[2019] UKUT 0226 (TCC)

Appeal number: UT/2017/0150
UT/2017/0151

INCOME TAX AND CORPORATION TAX — LLPs established to carry on activities relating to the production of films and games – individual members of the LLPs making capital contributions for membership – funding also coming from commissioning distributor – Whether activities carried on by the LLPs constituted a trade – Whether activities of the LLPs carried on with a view to profit – Whether expenditure incurred by the LLPs equal to 100% of production budget of film or game – Whether expenditure incurred wholly or exclusively for purposes of LLPs' trade – Whether LLPs' accounts compiled in accordance with generally accepted accounting practice – Whether LLPs' expenditure on film and games rights was capital expenditure for tax purposes – Income Tax (Trading and Other Income) Act 2005, ss 25, 26, 33, 34, 863 – Corporation Tax Act 2009 ss 46, 47, 53, 54, 1262, 1273

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

INGENIOUS GAMES LLP

INSIDE TRACK PRODUCTIONS LLP

INGENIOUS FILM PARTNERS 2 LLP

Appellants / Respondents

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents/ Appellants

TRIBUNAL: MRS JUSTICE FALK
JUDGE TIM HERRINGTON

Sitting in public at The Royal Courts of Justice, Rolls Building, Fetter Lane, London EC4 on 4-7, 11-14, 18, 22 and 25-28 March, 1-5 and 8-10 April 2019

Pushpinder Saini QC, David Milne QC, Richard Vallat QC, James Rivett QC, Edward Waldegrave and George Molyneaux, Counsel, instructed by White & Case LLP, for the Appellants ("the LLPs")

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GLOSSARY

Terms

Approved Production Budget	the budget agreed for the production of a film as set out in the relevant PSA
Approved Cashflow	the schedule attached to a PSA which phased the receipts of money into the Production Account over the period of the making of the film
BR	Borrower's Receipts, being 50% of the relevant LLP's receipts under the Waterfall
BDR	Borrower's Distributable Receipts, a percentage (varying with GDI) of BR
Completion Guarantor	an entity (being an associate of the CD for Studio films) which guaranteed to complete the relevant film on budget or abandon it and return monies to the parties
CD	a Hollywood studio or vehicle formed by independent producers and other financiers and which entered into contractual arrangements with an LLP in relation to the production and distribution of a film
CDA	a commissioning and distribution agreement entered into between a CD and an LLP in relation to the production and distribution of a film
CM	in relation to an LLP, its corporate member
Commissioning Distributor Model	a structure developed by Ingenious and constituted by the suite of agreements referred to in this decision (see [16] and [82] below)
CTA 2009	Corporation Tax Act 2009
Decision	the decision of the FTT initially released on 2 August 2016, as revised and corrected, and which is the subject of these appeals
Deed of Acknowledgement etc.	a deed incorporating a notice of assignment and irrevocable payment instruction pursuant to which monies equal to BDR or BR under the Waterfall were agreed to be directed to be retained by the CD
EP	an Ingenious company which agreed to render Executive Producer services in relation to a film or

	game in exchange for a fee of 5% of the budget for the film or game (the EP fee)
FTT	First-tier Tribunal (Tax Chamber)
Further Decision	the decision of the FTT released on 17 May 2017 which is also the subject of these appeals
GAAP	generally accepted accounting practice
GDI	gross distributable income, the term used in the Waterfall to describe the income remaining for distribution after the deduction of certain fees and expenses
Green-lighting	the process through which an LLP's involvement in a film would be approved, undertaken on behalf of the LLP through an executive committee referred to in this decision as the Green-lighting committee
HMRC	The Commissioners for Her Majesty's Revenue and Customs
independent film	a film other than a Studio film, namely where the CD was a vehicle formed by independent producers and other financiers, rather than being a Hollywood studio
Ingenious	the Ingenious Media Group and the individual companies comprised in that group
Ingenious Basis	the basis on which the LLPs computed their profits and losses, the LLPs assuming that they would incur the full budgeted cost of the film or game and would earn income which included amounts which were paid to or retained by the CD in reduction of the indebtedness of the CM, such income being no more than 54.45% of GDI
Ingenious company	a member of the Ingenious Media Group of companies
IG	Ingenious Games LLP
ITA 2007	Income Tax Act 2007
ITTOIA 2005	Income Tax (Trading and Other Income) Act 2005
ITP	Inside Track Productions LLP
IFP2	Ingenious Film Partners 2 LLP

LLPA 2000	Limited Liability Partnerships Act 2000
Loan Agreement	an agreement entered into between the CM and the CD pursuant to which the CD advanced funds which were paid directly to the PSC and which constituted 65% or 70% of the Approved Production Budget
LLPs	together IG, ITP and IFP2, appellants in these appeals
NRV	the net realisable value of a film or game as shown in the accounts of an LLP
Operator	an Ingenious company which acted as the operator of an LLP
Production Account	a bank account of the PSC into which the amount of the Approved Production Budget was paid
Production Funds	the cost of production of a film in an amount equal to the Approved Production Budget
PSA	a production services agreement entered into between an LLP and a production services company in relation to the making of a film, which broadly speaking mirrored the production obligations contained in the CDA relating to the film
PSC	a special purpose vehicle associated with a CD and which made a film pursuant to the terms of a PSA
Studio film	a film the CD for which was a Hollywood studio
Waterfall	the terms under which income (or receipts) from a film or game reaches those with an interest in it – some being entitled to income or reimbursement before others
WWBO	the worldwide box office receipts of a film
2010 Ultimates	calculations prepared by Ingenious for HMRC in 2010 of estimated ultimate receipts in relation to certain films in which the LLPs were involved
30:30 Basis	the FTT's preferred approach to the income arising and expenditure incurred under the contractual arrangements, under which the LLPs incurred 30% of the cost of a film or game and earned 30% of GDI

People

Mr Briggs	Eric Briggs of FTI Consulting Inc, an expert in forecasting the future income of films, one of the experts instructed by the LLPs in that regard
Mr Cannon	Richard Cannon, a chartered accountant employed by HMRC, the accountancy expert instructed by HMRC
Mr Clayton	James Clayton, who was Chief Executive of the Investment division of Ingenious until 2014
Mr Finney	Angus Finney, a writer, lecturer and specialist in the film industry, the expert instructed by HMRC in relation to the forecasting of income and profitability of films
Mr Holgate	Peter Holgate, a chartered accountant who had until 2013 been senior technical partner at PwC, one of the accountancy experts instructed by the LLPs
Mr McKenna	Patrick McKenna, the founder and Chief Executive of Ingenious
Mr Olsberg	Jonathan Olsberg, a management consultant specialising in the film industry, an expert instructed by the LLPs in relation to the forecast of the profitability of three films
Mr Reid	Duncan Reid, the commercial director of Ingenious
Mr Sills	Steven Sills of Green Hasson Janks LLP, an expert with experience in the auditing of profit participations from films, instructed by HMRC
Mr Steadman	Luke Steadman, a chartered accountant, head of the forensic investigations team at Alvarez & Marsal Global Forensic and Dispute Services LLP, one of the accountancy experts instructed by the LLPs

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DECISION

I. INTRODUCTION AND BACKGROUND

Introduction

1. This is the appeal of Ingenious Games LLP ("IG"), Inside Track Productions LLP ("ITP") and Ingenious Films Partners 2 LLP ("IFP2") (together, the "LLPs"). There is also a cross-appeal by HMRC. The appeal and cross-appeal are against two decisions of the First-tier Tribunal (the "FTT") (Judge Hellier and Mr Julian Stafford), the first of which was released on 2 August 2016 (the "Decision") and the second of which was released on 17 May 2017 (the "Further Decision"). The Decision was subject to further iterations upon review and, following that review and the correction of clerical errors and accidental slips or omissions under the slip rule, the final version of the Decision was released on 6 November 2017.

2. The appeal to the FTT was against closure notices issued to the LLPs by HMRC which amended their partnership tax returns to deny their claims for trading losses in successive tax years 2002-03 to 2009-10[1]. The Decision dealt with the question of whether and to what extent the LLPs' respective claims for trading losses in those tax years should be allowed. The Further Decision dealt with the question of whether those losses, so far as the Decision concluded they had been incurred, were revenue or capital in nature.

3. Investment in the LLPs was promoted by members of the Ingenious Media Group ("Ingenious") to individual high net worth investors. Between them the LLPs were involved in the production of a large number of films and video or computer games.

4. The determination of the tax position of any individual member of any of the LLPs is not within the scope of this appeal. However, determination of the questions that arise on this appeal is critical to establishing whether and to what extent sideways loss relief, pursuant to s 380 Income and Corporation Taxes Act 1988 and latterly s 64 Income Tax Act 2007, is available to the individual members of the LLPs, such that, as argued by the LLPs when promoting investment in the LLPs, they can offset their respective shares of the losses against other income for the relevant tax year.

5. The appeals of the LLPs are lead appeals for five follower LLPs. Collectively the loss claims in dispute, including the loss claims made by the follower LLPs, amount to over £1.6 billion, though the LLPs say that some of the tax at stake was, and all of that tax could be, recovered by HMRC as and when the LLPs make taxable profits.

6. The FTT found in the Decision that ITP and IFP2 were carrying on a trade and therefore incurred trading losses in the tax year in question, but to a smaller extent than claimed. The FTT also held that the trade that it found these LLPs were carrying

[1] 2002-03 to 2005-06 for ITP, 2005-06 to 2009-10 for IFP2 and 2005-06 to 2008-09 for IG.

on was carried on with a view to profit. HMRC argued that it followed from the FTT's findings that most of the limited expenditure found by the FTT to have been incurred was capital expenditure which could not create a trading loss. The FTT agreed with this in the Further Decision. On that basis, ITP and IFP2's trading losses as calculated for income tax purposes were limited to a relatively modest operating fee. Consequently, approximately 97% of the losses claimed by ITP and 96% of the losses claimed by IFP2 have been disallowed.

7. The FTT found in the Decision that IG was not carrying on a trade, and accordingly all of its losses were disallowed.

Relevant legislation

8. It is helpful at this stage to provide an overview of the statutory regime for the taxation of LLPs which was applicable during the tax years with which these appeals are concerned. We refer to the legislation as it was in force during the latest of the tax years in question; there is no material difference from the earlier legislation.

9. For income and corporation tax purposes an LLP is treated as a partnership (and its members as partners) provided it is carrying on a trade, profession or business "with a view to profit": see s 863(1) Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005") for income tax purposes and s 1273 Corporation Tax Act 2009 ("CTA 2009") for corporation tax purposes.

10. For these purposes, "trade" includes "any venture in the nature of trade": see s 989 Income Tax Act 2007 ("ITA 2007") and s 1119 Corporation Tax Act 2010 ("CTA 2010"). There is no further statutory definition of trade, the meaning of which has been developed through case law, to which we refer in some detail later.

11. The profits and losses of a partnership trade (including an LLP that is treated as a partnership) are calculated and taxed as follows:

> (1) where the partnership has a partner liable to income tax, the profits and losses of the trade are calculated as if the partnership were an individual: see s 849 ITTOIA 2005; and
>
> (2) where the partnership also has a partner liable to corporation tax, the profits and losses of the trade must also be calculated as if the partnership were a company chargeable to corporation tax: see s 1259 CTA 2009.

12. Each partner's share of profits or losses of the trade is determined in accordance with the partnership's profit-sharing arrangements: see s 850(1) ITTOIA 2005 and s 1262 CTA 2009.

13. Section 25(1) ITTOIA 2005 provides that the profits of a trade must be calculated in accordance with generally accepted accounting practice ("GAAP"), subject to any adjustment required or authorised by law in calculating profits for income tax purposes. Section 46 CTA 2009 sets out the corresponding provisions for corporation tax purposes. The same rules apply in calculating losses, subject to any express provision to the contrary: see s 26 ITTOIA 2005 and s 47 CTA 2009.

14. The relevant provisions for such adjustments required by law in the present case are as follows:

(1) s 33 ITTOIA 2005 and s 53 CTA 2009, which provide that in calculating the profits of a trade, no deduction is allowed for items of a capital nature; and

(2) s 34 ITTOIA 2005 and s 54 CTA 2009 which provides that in calculating the profits of a trade, no deduction is allowed for expenses "not incurred wholly and exclusively for the purposes of the trade", save for an identifiable part or identifiable proportion of the expense that is so incurred.

15. The effect of the legislative regime at the relevant time was that individual members/partners could claim relief for the trading losses allocated to them (subject to certain specific anti-avoidance provisions for partnership losses). Those losses could be set off against the individual's general income pursuant to s 380 of the Income and Corporation Taxes Act 1988 and latterly s 64 ITA 2007, commonly known as sideways loss relief[2].

Business model

16. Before turning to the issues dealt with by the FTT, we provide a brief summary of the business model within which the LLPs operated and the primary contentions of the parties in relation to the effect of those arrangements. We examine the precise contractual terms of the various agreements entered into by the respective parties to implement the arrangements in further detail later. The arrangements for films and games were broadly similar. In a nutshell, the arrangements for films were as follows:

(1) Each LLP had a number of individual members, to whom investment in the relevant LLP had been promoted through an Information Memorandum prepared and approved by an Ingenious company, and a single corporate member ("CM") which was either a special purpose company controlled by Ingenious or a special purpose company owned by a charity.

(2) The individual members made subscriptions (capital contributions) to the LLP for their membership.

(3) Each LLP had an operator, another Ingenious company, which charged a fee for its services (the "Operator").

(4) The arrangements through which the LLPs became involved in the production of films followed a complex structure developed by Ingenious and known as the Commissioning Distributor Model. This structure was constituted by a suite of agreements which included those referred to at (9) to (14) below, and which were all entered into at the same time in relation to each film.

[2] Subject to meeting the additional requirements set out in the legislation.

(5) In relation to each film (with a nominal budgeted cost of 100) 30 (or 35 in the case of ITP) of the budgeted cost was sourced from the subscriptions of individual members of the LLP.

(6) The remaining 70 (65) was sourced from a commissioning distributor ("CD") which was a Hollywood studio or a vehicle formed by independent producers and other financiers.

(7) The combined 100 was provided to a production services company ("PSC"), a special purpose vehicle associated with the CD. The PSC made the film in accordance with an agreed specification, as described at (12) below.

