordingly incorrect. A partner is taxable on allocated profits even where that partner has no entitlement to enjoy those profits because they are required, for example, to be applied to pay an annuity to a retired partner. s850 is concerned with the allocation of profits, not the entitlement of a partner to enjoy the profits allocated.

81. The appellants further submitted that HMRC's contention that the assets transferred to GSAM amounted to an unallocated reserve, rather than a right to share in the profits, is incorrect factually as the profits were in fact allocated to GSAM. s850 also does not allow for the creation of an "unallocated" reserve.

82. In the present case, it was submitted that the rights of the members of the LLP to share in the profits were governed by clause 10 of the LLP Deed and that profits allocated to GSAM in accordance with those provisions could not be regarded as profits of the individual members for income tax purposes. The allocation to GSAM was a genuine allocation, and it was not alleged by HMRC that it was a sham, and GSAM became absolutely legally and beneficially entitled to assets representing the profits allocated to it; it withdrew those funds and used them to acquire investments which it held in its own name for at least twelve months. There was no obligation under the LLP Deed to repay the amounts to the LLP. AG's evidence was that GSAM also applied some of the assets for GSA's purposes, to pay legal costs incurred in relation to the HMRC enquiries. Any notional earmarking of amounts cannot be relied upon as indicating that the allocation of profits to GSAM was not realistic, particularly given that such notional earmarking was not implemented in the case of one of the individual members.

83. It was submitted that any member rights arose only when there was a subsequent reallocation of Special Capital by GSAM, and such reallocation was at GSAM's absolute discretion. There was no requirement that GSAM was required to exercise that discretion in good faith. The decision in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)* ([2013] EWCA Civ 200 at §83) noted that the requirement to act in good faith in the exercise of a discretion only applies where discretion is limited to a particular range of options and not where there is a discretion as to whether to exercise an absolute contractual right.

84. It was submitted that GSAM had an absolute discretion and did not have to take into account any other party's interest such that no such term was required to be implied. There was no need to imply such a term as the LLP Deed does not lack commercial or practical coherence without it (per *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* ([2015] UKSC 72). Implying such a term would undermine the business reasons for the ability of GSAM to deal with the profits allocated to it and would be counter to the express provisions of the LLP Deed. Finally, any such rights arose a considerable time after the relevant period of account.

85. It was submitted that the profits allocated to GSAM cannot be regarded as allocated "in reality" (as contended by HMRC) to the individual members for a number of reasons:

(1) The statute considers only the legal rights of partners to the allocation of profits and not any wider matters such as the subsequent use to which a partner puts any profits allocated to it.

(2) Even if wider matters are relevant, the CAP was not a disguised or artificially contrived method of allocating profits to individual LLP members. It was a commercial strategy and was subject to genuine contingencies with real effects, as understood by the members. The commercial need to defer amounts on a contingent basis was genuine and had real effect: one of the partners, AB, left in circumstances which meant that he did not receive the amounts which had provisionally recommended to be paid to him.

(3) At the time when profits were allocated to GSAM it was wholly uncertain in whose favour and in what amounts reallocations might subsequently be made.

86. Further, it was submitted that it is not possible to ignore GSAM in the arrangements, as was effectively contended by HMRC: its acts and assets cannot be simply be treated as those of individuals who are neither shareholders nor directors. The individual members had no control over the way in which GSAM invested its funds. AG's evidence was that he wanted some of the funds to be invested in the expansion of HFFX's business, but GSA did not permit this.

87. The appellants submitted that HMRC's description of the payment from the CAP as reliable is made with hindsight and that the evidence of AG was that he did not consider that any payments would reliably be made.

88. Therefore, the appellants submitted that the structure was not artificial; the CAP structure did not confer any rights on individual members regarding the sharing of profits and, to the extent that it conferred any rights, did so only when amounts were reallocated from GSAM's Special Capital account. Only the LLP Deed set out the rights of the members to share in the profits.

89. The appellants also submitted that the cases of *RFC 2012 Plc (formerly The Rangers Football Club Plc) v Advocate General for Scotland (Scotland)* [2017] UKSC 45 ("*RFC 2012*") and *Barry George Hadlee and (2) Sydney Bridge Nominees Ltd v. The Commissioner of Inland Revenue Co (New Zealand)* [1993] UKPC 8 ("*Hadlee*") referred to in HMRC's submissions were not relevant to the interpretation of s850 ITTOIA, firstly because the relevant tax charge is not based on profits earned by partners but on the profits allocated to partners. It was common ground that a tax charge cannot be avoided by a partner directing that profits which have been allocated to him be paid to someone else. In this case, the issue is whether the profits have been allocated to the individual members and in that context, *RFC 2012* and *Hadlee* are not relevant. Secondly, it was submitted that the cases could be distinguished because the individual members of HFFX received shares of trading profits arising from the successful use of their models and not rewards for work. They were also exposed to

financial losses from such trading: if GSA made a loss as a result of HFFX's activity, it could recover such loss via GSAM.

90. The appellants also submitted that, in contrast to the position in *RFC 2012*, it was clear that the individual members were not entitled to an allocation of amounts from GSAM under the CAP "as of right" as the evidence of AG was that, having given in his notice as a good leaver, the CAP continued to operate only because he agreed to provide GSA with an opportunity to invest in his new business. If he had been entitled to the share "as of right", there would have been no requirement to provide GSA with this opportunity.

91. With regard to the possibility of requesting the alternative deferred remuneration mechanism provided in the LLP Deed, using restricted fund shares, the appellants submitted that there was no realistic possibility of using this mechanism as the evidence showed that GSA would not agree to the request unless necessary for US tax purposes, as they were concerned that these would be a less satisfactory control mechanism. AG's evidence was that he would have preferred to have been given restricted fund shares and it was submitted that he would have been expected to use this mechanism if there was a realistic possibility to do so.

Submissions by AB

92. For AB, the following submissions were also made:

93. Firstly, that HMRC's approach takes a selective approach to the facts: a "realistic view" of the facts requires that all relevant factors are viewed in context and, it was submitted, that any approach which allocates to AB income which he did not receive is inherently unrealistic.

94. The CAP arrangements were demonstrably commercial, being intended to provide the regulatory requirements as to deferral imposed by the FSA and not, as in *RFC 2012* (for example), being a tax driven arrangement. In this case, the CAP was required by GSA and replaced a previous deferred incentive plan. The purpose of the CAP was to incentivise performance and to retain LLP members, as members could only retain the prospect of future payments from GSAM on retiring from the LLP if they met specific conditions.

95. It was submitted that one of the apparent benefits of the CAP was that it achieved a similar tax position for LLP members to that which would have applied if they had been employees in receipt of deferred and conditional income. That position was consistent with the reasonable expectations of a fair tax system (as noted in *UBS AG & Anor v Revenue and Customs* [2016] UKSC 13 ("*UBS AG*") at §9).

96. Further, in considering all of the circumstances, it was submitted that it was necessary also to consider that any allocation to the individual members was not only deferred but contingent on meeting particular conditions. In the case of AB, it was submitted that the contingency was particularly relevant in a consideration of all the circumstances. Any rights of AB to share in profit ceased to exist as soon as he

handed in his notice, which took place at approximately the same time as the provisional recommendations were made. Accordingly, his retirement from the partnership was determinative in the allocation of profits and needed to be considered if considering all the circumstances, as he was never likely to receive anything other than his basic allocation for 2011. His rights to share in the profits of the LLP allocated to GSAM were, in all the circumstances, realistically non-existent.

97. In any case it was submitted that the decision in *Scottish Provident Institution v Inland Revenue Commissioners* [2004] UKHL 52 ("*Scottish Provident*") which HMRC refer to, which is quoted in *RFC 2012*, as to the disregard of contingencies refers only to commercially irrelevant contingencies. Commercially relevant contingencies remain relevant to the construction of statute, as noted in *UBS AG* at §76, §78 and §88.

98. In addition, it was submitted that, although HMRC argued that GSAM's discretion had to be exercised on a reasonable basis, they did not suggest that the withholding of any payment to AB was not reasonable. If a "realistic view of the facts" is to be taken, it was submitted that it is not possible to stop at the provisional recommendations and not consider other facts and events.

99. It was submitted that it was clear that, unlike the position in *RFC 2012*, there had been no redirection by the individual members to GSAM. There was no option for the LLP members to take the profits allocated to GSAM instead; those amounts were at the disposal of GSA to invest. AB resigned shortly after the allocation was made to GSAM and would not have chosen to redirect any amounts. Contrary to the position in *RFC 2012*, profits were not available to all members who left the partnership. The position was effectively the same as that in *Edwards v Roberts* (1935) 19 TC 618 in that the amounts were conditional and could not be treated as income until unconditional (a position endorsed by the Supreme Court in *RFC 2012* at §48 and §49).

HMRC submissions

100. HMRC submitted that the amounts apparently allocated to GSAM were in fact allocated to the individual members in the amounts set out in the initial recommendation made by AG to GSAM. As such, these were allocations of deferred profit share to those individuals and so were income of the individual members for the relevant years, and assessments were raised on that basis.

101. HMRC submitted that the individual members had a right to be considered for an immediate distribution of profit, in shares at the Managing Member's discretion, under clause 10.3(E) of the LLP Deed and a right to be considered for deferred distribution of profit, in such shares as the Managing Member with GSACS's consent recommended. This was subject to the right for the Managing Member to make further recommendations and GSAM's discretion, never actually exercised, to reallocate otherwise than in accordance with the Managing Member's recommendations. Such a right arose under clauses 10.3(D) and 11.9(C) of the LLP Deed.

102. HMRC submitted that it was not disputed that the individual members had a right to share in the profits of the LLP under clause 10.3(E) even though this was simply a right to the exercise of a discretion.

103. HMRC submitted that the contractual discretions conferred by the LLP Deed were not unfettered. The courts will generally imply a term that such discretion must be exercised in good faith, where the exercise of a discretion conferred on one party affects the rights of both parties to the contract (*Braganza v BP Shipping* [2015] UKSC 17 ("*Braganza*") at §18-30 and §102-103 and *Reinhard v Ondra LLP* [2015] EWHC 26 (Ch) at §412, §445). The discretion is in effect subject to the Wednesbury test that the resulting decision must not be so unreasonable that no reasonable decision-maker could have made it, and the decision-maker must consider all considerations and exclude all irrelevant considerations (*Braganza* at §24-30).

104. On this basis, as the discretions conferred on AG and GSAM affected both the rights of the decision maker and the individual members, both AG and GSAM were obliged to exercise their discretion in good faith. HMRC submitted that, accordingly, the individual members had rights to share in the profits of any given year as allocated by AG, taking into account both their present allocation and their deferred. AG's discretion was subject to the approval of GSA, but as the evidence was that GSA did not change any recommendations made by AG and it was submitted that the requirement for their approval had limited practical significance.

105. Similarly, HMRC submitted that GSA's powers to take over as Managing Member on AG's retirement of HFFX did not create any substantial uncertainty as to amounts which would be received. Although the LLP Deed permits the Managing Member to make further recommendations, HMRC submitted that these were limited to those which were required by law and that, further, GSA would be subject to a fiduciary duty to act in the best interests of HFFX and that it would be in breach of that duty if it arbitrarily reduced recommendations to zero. It was submitted that this was supported by evidence that showed that GSA did not consider that it was practical to take away AB's entitlement to a reallocation if he did not move to a competitor on leaving. Further, after AG retired from HFFX, the only recommendation made by GSA to GSAM was to use part of the CAP funds to pay towards the legal costs of GSA and HFFX in the early stage of this dispute with HMRC.

106. HMRC submitted that this was reflected in terms of the LLP Deed which should be interpreted as meaning that each member was given a "Pre-Retention Amount", closely linked to the hypothetical amount which would have been available for immediate distribution apart from the CAP. At least 30% of this was allocated to GSAM unless a partner requested, subject to AG's agreement at his discretion, to use it to acquire restricted fund shares. HMRC submitted that AG could not improperly refuse a request to use the restricted fund shares mechanism and did agree to allow one of the members (not an appellant in this case) to do so.

107. In addition, HMRC noted that recommendations were not changed by AG after they were made, if there was no reason to do so. They submitted that the payments were therefore predictable and that the evidence of individual members supported

this, as they stated that they understood that they would receive payments if there were no reasons not to do so, although HMRC acknowledged that the use of funds to pay legal costs meant that this was not always the case. Further, HMRC submitted that the terms of the LLP Deed provided that good leavers, who became "restricted members", would continue to be LLP members until they had received all allocations recommended for them. HMRC submitted that this effectively meant that acceptance of the recommendations was apparently a foregone conclusion.