(8) When the film had been made it was distributed by the CD, and the proceeds of distribution were divided in accordance with the terms of a "waterfall" that specified who should receive what and in what order, and under which amounts were to be paid to the LLP and paid to, or retained by, the CD (the "Waterfall").

(9) A loan agreement was entered into between the CD and the CM pursuant to which the CD agreed to lend 70 (65) to the CM, stated to be to enable a capital contribution to the LLP. Amounts advanced were to be paid direct to the PSC. The loan was expressed to be repayable from part (or all in the case of ITP) of the CM's drawings from the LLP.

(10) By a commissioning and distribution agreement ("CDA") the CD agreed with the LLP that the LLP would make the film in accordance with (i) an approved budget of 100, (ii) an approved cashflow and (iii) a detailed specification.

(11) The CDA provided that with effect from the delivery of the film on its completion, the LLP assigned to the CD all its rights to the film, and the benefit of any agreements with third parties in respect of the film. Until such assignment, the LLP granted the CD a sole and exclusive licence of its rights to the film.

(12) By a production services agreement ("PSA") the LLP agreed with the PSC for the making of the film in accordance with the same detailed specification and approved budget.

(13) The PSA provided that the PSC assigned to the LLP with immediate effect substantially all its rights to the copyright in the film, all physical materials embodying such copyright and the right to exploit the film.

(14) The PSC entered into an Executive Producer Agreement with an Ingenious group company (the "EP") under which the EP agreed to render to the PSC Executive Producer services in exchange for a fee of 5% of the budget for the film.

(15) The combined cash effect of those documents was broadly that after they had been signed: (i) the CD would pay 70 (65) to the PSC and the LLP would pay 30 (35) to the PSC; (ii) 30% (35%) of the income arising

from the film after the deduction of certain costs and fees would be paid to the LLP[3].

17. The LLPs contend that the legal, accounting and taxation effect of these arrangements can be summarised as follows:

(1) Each LLP had capital of 100 (using the illustrative figures in [16] above), consisting of the amounts contributed by the individual members and the CM.

(2) Each LLP incurred expenditure of 100 in making a film pursuant to its obligations under the relevant CDA (and discharged those obligations by sub-contracting to the relevant PSC).

(3) The LLP acquired a beneficial ownership interest in the copyright to the film as it was made.

(4) Each film was stock which was, on completion, sold to the CD in return for the amounts specified in the Waterfall as due to the LLP, the amounts receivable by the LLP amounting to up to 54.45% of the gross distributable income derived from the film.

(5) The LLPs intended to make a profit from the films and there was a realistic possibility that they would do so.

(6) The LLPs were carrying on a trade and doing so with a view to profit.

(7) For accounting purposes, each film had to be valued (at each accounting period end) at its "net realisable value" ("NRV"). NRV was individually calculated for each film, but on completion of the film might typically be 20% of cost. This gave rise to a significant loss in the first period.

(8) In later periods, profits would arise as amounts in excess of the NRV were received under the relevant Waterfall. From a tax perspective, given that it was expected that the LLP would generate such profits, the effect of the accounting treatment combined with the allocation of losses/profits to individual members would give rise to a reduction in income tax liabilities for those members in the early years, but this reduction would be reversed as the film generated taxable profits. In other words, the anticipated tax benefit was a deferral of tax (from the early loss-making years to the later profitable years), not an absolute reduction in tax.

18. HMRC contend that the LLPs' position does not reflect the substance and reality of the arrangements entered into by them. They contend that the arrangements were

[3] In the remainder of this decision we will refer predominately to 70 and 30 rather than 65 and 35, but unless the comment is specific to IFP2 or IG these references should be taken as encompassing references to the equivalent figures of 65 and 35 for ITP.

designed to generate first-year losses and to facilitate claims by the investors for sideways loss relief in respect of those losses, but the correctness of those claims depends upon whether, having regard to the substance and reality of the arrangements entered into by the LLPs, the following legislative conditions were satisfied:

(1) the conditions for sideways loss relief, which is only available in respect of trading losses, so that it is only if the LLP is trading that the members were entitled to offset their respective shares of the LLP's losses against other income in that manner;

(2) the conditions for the LLP to be taxed as a partnership (essentially, on a transparent basis rather than as a body corporate); it is only if the LLP is carrying on a trade with a view to profit that this condition can be satisfied; and

(3) the condition that the expenditure claimed by each LLP in the computation of its taxable profits and losses must be properly deductible for income tax purposes, as provided by the statutory provisions referred to at [13] and [14] above.

19. HMRC contend that what the activities of the LLPs and the transactions which they entered into amounted to can be encapsulated in the following seven short propositions:

(1) The LLPs were used by Ingenious as vehicles through which to raise finance for investment in films and games, which Ingenious was to identify.

(2) In the course of that activity, the LLPs generated for Ingenious substantial fees from individual investors.

(3) The finance raised by the LLPs would ultimately buy them a potential income stream under the Waterfall.

(4) The size of the LLPs' share in the Waterfall broadly reflected the size of their contribution to the budget of the film or game concerned. They put up 30% of the budget and they were entitled to 30% of the Waterfall.

(5) The LLPs thereafter retained their rights under the Waterfall indefinitely. They were not traded but they received such income as might flow from those rights.

(6) The majority of the income would arise in the first five years, though the rights lasted as long as the business lasted, and monies could be paid under the Waterfall for a long period.

(7) The LLPs did not have to recoup their costs before individual investors started to make a positive after-tax return. Virtually any film income from the Waterfall secured an after-tax profit for an investor.

20. As a consequence, HMRC contend that the substance and reality of the arrangements was as follows:

(1) None of the LLPs was carrying on a trade but merely bought and then held rights in a potential income stream from a film, which was an investment and not a trading activity.

(2) The LLPs were not carrying on business with a view to profit. Rather, their businesses were being conducted with the objective of providing tax shelter for their individual investors on the basis that any amount of income, not profit, would make an investment in that tax shelter a viable proposition and generate fees for the Ingenious group.

(3) The LLPs did not incur 100% of the budget but only the 30% of the budget that their investors actually contributed.

(4) The LLPs did not compute the losses in accordance with GAAP, because their accounts did not recognise the substance of what they had done.

(5) What the LLPs acquired were capital rights under the Waterfall which they did not intend to sell, with the result that no income tax losses could arise in respect of those assets in any event.

The issues before the FTT

21. Six issues emerged before the FTT for determination of the appeals, in the light of the statutory provisions referred to at [9] to [15] above. We set them out at [25] to [36] below with a brief summary of the FTT's decision on each of them. The first five of these issues were the subject of the Decision, and the sixth was the subject of the Further Decision. References to paragraphs in square brackets are, unless specified otherwise, references to paragraphs in the relevant FTT decision.

22. The FTT had to assimilate and analyse a vast amount of evidence and submissions which were made to it during the course of a series of hearings extending over more than a year and taking some 48 days. Both the Decision and the Further Decision demonstrate clearly that the FTT took a meticulous approach to its analysis of the evidence and the parties' submissions, as reflected in the fact that the Decision extends for some 343 pages, comprising 1826 paragraphs.

23. The FTT's decisions on the issues before it were informed by its conclusions on the construction of the suite of agreements referred to above. We refer to those conclusions and the FTT's reasoning in detail later but, in summary, the FTT concluded as follows (see [227] in particular):

(1) The CM was not obliged to contribute capital to the LLPs, and in the case of ITP it was unclear whether the CM in fact contributed capital. The FTT doubted whether the payment by the CD under the Loan Agreement of 70 to the PSC constituted the making of a capital contribution. Further, whether or not the CM made a capital contribution to the LLP, its rights to profits and drawings and on a winding up were unaffected.

(2) The LLPs were not contractually liable for 100% of the budgeted cost of each film or game. Their obligation was limited to pay no more than 30 to the PSC and that liability arose only once the whole of the 70 was paid.

(3) The LLPs had a right to receive from the CD only a share of the gross distributable income of the film after those amounts had been reduced by sums payable to the CD in respect of the repayment of the monies lent by the CD to the CM under the terms of the loan agreement, a share which the FTT found to amount to 30% of gross distributable income.

(4) The LLPs did not acquire any rights in the films (or games) beneficially, and they were or were equivalent to mere trustees in respect of such rights as they held.

24. The FTT referred to its preferred approach to the income arising and expenditure incurred under the contractual arrangements as the "30:30 Basis", as opposed to the approach contended for by the LLPs (that is at most 54.45% of the income in return for 100% of the expenditure), which it referred to as the "Ingenious Basis". We will also adopt those terms for the purposes of this decision.

(1) Whether the LLPs were trading (the "Trading Issue")

25. The FTT concluded that the contracts gave effective creative control over the production of the film to the CD, and that in practice Ingenious regarded the creative aspects of the production of the film as settled at the time the agreements were signed. Consequently, the LLPs did not interfere in any substantial way with the production of the film: see [350], [352] and [421] of the Decision.

26. Nevertheless, the FTT did find on the 30:30 Basis, in relation to ITP and IFP2, that their activities did amount to a trade. At [435] it found that in commercial substance those LLPs paid and were obliged to pay 30% (35%) of the budgeted cost of a film and received and were entitled to receive 30% (35%) of gross distributable income of the film, and that was a genuine commercial deal. They concluded on balance that the Operator did more than act as an investment manager of a portfolio of investments: through its actions and those of its agents the LLPs engaged in speculative, organised, repeated transactions in a way which involved work beyond that which would have been involved in the mere making of an investment: see [438] of the Decision.

27. The FTT held at [436] that had it found that the legal effect or commercial substance of the transactions was to be determined on the Ingenious Basis, then it would find that the deal was not commercial and therefore did not amount to a trade.

28. The FTT held at [454] that on the 30:30 Basis the fiscal motive of the LLP did not denature the activity as a trading transaction, but it held at [456] that if the Ingenious Basis was the correct analysis then it would conclude that the transactions lacked commerciality and that the fiscal motive of the LLPs when taken in the balance would mean that they were not trading.

29. The FTT found that the way that IG operated was different to ITP and IFP2, and concluded at [1233] that although the activity of IG involved some organisation, some modest repetition and was speculative in nature, overall and on balance it was "more the acquisition of a few financial assets dressed in a complex contractual framework than the conduct of trade".

(2) Whether the LLPs were carrying on their activities with a view to profit (the "View to Profit Issue")

30. At [827] the FTT held that it was "not persuaded" that the intention of those managing an LLP was to conduct its business so as to make a profit on the Ingenious Basis or that their view was that it would be so managed. They stated at [828] that "if the relevant test was simply whether the subjective intentions of the LLPs were to deliver a profit on the Ingenious Basis we would find that it was not proved that such was the case". It also concluded at [829] that it was unrealistic to hope for profit calculated on the Ingenious Basis.

31. At [830], however, it found that "an expectation of a profit calculated on the 30:30 Basis was realistic and not fanciful". It found at [833] that Ingenious' personnel had a view of the 30:30 result when the film contracts were entered into and as a result, the business conducted by the LLP was conducted with a view to obtaining that result and with the hope of a profit on that basis.

(3) Whether the LLPs incurred expenditure equal to 100% of the budget of the film or game (the "Incurred Issue")

32. At [882] the FTT held, applying what it said was a realistic view of the facts which a purposive interpretation of s 34 ITTOIA required, that "incurred" was concerned with whether the taxpayer bore the economic burden of an expense. On the basis of its analysis of the LLPs' obligations the only economic burden they suffered was the outflow of 30, and that was all that was incurred.

(*4) Whether the LLPs' expenditure was incurred wholly and exclusively for the purposes of their trade or business (the "Wholly and Exclusively Issue")*

33. At [883] the FTT held that if it could be said that the LLPs incurred expenditure of 100 then 70 (65) of that expenditure was not incurred for the purposes of the LLPs' business but for the purpose of providing a benefit to the CD of enabling the CD to reap a share of the benefits from the exploitation of the films.

34. At [892] the FTT concluded that if it was correct that the legal and economic deal was an investment of 30 for 30% of gross distributable receipts, then save for the 5% EP fee the expenditure of 30 was wholly and exclusively incurred for business purposes.

(5) Whether the LLPs' losses were computed correctly as a matter of GAAP (the "GAAP Issue")

35. The FTT concluded at [1106] that the accounts of the LLPs did not comply with GAAP. Changes were required in order to produce profits and losses computed in accordance with GAAP, and thus produce profits and losses for the purposes of income tax. Those changes in essence required the losses to be calculated, in line with the FTT's analysis of the contractual position, on the 30:30 Basis and not the Ingenious Basis. The FTT also decided that the LLPs' calculations of the NRVs of the films on completion (which was an important component of the calculation of the first-year losses) were too low.

(6) Whether the expenditure on the rights to income acquired by the LLPs was in the nature of revenue or capital (the "Income/Capital Issue")

36. The FTT concluded "with misgivings and reluctance" at [88] of the Further Decision that the rights acquired by the LLPs were capital in nature, stating that the period over which the rights were to play a part in the business was the factor which weighed most heavily in reaching that conclusion, despite the fact that the rights were ordinary commercial contracts and were the source of income rather than the setting in which it was generated.

Grounds of appeal and issues to be determined

37. HMRC appeal against the FTT's findings in the Decision on two grounds, as follows.

38. First, HMRC submit that the FTT was wrong to conclude that the activities carried on by ITP and IFP2 amounted in law to a trade. HMRC submit:

(1) the FTT misunderstood the law on what amounts to a trade; and/or

(2) the FTT reached the wrong conclusion on the Trading Issue when applying the law to the facts as found in relation to ITP and IFP2;

(3) further, the FTT erred in law in its approach to fiscal purpose; and

(4) further or alternatively, the FTT reached the correct conclusion for the reasons it gave in relation to the Trading Issue as it applied to IG, so that the reasons the FTT gave for distinguishing ITP and IFP2 from IG were faulty.

39. Secondly, HMRC submit that the FTT erred in its interpretation of the "with a view to profit" test found in the legislation referred to at [9] above; further and/or alternatively, the FTT erred in its application of such test. In particular, the FTT made an error of law in holding at [492(j)] that the test contained an "objective override" such that it would necessarily be satisfied if it was "inevitable" or "almost certain" to make a profit irrespective of the subjective intentions of the participants and conversely at [492(h)], that if there was "no realistic possibility of profit" on the basis that the taxpayer conducted or intended to conduct the business, then the test would necessarily not be met. Further, HMRC submit that the FTT made an error of law at

[824] and [825] in stating that the test would be satisfied if the LLPs had the hope and intention of carrying out, and carried out, actions (entering into the film contracts) which would give rise to a realistic possibility of making a profit.

40. HMRC submit that the test is purely subjective, but an objective analysis of the likelihood of profit constitutes a useful cross-check for the FTT in testing protestations of subjective intent.

41. Finally, HMRC submit that even if the FTT's formulation of the test were correct, it applied it wrongly by finding that there was a realistic possibility of the LLPs making a profit on the 30:30 Basis and that the activities of the LLPs were carried out with a view to profit on that basis.

42. The LLPs advance eight grounds of appeal which can be summarised as follows:

(1) **Contractual analysis:** The FTT erred in law in its construction of the contractual agreements entered into by the LLPs. In particular:

(a) the FTT adopted an incorrect approach to the construction of the relevant contracts in (i) impermissibly collapsing the contractual documents together, rather than considering the terms and effect of each agreement individually without regard (at that stage) to the tax consequences; and (ii) failing properly to distinguish *Ensign Tankers (Leasing) Limited v Stokes* [1992] 1 AC 655; and

(b) the FTT incorrectly construed the relevant agreements relating to the capitalisation of the LLPs, the funding of the films and games and the ownership rights of the LLPs in the films and games.

(2) **Findings of fact:** The FTT erred in law in making findings of fact that no tribunal properly instructed on the law could have reached, including (i) findings not open to the FTT on the evidence before it; (ii) mathematical errors in the calculations relied on for a number of its findings; (iii) findings not canvassed with the parties or relevant witnesses; and (iv) findings of fact based on reasoning that did not properly address the LLPs' case.

(3) **Trading:** The FTT erred in law in its conclusions as to the extent of any trade carried on by the LLPs and in any event in its conclusion that IG was not trading. In particular:

(a) the FTT erred in law in (i) concluding that whether the LLPs intended to make a profit depended on whether the profit was determined on the 30:30 Basis or the Ingenious Basis; (ii) concluding that the LLPs only intended to make a profit if determined on the 30:30 Basis; and (iii) concluding that the (supposed) lack of intention to make a profit on the Ingenious Basis outweighed the other factors relevant to determining whether the LLPs were trading for tax purposes, so that the FTT should have determined that the LLPs were trading, whether or not the Ingenious Basis was correct; and

(b) the FTT erred in law in concluding that IG was not trading.

(4) **View to profit:** The FTT erred in law in finding that, if the relevant arrangements were carried out on the Ingenious Basis, the LLPs were not carrying on business "with a view to profit". In particular:

(a) the FTT's assumption that a film investor contributing x per cent of the cost would expect to receive x per cent of the net income of the film was contrary both to the evidence before it (including the evidence of HMRC's expert witness) and commercial common sense;

(b) the FTT held (correctly) that "view to profit" imported a subjective test with an objective override, but wrongly interpreted the objective override as requiring at least a "realistic probability" of profit, whereas the appropriate dichotomy is between "realistically possible" and "merely fanciful";

(c) the FTT erred in law in its interpretation of the contracts, misunderstanding their financial effects and underestimating the probability that the LLPs would make a profit; and

(d) the FTT made multiple impermissible findings of fact in reaching its conclusions at [827] to [829] of the Decision, including wrongfully substituting its own views for those of the expert witnesses.

(5) **Expenditure incurred:** The FTT erred in law in finding the LLPs did not incur 100% of the budgeted cost of each film or game, a finding that was predicated on its flawed contractual analysis of the relevant documents.

(6) **Wholly and exclusively:** The FTT erred in law in finding that part of the LLPs' expenditure (including the EP fee) was not incurred wholly and exclusively for the purposes of the relevant LLP's trade. In particular:

(a) the FTT was wrong to conclude that the expenditure incurred by the LLPs was only incurred wholly and exclusively for trading purposes if the expenditure is viewed as 30 and not 100 (and was otherwise incurred partly to benefit the CD), and was also wrong to conclude that, if the expenditure incurred was 100, then 70 was incurred for a tax avoidance purpose and therefore not for the purposes of the LLPs' trades;

(b) the FTT was wrong to conclude that the LLPs did not incur the parts of the budget of films which were attributable to the EP fees wholly and exclusively for the purposes of their businesses; and

(c) alternatively, any disallowance in respect of the EP fees should be limited by reference to the proportion of the budgets which the LLPs are regarded as having incurred.

(7) **GAAP:** The FTT erred in law in finding that the LLPs' accounts were not in accordance with GAAP. In particular:

(a) the FTT's conclusions were predicated upon its erroneous findings as to the construction and legal effect of the relevant contractual agreements;

(b) the FTT wrongly rejected the evidence of the LLPs' expert witness on accounting matters, based on a misunderstanding of the true legal and financial effects of the contractual arrangements; and

(c) the FTT was wrong to conclude that the write-down of or provision in respect of the LLPs' rights against the various PSCs should not exceed 33% of the initial value of the relevant asset in the case of a Studio film.

(8) **Income/capita**l: The FTT erred in law in finding that, on the basis of its conclusions on the other issues, the LLPs' expenditure on films and games was capital, save for a proportion of the Operators' fees.

43. Permission to appeal on the Trading Issue and the View to Profit issue was given to HMRC by a decision of Judge Hellier in the FTT on 6 November 2017. By that decision, the FTT also gave permission to the LLPs to appeal on all the Grounds advanced by them, save for certain aspects of their Ground 2, and made various corrections to the Decision. In a further decision on 26 February 2018 the FTT granted permission in relation to some (but not all) of the outstanding Ground 2 challenges. On 30 May 2018 the Upper Tribunal (Judge Sinfield) granted permission to appeal on the remaining Ground 2 challenges.

44. We shall deal with each of the parties' respective grounds of appeal in the context of dealing with each of the six issues which emerged before the FTT, as summarised above, and which continue as the issues which need to be determined on the appeals before the Upper Tribunal.

45. Therefore, in dealing with:

(1) the Trading Issue, we shall address the LLPs' Ground 3 and HMRCs Ground 1;

(2) the View to Profit Issue, we shall address the LLPs' Ground 4 and HMRCs Ground 2;

(3) the Incurred Issue, we shall address the LLPs' Ground 5;

(4) the Wholly and Exclusively Issue, we shall address the LLPs' Ground 6;

(5) the GAAP Issue, we shall address the LLPs' Ground 7; and

(6) the Income/Capital Issue, we shall address the LLPs' Ground 8.

46. The LLPs' Ground 1 feeds into their arguments on all of the issues. Therefore, after reaching some general conclusions as to the construction of the contractual documents, we shall apply our conclusions on the relevant contractual issues that arise when considering each of the issues in turn.

47. The LLPs' Ground 2 challenges relate to a significant extent to the FTT's findings of fact on View to Profit Issue, but to some extent to other issues. To the extent that

we consider the factual challenges comprised in that Ground to be material, we will therefore deal them when considering the issue to which the challenge relates.

48. For the reasons set out in detail below, we have decided the Trading Issue entirely in favour of HMRC. That finding is sufficient to dispose of the entirety of the appeals, because the subject matter of these appeals is the LLPs' claims for trading losses in the relevant tax years which have been denied by HMRC in the closure notices referred to at [2] above.

49. However, the View to Profit Issue is relevant to the question as to whether the LLPs are to be treated as partnerships (and its members as partners) pursuant to the legislation referred to at [9] above, and taxed accordingly. That depends on whether the relevant LLP was carrying on a business with a view to profit in the relevant tax year. The issue also raises questions on which authority is lacking and guidance is appropriate. We have therefore set out in some detail our views on that issue. We express no view on the meaning of "business" as used in s 863 ITTOIA 2005 and s 1273 CTA 2009 since it was not in issue before us.

50. Because of the way in which we have determined the Trading Issue we also do not need to determine the other issues, but in case this matter goes further we have set out our views on those issues relatively briefly.

51. Before us, for the LLPs, Mr Pushpinder Saini QC led on the contractual analysis and (along with Mr Richard Vallat QC on one aspect) on the View to Profit Issue. Mr David Milne QC led for the LLPs on the Trading Issue, the Incurred Issue, the Income/Capital Issue and (along with Mr Vallat on one aspect) the GAAP Issue. Mr Vallat led for the LLPs on the Wholly and Exclusively Issue and issues with respect to IG's activities. Mr Malcolm Gammie QC led for HMRC on the contractual analysis, the Trading Issue, the Incurred Issue, the Wholly and Exclusively Issue and the Capital/Income Issue. Mr Jonathan Davey QC led for HMRC on the View to Profit Issue and Mr Michael Jones led for HMRC on the GAAP Issue and issues with respect to IG's activities.

52. We are extremely grateful to all the Counsel from whom we heard and their respective teams for the very comprehensive oral and written submissions that we received.

Errors of law and the Upper Tribunal's powers

53. Ground 2 of the LLPs' Grounds of Appeal consisted originally of 110 separate challenges to the FTT's findings of fact, a high proportion of which related to the FTT's findings on the View to Profit Issue. A number of those challenges were subsequently abandoned, but a large number remained by the time of the hearing.

54. Section 11(1) of the Tribunals, Courts and Enforcement Act 2007 ("TCEA") provides that a party to a case before the FTT only has a right of appeal to the Upper Tribunal on a point of law arising from the FTT's decision. There cannot be an appeal on a pure question of fact which is decided by the FTT. However, a tribunal may arrive at a finding of fact in a way which discloses an error of law. That is clear from

Edwards v Bairstow [1956] AC 14 in which Viscount Simonds referred to making a finding, without any evidence or upon a view of the facts which could not be supported, as involving an error of law: see at page 29. In the same case, Lord Radcliffe, at page 36, regarded cases where there was no evidence to support a finding or where the evidence contradicted the finding or where the only reasonable conclusion contradicted the finding, as cases involving errors of law. The LLPs rely on this reasoning for their challenges to the FTT's findings of fact set out in their grounds of appeal. As Lord Diplock observed in his speech in *Council for Civil Service Unions v Minister for the Civil Service* [1985] AC 374, at 410F - 411A, a better term for this ground for challenging a decision might be "irrationality".

55. In relation to an appeal which is said to involve a point of law of the kind identified in *Edwards v Bairstow*, we were reminded by HMRC of what was said by Evans LJ in *Georgiou v Customs and Excise Commissioners* [1996] STC 463 at 476, as follows:

> "It is right, in my judgment, to strike two cautionary notes at this stage. There is a well-recognised need for caution in permitting challenges to findings of fact on the ground that they raise this kind of question of law. That is well seen in arbitration cases and in many others. It is all too easy for a so-called question of law to become no more than a disguised attack on findings of fact which must be accepted by the courts. As this case demonstrates, it is all too easy for the appeals procedure to the High Court to be misused in this way. Secondly, the nature of the factual inquiry which an appellate court can and does undertake in a proper case is essentially different from the decision-making process which is undertaken by the tribunal of fact. The question is not, has the party upon whom rests the burden of proof established on the balance of probabilities the facts upon which he relies, but, was there evidence before the tribunal which was sufficient to support the finding which it made? In other words, was the finding one which the tribunal was entitled to make? Clearly, if there was no evidence, or the evidence was to the contrary effect, the tribunal was not so entitled."

56. He continued:

> "... for a question of law to arise in the circumstances, the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make."

57. He concluded:

> "What is not permitted, in my view, is a roving selection of evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong. A failure to appreciate what is the correct approach accounts for much of the time and expense that was occasioned by this appeal to the High Court."

58. Furthermore, as HMRC submitted, the bar to establishing an error of law based on the challenges to findings of fact is deliberately set high. As Lewison LJ said in *Fage UK Limited and another v Chobani UK Limited and another* [2014] EWCA Civ 5 at para 114:

> "Appellate courts have been repeatedly warned … not to interfere with findings of fact by trial judges, unless compelled to do so. This applies not only to findings of primary fact, but also to the evaluations of those facts and inferences to be drawn from them. … The reasons for this approach are many. They include:
>
> > i) The expertise of a trial judge is in determining what facts are relevant to the legal issues to be decided, and what those facts are if they are disputed.
> >
> > ii) The trial is not a dress rehearsal. It is the first and last night of the show.
> >
> > iii) Duplication of the trial judge's role on appeal is a disproportionate use of the limited resources of an appellate court, and will seldom lead to a different outcome in an individual case.
> >
> > iv) In making his decisions the trial judge will have regard to the whole of the sea of evidence presented to him, whereas the appellate court will only be island hopping.
> >
> > v) The atmosphere of the courtroom cannot, in any event, be recreated by reference to documents (including transcripts of evidence).
> >
> > vi) Thus even if it were possible to duplicate the role of the trial judge, it cannot in practice be done."

59. In the context of a tax appeal concerning whether the findings of the VAT and Duties Tribunal that the taxpayer knew or ought to have known that his transactions were connected to fraud (a so-called MTIC case) Briggs J (as he then was), sitting in the High Court in *Megtian Limited (in Administration) v HMRC* [2010] STC 840, observed at [11] that in considering whether a finding of fact involves an error of law when it is based upon non-existent or inadequate evidence:

> "The question is not whether the finding was right or wrong, whether it was against the weight of the evidence, or whether the appeal court would itself have come to a different view. An error of law may be disclosed by a finding based upon no evidence at all, a finding which, on the evidence, is not capable of being rationally or reasonably justified, a finding which is contradicted by all the evidence, or an inference which is not capable of being reasonably drawn from the findings of primary fact."

60. That the weight to be given to particular evidence is a matter for the first instance decision-maker was emphasised by Lord Millett in *Begum v London Borough of Tower Hamlets* [2003] UKHL 5, [2003] 2 AC 430 at [99]:

> "The court cannot substitute its own findings of fact for those of the decision-making authority if there was evidence to support them; and questions as to the weight to be given to a particular piece of evidence … are for the decision-making authority and not the court."