108. HMRC submitted that, accordingly, the realistic view of the CAP was that each partner's allocation was partly distributed at once and partly deferred, but the deferred share was still part of that individual partner's share of profits for the year. It was suggested that this was supported by the fact that payments made were reliable and by the recital in the LLP Deed which stated that HFFX had been set up to enable the HFFX Trader Group to exercise greater autonomy over their compensation.

109. HMRC also submitted that GSAM was required to use its assets to support HFFX's business and had no genuine entitlement to enjoy the profits of HFFX. Instead, HMRC argued, it was an instrument for the deferred compensation plan and treated investments as held on account of individual members, as shown in a spreadsheet produced by GSAM in 2013 which set out amounts next to each member's name. HMRC argued that even if the amounts were not allocated to the individual members, GSAM held an unallocated reserve out of which deferred amounts would be made and did not have a "right to share in the profits of HFFX". As such, the amount held by GSAM must be divided among the members who do enjoy the profits of HFFX in the same proportion as the members had divided the profit for the year.

110. Finally, HMRC submitted that the position in this case was analogous to that in *Hadlee*, in which the Privy Council held that a partner who had assigned his partnership share to a trust for his family was still taxable on it on the principle that "no taxpayer can, by way of assignment, escape assessment of tax on income resulting from his personal activities".

111. HMRC submitted that, in the case of HFFX, the amounts received by individual members of HFFX (both immediate and deferred) were rewards for work as they represented a deferral of bonuses and therefore were income resulting from personal activities and taxable on the individual whether or not paid to them, as long as the individual had acquiesced (as in *RFC 2012*) or consented to their redirection, as in *Hadlee*.

Discussion

112. For s850 to apply so as to render the individual members taxable in respect of sums paid to GSAM, the members must have had a right in respect of the sums paid to GSAM which amounts to a right to share in the profits of the trade of the LLP during that period.

113. The appellants submit in summary that:

(1) s850 ITTOIA specifically defines "profit sharing arrangements" and so the broader meaning of "arrangements" used elsewhere cannot be applied to the term in s850 ITTOIA.

(2) s850 accordingly applies to rights regarding allocation of profits for the relevant period and not any rights in relation to any future distribution of profits or application of assets representing profits, or any non-binding arrangements.

(3) The profits in question were actually allocated to GSAM and not to the individual members. Any discretionary right to be considered for a future distribution is not a right regarding allocation of profits and so is not within the scope of s850 ITTOIA.

114. HMRC submits, in summary, that:

(1) The calculation of the Pre-Retention Amount should be regarded as an allocation of profit to the individual members within the scope of s850 ITTOIA.

(2) The individual members had a discretionary right to be considered for a deferred distribution of profit and that, following *Braganza*, such discretion must be exercised in good faith and so as GSAM was required to act in good faith in the future distribution, the members should be regarded as having been allocated the amount which would have been available for immediate distribution if it had not been allocated to GSAM under the CAP arrangements.

(3) A consideration of all of the circumstances meant that the Pre-Retention Amount allocated to GSAM should be treated as if it had been allocated to the individual members in the amounts calculated by the Pre-Retention Amount mechanism.

Whether calculation of Pre-Retention Amount is an allocation of profit to the individual members

115. I do not consider that HMRC's contention that the calculation of the Pre-Retention Amount is effectively an allocation of profit within s850 ITTOIA is a sustainable position. The calculation is clearly expressed in the LLP Deed to be a hypothetical division, to calculate the amount which is actually allocated to GSAM. AG's use of the word "allocation" in correspondence in reference to the calculation of the Pre-Retention Amount does not, in my view, override the provisions of the LLP Deed.

116. If considering all of the circumstances, as submitted by HMRC, it is also clear that the individual members have no rights to the amounts calculated as, although the amounts form the basis of the initial recommendation for future distribution by GSAM, there is no guarantee that such amounts will be paid in full or at all. The recommendations were capable of being varied and were in fact varied. As shown in evidence, amounts were withheld at the requirement of GSA, and AB had received no reallocation of Special Capital as he had left HFFX before any reallocation was made by GSAM.

117. HMRC submitted that *RFC 2012* had agreed with the decision in *Scottish Provident* that the "composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned", and that therefore in this case the risk that a discretion may not be exercised in favour of an individual partner should be ignored.

118. Further, HMRC submitted that payments were predictable and that, as the LLP Deed provided that an individual remained a member of the LLP on a restricted basis until all allocations recommended for them have been paid out, the acceptance of such recommendations should be regarded as a foregone conclusion and so the amounts should be regarded as being an allocation to the members.

119. In my view, the decision in *RFC 2012* was considering a rather different scenario, in which the individuals involved understood that they would have immediate access to particular amounts and that there was no realistic prospect that such access would not be immediately available, and no realistic prospect that they would lose entitlement to the amounts if they left employment, although there was a theoretical possibility that a discretion may not be exercised in a particular way.

120. As already noted above, I consider that the possibility in this case that the recommendation to exercise discretion in a particular way would not be followed was clearly not merely theoretical and, as is clear from the evidence and the FSA requirements as to risk in deferral, the possibility at the outset that a distribution might not be made was part of way in which the scheme was intended to work and so is not something that can be ignored.

121. I consider that the recommendations were not defined amounts and that they could be, and were, changed by both AG and later GSA and as already noted, AB received no payment from GSAM. The evidence was that recommendations were also changed to accommodate new partners, so that such new members would potentially share in the amounts allocated to GSAM for periods before they became members of HFFX, and the recommendations for existing members were reduced accordingly.

122. Although individual members may have understood that they would get a payment if they did not do anything to lose the rights to participate, I do not consider that this means that there was an allocation to them of an amount. Accordingly, I do not consider that it was a foregone conclusion that the recommendations would be accepted and that the individual members would receive the amounts calculated via the Pre-Retention Amount calculation. This is also supported by AG's evidence that an existing member was sufficiently uncertain about GSAM complying with the recommendations that they insisted that HFFX provide a guarantee of payments during their non-compete period.

123. The fact that deferred payments to members might have been achieved in other ways which would have resulted in an immediate tax charge does not, in my view, mean that the existence of GSAM and the allocation of profit to GSAM can simply be ignored in a consideration of all the circumstances.

124. HMRC also submitted as an alternative argument that GSAM had no genuine entitlement to profits of the LLP, and that amounts were treated as held on account of the individual members who had contributed to the amounts paid to GSAM. As noted above, I do not consider that amounts were allocated to the individual members and so such amounts could not have been contributed by the members to GSAM. There is no evidence that GSAM were not entitled to deal with the profits allocated to them as their own property; the discretionary rights of the individual members to be considered for a future distribution does not, in my view, amount to an entitlement to amounts held by GSAM before such distribution is made. The GSAM spreadsheet of recommendations referred to by HMRC reflects the recommendations made but contains nothing which indicates that the amounts were specifically held for those individuals and does not contain any evidence to show that the amounts could not be altered by GSAM. As such, I do not consider that the spreadsheet demonstrates that GSAM held the investments on account of those individuals.

125. I do not agree with HMRC's alternative argument that GSAM should be regarded as holding an "unallocated reserve" which should be regarded as having been allocated to the individual members as if it had actually been allocated to them. This is effectively the same argument as before, that amounts allocated to GSAM should be regarded as having been allocated to the individual members and that GSAM should be ignored. Amounts are either allocated to a partner or they are not; there is nothing in partnership law that allows for the creation of an "unallocated reserve" in a partnership.

126. Accordingly, I do not consider that the calculation of the Pre-Retention Amount created an allocation of profit to the individual members.

Whether a right to be considered for a future distribution is a right to share in the profits

127. It was submitted that the rights of the members to be considered for future distribution amounted to profit-sharing arrangements within the scope of s850 ITTOIA, as a right to deferred distribution of profits.

128. HMRC submitted that the appellants had not disputed that clause 10.3(E) of the LLP Deed (which dealt with the allocation of a part of the profits to the individual members) gave the appellants a right to share in the profits of the LLP, even though the clause provided a right to a discretionary distribution. The appellants' submission was that s850 did not apply to the right to a discretionary distribution but, instead, to the rights arising as a consequence of the exercise of that discretion.

129. Both parties also made submissions as to the requirement to act in good faith in the exercise of a discretion. The requirement to act in good faith established by *Braganza* is a requirement not to allow a conflict of interest to interfere with the exercise of a discretion. It does not mean that the existence of a discretion meant that the initial recommendations made by AG could not be changed either by AG or GSAM, nor that the individual members could realistically challenge a decision of GSAM to distribute an amount other than the Pre-Retention Amount calculation, or a

decision of AG (or another Managing Member) to recommend a different reallocation.

130. Accordingly, even if one considers that it is not credible to believe that GSAM would act contrary to the purpose of the CAP structure, the CAP structure (and its purpose) allowed for alterations to recommendations, and deductions from any such recommendations, and also allowed for the complete loss of any rights to be considered for a future distribution.

131. A "right to be considered in a future distribution by GSAM" or the right to be considered for a discretionary distribution under clause 10.3(E) of the LLP Deed cannot be a "right to share in the profits" for the purposes of s850 because a right to be considered in the exercise of a discretion cannot apply to determine an amount which is taxable. It is only once the discretion has been exercised that a taxable right to share in the profits can arise. In the case of clause 10.3(E), for example, I consider that the right of an individual member to share in that element of the profits arose once the discretion in that clause had been exercised so as to determine the proportion of that element of the profits allocated to that individual member. If the discretion had been properly exercised so as to allocate nothing to an individual member, that member would not have a taxable right to share in that element of the profits.

Whether members acquiesced to amounts being transferred to GSAM

132. HMRC submitted that the individual members acquiesced to a share of profits which they would otherwise have received being allocated to GSAM, apparently because they signed the partnership agreement which included provisions for an allocation of profits to GSAM, and that this was analogous to the position of the employees in *RFC 2012*.

133. I consider that the position discussed in *RFC 2012* was rather different in this context: in *RFC 2012*, the employees had agreed to employment contracts which included payment of a specific amount to a trust. If the employee left employment, it was found that they would remain entitled to the amounts which had been paid into trust. They also had access to those amounts in full as they chose by various mechanisms from the outset.

134. In this case, the circumstances are markedly different: ignoring the fact that this is considering a partnership allocation of profits and not entitlement to employment income, the amounts which were to be allocated to GSAM are not defined (other than as to a minimum percentage of a calculated amount) and the individual members had no rights to those amounts beyond a right to be considered in a future distribution from GSAM's Special Capital account. The individual members had no right to continue to be so considered if they left the partnership other than in specific circumstances. As such, and for the reasons given above in respect of whether a "right to be considered" is a right within the meaning of s850, I do not consider that the LLP Deed provisions can be interpreted as meaning that amounts paid to GSAM were in fact allocations to (or otherwise "given to") the individual members which were diverted to GSAM, as submitted by HMRC.

135. I do not consider that members could be regarded as having "acquiesced" to a transfer of profits due to them by simply signing a partnership agreement which includes a non-discretionary allocation of profits to one of the members. If that were the case, any partnership in which the allocation of partnership profits was otherwise than in strict adherence to the capital shares contributed (and perhaps even then) could be regarded by HMRC as being capable of alternate interpretation.

Whether rights transferred to GSAM

136. I similarly consider that the case of *Hadlee* is not of particular assistance in this case, as that involved a specific assignment of rights by the relevant partner. There has been no such assignment of rights in this case; HMRC's submissions in this regard are based on their contention that the calculation of the Pre-Retention Amount amounted to an allocation being made to the individual members and which HMRC contend that they have agreed should be paid to GSAM. As noted above, I do not consider that the LLP Deed or the surrounding circumstances can be so interpreted.

Whether the ability to request restricted fund shares amounted to an allocation

137. HMRC further submitted that the provisions enabling a partner to request that the restricted fund shares mechanism be used rather than an allocation being made to GSAM effectively meant that the members should be regarded as having been allocated the amounts calculated by the Pre-Retention Amount.

138. Considering the provisions of the LLP Deed as a whole, I do not consider that these provisions mean that the calculation of the Pre-Retention Amount was effectively an allocation of profit to the individual members. The provisions of the LLP Deed in respect of the restricted fund shares state that a partner can request that an allocation of profit be made to them which is fulfilled by the purchase of restricted fund shares to their account. That request is subject to approval by the Managing Member at his absolute discretion and was also effectively subject to the approval of GSA as the documentation required for the acquisition of restricted fund shares was subject to their approval. I note that the provisions of *Braganza* as to the need for a discretion to be exercised in good faith applied to the position where there was a conflict of interest between the parties involved in the discretion and that the discretion should not be abused.