61. In *Megtian* at [12] Briggs J referred in the following terms to the need for appellate caution when considering whether to reverse a judge's evaluation of the facts, which will have been influenced by the impression made upon him by the primary evidence:

> "The restrictions imposed by an appeal limited to points of law are in addition to the well-recognised difficulties facing any appellate court, such as not seeing the witnesses giving evidence, being confined to a review of evidence considered in much greater detail by the court below, and being unable to capture from the judgement (however meticulous) every nuance which played an important part of the evaluation of the court below; see for example per Lord Hoffmann in *Biogen Inc v Medeva plc* [1997] RPC at 45…"

62. As regards multi-factorial assessments of the kind with which this case is concerned, Jacob LJ made the following observation at [9] of *Proctor and Gamble UK v HMRC* [2009] STC 1990:

> "Often a statutory test will require a multi-factorial assessment based on a number of primary facts. Where that is so, an appeal court (whether first or second) should be slow to interfere with that overall assessment…"

63. In support of that statement Jacob LJ quoted the following passage from the well-known speech of Lord Hoffmann in the House of Lords case of *Biogen v Medeva* [1997] RPC 1 at page 45, which was also referred to by Briggs J in the passage from *Megtian* referred to above:

> "The need for appellate caution in reversing the judge's evaluation of the facts is based upon much more solid grounds than professional courtesy. It is because specific findings of fact, even by the most meticulous judge, are inherently an incomplete statement of the impression which was made upon him by the primary evidence. His expressed findings are always surrounded by a penumbra of imprecision as to emphasis, relative weight, minor qualification and nuance … of which time and language do not permit exact expression but which may play an important part in the judge's overall evaluation."

64. An appellate court should also be slow to interfere with an assessment of the credibility of a witness. In *Alexander Langsam v Beachcroft LLP and others* [2012] EWCA Civ 1230 Arden LJ, as well as reiterating the correct approach to multi-factorial assessments, said at [72]:

> "It is well established that, where a finding turns on the judge's assessment of the credibility of a witness, an appellate court will take into account that the judge had the advantage of seeing the witnesses give their oral evidence which is not available to the appellate court. It is therefore, rare for an appellate court to overturn a judge's finding as to a person's credibility. Likewise, where any finding involves an evaluation of facts, an appellate court must take account that the judge has reached a multi-factorial judgement, which takes into account his assessment of many factors. The correctness of the evaluation is not undermined, for instance, by challenging the weight the judge has given to elements of the evaluation unless it is shown that the judge is clearly wrong and reached a conclusion which he was not entitled to reach."

65. We shall approach the various challenges to the FTT's findings of fact with these judicial statements firmly in mind.

66. If we conclude that one or more of the LLPs' criticisms of the FTT's findings of fact are made out, we may still consider whether the remainder, taken together with those matters relied upon by the FTT which were not challenged, nonetheless constituted a sufficient basis for the Decision. That is consistent with the passage from *Georgiou* quoted at [56] above: we should not regard any finding of fact as disclosing an error of law where it is not significant in relation to the findings in the Decision or the Further Decision with which these appeals are concerned.

67. Furthermore, the fact that we may find that one or more of the FTT's findings disclose errors of law on its part does not necessarily mean that we should allow the appeal and set aside the Decision. Section 12 TCEA provides that if the Upper Tribunal finds that the making of the relevant decision involved the making of an error on a point of law it "may (but need not) set aside" the decision, and that if it does it must either remit the case to the FTT with directions for reconsideration, or remake the decision. That language clearly indicates that we have a discretion in that respect. In our view, we should not exercise our discretion to set aside the Decision if we are satisfied, notwithstanding errors of law in the Decision, that there was a sufficient basis in the findings of the FTT which were fully reasoned and not subject to challenge to justify its conclusions on the relevant issue.

68. There is authority for this approach in *Megtian* where Briggs J said at [73]:

> "If I had concluded that one or more of Mr Patchett-Joyce's criticisms of the specific factors which the tribunal took into account in concluding that *Megtian* have the requisite knowledge of fraud was made out, it might have been necessary for me to consider whether the remainder, taken together with those factors relied upon by the tribunal which were not challenged, nonetheless constituted a sufficient basis for its conclusion."

69. In their skeleton argument, the LLPs submitted that the principles outlined above are confined solely to primary findings of fact. We reject that submission; the authorities quoted above do not seek to make a distinction between primary findings of facts and the inferences to be drawn from those findings. On the contrary, the authorities clearly demonstrate that the appellate court or tribunal should be slow to

interfere with the first instance decision maker's overall assessment of the primary facts.

70. Neither do we accept the LLPs' submission that, following Lord Carnwath's guidance in the Supreme Court's judgment in *HMRC v Pendragon plc* [2015] STC 1825 at [47] to [51], we should take a flexible approach to the distinction between issues of law and issues of fact. As Henderson LJ said in *Degorce v HMRC* [2017] STC 2226 at [75], that guidance is not to be taken as an indication that the Upper Tribunal has some special exemption from the restrictions to which Lewison LJ referred in *Fage* in the passage quoted at [58] above.

71. In this case, shortly before the hearing of the appeals the LLPs filed a document entitled "Ground 2 Errors – Significance and Evidence" which sought, in tabular form in relation to each of the Ground 2 challenges, to identify the relevant evidence available to the FTT in respect of the challenge in question and to explain the significance of the finding to the Decision. However, in our view that table fails to a large extent in that endeavour. Inevitably, where as in this case there is voluminous documentary evidence (we were told over 1 million pages, the vast majority of which we fortunately received in electronic form) the heavy burden on the LLPs to establish a negative (such as that there was no evidence for a particular finding) is particularly difficult to satisfy, and the references in the table to particular items of evidence that were available to the FTT on the point in question will necessarily be selective.

72. Neither did the LLPs step back from the table and provide an overall assessment of how the findings of the FTT had been undermined to such an extent that the cumulative effect of the alleged errors was such that the FTT's conclusions on the relevant issue could not safely stand. There was no suggestion in relation to any one of the Ground 2 challenges that it was so significant in itself that the FTT could not have reasonably reached the conclusion that it did on the issue in question. It is not for either the respondent or the tribunal itself to undertake that exercise.

73. Inevitably, as we refer to later when dealing with the Ground 2 challenges when considering the issues to which they relate, in a decision as long as the one that we are concerned with in this case, and bearing in mind the amount of evidence made available to the FTT, it was impossible for the FTT to capture every element of its impressions. It is also the case that some of its findings may have been better expressed. However, we are unable to conclude that, taken cumulatively, such of the Ground 2 challenges as our later findings demonstrate have been made out amount to an error of law of such materiality that we should exercise our discretion to set aside the FTT's findings on the matters to which those errors relate.

74. In summary, extreme caution is required to be exercised before setting aside conclusions based on careful evaluative findings of fact made on the basis of extensive evidence, in contrast to the position where an *ex facie* error of law is identified.

II. CONTRACTUAL ANALYSIS

Contractual construction – basic principles

75. As the FTT observed at [74], the nature of the contractual rights and obligations of the LLPs under the contractual documents summarised at [16] above are relevant to the following issues which arise on these appeals:

(a) whether the LLPs were trading. Here questions arise as to whether the LLPs owned an asset, the film, which they sold, or whether they laid out monies in return for an income stream; and whether in some way they provided a service or merely invested;

(b) whether the LLPs' activities were undertaken with a view to profit. The LLPs computed their profits on a basis which assumed that they had incurred 100% of the cost of the film and were entitled to the portion of the distributable income described in the Waterfall. Questions arise as to whether in fact the LLPs' profit or loss should be computed by reference to expenditure of 30% of the budgeted cost and a different income entitlement, and, if that was the case, whether that affected whether the LLPs had a view to profit;

(c) whether the LLPs incurred 100% of the cost of the films or games or a lesser amount; and

(d) the legal matrix to which GAAP should be applied to compute the profits or losses of the LLPs.

76. At [75] of the Decision, the FTT set out the approach to be taken to determining the contractual rights and obligations and their nature as follows:

> "As the following discussion of the authorities indicates, the tribunal must undertake a two stage process: it is first necessary to determine what rights and obligations arise under an agreement or suite of agreements, and then necessary to characterise them. In conducting the second step the labels the parties attach are not conclusive."

77. Both parties accept that was the correct starting point. However, the LLPs say that the FTT then made an error of law by overlooking well-established principles of contractual construction, and impermissibly applied the principle of statutory construction established in the line of cases commencing with *WT Ramsay v IRC* [1982] AC 300, namely whether the relevant provision of the statute, upon its true construction, applies to the facts as found. The LLPs say that the FTT should have applied the *Ramsay* principle only at a later stage, as part of the process of statutory construction, although they say that *Ramsay* is not relevant on the facts of this case.

78. HMRC say that the FTT adopted the correct approach to contractual construction by following the approach taken by Lord Templeman in his speech in *Ensign Tankers (Leasing) Limited v Stokes* [1992] 1 AC 655 ("*Ensign Tankers*") by construing the documents together as a single composite agreement or arrangement.

79. The basic principles to be applied to the construction of written contracts have been set out in a number of relatively recent Supreme Court judgments, namely *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900, *Arnold v Britton* [2015] AC 1619, and *Wood v Capita Insurance Services Limited* [2017] AC 1173 where Lord Neuberger PSC summarised the approach to be taken at [10] to [15]:

> "10. The court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. It has long been accepted that this is not a literalist exercise focused solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning. In *Prenn v Simmonds* [1971] 1 WLR 1381 (1383H-1385D) and in *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 (997), Lord Wilberforce affirmed the potential relevance to the task of interpreting the parties' contract of the factual background known to the parties at or before the date of the contract, excluding evidence of the prior negotiations. When in his celebrated judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 Lord Hoffmann (pp 912-913) reformulated the principles of contractual interpretation, some saw his second principle, which allowed consideration of the whole relevant factual background available to the parties at the time of the contract, as signalling a break with the past. But Lord Bingham in an extra-judicial writing, *A new thing under the sun? The interpretation of contracts and the ICS decision* Edin LR Vol 12, 374-390, persuasively demonstrated that the idea of the court putting itself in the shoes of the contracting parties had a long pedigree.
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> 11. Lord Clarke elegantly summarised the approach to construction in *Rainy Sky* at para 21f. In *Arnold* all of the judgments confirmed the approach in *Rainy Sky* (Lord Neuberger paras 13-14; Lord Hodge para 76; and Lord Carnwath para 108). Interpretation is, as Lord Clarke stated in *Rainy Sky* (para 21), a unitary exercise; where there are rival meanings, the court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense. But, in striking a balance between the indications given by the language and the implications of the competing constructions the court must consider the quality of drafting of the clause (*Rainy Sky* para 26, citing Mance LJ in *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2)* [2001] 2 All ER (Comm) 299 paras 13 and 16); and it must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest: *Arnold* (paras 20 and 77). Similarly, the court must not lose sight of the possibility that a provision may be a negotiated compromise or that the negotiators were not able to agree more precise terms.
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> 12. This unitary exercise involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated: *Arnold* para 77 citing *In re Sigma Finance Corpn* [2010] 1 All ER 571, para 10 per Lord Mance. To my mind once one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each.

> 13. Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type. The iterative process, of which Lord Mance spoke in *Sigma Finance Corpn* (above), assists the lawyer or judge to ascertain the objective meaning of disputed provisions.
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> 14. On the approach to contractual interpretation, *Rainy Sky* and *Arnold* were saying the same thing.
>
> 15. The recent history of the common law of contractual interpretation is one of continuity rather than change. One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation."

80. In *Arnold v Britton* at [15] Lord Neuberger said that when interpreting a written contract, the court is concerned to "identify the intention of the parties by reference to what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean" (citing Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Limited* [2009] AC 1101 at [14]), by focusing on the meaning of the relevant words, in the documentary, factual and commercial context.

81. The FTT did not appear to have these judgments in mind when construing the suite of agreements entered into by an LLP in relation to a particular film or game. Although the Supreme Court judgment in *Wood v Capita* post-dates the Decision, the FTT makes no reference to the other judgments referred to above.

82. At [91] the FTT summarised the suite of agreements that were entered into by IFP2 relating to the film *Hot Fuzz*, which the parties accepted both before the FTT and ourselves was typical of the documentation entered into in respect of a Studio film, as comprising the following:

(1) A licence of the screenplay by the CD to the LLP.

(2) The CDA. This recited that the CD had commissioned the LLP to make the film or game. It included provisions relating to the specification of the film and its delivery to the CD. It dealt with the relationship between the CD and the LLP in relation to decisions about the film or game. In schedule 7 (the Waterfall) the gross receipts from the film were divided up. After the payment of certain expenses and distribution fees the balance, termed (in the IFP2 agreements) the Gross Distributable Income ("GDI"), was divided between the LLP and the CD in proportions which varied with the level of GDI.

(3) The PSA. By this agreement the LLP delegated to the PSC as principal the making of the film in accordance with the specification (broadly mirroring the provisions in the CDA). Payment was to be made to a Production Account in the PSC's name in accordance with an Agreed Budget and an Approved Cashflow (which phased the receipts of money over the period of the making of the film, 11 months in the case of *Hot Fuzz*). The agreement dealt with the delivery of the film and with rights in the film. It included provisions relating to creative control.

(4) A Loan Agreement between the CD and the CM. Under this agreement the CD agreed to make a facility available to the CM "to enable it to make [a] capital contribution to the LLP". By clause 4.1 the loan was to be drawn down in accordance with the Approved Cashflow, and was directed to be paid directly to the Production Account (or otherwise as the PSC required).

The amount of the facility was 70% of the Budget for the film. The loan bore no interest.

In the case of ITP the loan was repayable only from Borrower's Receipts ("BR") which were defined as 50% of the amount which was stated to accrue to the LLP under schedule 7 of the CDA.

In the case of IFP2 the loan was repayable only from "Borrower's Distributable Receipts" ("BDR"). This was defined as a percentage of Borrower's Receipts. That percentage varied, in tandem with the variation of one of the elements of the CD's share of GDI (the Studio Participation) under schedule 7 of the CDA.

Clause 5.4 provided that the CM could prepay the loan.

(5) A Guarantee Agreement (not present in the case of IG). For a fee a Completion Guarantor (in the case of Studio films a member of the Studio group) agreed to complete the film if it ran over budget, or to abandon it and return monies to the parties.

(6) A Deed of Acknowledgement, which incorporated a Notice of Assignment and Irrevocable Payment Instruction (the "Deed of Acknowledgment etc."). Each of the Operator, the Completion Guarantor, the PSC, the CD and the LLP were parties to the Deed and the CM was the maker of the assignment and payment instruction. Under this combined document monies equal to BDR (BR) which were allocated to the LLP under schedule 7

of the CDA were agreed to be directed to be retained by the CD. It also gave details of the Production Account to which the CD should make payment under the Loan Agreement.

(7) A Pledgeholder Agreement in which the film laboratory which held the master negative of the film undertook to hold it for the CD and the Completion Guarantor.

(8) Security Agreements under which rights in the film were assigned by way of security.

83. At [92] the FTT made the following finding in respect of that suite of agreements:

> "All the agreements for a particular film were entered into on the same day. They cross-refer and are not intended to take effect sequentially. We regard them as a single package to be construed as one composite agreement."

84. In coming to that conclusion, the FTT followed the approach of Lord Templeman in *Ensign Tankers*. We shall need to return to that case in some detail later when considering a number of the issues that arise in this case, but it is helpful at this stage to set out some of the factual background to the case, adopting the helpful summary set out by the FTT at [77] and [78] as follows:

(1) The case concerned a film, Escape to Victory, being made by Lorimar.

(2) Ensign became a partner in Victory Partnership, a limited partnership, and together with other partners contributed capital equal to 25% of the budget for the film ($3.25m).

(3) On the same day 16 further documents were entered into involving eight further parties. The most important of these were:

(a) a loan agreement between Lorimar and Victory Partnership under which Lorimar agreed to lend Victory Partnership 75% of the cost of the film;

(b) a production services agreement between Lorimar and Victory Partnership under which Lorimar agreed to complete the making of the film and Victory Partnership agreed to pay Lorimar 25% of the budget immediately and the remaining 75% in stage payments; and

(c) a distribution agreement between Victory Partnership and two distributors under which the Victory Partnership granted the distributors exclusive distribution rights over the film in return for the gross receipts after deducting distribution fees and expenses.

(4) The agreements provided that the loan was to be provided to Victory Partnership in tranches as Victory required the funds to meet the budgeted cost of the film, but that those sums be paid into a special restricted bank account of Victory Partnership and on the same day repaid to Lorimar. The payments into

the account were described as the making of the loan, and the payments out as the funding of expenditure on the film. The loan was expressed to be repayable only from 75% of the net proceeds of distribution (termed a non-recourse loan). By a letter the distributors were irrevocably directed to pay 75% of the net receipts to Lorimar. Those payments were documented as repayments of the non-recourse loan.

85. The central issue in the case was whether the Victory Partnership was entitled to first-year capital allowances in respect of the whole of the cost of the film.

86. At [80] the FTT set out the following observations from Lord Templeman's speech in the House of Lords, which are set out at page 665 of the report:

> "The parties agree that the 17 documents dated 14 July 1980 were interdependent, and constituted one single composite agreement or transaction, which was a tax avoidance scheme and must be read as a whole.
>
> If the documents constituting the scheme are read as a whole, the rights of Victory Partnership under the scheme are the rights which were and remain vested in Victory Partnership after all documents had been signed. Similarly the obligations of Victory Partnership under the scheme are the obligations which were and remain enforceable against Victory Partnership after all documents had been signed. The financial consequences to Victory Partnership of the scheme are the consequences which flowed from the rights conferred and the obligations imposed on Victory Partnership. The taxation allowances and taxation liabilities of Victory Partnership are the allowances and liabilities which, pursuant to the taxing statutes are applicable to the final financial consequences.
>
> When all the documents had been entered into, Victory Partnership was subject to an obligation to pay [25% of the budget] to [Lorimar] and subject to an obligation whereby any money paid by Lorimar into the scheme current account was immediately transferred back to [Lorimar]…When all the documents had been entered into, Victory Partnership had a right to 25% of the net receipts from the exploitation of the film."

87. From this passage the FTT concluded at [81] that the tax results of the arrangements followed the financial consequences, which in turn followed from the rights and obligations created by the documents, and that those were to be determined by considering the position under what it says was a composite agreement after all the documents had been signed.

88. The FTT (at [84] to [86]) relied on a number of cases to support its finding at [161] that analysing a set of agreements to determine the rights and obligations which arise from them as a composite is a general and proper approach. Before us HMRC supported that finding.

89. In particular, HMRC rely upon *Antoniades v Villiers* [1990] 1 AC 417. That case was one of two appeals heard by the House of Lords at the same time on the question of whether what purported to be licences to occupy were in fact tenancies, and therefore within the Rent Acts. A landlord had entered into separate but identical agreements with a young man and his girlfriend, whom the landlord knew would be

living together, granting the right to occupy the top flat in his property comprising a bedroom with a double bed, a sitting room with a bed-settee, a kitchen and bathroom. The agreements were expressed to be licences, stated that the Rent Acts did not apply, that the licensor was not willing to grant exclusive possession and (under clause 16) that the use of the rooms was "in common with the licensor and such other licensees or invitees as [he] may permit from time to time to use the said rooms". The landlord did not at any point allow another occupant into the flat, but he did consent to a friend of the couple staying for a few weeks on the bed-settee.

90. The House of Lords unanimously held that the two agreements should be read together as a single agreement, on the basis that there had been an intention to confer exclusive possession of the flat for a term in consideration of periodical payments, and accordingly a tenancy had been created. The reasoning of the speeches delivered however differed in some respects.

91. Lord Bridge referred at page 454 to the "pretence" that two identical agreements entered into by a man and woman who are going to live together in a small flat and share a double bed created several rather than joint rights and obligations. The provision allowing the landlord to share occupation himself or introduce third parties was repugnant to the true purpose of the agreement and no one could suppose that it was ever intended to be acted upon. He said it was simply an attempt to disguise the true character of the agreement to prevent the couple enjoying the protection of the Rent Acts.

92. Lord Oliver referred to the "total unreality" of the documents (at page 467H) and stated that the clauses permitting the landlord to enter occupation or permit others to do so could not seriously be intended to have any practical operation (at page 468B). At pages 468 to 470 he said that the two documents were sham documents designed to conceal the true nature of the transaction, and had to be read together. Lord Jauncey agreed that the documents had to be read together on the basis that the agreements could not be considered without regard to the surrounding circumstances, and the substance and reality was to create a tenancy, agreeing with Lord Bridge that the parties never intended clause 16 to operate.

93. Lord Templeman took a different approach. He focused (at page 458) on the inability of parties to contract out of the Rent Acts, stating that any document which purported to create a licence would nevertheless create a tenancy if the rights and obligations satisfied the legal requirements. It was necessary to consider the surrounding circumstances including the relationship between the prospective occupiers, the negotiations and the nature and extent of the accommodation and intended and actual mode of occupation. At page 459D Lord Templeman said that the court had a duty to enforce the Rent Acts and in doing so to observe the principle that parties could not contract out of them. Clause 16 was inconsistent with the provisions of the Rent Acts because until the landlord's power to add occupiers was exercised the couple were jointly in exclusive occupation and there was a tenancy (page 462C and D and also 465G).

94. At Page 460H Lord Templeman, in referring to the two agreements, made the following statement which is particularly relied upon by HMRC:

> "… The two agreements were interdependent. Both would have been signed or neither. The two agreements must therefore be read together."

95. He made that statement immediately prior to an observation at page 461A that the young couple applied to rent the flat jointly and sought and enjoyed joint and exclusive occupation of the whole of the flat. He said that they shared the rights and the obligations imposed by the terms of their occupation, acquiring joint and exclusive occupation of the flat in consideration of periodical payments and therefore acquiring a tenancy jointly.

96. Lord Templeman went on to say that there was a separate and alternative reason to ignore clause 16, which was that it was not a "genuine reservation" of a power to authorise others to share the flat (page 462E). It was a pretence, the facilities not being suitable for sharing between strangers and the landlord never purporting to exercise the right to introduce additional occupiers (page 463D and 465H).

97. Lord Ackner made a similar comment to Lord Bridge about attempting to disguise a tenancy (at 466D) and agreed with both Lord Templeman and Lord Oliver.

98. In our view the underlying basis for the decision, reflected in all of the speeches, is that clause 16 was unrealistic (or a pretence) that was never intended to be acted on. In addition, Lord Templeman, with whom Lord Ackner agreed, relied specifically on the parties' inability to contract out of the Rent Acts. It is in that context that Lord Templeman's observation that the two agreements must be read together must be considered. The comment was made in support of his analysis of the nature of the legal relationship that was created, namely a tenancy rather than a licence, against the principle that it is not possible for the parties to contract out of a mandatory statutory scheme. Therefore, in our view, this case does not offer support for an approach to contractual construction which permits a number of agreements entered into together in relation to a single transaction to be construed as a single composite agreement.

99. It is important to note that *Antoniades* was not decided on the basis that the contractual arrangements were a sham. Diplock LJ in *Snook v London and West Riding Investments Limited* [1967] 2 QB 786 at 802 defined a sham as:

> "acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create … for acts or documents to be a "sham", with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating."

100. Although all the opinions in *Antoniades* conclude that clause 16 was unrealistic (or a pretence) that was never intended to be acted on, and there is therefore clearly an

analogy with the concept of sham, the distinction is that there was no "common intention" of the parties in relation to clause 16, because the young couple simply did not understand the provisions in the documents they were signing. Rather, the case is an illustration of the principle that the court is not bound by labels the parties have chosen to apply if those labels do not reflect the true nature of the legal rights and obligations, or by provisions in documents that the parties never intended to be acted upon and which are inconsistent with the true nature of the transaction.

101. The same point about the court not being bound by labels was also at the heart of the decision in *Street v Mountford* [1985] AC 809, another of the cases relied on by the FTT, where the question was whether an agreement gave rise to a tenancy or a licence. Lord Templeman said at page 819 that if the agreement satisfied all the requirements of a tenancy, the parties could not alter the effect of the agreement by insisting that they only created a licence.

102. Similarly, in *Agnew v IRC* [2001] 2 AC 710 (PC), another case relied on by the FTT, the question was whether a charge was fixed or floating. Lord Millett said at [32] that the question was not merely one of construction but one of ascertaining the nature of the rights and obligations which the parties intended to grant to each other in respect of the charged assets, and then moving on to consider how to categorise the transaction as a matter of law. The second step did not depend on the intention of the parties.

103. Neither do we agree with HMRC that the approach taken by Lord Templeman at page 665 of his speech in *Ensign Tankers* ([86] above) was the right approach as a matter of pure contractual construction. In our view, the approach taken by Lord Templeman was an early example of the application of the principle derived from the *Ramsay* line of cases, namely (as expressed at the time) that the fiscal consequences of a preordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole, and not by dissecting the scheme and considering each individual transaction separately. Indeed, Lord Templeman started his speech at page 661 by describing the appeal as being concerned with a tax avoidance scheme, "a single composite transaction whereunder the tax advantage claimed by the taxpayer is inconsistent with the true effect in law of the transaction". Lord Templeman's remarks at page 665 must be read in the light of that opening statement. He also referred to *Ramsay* and the later authorities applying it in support of his approach: see page 676E were he remarks that no difficulties will arise in applying the *Ramsay* principle to a single composite transaction provided that the results of the transaction read as a whole are correctly identified.

104. That the House of Lords was seeking to apply the *Ramsay* principle rather than engaging in an exercise of contractual construction is supported by the speech of Lord Goff. He said this at page 681E to G:

> "Now, if one takes certain individual features of the transaction, and considers them in isolation, it is possible to give some colour to Victory Partnership's argument. For example, it is no doubt correct that the mere fact that the taxpayer borrows money in order to incur capital expenditure does not prevent him from qualifying for a capital allowance under the section; likewise the mere fact that

> such a loan is a non-recourse loan in the sense that the taxpayer is not personally liable for its repayment, the loan being repayable out of property or proceeds in the hands of the taxpayer, will not of itself prevent the transaction from constituting what is in truth a loan, or the expenditure so financed qualifying for a capital allowance. But it is well established in the cases that we should not, for present purposes, have regard to such features in isolation. Indeed the authorities require us to look at related transactions such as those which were entered into on 14 July 1980 as one composite transaction. It is that composite transaction which we have to analyse, as a whole, in order to ascertain its true nature and effect, and to decide whether the transaction so analysed results, on a true construction of the relevant statutory provision, in the taxation consequences for which the taxpayer contends."

105. These remarks need to be read in the context of the authorities to which he was referring, which can only be *Ramsay* and the cases following it referred to by Lord Templeman. The final sentence is also very close to the way in which the *Ramsay* approach is now authoritatively expressed, namely whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.

106. That similarity was recognised by Lord Walker in his judgment in *Tower MCashback v HMRC* [2011] STC 1143. When referring to similar remarks of Lord Goff at page 682 of *Ensign Tankers*, Lord Walker said at [47] that Lord Goff had emphasised that the *Ramsay* principle was a principle of statutory construction, now to be applied in the manner described above.

107. We are therefore not persuaded that, as a matter of contractual construction, the FTT was correct in adopting a "composite agreement" approach without reference to *Ramsay*. In our view, the starting position for the FTT in construing the contracts should have been to consider them separately in accordance with the basic principles set out at [79] and [80] above.

108. However, where a number of contracts are entered into together, at the very least the existence of the other contracts is part of the factual background known to the parties at or before the date of the contract, as referred to by Lord Neuberger at [10] of *Wood v Capita* (quoted at [79] above) and commonly referred to as the "factual matrix". The existence of the other contracts is therefore a relevant part of the factual matrix when construing any one of them. Furthermore, where the contracts specifically cross-refer or there are other indications that they are intended to operate only as a package, then that fact will be relevant.

109. Authority for this approach is to be found in Lewison on the Interpretation of Contracts, 6th edition, paragraph 3.03 where it is said:

> "Many transactions take place by the entry into a series of contracts…. In such cases, where the transaction is in truth one transaction all the contracts may be read together for the purpose of determining their legal effect. This principle is a more specific example of the general principle that background is admissible in interpreting a written contract. It applies to other documents executed as part of the same transaction,

> whether they happen to be executed before, at the same time as, or after the document requiring to be interpreted."

110. Therefore, where there is in truth one transaction, the tribunal is entitled to read the contracts together for the purpose of determining their legal effect. That is not the same as saying that where there is a series of contracts to implement a transaction there is a single composite agreement. As we have said, the "composite agreement" approach is not correct as a matter of contractual construction. However, what must not be done is to adopt blinkers in looking at each agreement. In determining the legal rights and obligations acquired by the LLPs pursuant to the contractual arrangements, the FTT was entitled and correct to look at the entirety of each set of transaction documents, which it found at [91] were entered into at the same time and as a single package. That set of documents, which we have referred to at [82] above, reflected what was undeniably a single, albeit multi-party, transaction as a commercial matter. Even though it was common ground that none of the documents in question could be regarded as a sham, the absence of any allegation of sham does not prevent the tribunal following the approach outlined above or, for example, examining critically whether the written provisions of the documents had the effect when read together that the LLPs maintained that they did. This is consistent with the principle, illustrated in *Antoniades v Villiers* as discussed above, that the tribunal is not bound by labels that the parties have chosen to apply if those labels do not reflect the true nature of the legal rights and obligations created pursuant to the contractual arrangements.