139. With regard to a request of this nature, the relevant conflict of interest was not identified: AG's position would not appear to be diminished by approving the request of another individual member. Similarly, GSA's position would not appear to be diminished (both the restricted fund shares and GSAM's allocated profits were effectively invested at GSA's direction, and the Pledge Agreement required was apparently intended to give similar rights with regard to compensation for liabilities).

140. It was argued that AG could not improperly refuse a request by an individual member in this respect. However, it is clear from the LLP Deed that (even if there were to be a conflict of interest in respect of this request) AG could properly refuse such a request and it is clear from case law that even if there is a conflict of interest

the test is whether the decision-making process was rational and consistent with the contractual purpose (*Braganza*, §30). In the circumstances, I do not consider that the LLP Deed or the surrounding circumstances mean that approval had to be granted unless there was an overwhelming reason not to grant it. There is a substantial gulf between, on the one hand, the right to make a request which is subject to the exercise of a discretion and, on the other, absolute entitlement.

141. In my view, the provisions in respect of the restricted fund shares therefore do not give the individual members an absolute right to an allocation of profit, only a right to request such an allocation.

142. I consider that a right to request an allocation, which can be refused, cannot be regarded as a right to share in profits unless and until the request is made and approved. If an individual partner does not make such a request, I do not consider that such lack of request can be regarded as acquiescing to an allocation to GSAM nor as a transfer of allocated profits to GSAM.

143. I have considered whether the fact that AG was the Managing Member at the relevant time meant that he may have been regarded personally as acquiescing to the allocation to GSAM of amounts which he might otherwise have been allocated, on the basis that any request by him for restricted fund shares was subject to his own approval. As noted above, however, his discretion in this matter is fettered both by the principle in *Braganza* and also by the requirement that GSA approve the necessary documentation.

144. I also note AG's evidence that he was effectively subject to the control of GSA as the Corporate Member, as they could terminate his position as Managing Member at relatively short notice, in which case they would take over as Managing Member, and had threatened to do so when he proposed things with which they disagreed. Further, I note also that AG's evidence was that GSA had stated that they would use the requirement that they approve the documentation to effectively refuse any request by him to be allowed to allocate profits to himself to be used to acquire restricted fund shares. Although HMRC argued that his interest in the intellectual property of HFFX gave him substantial power, I consider that it is clear from the evidence that AG did not have such power over GSA.

145. Accordingly, I do not consider that the LLP Deed provisions as to the restricted fund shares meant that AG had a right to allocate profits to himself which could be regarded as transferred to GSAM either explicitly or by acquiescence. Further, any such right under the relevant provisions of the LLP Deed would have been required to have been exercised by the acquisition of restricted fund shares and would not have been unfettered rights to allocation of profit.

146. For the reasons given, I do not consider that the profit sharing arrangements of HFFX entitled the individual members to the amounts allocated to GSAM. I find therefore that s850 ITTOIA 2005 does not operate to include these amounts in the partnership profit shares allocated to the individual members for the relevant periods.

Issue 2a – whether Special Capital taxable as miscellaneous income

147. HMRC argued, in the alternative, that if amounts paid to GSAM were a profit share of GSAM then the subsequent reallocation of Special Capital to the individual members were liable to income tax under s687 ITTOIA when those reallocations were made.

148. s687 ITTOIA provides that:

> "Income tax is charged … on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act …"

Appellants' submissions

149. The appellants submitted that, for s687 ITTOIA to apply, the income must be "from [a] source". Although the decision in *Spritebeam Ltd and ors v Revenue and Customs Commissioners and anor* [2015] UKUT 75 (TCC) ("*Spritebeam*") had noted that the question was open, the Upper Tribunal in *Kerrison v Revenue and Customs Commissioners* [2019] UKUT 8 (TCC) ("*Kerrison*") said (§70) that

> "section 687(1) expressly refers to income from any source which suggests to us that for income to be taxable under Case VI it requires a source. Moreover, it is hard to see how a receipt which had no source could be euisdem genesis with the other heads of charge in what was formerly Schedule D, all of which require a source for the receipt in question".

150. The appellants also submitted that a source must be required, otherwise there would have been no requirement for s319(2) of the Proceeds of Crime Act 2002, which permits the making of an assessment under s687 without a source being identified.

151. It was submitted that a purely voluntary payment (that is, one which the payer is under no legal obligation to either make or consider whether or not to make) cannot have a source for the purposes of s687 (per *Versteegh Ltd and others v* HMRC [2013] UKFTT 642 (TC) ("*Versteegh*"); *Spritebeam* at §68; and *Stedeford v Bede* [1932] AC 388) ("*Beloe*").

152. The appellants argued that the payments were purely voluntary because GSAM was not under any legal obligation to reallocate its Special Capital, or to even consider whether to do so, as the LLP Deed gave any member with Special Capital sole and absolute discretion as to whether to reallocate any part of that Special Capital. It was irrelevant that there may have been an expectation that amounts would be reallocated.

153. It was also submitted that HMRC's argument that a right to be considered should be implied was incorrect, as set out above, and that a right to be considered is in any case not sufficient to constitute a source of income (per *Drummond v Collins* [1915] 6 TC 525 at 540). The position is not analogous to that of a discretionary trust,

where the settlement and exercise of discretion together operate to create an obligation on the trustees to pay the income.

154. The appellants argued that HMRC's submissions that the activities of the individual members were the source of payment was, in effect, another argument for the reallocation of partnership profits. Further, case law had determined that there must be a binding legal obligation to make the payment in return for the provision of services for s687 to apply (*Brocklesby v Merricks* (1934) 18 TC 576 at 582-583; *Bloom v Kinder* (1958) 38 TC 77 at 84-85; *Scott v Ricketts* (1967) 44 TC 303 at 316 and 321; *Manduca v Revenue and Customs Commissioners* [2015] STC 2002, §§34-35). As there was no binding obligation on GSAM to pay anything, whether in return for activities or otherwise, it was submitted that the activities of the individual members cannot be a source for the purposes of s687 ITTOIA, as what is required is an enforceable right to be paid.

HMRC submissions

155. HMRC submitted that the payments made by GSAM to the individual members were for the purpose of rewarding them for their performance and incentivising good behaviour, because:

(1) The letters from AG described the payments as being "in respect of your performance", and individual members were required by the LLP Deed to devote their whole time and attention during normal business hours to HFFX's business. The evidence of individual members was that they expected to receive reallocations if they continued to perform.

(2) The CAP was described to the individual members as being "for the purpose of promoting the business of the Partnership by incentivising its members (and other persons)".

(3) AG made recommendations to GSAM to reallocate Special Capital on the basis of the individual in question having continued to satisfy requirements as to their behaviour.

(4) AG stated that he considered the CAP to be a tool for maintaining team performance and he described the reallocations as rewards.

(5) The pro-forma recommendation letter to GSAM in the LLP Deed describes the recommendations on which the reallocations are based as "remuneration".

156. As such, it was submitted that there was a clear link between the members' work for HFFX and the reallocations under the CAP.

157. It was further submitted that:

(1) It was established in *Ryall v Hoare* (8 TC 251 at 525) that payments received in return for "some service rendered by way of action or permission, or both" are taxable as miscellaneous income if they fall short of trade or employment. In this case, GSAM made payments to reward performance of a

service rendered by the individual members to GSAM which, as another partner, benefited from the continued profitability of HFFX. Payments to restricted members were made in order to encourage them to refrain from activities that would have undermined that profitability.

(2) The charge on miscellaneous income applies where income receipts are analogous to chargeable forms of income (Viscount Dunedin in *Leeming v Jones* [1930] AC 415, at 422). In this case, the receipts of Special Capital were analogous to employment income, as AG described them as being analogous to deferred bonuses.

(3) Where a third party supplements a person's income, that is typically taxable as income (*IRC v Falkirk Ice Rink* [1975] STC 434, regarding contributions to a trader). These payments were additional receipts derived from the partners' business even if not brought into the business directly.

158. HMRC submitted that the appellants' argument that there was no source for the payment, and so no charge as miscellaneous income, was incorrect. It was still open as to whether a source needs to be identified before a charge can arise (per *Spritebeam* at §55). In this case, the income under the CAP did have a source, being the activities of the individual member receiving the income and their rights to consideration under the CAP arrangements. An activity can be the source of different kinds of income (per *Black Nominees v Nicol* [1975] STC 372). Further, HMRC submitted that the individual members considered they had valuable rights in the CAP as shown by AG's evidence that he would not have agreed to give GSA an interest in the new business when HFFX separated from GSA, if it had not been for the amounts held in the CAP.

159. HMRC's view was that the reallocation by GSAM cannot be considered to be voluntary because:

(1) GSAM was set up to carry out functions under the CAP. The purpose trust which owned GSAM required it to promote the business of GSACP and the business of HFFX, and thus resolutions approving AG's recommendations stated that "consistent with the purposes of the Trust … [GSAM] should follow the recommendations made by HFFX";

(2) GSAM had no proper basis to depart from AG's recommendations as he was the only person who knew how the individual members were performing. GSAM's director met AG only rarely, and AG acknowledged that GSAM largely depended on his recommendations, which he expected to be accepted provided that they were reasonable. Resolutions to accept AG's recommendations were generally made within 48 hours of the recommendation letter and it appears that GSA would send draft resolutions for signature with the letter.

(3) GSAM was required to exercise any discretion in good faith (per *Braganza*) and this was a contractual obligation owed by GSAM to the individual members.

(4) It was submitted that GSAM was therefore legally obliged to at least consider whether to reallocate Special Capital, and that such discretion was tightly construed and predictably exercised such as to amount to an obligation to reallocate in accordance with AG's recommendations. As such, the reallocation cannot be described as purely voluntary payments.

Discussion

Whether s687(1) requires a source

160. In one sense, there was obviously a source: funds were reallocated from GSAM to the individual members. The amounts received by the Special Members did not appear from nowhere. Case law has, however, considered what is meant by a source in this context and whether one is required for a tax charge to arise.

161. Although it was argued in *Brocklesby v Merricks* that an enforceable right to payment was required for a source to exist, the subsequent decision of *Versteegh* notes that

> "… in seeking to ascertain whether a receipt has a source so as to render it taxable income, it is necessary to discover how the entitlement to that receipt, once made, has arisen. We accept, because it is covered by authority such as *Stedeford v Beloe*, that a purely voluntary payment cannot have a source for this purpose. But, as the cases show, that does not mean that, for there to be a source, the recipient must have a right, still less an enforceable right, to the payment before it is made" (§126)

162. The court in *Versteegh* considered the matter further, noting at §131:

> "[although there must be] the necessary connection … between the taxpayer and the source from which the income in question has arisen … it does not, as cases such as *Lindus & Hortin* and *Cunard's Trustees* demonstrate, require ownership, or any right, whether contractual or otherwise, to enforce the making of the relevant payment. The existence of such a right might, as was the case in *Stedeford v Beloe*, enable one to distinguish between cases that do amount to purely voluntary payments and those that do not, but, as the authorities show, the existence or enforceability of a right is not an essential ingredient in making that distinction."

163. More recently, the Upper Tribunal in *Kerrison* stated (§73) that they "would be minded to accept that a receipt taxable under section 687(1) ITTOIA must have a source" although the statement is obiter. However, the Upper Tribunal also noted that

> "We consider that the FTT was correct when it concluded at [§143(1)] that the Loan Waiver was an entirely voluntary transaction. Although Mr Ghosh QC argued that a dividend was similarly a voluntary event, we reject that argument. It is true that a shareholder cannot usually compel the declaration of the dividend (either by the board of directors or by the company in general meeting), but the right to a dividend once declared forms part of the bundle of rights comprising a shareholder's

> entitlement qua shareholder. A dividend is therefore different from an entirely voluntary transaction."

164. The First-tier Tribunal decision in *Kerrison v The Commissioners for Her Majesty's Revenue & Customs* ([2017] UKFTT 322 (TC)) at §143 also concluded, which the Upper Tribunal did not reject, that

> "In contrast, a dividend or other distribution paid in respect of the share is not entirely voluntary. Although it is typically the case that a shareholder has no right to require a dividend to be paid, any dividend or distribution that is paid is paid in accordance with the rights attaching to his shares, and by virtue of those rights. In my view this is analogous to the situations considered in *Drummond v Collins* and *Cunard's Trustee*. However, the same does not apply to a gratuitous loan waiver which has no legal relationship to the rights attaching to the shares."

165. In *Drummond v Collins* Earl Loreburn, giving the judgment at 539 stated that:

> "[the amounts in question] were payments made… in the exercise of a discretion conferred … They were the [beneficiaries'] income in fact … My Lords, I can see nothing in these Acts which leads to the view that property of this kind was intended to be free from this taxation"

166. In the same case, at 540/541, Lord Wrenbury agreed that

> "so soon as their discretion is exercised in favour of the [beneficiary], the resulting payment seems to me, upon the language of the Will, to be a payment of income to which the [beneficiary] is entitled by virtue of the gift made by the testator. I cannot see any ground upon which such income is not subject to income tax."

167. *Cunard's Trustee v IRC* (1945) 27 TC 122 (pp133-134), as referred to by the First-tier Tribunal in *Kerrison* and noted in *Versteegh* at §119, drew a

> "distinction … between voluntary payments and payments made in the exercise by trustees of a will to a beneficiary during the administration period … the payments were not voluntary in any relevant sense, but were made in the exercise of a discretion conferred by the will out of a fund provided for the purpose by the testatrix. The trustees were bound to consider exercising their discretion. The fact that they might have concluded to decline to make a payment did not give the payment the character of a voluntary payment. The money, when received by the beneficiary, was received by her through the joint operation of the will and the exercise of their discretion by the trustees."

168. In my view, the position in this case is clearly analogous to the contrasting position set out by the First-tier Tribunal in *Kerrison*. Clause 11.9(C) of the LLP Deed provides GSAM with "absolute" discretion to reallocate some or all of their Special Capital from their Special Capital Account to the Special Capital Accounts of one or more other members of HFFX.

169. If that discretion is exercised so as to decide to reallocate amounts, Special Capital will be reallocated to other Members, credited to their Special Capital account. Even if the members have no right to require reallocation, any reallocation that takes place does so in accordance with the provisions of the LLP Deed and by virtue of those rights. There is therefore a relevant relationship between the reallocation and the individual members' rights under the LLP Deed such that there is a source for the purposes of s687.

170. The background to the CAP should not be overlooked. It was described as a deferred bonus scheme. One of the reasons for the implementation of the CAP was to comply with FSA requirements for deferral of amounts derived by the individuals from their work. It was clear from the evidence, not least the fact that recommendations could be and were altered before reallocations were made, that the payments were made to reward individual members for their performance and to incentivise particular behaviour.

171. Although these were not allocations of profit, as established above, it is nevertheless clear that there is a connection between the activities of the individual members and the subsequent reallocation of Special Capital.

172. For these reasons, I find that there is a sufficient link such that the reallocation was not an entirely voluntary transaction and therefore a source exists for the purpose of s687(1) ITTOIA 2005. As I have found that the payments were not taxable under s850 ITTOIA, and have not otherwise been subject to income tax, it follows that the reallocation of Special Capital to the individual members is taxable under s687 ITTOIA 2005.

Issue 2b – whether taxable as sale of occupation income

173. Having found for HMRC on Issue 2a, it is not strictly necessary to consider their alternative argument regarding Issue 2b. However, the issue was fully argued and so I have considered the arguments put by the parties with regard to this issue.

174. HMRC contends that, as a further alternative, the Special Capital paid to individual members should be chargeable to income tax under Chapter 4, Part 13 ITA 2007 (sale of occupation income rules).

175. The rules apply where transactions are effected or arrangements made to exploit the earning capacity of an individual in an occupation, and the main object or one of the main objects of the transaction or arrangements is the avoidance or reduction of liability to income tax.

Relevant law

176. Chapter 4, Part 13 Income Tax Act 2007 provides, as relevant:

177. s773 Overview of Chapter

(1) This Chapter imposes a charge to income tax—

(a) on individuals to whom income is treated as arising under section 778 (income arising where capital amount other than derivative property or right obtained), and

(b) on individuals to whom income is treated as arising under section 779 (income arising where derivative property or right obtained).

(2) Income is treated as arising under those sections only if—

(a) transactions are effected or arrangements made to exploit the earning capacity of an individual in an occupation, and

(b) the main object or one of the main objects of the transactions or arrangements is the avoidance or reduction of liability to income tax.

178. s774 Meaning of "occupation"

In this Chapter references to an occupation, in relation to an individual, are references to any activities of a kind undertaken in a profession or vocation, regardless of whether the individual—

(a) is carrying on a profession or vocation on the individual's own account, or

(b) is an employee or office-holder.

179. s776 Charge to tax on sale of occupation income

(1) Income tax is charged on income treated as arising under-

(a) section 778 (income arising where capital amount other than derivative property or right obtained), or

(b) section 779 (income arising where derivative property or right obtained).

(2) Tax is charged under this section on the full amount of income treated as arising in the tax year.

(3) The person liable for any tax charged under this section is the individual to whom the income is treated as arising …

180. s777 Conditions for sections 778 and 779 to apply

(1) Sections 778 and 779 apply only if conditions A to C are met in respect of an individual.

(2) Condition A is that the individual carries on an occupation wholly or partly in the United Kingdom.

(3) Condition B is that transactions are effected or arrangements made to exploit the individual's earning capacity in the occupation by putting another person (see section 782) in a position to enjoy—

(a) all or part of the income or receipts derived from the individual's activities in the occupation, or

(b) anything derived directly or indirectly from such income or receipts.

> (4) The reference in subsection (3) to income or receipts derived from the individual's activities includes a reference to payments for any description of copyright or licence or franchise or other right deriving its value from the individual's activities (including past activities).
>
> (5) Condition C is that as part of, or in connection with, or in consequence of, the transactions or arrangements a capital amount is obtained by the individual for the individual or another person.
>
> (6) For the purposes of subsection (5), the cases where an individual ("A") obtains a capital amount for another person ("B") include cases where A has put B in a position to receive the capital amount by providing B with something of value derived, directly or indirectly, from A's activities in the occupation.
>
> (7) In this Chapter "capital amount" means an amount in money or money's worth which does not fall to be included in a calculation of income for purposes of the Tax Acts otherwise than as a result of this Chapter.

181. The LLP Deed permits Special Capital to be allocated to an individual member either as cash (which would be charged under s778, if there is a charge) or in the form of property (which would be charged under s779, if there is a charge). The Tribunal was not asked to consider which of the two sections would apply in relation to each of the individual members nor given evidence as to the nature of the amounts reallocated.

Appellants' submissions

182. "Occupation" is defined in s774 ITA 2007 as "activities of a kind undertaken in a profession or vocation". The appellants submitted that the reference to profession or vocation means that the legislation is clearly not intended to apply to activities of a kind undertaken in a trade and that HMRC were incorrect in their approach, which assumes that every skilled activity must necessarily be a profession.

183. The appellants submit that the individual members were not carrying on a profession or vocation and their activities were not of a kind undertaken in a profession or vocation. Further, the appellants submitted that Parliament deliberately omitted "trade" from the legislation and that the legislation should not be interpreted so widely as to include activities which are those of a trade.

184. The appellants submitted that the evidence of AG, PH and PB was that they were carrying on a trade of devising strategies for high frequency trading in currencies and profiting from the performance of such trading strategies. The skills of the members were applied to achieve profits from buying and selling foreign currencies, as the profits of HFFX were derived from the profits of GSACP.

185. As such, in devising and implementing models for dealing in foreign exchange instruments, the appellants were undertaking an occupation which is substantially the making of arrangements for the sale and purchase of commodities in order to make profits from the buying and selling of such commodities. Scrutton LJ in *The*

Commissioners of Inland Revenue v Maxse (1919) 12 TC 41 ("*Maxse*") had concluded that the arrangements for the production or sale of commodities amounted to a trade rather than a profession.

186. Further, it was submitted that *Christopher Barker & Sons v IRC* [1919] 2 KB 222 ("*Barker*") established the same point as the court held (at p228) that the "exercise of commercial knowledge in connection with the sale of commodities in the market" is not a profession. This followed the decision of Scrutton LJ in *Burt & Co v Commissioners or Inland Revenue* [1919] 2 KB 650 ("*Burt*") which distinguished between professional advice and commercial advice and concluded that the activities, which included maintaining knowledge of particular markets, related to commercial advice and not professional advice.

187. The appellants also noted that HFFX and its members were not regulated nor members of any professional body, and their activities depended on their abilities rather than particular qualifications. In addition, the members had no clients or customers in the way that would be expected in a profession: trades were carried out using automated systems.

188. The appellants submitted also that the roles and activities did not amount to a vocation but, instead, contributed to the trade of HFFX as a whole. Following *Asher v London Film Productions Ltd* [1944] KB 133 ("*London Film Productions*") (at 138) roles carried out by employees as part of a trade as a whole cannot be analysed separately as professions or vocations. The appellants also submitted that the activities of a manager, which was a substantial part of AG's activities, are not activities of a profession or vocation, as also noted in *London Film Productions*.

189. With regard to the second aspect of the rules, the appellants submitted that to determine whether there is a main object of avoiding taxation, it is necessary to consider:

(1) whose objects are relevant;

(2) distinguish between objects and known or inevitable consequences; and

(3) focus only on the important objects.

190. The appellants submitted that it is only their objects which are relevant, following the decision in *Oxford Instruments UK 2013 Ltd v Revneue and Customs Commissioners* [2019] UKFTT 254 (TC) ("*Oxford Instruments*"). Further, the objects of AG are most relevant, as he was the managing member and had the central role amongst the individual members in the creation of HFFX and the CAP.

191. AG's evidence was that GSA had insisted on the structure, and had controlled the process: they had, for example, insisted on the allocation to GSAM being 50% rather than the 30% preferred by AG. The scheme had no tax advantage for GSA, such that tax could not have been a motive of GSA. To the extent that GSA had mentioned the tax elements of the structure, AG's evidence was that he considered that this was in order to make it easier to 'sell' the arrangements to the individual members.

192. It was submitted that AG's evidence showed that the main objects of the CAP were commercial, to ensure compliance with regulatory requirements and to allow for control over individual members, as it was considered easier to deny vesting rights than to forfeit rights in the event of a member being a bad leaver or in a downturn in performance. Further, AG's evidence was that he did not take tax advice, and that tax was only raised in response to his commercial concerns regarding the CAP.

193. The tax consequences of the restricted fund shares were raised as a means of dissuading interest in that route, and AG's evidence was that he was unwilling to sacrifice other commercial advantages to push this further. PH's evidence was that although he understood that there might be some tax benefit he considered that this was a control tool, and of little relevance when there was no guarantee that the CAP would make any payments, As such, he did not consider that this altered the undesirability of the CAP and the deferral involved. PB's evidence was that he did not understand that there would be any tax benefit and that he did not have any power to negotiate anything in relation to the CAP.

194. As such, it was submitted that tax was not an object of AG's in accepting the HFFX and CAP structure. It was submitted that GSA's prime concern was the enforcement advantages of the CAP, as it would be indifferent to the tax position of the individual members. It was submitted that, although AG wanted to ensure that there was no tax charge on profits which were never allocated to partners, this did not amount to a main object of avoiding a liability to tax.

195. The appellants submitted that any tax advantage was an inevitable consequence of the steps taken and that, as noted in *Lloyds Bank Leasing (No 1) Ltd v Revenue and Customs Commissioners* [2015] SFTD 1012 ("*Lloyds Bank Leasing (No 1)*") (at §37), "the fact that the tax consequences inform a transaction does not necessarily mean that obtaining an advantage was a main object".

196. Finally, the appellants submitted that the "main objects" are those which are important (as noted by the Court of Appeal in *Travel Document Services v Revenue and Customs Commissioners* [2018] STC 723 at §48 and that, in this case, the important objects were commercial as shown by the evidence of the individual members.

HMRC submissions

197. HMRC submitted that, if there has been a genuine allocation of profits to GSAM, then it is clear that transactions have been effects or arrangements made to exploit an individual's earning capacity because GSAM is put in a position to enjoy part of the income derived from the individual members' activities. If the receipt of Special Capital is not otherwise brought into account for income tax purposes the rules mean that, if the activities are those of a profession or vocation, then the amounts received by the individual members on a reallocation of Special Capital are subject to income tax.

198. HMRC submitted that the rules are intended to catch schemes through which individuals effectively sell their earnings potential in exchange for capital payments. The purpose of the rules would be frustrated if "profession" or "vocation" were to be constructed in a narrow, technical, or outdated manner.

199. HMRC submitted that the individual members were carrying on activities of a kind undertaken professionally, and that the question of what amounts to a profession was considered by Scrutton LJ in *Maxse* (at 61) and that it

> "involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture, or surgery, skill controlled by the intellectual skill or the operator, as distinguished from an occupation which is substantially the production, or sale, or arrangements for the production or sale of commodities".