Relevance of the *Ramsay* approach

111. Mr Saini submitted that at the first stage of contractual construction, the *Ramsay* approach is to be ignored. We do not agree, provided its scope is properly understood and the principles are correctly applied. There is no reason why the tribunal should not come to a conclusion as to the overall effect of the arrangements through a process of construing the relevant contracts alongside a consideration of the extent to which the application of the *Ramsay* principle affects the position. Nevertheless, in our view, it is equally permissible to take the approach of first construing the relevant contracts conventionally, and then considering whether and to what extent the *Ramsay* principle applies. In the end, the same conclusion is reached because, as Mr Saini rightly accepted, depending on the statutory provision, it may be necessary to view the facts in a certain way. Consequently, if the two-stage approach is followed, the conclusions reached at the first stage of the process may need to be revisited. Whichever process is followed, it must always be borne in mind that the facts must be analysed in the light of the particular statutory provision being applied, and taking account of the need (depending on the relevant question) to view the transaction realistically.

112. Where, as here, there is more than one tax question to be answered such that different statutory provisions are relevant, then the approach of looking at the contracts conventionally at the first stage without reference to the relevant statutory provisions may be less likely to lead to error. That was well illustrated in the case of *UBS AG v Revenue and Customs Commissioners* [2016] STC 934 (*"UBS"*) where the Supreme Court held that conditions attached to shares which had no business or

commercial purpose were to be disregarded for the purpose of deciding whether the shares were restricted securities, since that was necessary in order to apply the tax benefit attaching to such shares as Parliament intended; but they did not have to be disregarded for the purpose of assessing the value of the perquisite of employment which the shares constituted, since ordinary taxation principles required the tax to be based on its true value: see [94] and [95] of the judgment.

113. It is therefore helpful to set out the essence of the *Ramsay* approach as it has now developed. An authoritative summary of the approach, reviewing the previous authorities, is to be found in the well-known case of *Barclays Mercantile Business Finance Limited v Mawson (Inspector of Taxes)* [2005] STC 1 ("*Barclays Mercantile*") at [32] to [38], where Lord Nicholls said:

> "32. The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in *MacNiven v. Westmoreland Investments Ltd.* [2003] 1 AC 311, p 320, para 8:
>
> > "The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case."
>
> 33. The simplicity of this question, however difficult it might be to answer on the facts of a particular case, shows that the *Ramsay* case did not introduce a new doctrine operating within the special field of revenue statutes. On the contrary, as Lord Steyn observed in *McGuckian* [1997] 1 WLR 991, p 999 it rescued tax law from being "some island of literal interpretation" and brought it within generally applicable principles.
>
> 34. Unfortunately, the novelty for tax lawyers of this exposure to ordinary principles of statutory construction produced a tendency to regard *Ramsay* as establishing a new jurisprudence governed by special rules of its own. This tendency has been encouraged by two features characteristic of tax law, although by no means exclusively so. The first is that tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said, "in the real world". The second is that a good deal of intellectual effort is devoted to structuring transactions in a form which will have the same or nearly the same economic effect as a taxable transaction but which it is hoped will fall outside the terms of the taxing statute. It is characteristic of these composite transactions that they will include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge.

35. There have been a number of cases, such as *Inland Revenue v. Burmah Oil Co. Ltd.* 1982 SC (HL) 114, *Furniss v. Dawson* [1984] AC 474 and *Carreras Group Ltd. v. Stamp Commissioner* [2004] STC 1377 in which it has been decided that elements which have been inserted into a transaction without any business or commercial purpose did not, as the case might be, prevent the composite transaction from falling within a charge to tax or bring it within an exemption from tax. Thus in the *Burmah* case, a series of circular payments which left the taxpayer company in exactly the same financial position as before was not regarded as giving rise to a "loss" within the meaning of the legislation. In *Furniss*, the transfer of shares to a subsidiary as part of a planned scheme immediately to transfer them to an outside purchaser was regarded as a taxable disposition to the outside purchaser rather than an exempt transfer to a group company. In *Carreras* the transfer of shares in exchange for a debenture with a view to its redemption a fortnight later was not regarded as an exempt transfer in exchange for the debenture but rather as an exchange for money. In each case the court looked at the overall effect of the composite transactions by which the taxpayer company in *Burmah* suffered no loss, the shares in *Furniss* passed into the hands of the outside purchaser and the vendors in *Carreras* received cash. On the true construction of the relevant provisions of the statute, the elements inserted into the transactions without any commercial purpose were treated as having no significance.

36. Cases such as these gave rise to a view that, in the application of any taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far. It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, to decide whether the transaction in question does so. As Ribeiro P.J. said in *Collector of Stamp Revenue v. Arrowtown Assets Ltd*. [2003] HKCFA 46, para 35:

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

37. The need to avoid sweeping generalisations about disregarding transactions undertaken for the purpose of tax avoidance was shown by *MacNiven v. Westmoreland Investments Ltd.* [2003] 1 AC 311 in which the question was whether a payment of interest by a debtor who had borrowed the money for that purpose from the creditor himself and which had been made solely to reduce liability to tax, was a "payment" of interest within the meaning of the statute which entitled him to a deduction or repayment of tax. The House decided that the purpose of requiring the interest to have been "paid" was to produce symmetry by giving a right of deduction in respect of any payment which gave rise to a liability to tax in the hands of the recipient (or would have given rise to such a liability if the recipient had been a taxable entity). As the payment was accepted to have had this effect, it answered the statutory description notwithstanding the circular nature of the payment and its tax avoidance purpose.

> 38. *MacNiven* shows the need to focus carefully upon the particular statutory provision and to identify its requirements before one can decide whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute. In the speech of Lord Hoffmann in *MacNiven* it was said that if a statute laid down requirements by reference to some commercial concept such as gain or loss, it would usually follow that elements inserted into a composite transaction without any commercial purpose could be disregarded, whereas if the requirements of the statute were purely by reference to its legal nature (in *MacNiven*, the discharge of a debt) then an act having that legal effect would suffice, whatever its commercial purpose may have been. This is not an unreasonable generalisation, indeed perhaps something of a truism, but we do not think that it was intended to provide a substitute for a close analysis of what the statute means. It certainly does not justify the assumption that an answer can be obtained by classifying all concepts *a priori* as either "commercial" or "legal". That would be the very negation of purposive construction: see Ribeiro P.J. in Arrowtown at paras 37 and 39 and the perceptive judgment of the Special Commissioners (Theodore Wallace and Julian Ghosh) in *Campbell v. Inland Revenue Commissioners* [2004] STC (SCD) 396."

114. The principle was explained further by Lord Reed in *UBS*. Having made reference to the well-known statement of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown* [2003] HKCFA 46 cited at [36] of *Barclays Mercantile* as set out above, he said at [67] and [68]:

> "67. References to "reality" should not, however, be misunderstood. In the first place, the approach described in *Barclays Mercantile* and the earlier cases in this line of authority has nothing to do with the concept of a sham, as explained in *Snook*. On the contrary, as Lord Steyn observed in *McGuckian* at p 1001, tax avoidance is the spur to executing genuine documents and entering into genuine arrangements.
>
> 68. Secondly, it might be said that transactions must always be viewed realistically, if the alternative is to view them unrealistically. The point is that the facts must be analysed in the light of the statutory provision being applied. If a fact is of no relevance to the application of the statute, then it can be disregarded for that purpose. If, as in *Ramsay*, the relevant fact is the overall economic outcome of a series of commercially linked transactions, then that is the fact upon which it is necessary to focus. If, on the other hand, the legislation requires the court to focus on a specific transaction, as in *MacNiven* and *Barclays Mercantile*, then other transactions, although related, are unlikely to have any bearing on its application."

115. A number of the issues between the parties in this case clearly require us to consider the "overall economic outcome" of the transactions. That certainly applies to the Trading Issue and the View to Profit Issue.

116. As regards the question of whether what the LLPs did amounted to the carrying on of a trade, although we deal in detail with some of the leading cases on that question when addressing the Trading Issue, we make some observations at this stage derived from those cases as to the relevance of the *Ramsay* principle to that question.

117.In *Ensign Tankers,* it was clear from the passage from Lord Templeman's speech set out at [86] above that his view of the package of documents as a composite transaction was relevant to the question of whether the Victory Partnership carried on a trade, which remained a live issue in the House of Lords.

118.*Eclipse Film Partners No 35 LLP v HMRC* [2015] STC 1429 (CA) ("*Eclipse*"), concerned a complex series of transactions entered into by a limited liability partnership and its members in relation to the acquisition, distribution and marketing of film rights in relation to two films produced by the Disney group. The key question for the Court of Appeal was whether the activities carried on by the partnership constituted a trade.

119.At [109] Sir Terence Etherton C, who delivered the judgment of the court, stated that the case concerned the proper meaning and application of "trade", as that term is used in s 863(1) ITTOIA 2005. He then referred at [110] to the *Ramsay* principle, as summarised in *Barclays Mercantile* and at [111] commented that the "unblinkered approach to the analysis of the facts" and "realistic approach to the transaction" which underpin that principle derive "at least in part" from the speeches of the House of Lords in the leading case of *Ransom v Higgs* [1974] STC 539. In that case Lord Morris said at [550] that "in considering whether a person "carried on" a trade it seems to me to be essential to discover and examine what exactly it was that the person did". The Chancellor commented that it was necessary to stand back and look at the whole picture and, having particular regard to what the taxpayer actually did, ask whether it constituted a trade.

120.It was therefore clear that the court in *Eclipse* proceeded on the basis that the *Ramsay* principle was relevant when considering whether the activities carried on by the partnership answered to the description of a "trade", as that term is used in s 863(1) ITTOIA 2005.

121.This approach was endorsed by Henderson LJ in *Samarkand Film Partnership No 3 v HMRC* [2017] STC 926 ("*Samarkand*") where he stated at [59] that it was clear from *Eclipse* at [111] that the question whether what the taxpayer actually did constituted a trade has to be answered by standing back and looking at the whole picture, and again by Henderson LJ in *Degorce v HMRC* [2017] STC 2226 at [52].

122.Consequently, in coming to its conclusions on the trade question in *Eclipse* the court was guided by what the FTT in that case found to be the "substantial reality" of the transactions, established by reducing them to their core following a detailed factual investigation into what actually happened and what the taxpayer actually did on "a realistic view of the facts": see [138], [141] and [145] of the judgment. It is therefore clear that the FTT is entitled to make an overall assessment of the nature of the arrangements.

123.That approach does not amount to a process of recharacterisation of the contractual arrangements, nor is it inconsistent with the fact that no allegation of sham is made in the present case. At [61] of *Samarkand* Henderson LJ observed that it was important to distinguish between the evaluative exercise which the FTT has to

perform, on the one hand (following the approach set out above), and the proposition that a taxpayer cannot be taxed by re-characterising what he has actually done as something else, on the other hand, which, as Henderson LJ said would amount to an "impermissible transformation of the taxpayers' activities into an economic equivalent". The task of the FTT is to express the ultimate inference of fact which they draw from the totality of the primary facts which they find.

124.As regards the Incurred Issue, as we discuss later, there is specific judicial guidance in the context of capital allowances, notably in *Barclays Mercantile* as well as *Ensign Tankers*. There the statutory context is different. *Barclays Mercantile* was a decision as to whether the taxpayer was entitled to capital allowances for expenditure under s 24(1) of the Capital Allowances Act 1990, which provided for allowances to a person carrying on a trade who had incurred capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade, and to whom it belonged in consequence of the expenditure. The plant in question in that case was a natural gas pipeline and in the Court of Appeal ([2003] STC 66) (whose judgment was upheld by the House of Lords for substantially the same reasons) Carnwath LJ said at [57] that that the statutory provision being considered left "very little room for the application of the *Ramsay* principle". Neither the "reality of the pipeline" nor the fact that ownership was transferred to the taxpayer could be ignored, the transactions concerned being "real transactions with lasting consequences in the real world".

125.In looking at the facts realistically, it may be appropriate in some cases to disregard theoretical possibilities that may exist as a matter of contract law but which, realistically, were never contemplated by the parties. For example, in *IRC v Scottish Provident Institution* [2005] STC 15, the effect of a composite transaction was 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: see [23] of the opinion of the House of Lords.

126.Mr Saini cited *Rossendale Borough Council v Hurstwood Properties* [2019] EWCA Civ 364 as demonstrating that there are limits to the application of the *Ramsay* principle. That case concerned two schemes designed to avoid the payment of National Non-Domestic Rates (NDR) on properties which in most instances were unoccupied. Both schemes involved the grant of leases of the properties to special purpose vehicle companies (SPVs) without assets or liabilities which, as part of the scheme in question, were placed in voluntary liquidation or allowed to be struck off the register of companies as dormant companies, and thus dissolved.

127.The local authorities sought to recover the NDR from the freehold or leasehold proprietors who had granted the leases to the SPVs. Those proprietors maintained, by virtue of the leases, that the SPVs were the owners of the properties for the purposes of liability to pay NDR during the currency of the leases. The local authorities accepted that this was the case unless the leases or the SPVs could as a matter of law be disregarded. One of the issues in the case was whether it was arguable that the leases fell to be disregarded by application of the *Ramsay* principle.