200. Here, the team consisted of researchers, who analysed data to create models to predict short-term movements in the market, and software developers who converted the models into production code. These roles required individuals with graduate-level mathematics skills as well as skills in probability theory, statistics, econometrics and software coding. The individual members were therefore highly skilled, and their skills were used in an organised way to provide trading strategies to GSA, and as such their activities were of a kind undertaken in a profession.

201. Further, HMRC submitted that the requirement is that the individual members be engaged in the kind of activities that professionals engage in; not specifically that they were exercising a profession. The members were required to comply with FSA rules, under the terms of their secondment agreements with GSA, and so were carrying out regulated activities.

202. HMRC also submitted that the activities could be regarded as those of a vocation, as the term "vocation" should similarly be widely interpreted and the courts have accepted the term to mean any way of earning money which is systematically carried on but is not a form of buying and selling, as held in *Partridge v Mallandaine* (1886) 2 TC 179 (at 181) and recognised in *Graham v Green* (1925) 9 TC 309 (at 313-14), which considered that a bookmaker was carrying on a vocation as his calculation of "odds … over a long period of time and quoting them so that … the aggregate odds …are in his favour" was "organising an effort in the same way that a person organises an effort if he sets out to buy himself things with a view to securing a profit".

203. HMRC submitted that the members of HFFX set out to make profits in a systematic manner, and were not engaged in buying and selling, and so were engaged in the kind of activities undertaken in a vocation.

204. With regard to the tax avoidance requirement, HMRC submitted that the evidence was that GSA's lawyers had, in explaining the CAP to AG, stressed that the result would be that a significant part of the members' earnings would be subject to tax only at the corporation tax rate of 28%, which at the time was anticipated to fall to 26%, rather than the then new 50% income tax rate. The alternative deferral method

of restricted fund shares was described as less tax efficient in a document copied to AG. Although AG had stated that he thought this was the view of a particular lawyer, rather than GSA, the relevant law firm had drafted the HFFX LLP Deed and advised GSA throughout the setting up of the CAP.

205. In giving evidence, AG had confirmed that he did not consider that it was very attractive to have all of his profit allocation deferred by multiple years, as the restricted fund shares deferral mechanism would require the upfront allocation to be used to pay the tax charge. HMRC submitted that AG's evidence was therefore that both the CAP and the restricted fund shares method had been discussed and were the subject of negotiation. He had been persuaded not to use the alternative deferral method by the tax arguments; it was submitted that his evidence that GSA would not allow him to use the restricted fund shares method related only to the period after HFFX was created.

206. The evidence of the members was that AG had explained to PH that the CAP would have tax benefits, and that PH had understood that these arose because of the difference between income tax and corporation tax rates. PB's evidence was that he was told that the CAP was a tax efficient plan which had been investigated by a tax QC and found to be okay, although he left tax compliance details to his accountants who had been recommended to him by HFFX.

207. Further, HMRC submitted that the Declaration of Trust showed that the core purpose of the Trust was to own GSAM to not only promote the businesses of GSACP and HFFX for "inter alia, fiscal reasons".

208. HMRC submitted that the reduction in a charge to tax was one of the main reasons that the parties carried out this scheme. On that basis, an income tax charge under Chapter 4, Part 13, ITA 2007 arises when Special Capital is allocated to an individual member.

Discussion

Are the activities those of a kind undertaken in a profession or vocation

209. The question of what constitutes a profession was raised in the case of *Burt*, referred to by the appellants, where the court noted that (at 658) a profession is one in which

> "the profits … are dependent mainly upon the personal qualifications of the person by whom the profession is carried on".

210. Similarly, the decision in *Maxse* clearly states that a profession

> "involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture, or surgery, skill controlled by the intellectual skill or the operator, as distinguished from an occupation which is substantially the production, or sale, or arrangements for the production or sale of commodities".

211. I consider that the descriptions of the roles of the individual members given in evidence fall within the definition in *Maxse*: the roles were described as involving an extremely high degree of intellectual skill, designing trading models which would predict when to buy and sell in the foreign exchange markets, and creating computer systems to trade foreign exchange financial instruments on the basis of those models.

212. I do not accept the appellants' argument that their activities amounted to making arrangements for, or the exercise of commercial knowledge in, the buying and selling of commodities (per *Barker* and *Burt*). It was clear from the evidence of the individual members that their activities in respect of HFFX were the design and development of software-based trading strategies. Their titles (whilst not conclusive) support this: the team consisted or researchers and developers, not commodity traders or market advisers. They had none of the infrastructure required for such buying and selling. The evidence provided was that all of the infrastructure and functions relating to the foreign exchange transactions was provided by GSA and that trading in foreign exchange financial instruments was undertaken by GSA.

213. AG stated, in his witness statement, that the team's trading strategies were to be available to be used by GSA's funds. That is, any buying and selling that took place was undertaken and arranged by GSA. The fact that the strategies developed were used by GSA to buy and sell commodities does not affect the nature of the activities of the individual members of HFFX. Similarly, the fact that the income of HFFX was calculated by reference to the profits earned by GSA from the strategies developed by HFFX does not mean that the members of HFFX can be regarded as either buying and selling or making arrangements for the buying and selling of commodities.

214. It was argued that the members of HFFX were not regulated and that they had no specific professional qualifications and had no customers in the way that would be expected of a profession. Referring to the legislation, the requirement is that the activities are those of a kind undertaken in a profession or vocation; this does not, in my view, extend to requiring particular qualifications or particular customers. In the case of *Maxse* a journalist was considered to undertake a profession, and no qualifications or membership of professional body was required - activities depend on abilities and not particular qualifications. I also do not consider that any particular number or type of customers is required for activities to be akin to those of a profession.

215. I note the appellants' arguments that the term "trade" was deliberately omitted by the legislation and that the wording should not be so construed as to encompass the activities which are those of a trade. However, I consider that the wording of s774 is clear: what matters is whether the activities of the individual are those "of a kind undertaken in a profession or vocation" so that activities which are in fact undertaken by the relevant individual contributing to a wider trade are not precluded from being within the meaning of the term "occupation". I consider that if Parliament had intended the section to exclude any activities actually undertaken as part of a trade, the words "of a kind" would not have been included.

216. The appellants also argued that AG's role as manager meant that his activities could not be regarded as those of a profession or vocation, following the decision in *London Film Productions*.

217. The decision in that case was considering "the occupation of a manager, or person of that kind, who is engaged under a service contract to manage a business or some particular branch of a business". AG was a partner in HFFX: he was the managing member, and so had particular responsibilities as set out in the LLP Deed. AG's evidence was that his role had changed over time with the research role reducing to less than 50% by 2012 and that, by 2014, he was spending all of his time negotiating the exit of the HFFX business from GSA.

218. I do not consider that this is equivalent to being engaged under a service contract to manage a business or branch thereof. The secondment agreement between HFFX and GSA in respect of AG does not include any reference to business management obligations. AG was not engaged to manage an exit from GSA. The fact that he undertook some management aspects of the LLP does not, in my view, mean that he did not have a qualifying occupation for these purposes.

219. I find, therefore, that the activities of the individual members were "of a kind undertaken in a profession" so that they carried on an occupation for the purposes of the legislation.

220. I note that submissions were made as to whether the activities amounted to those of a kind undertaken in a vocation; as I have found that the activities were those of a kind undertaken in a profession it is not necessary to consider whether they could also be those of a vocation.

221. Nevertheless, I would note the appellants' submission that activities of the individual members contributed to the trade of HFFX as a whole and that roles carried out as part of a trade should not be analysed separately as those of a vocation. This was said to be following the decision in *London Film Productions* which was said to have noted that the roles of employees cannot be analysed separately as professions or vocations.

222. Notwithstanding the fact that we are here dealing with LLP members and not employees, s774 specifically states that the question of whether the individual carries on an occupation is determined by the nature of their activities "regardless of whether the individual … is an employee or office-holder." As such, the decision in *London Film Productions*, which was concerned with somewhat different provisions of the legislation, could be of no particular assistance.

Was there a main object of avoiding or reducing a liability to tax in the arrangements

223. In addition to requiring that the individual undertake an occupation, for a tax charge to apply the legislation also requires that one of the main objects to the arrangements is the avoidance or reduction of liability to income tax (s773(2)(b) ITA 2007).

224. The appellants submitted that the purpose of the arrangements was commercial, to ensure regulatory compliance, and to allow for control over individual members. Any tax advantage was an inevitable consequence of the steps taken, not a main object of the arrangements.

Whose objects need to be considered?

225. I note the decision in *Oxford Instruments* that

> "the significance of the tax advantage to the relevant taxpayer as a matter of subjective intention, which necessarily involves a careful analysis of all the reasons the taxpayer had for entering into the transaction".

226. Whilst *Oxford Instruments* is not binding upon me, being a First-tier Tribunal decision, I do agree with the principle stated. In this case, as noted by the appellant's AG's central role amongst the members of HFFX in the creation of HFFX and the CAP means that his objects are most relevant amongst the objects of the team members.

227. However, I also note that the decision in *Oxford Instruments* considered that (at §101)

> "if the evidence in this case pointed to the fact that … the directors of the Appellant were just acting as the puppets of the directors or employees of OI Plc and simply acceding, without independent thought, to the requests made of them by the directors or employees of OI Plc, then the intentions of the directors or employees of OI Plc might well inform my findings in relation to the intentions of the Appellant."

228. I agree with this point as well. Although I do not consider that AG and the other members were acting as "puppets" of GSA, I consider that the same principle applies when another party is significantly involved in the decision-making involved in the arrangements.

229. It is clear from the evidence that GSA had originated the proposal for the CAP and placed substantial importance on it being entered into. GSA had substantial influence over the arrangements and the decisions involved in those arrangements being entered into. I therefore consider that it is necessary to consider the objects of GSA (in this context, those making decisions for GSA) with regard to the arrangements. Although it was argued that GSA had no tax exposure to the arrangements, it does not necessarily follow that their objects with regard to the arrangements could not include any tax-related object.

AG's objects

230. AG stated that he was not interested in any tax benefit to the arrangements but also stated in giving evidence that "to the extent that tax was a factor, it was to avoid a deeply unfair tax position that could arise with deferral arrangements … this was

clearly unfair … GSA considered that the CAP would satisfy the regulatory position in a way that meant members would not pay tax on amounts they never received. [GSA] was also clear that we could also expect certain tax savings if the CAP was used." It is also clear as set out below that he had been provided with information that made it clear that a significant tax reduction could be expected with the CAP.

231. PH's evidence was that AG had explained that there would be tax benefits to using the CAP: as such, the tax benefits must have been important in AG's view to so draw them to the attention of others who would be following and affected by his decision to agree to the CAP. I would note that PH's evidence that he did not think there would be a significant tax saving was not entirely credible: a reduction in applicable tax rate from 50% to 33% (the rate he thought would apply to the Special Capital amounts) is a saving of approximately one-third.

232. AG's evidence was that he had taken no advice as to the tax benefits of the CAP arrangements because it was not important to him; however, there was no clear evidence that he had taken substantial advice as to the commercial benefits of the CAP arrangements either. He engaged advisers who he described as employment law specialists, and the copy advice produced in evidence was as to the then new FSA requirements as to bonuses and variable remuneration, rather than in respect of the CAP itself. That advice includes the note that there is a "need to start planning how to defer remuneration in a tax efficient manner". The email correspondence produced in evidence indicates that he sent the HFFX proposal to them, but there was no evidence of any advice as to the commercial aspects of the proposal to establish HFFX and enter into the CAP.

233. I consider that AG's evidence that he accepted the CAP because the overall arrangements, including the establishment of HFFX, gave greater autonomy to his team is inconsistent with his evidence as to GSA's control over HFFX and himself. The provisions of the LLP deed require GSA approval in various forms for most decisions, including requiring GSA consent to the secondment of any individual member to GSA, although AG stated that one of the reasons for entering into the LLP arrangements was to obtain greater autonomy over hiring team members. As the entire business of HFFX was the secondment of its members to GSA, the consent required to secondment appears to be inconsistent in practice with the LLP members having significant autonomy over hiring new members.

GSA's objects

234. The HFFX proposal, drafted on behalf of GSA, was circulated on 4 August 2010. This described proposals to set up a new LLP to be a member of GSA, to deal with AG's concern about direct membership of GSA. It includes comments as to autonomy of the LLP which, as noted above, are not reflected in the terms of the LLP Deed.

235. The proposal states that "effective deferral on an individual basis for [LLP members] would be highly complex and would entail significant paperwork and administrative burden. For example … each member [would have to] sign two pledge

agreements". The CAP was described as a "simpler and more streamlined … way to incentivise" members.

236. The overview of the deferred compensation planning for the LLP notes that "It is envisaged that [the transfer of capital after deferral] should not result in an income tax or capital gains tax charge for the redeeming member". This is repeated in the "Step by Step" description of the deferred compensation planning.

237. In a section headed "Tax Implications", the proposal states that "the only tax payable [on deferred compensation] will be corporation tax … Successful implementation of the … planning should thus lead to a significant reduction in the overall tax suffered by the members" (emphasis added). In my view, the wording indicates that the tax reduction is an intended result of the arrangements, not an inevitable consequence of those arrangements.

238. Whilst this document was initially prepared by GSA's lawyers, it was circulated by GSA and the associated email correspondence chain leading up to GSA sending the document to AG makes it clear that those making decisions on behalf of GSA had been involved in the preparation of the document. The correspondence also notes that "more information about the rationale" had been added so that it was "robust from a tax planning perspective", again clearly reflecting the fact that the tax aspects were important and suggesting that the note had focussed more on the tax aspects of the arrangements and less on the "rationale" for the those arrangements. In my view, this is incompatible with the tax reduction being of nothing more than incidental interest.

239. The overall arrangements included the use of a Cayman Islands Star Trust to own GSAM. The purpose of the trust was stated to be to promote the business of GSCAP and HFFX and to carry out the Business Plan. The Business Plan states that the voting shares of GSAM are held "for the purpose of promoting the businesses of the LLPs for, inter alia, fiscal reasons and to exercise the rights of the" shares in GSAM.

240. On the balance of probabilities, I consider one of the main objects of those making decisions on behalf of GSA with regard to the arrangements was the obtaining of a reduction in tax liability. The legislation does not require a match between the person who forms the object and the tax savings. I do note that although the HFFX arrangements did not directly reduce the tax charge on GSA members, GSA intended to implement the same arrangements within GSA. The minutes of a meeting of the management committee of GSACP on 28 October 2010, introduced in evidence (approving the restructuring of the AG team into HFFX, and also approving the CAP arrangements) noted that the CAP structure was proposed to be implemented for GSACP as a whole as it had been "necessary to revisit remuneration structures for all members of" GSACP given the FSA changes.

Whether there was a main object of avoiding or reducing a liability to tax

241. I consider that it is clear from AG's evidence that he had a main object of reducing a liability to tax in agreeing to the CAP, as he considered that the alternative

restricted fund shares arrangements carried an "unfair tax position" and also believed that there would be tax savings to the use of the CAP. Whilst he also had other objects in agreeing to the CAP, I consider that it was clear from his evidence that the tax position was an important part of that decision as he emphatically contrasted the tax position that would arise from the alternative deferral arrangements that were under consideration and also explained the tax benefits of the arrangements to PH. I do not consider that it is credible that he was not interested in a potential tax saving of more than 40% on very substantial earnings.

242. In addition, I consider that it is clear that those making decisions on behalf of GSA also had a main object of reducing a liability to tax.

243. The test is whether one of the main objects is "is the avoidance or reduction of liability to income tax". It was argued that it could be noted from *Lloyds Bank Leasing (No 1)* that the fact that tax consequences arise from a transaction does not necessarily mean that obtaining an advantage was a main object of that transaction. However, the same decision concludes (at §85) that

> "although the transactions would have gone ahead in some form driven by their paramount commercial purpose, regardless of the availability of the [tax advantage], we think it unlikely that they would have taken the form they did but for the possibility that [the tax advantage] would be available."

244. It is clear that the FSA changes with regard to variable remuneration meant that some form of restructuring of remuneration arrangements would have had to take place. No alternative structures to the CAP appear to have been considered, other than the retention of the restricted funds mechanism for US nationals as a consequence of the US tax consequences arising from the use of the CAP.

245. It is also clear that taxpayers are not required to select the worst possible tax position when considering how to structure their affairs and that, as such, it may be that in choosing between two or more viable commercial structures, an option with a non-adverse tax charge may be able to be taken without there being a main benefit of obtaining a reduction in a tax liability.

246. However, in this case, I consider that the steps involved in the arrangements were intended to lead to a significant tax reduction for the individual members; this was not a by-product of choosing one structure over another, nor was this submitted to be the only possible structure available.

247. Accordingly, I find that one of the main objects of the arrangements was the avoidance or reduction of a liability to tax. As I have also found that the activities of the individual members were of a kind undertaken in a profession, and it was not disputed that the arrangements were made to exploit the earning capacity of the individual members, it follows that an income tax charge would have arisen under the provisions of Chapter 4 of Part 13 ITA 2007 when the amounts of Special Capital were allocated to the individual members.

Issue 3 – whether discovery amendment invalid

248. There is no requirement to consider this issue as the question of discovery only arises in relation to Issue 1 and, as I have found Issue 1 for the appellant, so the assessment in question falls away. However, as the matter was argued in full, I have considered the arguments put forward.

249. s30B TMA 1970 provides as relevant that:

> "(1) Where an officer of the Board or the Board discover, as regards a partnership statement made by any person (the representative partner) in respect of any period—
>
> (a) that any profits which ought to have been included in the statement have not been so included, or
>
> (b) that an amount of profits so included is or has become insufficient, or
>
> (c) that any relief or allowance claimed by the representative partner is or has become excessive,
>
> the officer or, as the case may be, the Board may, subject to subsections (3) and (4) below, by notice to that partner so amend the partnership return as to make good the omission or deficiency or eliminate the excess.
>
> …
>
> (9) In this section—
>
> "profits"—
>
> (a) in relation to income tax, means income,
>
> (b) in relation to capital gains tax, means chargeable gains, and
>
> (c) in relation to corporation tax, means profits as computed for the purposes of that tax"

Appellants' submissions

250. The appellants noted that HMRC is only allowed to make a discovery assessment in specific circumstances set out in s30B TMA 1970. The appellants submitted that these circumstances do not include disagreeing with the allocation of profits as between the members as shown on the partnership statement. Even if HMRC succeeded with regard to Issue 1, it was therefore not open to HMRC to exercise their powers under s30B to issue such assessments.

251. HMRC had argued that s30B can be used to address the situation where the full amount of the profits that should have been allocated to each partner have not been included in that partner's profit share on the partnership statement, and that such a construction is required because the purpose of the legislation is to ascertain profits and resolve disputes at a partnership level.

252. The appellant submitted that the draftsman was aware that a partnership statement included both the overall profits of a partnership as well as a statement as to

how such profits were to be allocated as between partners. On this basis, the clear wording of s30B cannot be departed from to 'read in' an additional circumstance to address allocation even if HMRC's general view of the purpose of the legislation was accepted.

253. The appellants submitted that, in any event, such a broad approach to the interpretation and application of s30B was rejected *in Albermarle 4 LLP v Revenue and Customs Commissioners* [2013] STFD 664 (at §§64-69), in which the Tribunal that the purpose of s30B was to enable an amendment where a loss of tax was discovered where a positive amount of profits had not been declared or were understated or where reliefs or allowances were excessive.

254. The appellants further submitted that, as HMRC cannot rely on s30B to alter the allocation of profits between the members of HFFX, HMRC also cannot rely on the s29 TMA 1970 discovery assessments, which were issued to the individual members for the purpose of HMRC's alternative arguments under Issue 2, for the purposes of Issue 1.

HMRC submissions

255. HMRC submitted that s30B does permit adjustment of income allocated to members because s30(1)(b) allows for amendment where "an amount of profits [included in the partnership statement] is or has become insufficient". "Profits" are defined to include income and the partnership statement includes amounts for income allocated to each partner. These are amounts of income in the partnership statement and HMRC has amended them as they are insufficient.

256. HMRC submitted that s12AA(1) TMA 1970 states that the purpose of the partnership tax return is to facilitate the statement of the amounts in which each partner is chargeable to income tax and corporation tax. Given that, it would be extraordinary if s30B, giving power to make amendments to that return, could not change amounts to which any given partner is chargeable to income tax unless they also changed the amount of income received by the partnership as a whole.

257. HMRC submitted that the appellants' interpretation of s30B would mean that HMRC would have no means of correcting the position where members have been allocated too much and so have paid too much tax, although they would be able to raise assessments against members who had been allocated too little.

258. HMRC further submitted that the discovery assessments made under s29 TMA 1970 were clearly issued to deal with Issue 1 as well as Issue 2, as each letter stated that the assessment was made because HMRC believed that the allocation of profit to GSAM should be treated as allocations of profit to the individual members. In addition, the evidence of Officer Frusher (set out below) was that the assessments were made on the two alternative bases. Further, as there were no receipts of Special Capital until May 2012, the only basis for the assessments for 2011-12 was Issue 1.

259. HMRC submitted that it is clear that the appellants understood that this was the position, as set out in their responses to the assessments.

Discussion

260. The appellants argued, in effect, that the word "profits" in s30B(1) could only mean the total profits of the partnership, so that HMRC could not amend the partnership statement where the total profits were not in dispute, and that it was not possible to "read in" wording that would allow for an amendment to address the allocation of profits.

261. HMRC argued that "profits" were defined to include income and that, as amounts of income in the partnership statement had been found to be insufficient, HMRC were entitled to make an amendment in respect of those amounts.

262. The legislation clearly defines "profits" in s30B(9) TMA 1970 as being both "income" for the purposes of income tax and "profits as computed for the purposes of [corporation] tax".

263. s30B(1)(b) applies where "an amount" of profit included in the statement is insufficient, not "the amount". I consider the definition of "profits" in s30B(9) means that no additional words are required to read into s30B(1)(b) the ability for HMRC to make an amendment where the partnership statement includes an amount of income as calculated for the purposes of income tax which has been found to be insufficient. It does not require that the total profit of the partnership has been found to be insufficient.

264. I therefore find that, if HMRC had succeeded in respect of Issue 1, the amendment would not have been invalid.

265. As the appellants' objection to the s29 TMA 1970 assessments was that HMRC could not rely on the s30B amendment to make those assessments, it follows that the s29 assessments would not have been invalid.

Issue 4 – whether discovery assessments stale

266. To the extent that the argument as to staleness relates to the s30B amendment and the s29 assessments, both of which relate to Issue 1, there is no requirement to consider arguments as to staleness in respect of the s30B amendment and the s29 assessments for the 2011/12 tax year. However, the arguments put forward also related to the discovery assessments issued to the Individual Appellants for the 2012/13 tax year and to that extent, the question remains to be resolved.

Appellants' submissions

267. The appellants noted that *Clive Beagles v The Commissioners for HM Revenue and Customs (Tax)* [2018] UKUT 380 TCC ("*Beagles*") had established (at §§58-60) that the validity of a discovery assessment depends on the discovery not having

become ‘stale’ by the time that the assessment was made. The Court of Appeal in *Revenue And Customs v Tooth* [2019] EWCA Civ 826 (“*Tooth*”) (at §§60-61) had endorsed the view of the Upper Tribunal in *HMRC v Charlton Corfield & Corfield* [2012] UKUT 770 (TCC) (“*Charlton*”) that a discovery may lose its ‘essential newness’ if an assessment is not made within a reasonable time after the discovery is made. The appellants submitted that the same reasoning should apply to a discovery amendment made under s30B TMA 1970.

268. The appellants submitted that HMRC have failed to prove that no discovery was made by an officer of HMRC prior to Officer Frusher. As the task of making the assessments was not delegated to Officer Frusher, if there was such an earlier discovery then the amendment and assessments made by her would be invalid.

269. The appellants noted that Officer Frusher had accepted that there were limits to the evidence she could give on the question of whether another officer had made an earlier discovery. Her evidence was that there was a team of individuals working collaboratively on corporate partner avoidance since at least 2013. As HMRC issued discovery assessments in respect of another partnership (*BCM Cayman / Bluecrest v Revenue and Customs* [2017] UKFTT 226 (“*BCM*”)) in early 2013, it was submitted that they must have reached a conclusion in relation to Issue 1 by that date. The planning described in the BCM Capital case was identical in essential details to the CAP in this case. An HMRC officer, Officer Taylor, was involved both the *BCM* case and also in the investigation into HFFX. He produced a risk assessment document in respect of GSACP in August 2014 which identifies the issues arising in respect of HFFX and commented that GSAM operated a “phase 1” corporate partner avoidance scheme.

270. The appellants submitted that Officer Frusher had accepted that, when an enquiry letter was sent to HFFX on 5 September 2014, HMRC knew what they were looking for and believed that this was an example of avoidance before receiving a response to that letter. Officer Frusher had also accepted that the HMRC officers involved at that time had decided that the scheme did not work.