128. Henderson LJ, who gave the judgment on this issue, said at [72] that it was necessary to ask whether the execution of each lease in favour of an SPV had the effect in law of transferring the immediate legal right to possession from the proprietor to the lessee company. On the basis that it was accepted that the leases were valid and not shams, the effect in law of their execution was to grant the immediate legal right to exclusive possession of the property to the tenant. At [73] Henderson LJ said that it followed from that basic proposition of land law, that once each scheme lease was executed, the right to legal possession of the property passed from the proprietor to the lessee. Accordingly, the liability to NDR in respect of the property also passed to the lessee, because from the day the lease was granted it was the lessee, and not the proprietor, which satisfied for the ownership condition in the relevant legislation which imposed the liability to the NDR. That was the relevant condition which had to be satisfied for the purposes of the statutory scheme, and as a matter of law the transfer of ownership took effect immediately upon the execution of the lease, regardless of the motivation of the parties in entering into it. He went on to say in the same paragraph:

> "… for the purposes of [the statutory provision] the only relevant concept is whether ownership of the property has passed from the lessor to the lessee. On the agreed facts in the cases with which we are concerned, that condition was unquestionably satisfied, and I cannot see any scope for giving to the concept of ownership in this context, as defined in the [statutory provision], anything other than its normal legal meaning. The legislation is therefore not amenable to a wider, purposive construction which could allow scope for the *Ramsay* principle to operate."

129. At [74] Henderson LJ dealt with an argument that the notion of an owner of a hereditament entitled to possession has to be interpreted purposively as an owner with a real entitlement to possession, such that an SPV whose only reason for existence was to accept a lease, with no commercial purpose other than to avoid the liability to pay NDR, was not the owner of a hereditament. That argument was rejected on the basis that it was not enough merely to point to the tax avoidance motive of the ratepayer, or the pre-ordained nature of the transactions which were undertaken; the concept of entitlement to possession which gave rise to the liability to pay NDR was an intrinsically legal one, which was satisfied the moment that a valid lease to the SPV had been executed. The argument was not so much an attempt to construe words in the statute, but to divine purpose behind a provision in the statute, extract that purpose and then apply the principle that a person should not be able to evade that purpose because it was Parliament's purpose (para [76], citing Mann J's judgement in *Westbrook Dolphin Square Ltd v Friends Life Ltd (No2)* [2014] EWHC 2433 (Ch) at [135]).

130. We do not find anything in *Rossendale* which casts doubt on our analysis as set out above and the applicability of the *Ramsay* principle to the transactions with which we are concerned. *Rossendale* emphasises the need to focus on the relevant statutory provision. In that case, the statutory provision imposed liability on the person who had the legal right to possession and the legislation was not amenable to wider construction.

Key provisions to be construed

131.In this case, in construing the contractual arrangements, the key questions to bear in mind include (i) what an LLP was required to pay to the PSC; (ii) what rights the LLP acquired under the arrangements; and (iii) what the LLP's role was in the film or game production process. In addressing these questions, the FTT was entitled to look carefully at the true effect of the arrangements and was not prevented from doing so either by the fact that there were a number of different agreements or by the fact, urged on us by the LLPs, that individual features of the arrangements, such as the use of sub-contractors, SPV production companies, non-recourse loans or security arrangements, are common in the film industry.

132.In the light of our discussion above, we consider the position both on the basis of conventional contractual construction and legal principles and, having regard to the Trading Issue in particular, by reference to an overall assessment of the nature of the arrangements entered into by the LLPs.

133.We set out at [134] to [163] below a summary of our conclusions on the contractual arrangements, with a more detailed analysis of the funding and income distribution arrangements in the Appendix to this decision. Unless otherwise indicated, the provisions referred to are those in the documentation for *Hot Fuzz*.

Was the LLP obliged to pay 100 as regards the funding of a film or game and does it have any right to receive BDR[4]?

134.This question is relevant to the Trading Issue, the View to Profit Issue and the GAAP issue. The first part of the question is also relevant to the Incurred Issue.

135.Clause 3.1 of the PSA provides that the LLP shall "subject to receipt by the [CM] of funding under the Loan Agreement and opening of the Production Account, advance, or cause to be advanced, the Production Funds to the Production Account…". The Production Funds was an amount equal to the budget for the film (i.e. the notional 100 amount) and the Production Account was an account maintained by the PSC. Although this provision refers to receipt by the CM, clause 4.1 of the Loan Agreement in fact required the CD to pay the amount drawn to the Production Account, or as otherwise directed by the PSC.

136.Although at first sight the LLP appears to take on an obligation to pay 100 to the Production Account we conclude, based on our analysis set out in more detail in the Appendix, that the LLP only has to pay 30 and is never exposed to the risk of paying any more than 30. We come to that conclusion on the conventional approach to the construction of the PSA by reference to the factual matrix, without any reference to the *Ramsay* principle.

[4] BR in the case of ITP.

137.Neither in our view does the LLP ever obtain any substantive legal or equitable rights to BDR, which are paid to or retained by the CD as lender in satisfaction of the repayment obligations of the CM under the Loan Agreement. Those rights are assigned by the LLP from the outset of the arrangements. Although that was effected by means of an assignment by way of security (with an equity of redemption), in practice those rights will be exhausted in repaying the sums due under the Loan Agreement to the CD. As we explain in more detail in the Appendix, a scenario under which the option to prepay the loan from other sources is exercised is quite unreal, and on any realistic view of the facts (being the approach we must take for the Trading Issue at least) that possibility must be ignored. As we also explain later, that prepayment scenario also ignores the full extent of the security arrangements.

138.In our view it makes no material difference to the issues to be decided whether the payment of 70 was characterised as a loan made by the CD as lender to the CM, or as a capital contribution by the CM to the LLP. The LLP is never obliged to pay 70, and BDR amounts are never realistically amounts to which the LLP can be said to be entitled.

139.These conclusions fit with the economic and factual realities. It is clear from the findings of the FTT and the terms of the contractual arrangements that the CD (and its associated entities) was not prepared to take any risk that would arise if the funds passed through the LLP (either the funding advanced to the PSC or the BDR which came from the CD through the Waterfall). Neither would the LLP take any risk that it might have to pay any part of the 70. As demonstrated by the FTT in tables that it set out at [251] in relation to ITP and [264] in relation to IFP2, the true position was that GDI was split as to 70 to the CD and 30 to the relevant LLP.

Acquisition, ownership and disposal of film and game rights

140.This is relevant to the Trading Issue, the GAAP issue and the Income/Capital Issue.

141.At [181] and [182] the FTT set out the principal contractual provisions regarding the LLPs' rights in relation to a film as follows:

> "181. The following provisions of the CDA (*Hot Fuzz*) are relevant:
>
> (a) Clause 2.1 provides that from the Delivery Date (when the film is finished) the LLP assigns to the CD all its rights in the film. It says that, subject to the licence in clause 2.7, nothing in clause 2 shall vest rights in the film in the CD before the Delivery Date.
>
> (b) By clause 2.4 an undated executed assignment is to be delivered by the LLP to the CD to have the delivery date inserted by the CD to give effect to 2.1.
>
> (c) Clause 2.5 provides for a back up option for the CD to acquire the rights in the film if a court declares the assignment ineffective, (and the LLP acknowledges that specific performance would be an appropriate remedy if the option is not complied with).

(d) Clause 2.6 makes Clause 2 subject to the Reserved Copyright under the PSA and provides that the rights to that copyright transfer to the CD only when they move to the LLP from the PSC. (The Reserved Copyright is 5% of the copyright in the film, which under the PSA is reserved by the PSC from the assignment of all present and future copyright in the film to the LLP until the completion of the film when it is "assigned to [the LLP] simultaneously with and included within [the LLP's] assignment of the copyright to the [CD]").

(e) By clause 2.7 the LLP grants to the CD an exclusive and irrevocable licence of the rights in the film in perpetuity or until the date of the assignment (subject to the LLP's right to produce, complete and deliver the film under the agreement). The carve out of the right to produce and deliver the film indicated that the licence was intended to exclude the LLP from using the film rights as well as prohibiting its granting such rights to others.

(f) Clause 6.3 gives the CD exclusive control over the distribution and marketing of the film; and clause 6.4 gives it the exclusive right to gross receipts, although it has to pay the LLP under the waterfall.

(g) In the warranties in clause 7 the LLP warrants that it will not authorise anyone else to exploit the film, create encumbrances over, or otherwise deal with rights to the film, and in clause 9.20 it agrees not to release the film to any third party.

182. In addition in the Deed of Guarantee, Security Assignment and Charge the LLP assigned by way of security such rights as it might have at any time in the film to the CD and, in another similarly entitled document, also assigned them by way of security to the Completion Guarantor. What rights the LLP had must have been limited to the equity of redemption under these deeds."

142. The FTT summarised the effect of those provisions at [184] to [187] as follows:

"184. The effect of those clauses of the CDA is to deprive the LLP of any substantial right in relation to the film while it is being produced. Its rights are limited to those in relation to the making of the film and, if it can be said to be a right, a right to deliver what interest it has on the Delivery Date (a "right" to which the CD, not the LLP, gives effect by dating the assignment required by clause 2.4). Any attempt by the LLP to renege on the agreement would in our view be subject to a remedy of specific performance in favour of the CD. Moreover the interest the LLP has is subject to the terms of the exclusive licence to the CD and its obligations not to exploit the film.

185. Before the date of completion of the film the LLP is in a position analogous to that of a trustee of the film. It is the holder of 95% of the copyright in the film but, as a result of the licence, the benefit of that copyright is enjoyed exclusively by the CD. After the date of completion of the film the LLP has no different right to exploit the film and the CD's right to exploit the film is the same as it was beforehand.

186. The remaining 5% of the copyright is assigned to the LLP and by the LLP to the CD at the same time. The effect is that the LLP never has the right to that 5%.

187. The commercial effect of the provisions is that the LLP can do nothing with any part of the rights associated with the film at any time during its production. It is bound by iron fetters. The LLP cannot even get its hands on rights to exploit the film by defaulting on the agreement since the laboratory would not let it have the materials, the licence would remain in effect and specific performance would almost certainly be given."

143. At [193] the FTT deals with an argument of the LLPs that because in certain circumstances the rights to the film will be transferred to the Completion Guarantor the CD cannot be the beneficial owner when its entitlement depends upon a contingency, namely the completion of the film as opposed to its abandonment by, and transfer to, the Completion Guarantor. The FTT said that the LLP "is a constructive trustee of the rights it holds in the film for the benefit of the CD or, if the contingency arises, the guarantor notwithstanding clause 2.1 of the CDA".

144. It would therefore seem that when at [185] the FTT says that the LLP "is in a position analogous to a trustee" it means that it holds whatever rights it has in the film as a constructive trustee (see also paragraph [382], which also refers to a finding of constructive trusteeship).

145. At paragraph [188] the FTT referred to a number of cases relied on by HMRC in support of their submission that the LLP held such rights as accrued to it under the PSA prior to completion of the film as constructive trustee for the CD. The first of those cases, *Lloyds Bank plc v Carrick* [1996] 4 All ER 630, a case involving the sale of land, is authority for the proposition that where the whole of the consideration has been provided, the vendor loses any beneficial interest and becomes a "bare trustee" of the property. In the second case, *Mountney v Treharne* [2003] Ch 135, it was said at [71] that although the basis of the equitable jurisdiction is founded on an order *in personam*, equity treats as done that which ought to have been done, which was why a purchaser under a specifically enforceable contract for the sale of land is treated in equity as the owner, and a trust beneficiary is treated as immediately entitled to his interest in the trust property, even though no court order has been made.

146. As the LLPs submitted, a person who has contracted to sell real estate (or other unique property) is under an obligation to use reasonable care to preserve the property until completion. That the vendor assumes certain trustee-like duties in respect of the property does not, however, mean that he or she immediately relinquishes all beneficial interest in it upon conclusion of the contract of sale. Subject to the terms of the contract, the vendor will, for example, remain entitled to the enjoyment of the land or its rental income until the contractual completion date has been reached, and the purchase price paid in full. So, in *Jerome v Kelly (Inspector of Taxes)* [2004] STC 887, Lord Walker said at [32] that it would be wrong to treat an uncompleted contract for the sale of land as equivalent to an immediate, irrevocable declaration of trust (or assignment of a beneficial interest) in the land. Neither the seller nor the buyer has unqualified beneficial ownership.

147.We agree with the LLPs that *Lloyds Bank* and *Mountney* illustrate that a person who comes under a present obligation to transfer unique property relinquishes his or her beneficial interest in it, notwithstanding that he or she retains legal title. But neither case provides support for the proposition that a person who will in future come under an obligation to transfer property ceases to have a beneficial interest before that obligation crystallises.

148.HMRC submit that, once the transaction documents had been entered into, the consideration for the transfer of the film to the CD had already been provided: the consideration had been "executed" (meaning that the CD had performed the relevant obligations constituting the consideration). They say that, as in this case, where an assignor promises or agrees for valuable consideration to assign an existing legal or equitable chose in future (as opposed to a present assignment intended to operate immediately) for consideration that has been executed, equity will give effect to such an agreement by treating the agreement as performed to the extent that it will cause a beneficial interest in the chose to vest in the assignee. In that situation, the beneficial interest arises as a result of the imposition of a constructive trust, the assignor holding the chose as trustee for the benefit of the assignee, irrespective of whether specific performance would be ordered (see Guest on the Law of Assignment, 3rd edition, at 3-19).

149.It seems to us that this analysis depends on treating the consideration for the transfer of the film as a vested chose in action, such that it is fully satisfied (or executed) from the date of the contract, rather than as a deferred obligation to pay money. Whilst we agree that a right to an unascertainable amount at a future date is a chose in action and not a debt: see *Marren v Ingles* 54 TC 76, that does not mean that this type of consideration should necessarily be treated as "executed", whereas a fixed price for a film that has not yet fallen due to be paid, and will not be paid unless the film is completed and delivered, is not. That would lead to an apparently irrational difference of treatment depending on the precise form of consideration to be provided. In reality, the CD's obligation to provide consideration, in the form of the LLP's rights under the Waterfall, crystallises only once the film is delivered. HMRC's analysis also overlooks the fact that it is clear from the terms of the CDA that the parties did not intend title to the copyright in the film to transfer until the "Effective Date" (generally the Delivery Date referred to at paragraph [141] above). We also note that even if an order of specific performance could be obtained in advance of that date it would require the transfer only on the date the parties had agreed: see *Hasham v Zenab* [1960] AC 316 at 330.

150.However, aside from its constructive trustee analysis, which for the reasons set out above we find to be flawed, the FTT rightly took into account the exclusive licence given to the CD pending assignment on completion of the film, subject only to a carve out to allow production and delivery of the film. The FTT said, correctly in our view, at [193] that whether or not it was a constructive trustee of the rights it held in the film it was clear that the LLP "was always devoid of any of the benefits of ownership of the film". As the FTT said at [187] it was "bound by iron fetters".