271. A response to this letter was sent to HMRC in December 2014 and included the LLP Deed, amongst other information provided. In a further letter sent by Officer Shah dated 18 February 2015, the appellants submitted that the information had clearly read as it was described as “very helpful” in the letter. The terms of the LLP Deed would have given enough information for the officer to realise that there was an insufficiency in respect of the individual members and, from the information provided, what Special Capital allocations had been made.

272. As such, the appellants submitted that he would have reached a discovery in respect of both Issue 1 and Issue 2 by this stage. Although HFFX responded to Officer Shah’s letter on 9 April 2015, it was submitted that none of the information provided could have altered the view that there was an insufficiency for all relevant tax years. No further information was provided by HFFX between that date and the date on which the discovery amendment and assessments were made in March 2016.

273. Further, it was submitted that the draft submission to HMRC Solicitor's Office which is referred to in the handover note between Officer Shah and Officer Frusher is described as addressing the "issues in detail following the response to my initial letters". The appellant submitted that it should be concluded that Officer Shah had made a discovery by this point.

274. In correspondence dated 21 December 2015, sent at Officer Frusher's direction shortly after she started to work on the case, there is a statement that there are inaccuracies in HFFX's return for the year ended 31 March 2014. The appellant submitted that the only reasonable inference is that a discovery had already been made by HMRC and that Officer Frusher had adopted this view when she made the amendment and assessments in March 2016.

275. Further, the appellants submitted that Officer Frusher was unable to provide detail as to how she made the calculations for the assessments, nor explain the discrepancies between the s30B amendment and the s29 assessments. Her evidence was that she did not identify anything new in terms of documentation. Officer Frusher was also unable to identify why she was not able to make discovery assessments for 2012/13 in March 2016 when the assessments for 2011/12 were made.

276. The appellants therefore submitted that the evidence indicates that the discovery on which the amendment and assessments were based was made in late 2014 or early 2015. On that basis, it was submitted that as the assessments for 2011/12 were made over a year later, with an intervening period of inactivity, the discovery was stale. The appellants submitted that the same applies to 2012/13 as a conclusion in respect of that year must, similarly, have been reached by mid-2015.

277. The appellants submitted that HMRC had failed to provide any evidence from the officers who made the discovery assessments for 2011/12 and 2012/13 on AG as to when the relevant discoveries were made. The appellants submitted that HMRC have therefore failed to prove whether a discovery was made by either officer and when such discovery was made, and that these assessments must therefore be found to be invalid as HMRC have failed to plead their case or provide relevant evidence as they are required to do so (per *Burgess & Anor v Revenue And Customs* [2015] UKUT 578 (TCC)).

HMRC evidence

278. For HMRC, Officer Rachel Frusher provided a witness statement and gave oral evidence.

279. Officer Frusher's evidence was that:

280. She was allocated to the review of the CAP arrangements operated by GSACP and HFFX and started work on the case in January 2016, as the team were struggling to get through all of the material which had been provided.

281. She was part of a team working on arrangements regarded by HMRC as corporate partner avoidance schemes which had been in place since at least 2013. The purpose of the group was to pool knowledge to assist each other with dealing with enquiries. The HMRC policy view was that the schemes did not work.

282. She agreed that the planning described in the BCM Capital LP case was identical in essential details to the CAP in this case.

283. Before her involvement, the review of the arrangements was being undertaken by Officer Shah. Officer Frusher was not aware that any other officer had been involved with the review prior to Officer Shah. She had not met Officer Taylor and had not worked with him on this case.

284. She accepted that there were limits to her knowledge and that someone with earlier involvement could have made a discovery that she did not know about. There was no information on the file that showed that someone had made a discovery.

285. On reviewing the file in December 2015, she found Officer Shah's handover note which provided details of what had been done, and what still needed to be done. She had also read the draft letter to the HMRC Solicitor's office referred to in the handover note.

286. The file showed that Officer Shah had opened an enquiry into the HFFX partnership return for the 2012/13 tax year on 5 September 2014, and an enquiry into the GSAM corporate tax return for the year ended 31 March 2014 on 8 September 2014. Information and documentation was requested from the partnership and the company at that time; these were received by 8 December 2014. Further information was requested by Officer Shah on 18 February 2015, and this was received on 9 April 2015. Officer Shah left HMRC around June/July 2015. Officer Frusher had noted that no information as to the arrangements was provided in the partnership tax return for the 2011/12 tax year, other than the profit allocation to GSAM.

287. She believed that no one had reviewed the information sent by the appellant in December 2014 before she began working on the case. She was not aware of any other HMRC officer reviewing the arrangements after Officer Shah left HMRC.

288. A letter of 21 December 2015 referring to "inaccuracies" in the partnership return for the year ended 31 March 2014 sent by this other officer was sent at the direction of Officer Frusher as Officer Frusher had only recently started working at HMRC.

289. Her initial view of the case on review was that at a high level it had similar characteristics to an "EY scheme". She was aware that Bluecrest had operated a similar scheme. She was aware that there were variations on the scheme, with at least three iterations. Another version, for example, had no tax at the corporate level. She considered that Bluecrest had used a different version to HFFX although, as it was two years since she had last dealt with Bluecrest she could not specifically confirm any similarities.

290. On reviewing the further information provided from December 2014 onwards, she concluded that the profits allocated to GSAM were always intended to be allocated to the individual members. The documentation provided demonstrated the steps by which partnership profits were eventually paid to individual members.

291. On this basis, she made a discovery amendment in respect of the partnership return for the 2011/12 tax year on 22 March 2016.

292. In early 2016, as a result of her review of the information provided from December 2014 onwards and following advice from technical specialists within HMRC, the alternative position that the individual members should be assessed directly was established and she issued discovery assessments for the individual members for the 2011/12 tax year on 31 March 2016.

293. Throughout 2016, GSACP had acted on behalf of HFFX in respect of the enquiries into the CAP and there was significant detailed correspondence during that year between HMRC, GSACP and the legal representatives of GSACP and HFFX. This included requests for further outstanding information on the CAP, the issue of an information notice and correspondence and an appeal in respect of that notice, and correspondence regarding the application of s733 ITA 2007.

294. In mid-December 2016, GSACP notified HMRC that it was withdrawing from tribunal proceedings with regard to the arrangements for its own partners. HFFX would be representing its own affairs in future, separate to GSACP.

295. HMRC met with HFFX and their new legal representatives in February 2017 to discuss the matter and for HFFX to explain the rationale behind the CAP arrangements. Officer Frusher considered that the meeting was an opportunity to ascertain whether there was any further information that HMRC may not previously have been aware of, and to obtain outstanding documentation which had been requested. She also hoped that the appellants might agree to withdraw as GSACP had done.

296. The outstanding documentation was provided on 3 March 2017 and HFFX confirmed further background information regarding the operation of the CAP and AG's involvement.

297. The meeting and additional information was useful but did not revise Officer Frusher's view of the nature of the CAP.

298. After reviewing the additional correspondence, Officer Frusher concluded that the 2012/13 self-assessments of the individual members were insufficient and so raised discovery assessments for 2012/13 on 31 March 2017.

299. She could not explain the details of the assessments as these would have been prepared by someone else in the team.

HMRC submissions

300. HMRC submitted that, if there is a test of staleness, then the discovery amendment for 2011-12 and the discovery assessments for 2011-12 and 2012-13 were not stale.

301. The amendment and 2011-12 assessments were made in March 2016. Officer Frusher took over the investigation into the use of the CAP in December 2015. The previous investigator, who left HMRC in June 2015, had clearly made no decision at the time that he left as his handover notes made it clear that he had not yet made a decision on how to proceed as the note states that he had yet to review the information provided in December 2014 and "Depending on responses, this case may well be at a point where fact finding is complete and a decision needs to be taken on how to proceed". Accordingly, any decision made by HMRC must have been made between December 2015 and March 2016 and, as such, there was no serious delay between the decision being made and the amendment and assessment being issued.

302. The discovery assessments for 2012-13 were made on 31 March 2017. HMRC submitted that it was clear from the evidence that there had been substantial correspondence and meetings between HMRC and the appellants' representatives in late 2016 and early 2017, exploring the possibility of a charge on the individual members. As such, there was no serious delay between the decision being made following such correspondence and meetings and the issue of the assessments on 31 March 2017.

Discussion

303. The appellants argued, in summary, that HMRC had not established that a discovery had not been made before Officer Frusher took over the case and that, as the arrangement in this case were the same as those used in other cases where HMRC had reached a decision by 2013, HMRC must have made the relevant discovery in respect of 2011/12 sometime in late 2014 or early 2015, given that the handover note from Officer Shah in mid-July refers to a letter addressing the issues in detail. The appellants' case was that nothing had been put forward to justify a discovery having been made in respect of the later assessments between March 2016 and March 2017.

304. HMRC submitted that, in the handover note from Officer Shah, it is specifically stated that a decision remained to be made and that therefore no relevant discovery had been made before Officer Frusher's discovery shortly before the amendment was issued. There had then been further correspondence and meetings in the intervening twelve months considering the possibility of a charge on the individual members.

305. The Court of Appeal in *Tooth* agreed with the decision of the Upper Tribunal in *Charlton* that a discovery can lose its "essential newness" and that an assessment based on that discovery can therefore be invalid if not made within a reasonable period. In *Charlton* and subsequent cases, delays which have some purpose and are not simply due to inactivity on the part of HMRC have not lost their "essential newness".

306. On the balance of probabilities, I consider that no relevant discovery had been made before Officer Frusher concluded sometime in January 2016 that there were grounds to make the amendment to the 2011/12 partnership statement which was made on 22 March 2016 and raise the 2011/12 discovery assessments on 31 March 2016.

307. The fact that HMRC had formed the view that similar schemes did not work does not mean that they must have concluded the same in respect of these arrangements without analysis of the requested information and documentation. The handover note, in my view, makes it clear that the decision has not been made. The issues in the case may be set out in detail (as noted in respect of the letter referred to in the note), together with the type of information needed in cases such as this, without having come to a relevant discovery. One would expect HMRC to have considered all of the information put to them in a particular case before reaching a conclusion in respect of that case rather than reaching a conclusion based on the unexamined, or inadequately examined, assumption that the case was identical to or similar to those of another taxpayer.

308. Officer Frusher's agreement in cross-examination that various things could have occurred before her involvement does not amount to evidence that such matters did in fact take place.

309. The continuing correspondence during 2016 and the meeting in early 2017 indicates that Officer Frusher was considering the possibility that some further information or evidence may arise from that active communication before making the assessments, in order to consider all of the information available before reaching a decision to make those assessments. This is not a case where HMRC were inactive or where the taxpayers could have been in any doubt as to whether HMRC were pursuing the enquiry.

310. On that basis, even if Officer Frusher had made the relevant discovery in respect of the later assessments in March 2016, when I find that she made the relevant discovery for the 2011/12 amendment and assessments, I do not consider that such discovery would have become stale by the time the remaining assessments were raised in 2017.

Conclusion

311. As set out above, the appellants succeed on Issue 1 such that HFFX's appeals against the amendments to the partnership return for the year ended 31 March 2012, 5 April 2013 and 5 April 2014 succeed. The Individual Appellants' appeals against discovery assessments for the tax years 2011/12 also succeed.

312. HMRC succeed on Issue 2a, such that the Individual Appellants' appeals against the amendments made by discovery assessment for the tax year 2012/13 and closure notices for the tax years 2013/14, 2014/15 and 2015/16 are dismissed. The appellants' appeal that the discovery assessments raised for the tax year 2012/13 were invalid on the basis of staleness is dismissed.

313. HMRC requested that, if they succeeded on Issue 2 but not Issue 1, the assessments against the Individual Appellants for 2012/13 to 2015/16 (other than the closure notice in respect of Stephan Atkins for 2013/14) should be amended to reflect the amounts of Special Capital actually paid in those tax years.

314. s50 TMA 1970 provides, as relevant, that:

> (7) If, on an appeal notified to the tribunal, the tribunal decides
>
> (a) that the appellant is undercharged to tax by a self-assessment
>
> (b) that any amounts contained in a partnership statement are insufficient; or
>
> (c) that the appellant is undercharged by an assessment other than a self-assessment,
>
> the assessment or amounts shall be increased accordingly …
>
> (8) Where, on an appeal notified to the tribunal against an assessment (other than a self-assessment) which-
>
> (a) assesses an amount which is chargeable to tax, and
>
> (b) charges tax on the amount assessed,
>
> the tribunal decides as mentioned in subsection (6) or (7) above, the tribunal may … increase only the amount assessed; and where any appeal notified to the tribunal is so determined the tax charged by the assessment shall be taken to have been reduced or increased accordingly.

315. As no objection was raised as to the amounts stated to have been paid as Special Capital for the relevant periods, I conclude that the amounts assessed shall be increased as set out in the table in Appendix 1 below.

Rule 14 Application by the Appellants

316. A draft decision was provided to the parties, given the length and complexity of the issues in this matter.

317. On 10 November 2020 the Appellants made a formal application, under Rule 14 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 for the Appendix included in the draft decision to be redacted on the basis that:

> (1) The figures are confidential and commercially sensitive and there is no need for them to be contained within any published decision;
>
> (2) The Appellants had anticipated agreeing figures with HMRC once the decision had been handed down on the substantive issues.

318. The Appellants argued that the reasoning in *BCM Cayman LP v HMRC* [2020] UKFTT 0298 (TC) ("*Bluecrest*") that the test was of one exceptionality, as in cases of anonymity, was incorrect as there was an obvious difference between anonymity and redaction of figures. Further, the relevant figures in *Bluecrest* had appeared in an agreed statement of figures provided to the Tribunal and relied upon by the parties. In

contrast, in this case the figures were not in a statement of agreed facts nor in HMRC's statement of case. The figures were in an appendix to HMRC's skeleton argument but it was submitted that this was only for the purposes of correcting errors in relation to Issue 2. Both parties made their submissions without reference to the figures.

319. The Appellant submitted that the correct approach to an application for redaction of commercially sensitive information is set out in *Unwired Planet International Ltd v Huawei Technologies Co Ltd (No.3)* [2018] RPC 8 per Birss J. at §§23-24:

> "23. … There is therefore a strong principle that all parts of a judgment should normally be publicly available. Nevertheless there are occasions on which judgments may be redacted. Redactions will require powerful reasons, supported by cogent evidence which addresses the details. Generalities will not do … In any event however redactions must be kept to the bare minimum.
>
> 24. Factors which will be relevant include:
>
> (i) The nature of the information itself: for example cases in which some redaction may more readily be accepted could include technical trade secrets and private information about family life.
>
> (ii) The effect of the publication of the information. This will be a critical factor. If publication would be truly against the public interest then no doubt the information should be redacted. If publication would destroy the subject matter of the proceedings – such as a technical trade secret – then redaction may be justified. The effect on competition and competitiveness could be a factor but will need to [be] examined critically.
>
> (iii) The nature of the proceedings: for example privacy injunctions and competition law claims may require some redaction while an intellectual property damages claim may not. The point is not that different kinds of case demand a different approach, it is that the balance of factors will change in different cases (e.g. the need to encourage leniency applications in competition law).
>
> iv) The relationship between the information in issue and the judgment (as well as the proceedings as a whole). Obviously judges do not deliberately insert irrelevant information into judgments but not every word of a judgment is as important as every other word. It may be that some sensitive information can be redacted without seriously undermining the public's understanding of the reasons.
>
> (v) The relationship between the person seeking to restrain publication of the information and the proceedings themselves (including the judgment). For example, a patentee seeking damages for patent infringement on a lost profit basis knows that they will have to disclose their profit margin in the proceedings and that those proceedings are public. A third party whose only relationship with the case is that they are a party to a contract disclosed by one of the parties to the litigation is in a different position."

320. The Appellants submitted that:

(1) The numbers are not required in order to fully understand the decision;

(2) The only figures included in the Appendix are those correcting the amount of the assessments where HMRC had previously made an error in underassessing;

(3) The figures are commercially sensitive as many of the Appellants continue to work together and revealing pay discrepancies may have a deleterious effect on the team. The information may also benefit competitors.

321. The Appellants requested that, if the Tribunal was not minded to grant the Rule 14 Application, the figures should be redacted pending an appeal so that such an appeal was not rendered nugatory.

322. HMRC provided representations in reply on 5 January 2020, objecting to the application as the figures in the Appendix formed part of the decision and should be published in the interests of open justice.

323. HMRC submitted that the test was one of exceptionality, as noted in *A v HMRC* [2012] UKFTT 541 at §6:

> "The usual practice in this tribunal is not only to hold its hearings in public, but also to make no attempt to conceal, either during the course of the hearing or in its published decisions, the details of a taxpayer's income and other financial circumstances relevant to the appeal. Redaction of such details was … exceptional."

324. Similarly, in *HMRC v Bannerjee (No. 2)* [2009] EWHC 1229 (Ch) at §§34-35:

> "34. … any taxpayer has a reasonable expectation of privacy in relation to his or her financial and fiscal affairs, and it is important that this basic principle should not be whittled away. However, the principle of public justice is a very potent one, for reasons which are too obvious to need recitation, and in my judgment it will only be in truly exceptional circumstances that a taxpayer's rights to privacy and confidentiality could properly prevail in the balancing exercise that the court has to perform.
>
> [35] It is relevant to bear in mind, I think, that taxation always has been, and probably always will be, a subject of particular sensitivity both for the citizen and for the executive arm of government. It is an area where public and private interests intersect, if not collide; and for that reason there is nearly always a wider public interest potentially involved in even the most mundane seeming tax dispute. Nowhere is that more true, in my judgment, than in relation to the rules governing the deductibility of expenses for income tax. Those rules directly affect the vast majority of taxpayers, and any High Court judgment on the subject is likely to be of wide significance, quite possibly in ways which may not be immediately apparent when it is delivered. These considerations serve to reinforce the point that in tax cases the public interest generally requires the precise facts relevant to the decision to

> be a matter of public record, and not to be more or less heavily veiled by a process of redaction or anonymisation. The inevitable degree of intrusion into the taxpayer's privacy which this involves is, in all normal circumstances, the price which has to be paid for the resolution of tax disputes through a system of open justice rather than by administrative fiat."

325. Further, the Court of Appeal in *R (Mohamed) v Foreign Secretary* (No 2) [2010] EWCA Civ 158 noted at §176 that:

> … the court should administer justice in public, which means that all parts of a judgment should be publicly available, unless there is a very powerful reason to the contrary. This principle is so important not merely because it helps to ensure that judges do not, and do not appear to, abuse their positions, but also because it enables information to become available to the public. What goes on in the courts, like what goes on in Parliament or in local authority meetings or in public inquiries, is inherently of legitimate interest, indeed of real importance, to the public. Of course, many cases, debates, and discussions in those forums are of little general significance or interest, but it is not for the judges or lawyers to pick and choose between what is and what is not of general interest or importance …
>
> 184 … In any case where a judgment is being given, there is a significant public interest in the whole judgment being published …

326. HMRC also submitted that the Court of Appeal in *Mohamed* had found that even if the redaction sought does not affect the conclusions in the decision, that did not justify redaction:

> 177 … if one deletes the redacted paragraphs from the first judgment, the main conclusions reached by the court would remain the same, and the deletion would not even affect a fair summary of the reasons for those conclusions. … To that extent, they were not "necessary", but the fact remains that the redacted paragraphs were part of the court's reasoning, and litigants should not be entitled to challenge the appropriateness of the court including a statement in a judgment simply on the ground that it is not a strictly necessary ingredient of the reasoning."

327. HMRC submitted that the Appendix forms part of the decision and the figures cannot be regarded as irrelevant to the decision. The figures are the amendments sought by HMRC to the appellants' self-assessments in the closure notices under appeal and so are the subject matter of the appeal. HMRC submitted that the removal of the figures would prevent the public from knowing what the appeal was about and what the Tribunal has actually done, in terms of the variations made.

328. HMRC further submitted that the Appellants had no basis for agreeing figures with HMRC after the decision was handed done; HMRC had sought that the Tribunal uphold the amendments and assessments with these variations. If the Appellants disputed the figures, they should have done so earlier. Although the Appellants had referred to errors, they noted only one typographical error. Such errors can and should be dealt with by revision of the draft decision.

329. HMRC submitted that the principles set out in *Unwired Planet* should be considered against the context of that case, which involved intellectual property litigation between private commercial parties. As such, the only public interest engaged was that of open justice. Even so, the court considered that (at §24(v)):

> "a patentee seeking damages for patent infringement on a lost profit basis knows that they will have to disclose their profit margin in the proceedings and that those proceedings are public"

330. HMRC submitted that, in this case, the figures sought to be redacted are comparable to the profit margin in that comment. In contrast, in tax litigation, there are other public interest matters to be considered including the public interest in understanding how tax legislation is applied. Removing the figures would disembody the report and make it harder for the public to understand its significance.

331. Further, HMRC submitted that another aspect of public interest is the perception that the Tax Tribunals treat rich and poor alike. Published decisions typically include the figures for the tax in dispute. In *A v HMRC,* Judge Bishopp noted that (§14):

> There is an obvious public interest in its being clear that the tax system is being operated even-handedly, an interest which would be compromised if hearings before this tribunal were in private save in the most compelling of circumstances. The fact that a taxpayer is rich, or that he is in the public eye, do not seem to me to dictate a different approach; on the contrary, it may be that hearing the appeal of such a person in private would give rise to the suspicion, if no more, that riches or fame can buy anonymity, and protection from the scrutiny which others cannot avoid. That plainly cannot be right."

332. With regard to the specific reasons given for the application, HMRC submitted that:

(1) The information is no longer confidential as between the Appellants: it was included In HMRC's skeleton argument and other similar information was included in the closure notices in the trial bundles and has been included in the draft decision provided to the parties. Even if the information has not been provided to all of the Appellants, they would be entitled to request the information from their solicitors and so it is not confidential from them, even if they have not exercised their right to obtain it.

(2) Any impact as between the Appellants will only arise as a result of the information being instantly available rather than being available to be requested from their solicitors.

(3) The information relates to payments made between four and seven years ago, originating at a different firm to that in which some of the Appellants are now members. This is not information which has such commercial sensitivity as to justify redaction.

333. HMRC accepted that the relevant figures show only the variations to the original assessments, and not the original assessment figures. As such, for some appellants no information is provided either because variation was sought only on the

issue on which the Appellants have succeeded or because no variation was sought. There is, accordingly, some randomness between the treatment of individual appellants. HMRC therefore submitted that, in the alternative, if the individual figures are to be redacted, that the global figure of tax payable as a result of the decision should be provided. They submitted that this would meet some of the relevant public interests engaged without providing the details which concern the Appellants.

334. Having considered the arguments of the parties, I consider that the Appendix should not be redacted. I do not agree that the "powerful reasons [and] evidence" required for redaction as noted in *Unwired Planet* are present: in particular, the information is question is now several years out of date and the Appellants should have known that the information would need to be disclosed in public proceedings. The fact that some of the Appellants may not have received all of the information to date is irrelevant, as I agree that they would be entitled to receive the information if they requested it.

335. Nevertheless, as in *Bluecrest* and other similar cases, I have redacted the figures in the Appendix to avoid rendering nugatory an application for permission to appeal by the Appellants.

336. HMRC requested that the appeal period in respect of this decision in relation to the Rule 14 Application be shortened to 7 days to enable a full decision to be published if no appeal is made. That request is denied; I do not consider that the inconvenience of publishing an updated decision if no appeal is made justifies shortening the appeal period set out in the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009.

337. 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.

ANNE FAIRPO
TRIBUNAL JUDGE
RELEASE DATE: 08 FEBRUARY 2021

Appendix 1 – decisions appealed

Appellant	Decision appealed	Amended amount of Special Capital

		assessed
HFFX LLP	Discovery amendment issued under s30B TMA 1970 to partnership return for year ended 31 March 2012	[redacted]
	Closure notice amendments under s28B TMA 1970 to partnership returns for years ended 5 April 2013 and 5 April 2014	[redacted]
Stephan Atkins	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Yuri Bedny	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Paul Bereza	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Alexander Gerko	Discovery assessment under s29 TMA 1970 for tax year 2011/12	[redacted]
	Discovery assessment under s29 TMA 1970 for 2012/13	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]

	Partial closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Philip Howson	Discovery assessment under s29 TMA 1970 for tax year 2011/12	[redacted]
	Discovery assessment under s29 TMA 1970 for 2012/13	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Renat Khabibullin	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Joshua Leahy	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Jacob Metcalfe	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Alex Migita	Discovery assessment under s29 TMA 1970 for tax year 2011/12	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]

	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Dmitry Shakin	Discovery assessment under s29 TMA 1970 for tax year 2011/12	[redacted]
	Discovery assessment under s29 TMA 1970 for 2012/13	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Andonis Sakatis	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Christopher Shucksmith	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]
Evgeny Tanhilevich	Discovery assessment under s29 TMA 1970 for tax year 2011/12	[redacted]
	Discovery assessment under s29 TMA 1970 for 2012/13	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2013/14	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2014/15	[redacted]
	Closure notice amendment under s28A to tax return for tax year 2015/16	[redacted]