151.The provisions of Clause 2.1 of the CDA, which provides for immediate and automatic assignment with effect from the Effective Date, together with the backup provisions of Clauses 2.2 to 2.5 which among other things specifically contemplate specific performance and require the provision of an executed and undated assignment and power of attorney, emphasise the lack of control of the LLP over the film as well as the absence of any benefits of ownership.

152.In addition to the terms of the licence, the effect of Clauses 6 and 7 of the CDA is to give further control to the CD over the exploitation of the film.

153.Under clause 6.1 the CD has the exclusive right to appoint distributors of the film with effect from the date of the CDA. Clause 6.3 gives the CD sole and exclusive control of the distribution, marketing, advertising, publicising, exploitation, sale or other disposition of the film. Clause 6.4 provides that the CD owns all rights to the gross receipts generated by the film, including the right to hypothecate them. Clause 7.5 contains a prohibition against the LLP authorising any party to distribute, exhibit or exploit the film by any means. Clause 7.7 prevents the LLP disposing of or dealing in any way with any physical materials. Clause 7.8 prevents the LLP creating any encumbrances of any kind against the film and under Clause 7.9 the CD can exploit the film and trailers for the film worldwide without the payment of any royalties to the LLP.

154.Finally on this point, the LLP had no control over the post production processing of the film because pursuant to a Pledgeholder Agreement the laboratory carrying out that processing held all negative and positive material and all sound material made in connection with the film as pledgeholders for the CD in support of the security arrangements.

155.However, the LLPs contended that the equity of redemption that it retained in the film as a result of the security arrangements was a meaningful right. We accept that the security documents executed in favour of the CD and the Completion Guarantor did not by themselves deprive the LLP of all ownership rights, and that in principle there was an equity of redemption. However, in our view, this was a theoretical rather than a real right. The security in favour of the CD was in reality bound to stay in place until after the film was complete and copyright was formally assigned, as provided for in the CDA. Even if the loan provided to the CM was pre-paid (which in our view was fanciful given its interest-free nature and the fact that the CM had no funds of its own, which meant that the loan could only be repaid out of BDR) then the security could not be redeemed because it secured the LLP's obligations under the CDA as well as the obligations under the Loan Agreement.

156.The obligations under the CDA were clearly not to be fulfilled until the film had been delivered. Mr Saini put forward the hypothesis of a repudiatory breach by the CD of the CDA which would make it advantageous for the LLP to terminate the CDA, prepay the loan and exploit the film itself. That hypothesis is not only unreal in practice bearing in mind the limited extent of the obligations that the CD incurred under the CDA, but also conflicts with clause 25 of the CDA, which provides that in no event shall the LLP be entitled to terminate or rescind the agreement. In response,

Mr Saini submitted that even if Clause 25 did prevent acceptance of a repudiatory breach (which he did not accept) it only dealt with contractual termination rather than termination of the CDA for other reasons, such as frustration or rescission for fraudulent misrepresentation. Again, we find that scenario to be entirely hypothetical and unreal. In particular, in the context of the Trading Issue (and, given FRS 5, the GAAP Issue) a realistic approach is needed which takes account of the substance, rather than theoretical and implausible possibilities which neither party contemplated.

157. Mr Saini also submitted that another substantial right held by the LLPs was the ability to sue any infringer of the copyright in the film. That presupposes that rights vested in the LLP through the equity of redemption but, as we have said, those rights lacked reality even if, which we doubt, the security arrangements did not prevent the LLP taking the necessary action against the infringer.

158. We conclude that the LLP had a mere shell of ownership rather than any meaningful rights in the film. It had no control of the rights and was powerless to prevent delivery of the film to the CD. This is consistent with what we have said about the commercial reality of the situation: the CD was not prepared for the LLP to have any substantive rights to the film. Instead, the real interest the LLP had in the film was in the CD's own rights to exploit it, from which the LLP would benefit indirectly via the Waterfall.

159. We therefore come to the same conclusion as the FTT did on this issue, but for different reasons. Although the FTT referred to there being a constructive trust and to the CD being the beneficial owner of the film, it made it clear at [193] that its findings did not depend on a conclusion that the LLP was a constructive trustee. Given the limitations on the LLP's rights described above, we do not think the error of law on the part of the FTT on this point was material. The true nature of the transactions, viewed realistically, was that they did not involve the acquisition, ownership and disposal of film rights.

Were the LLPs in reality producers of films?

160. This question is clearly material to the Trading Issue and, in particular, the point that in deciding whether the activities of the LLPs constituted a trade it is necessary to examine what they actually did.

161. At [233] to [238], by reference to the PSA for *Hot Fuzz*, the FTT summarised the contractual arrangements relating to the control exercised by the LLPs over the making of the film as follows:

> "233. The PSA provides for the PSC to make the film as an independent contractor. The film is defined as the film conforming to a specified screenplay and a Specification which details, among other things, the producer, director, proposed artist(s), location, length, budget and delivery date.
>
> 234. Clause 2.3 of the PSA provides that creative control shall be exercised by the LLP (although day-to-day decisions are to be made by the PSC) but that the LLP is prohibited from taking any decision which would impair the approval

rights of the CD under the CDA (see below). The PSC acknowledges that certain matters are, under the CDA, subject to the approval or consent of the CD and agrees to obtain CD approvals on behalf of the LLP and keep the CD informed.

235. Clause 4.1 of the PSA sets out matters over which the LLP is initially expressed to have a right of approval but requires that the LLP and the PSC shall "consult meaningfully" with each other over them, and that if there is any dispute the Completion Guarantor's decision shall be final. The relevant matters include items such as producer, directors, cast, crew, composer, designer, screenplay and Cashflow. In relation to these matters, the effect of this clause is to give the LLP a chance of influencing the making of the film but only if its suggestions or ideas are acceptable to, or coincide with, those of the Completion Guarantor (a company associated with CD). It has the right to be heard.

236. The obligations placed by the PSA on the PSC to make the film are mirrored in obligations of the LLP under the CDA. The CDA provides that the LLP shall proceed with the production of the film (which is defined by reference to the same specification as in the PSA). It provides that the CD shall have an absolute right of approval over the list of all the matters which were in clause 4.1 of the PSA. It too provides for meaningful consultation between the CD and the LLP, but also provides that on any dispute the Completion Guarantor's decision shall be final.

237. The CDA provides that the film shall conform to the specified screenplay and, subject to the list of approvals, permits the LLP to exercise, in consultation with the CD, creative control over other matters, but also that the LLP shall comply with all lawful requests of the CD in relation to the film. Taken together with the equivalent terms of the PSA this gives the CD or an associate company effective control over the making of the film.

238. In their first Note of Evidence HMRC show in relation to the film *Australia* how each obligation of the PSC to the LLP under the PSA in relation to the making of the film is matched by corresponding obligation of the LLP to the CD although there are three obligations of the LLP to the CD under the CDA (to deliver a cost statement, copies of documents in relation to the film and rushes) which are not mirrored in the PSA. The summary is not disputed by the Appellants."

162. Then, at [239] and [240] it concluded as follows:

"239. Thus, after the documents were signed all the LLP had to do under the agreements was to pay and sit back and wait. If asked it could consent to matters in the Approvals List, but it could always be overridden by the CD through the Completion Guarantor, and in any event it was likely that anything it was asked to approve had the approval of the CD (since the PSC was its associate). If it wanted it could make suggestions but it had no right to compel the execution of its ideas or at least any ideas of substance. But there was also a disincentive to interference: clause 16.2 of the CDA (*Hot Fuzz*; clause 17.2 in *Australia*) provided that the LLP would not be liable for any default which derived from a default of the Studio, the Completion Guarantor or the PSC unless the PSC's default derived from an autonomous act of the LLP. If the LLP interfered it did so at its own risk.

> 240. In summary: the CD had control over the creative content of the film. The LLP had a right to be heard but was incentivised not to interfere."

163. In our view, the FTT was entitled to conclude that, reading the CDA together with the PSA, the LLP just had to "pay and sit back and wait" once the agreements were signed. The LLPs say that is not the case with reference to the Completion Guarantor, which was a third party for independent films and was not necessarily associated with the CD. However, in our view, that does not help the LLPs. The point correctly made by the FTT at [239] and [240] was that the LLP had a limited role in relation to the production of films and either the CD, or the CD and the Completion Guarantor, in practice called the shots. We return to that issue in more detail when considering the Trading Issue.

III. THE TRADING ISSUE

Legal Test

164. We start with consideration of the principles as to what constitutes a trade as developed by the case law. The LLPs rely heavily not only on the House of Lords decision in *Ensign Tankers* but also on the analysis of Millett J (as he then was) in the High Court in that case, [1989] STC 705, and in particular at 762d to 764c, where the judge set out nine propositions on the basis of which he held that the limited partnerships in that case were trading. Those propositions were not disputed in the subsequent appeals in that case and we set them out as follows:

> "(1) In order to constitute a transaction in the nature of trade, the transaction in question must possess not only the outward badges of trade but also a genuine commercial purpose.
>
> (2) If the transaction is of a commercial nature and has a genuine commercial purpose, the presence of a collateral or ulterior purpose to obtain a tax advantage does not "denature" what is essentially a commercial transaction. If, however, the *sole* purpose of the transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose.
>
> (3) Where commercial and fiscal purposes are both present, questions of fact and degree may arise, and these are for the Commissioners. Nevertheless, the question is not which purpose was predominant, but whether the transaction can fairly be described as being in the nature of trade.
>
> (4) The purpose or object of the transaction must not be confused with the motive of the taxpayer in entering into it. The question is not *why* he was trading, but *whether* he was trading. If the sole purpose of the transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose. But it is perfectly possible to predicate a situation in which a taxpayer whose sole motive is the desire to obtain a fiscal advantage invests or becomes a sleeping partner with others in an ordinary trading activity carried on by them for a commercial purpose and with a view of profit.
>
> (5) The test is an objective one. In *Newton v Commissioner of Taxation of Australia* [1958] AC 450 at 465, Lord Denning said … "The purpose of a

contract, agreement or arrangement must be what *it* is intended to effect and that intention must be ascertained from its terms". The objective nature of the enquiry appears clearly from both the dividend-stripping cases and the cases of intra-group transactions …. In each of these cases the purpose of the transaction was objectively ascertained by a detailed analysis of the terms and circumstances of the transaction itself without enquiry into the motives and subjective aspirations of those who effected it.

(6) In considering the purpose of a transaction, its component parts must not be regarded separately but the transaction must be viewed as a whole. That part of the transaction which is alleged to constitute trading must not be viewed in isolation, but in the context of all the surrounding circumstances. But this must mean all *relevant* surrounding circumstances; that is to say, those which are capable of throwing light on the true nature of the transaction and of those aspects of it which are alleged to demonstrate a commercial purpose.

(7) If the purpose or object of a transaction is to make a profit, it does not cease to be a commercial transaction merely because those who engage in it have obtained the necessary finance from persons who are more interested in achieving a fiscal advantage from their investment. Even where the trader is the creature of the financier, the two activities are distinct and the object of one is not necessarily the object of the other.

(8) In *FA and AB Limited v Lupton*, Lord Morris said, 47 TC 580 at 620:

> "It is manifest that some transactions may be so effected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction. The result will be not that a trading transaction with unusual features is revealed but that there is an arrangement or scheme which cannot fairly be regarded as being a transaction [in the nature of trade]."

In my judgment this is the true significance of a fiscal motive. Fiscal considerations naturally affect the taxpayer's evaluation of the financial risks and rewards of any proposed venture, and are often the decisive factor in persuading him to enter into it. First year allowances, enterprise zones, government grants and the like operate as financial inducements to businessmen to engage in commercial activities which would be financially unattractive or unacceptably speculative without them. Such motivations, even if paramount, do not alter the character of the activities in question. But while a fiscal motive, even an overriding fiscal motive, is irrelevant in itself, it becomes highly relevant if it affects, not just the shape or structure of the transaction, but its commerciality so that, in Lord Morris' words, "the shape and character of the transaction *is no longer that of a trading transaction*". But nothing less will do.

(9) Accordingly, in my judgment, and adapting the words of Lord Simon in *Thomson v Gurneville* (47 TC 633 at 679), the question is whether, in the light of all relevant circumstances, the transaction is capable of being fairly regarded as a transaction in the nature of a trade, albeit one intended to secure a fiscal advantage or even conditioned in its form by such intention; or is incapable of being fairly so regarded but is in truth a mere device to secure a fiscal advantage, albeit one given the trappings normally associated with trading transactions."

165.Millett J found at page 765d that the Special Commissioners' conclusion that the transactions concerned were not trading transactions was based on the absence of any commercial motive on Ensign Tankers' part coupled with further findings, among other things, (i) that there was no evidence of any significant activity by Victory Partnership after it entered into the arrangements, that event having no impact on the actual production and distribution of the film, and (ii) the limited partnerships made no attempt to control expenditure on the films.

166.Millett J held that none of these features threw any light on the question the Commissioners had to decide. Victory Partnership's lack of activity was a result of the arrangements it had entered into, namely acquiring and paying for a partially completed film, engaging the services of a sub-contractor to complete the film on its behalf, undertaking to deliver the completed film and entering into arrangements for the distribution and exploitation of the film. Millett J held at page 765f that such transactions were ordinary trading transactions. Consequently, all the events that subsequently happened were in accordance with the arrangements previously made, and those arrangements did not call for any significant degree of activity on the part of Victory Partnership. Millett J observed that it is open to a partnership, like any other trader, to act through agents or independent contractors.

167.The Commissioners were criticised for not having pursued the "crucial enquiry" which was whether the financial terms which Lorimar offered were so unfavourable to the limited partnership that the transactions which resulted could not fairly be described as commercial (page 766j).

168.At page 767g to h Millett J observed that for purely fiscal reasons, the transactions were so structured that instead of acquiring a 25% interest in the venture, Victory Partnership borrowed 75% of the budgeted cost and acquired 100% interest. The loan was made without recourse, and Victory Partnership had to concede a 75% interest in any ultimate profits in consequence. He therefore characterised the arrangements "as being in substance the acquisition of a 25% interest", observing at page 767h that the arrangements actually adopted, like the acquisition of a minority stake in a trading venture, also prima facie constituted a transaction in the nature of trade.

169.In the circumstances in which the limited partnership appeared on the scene, at page 768c Millett J formulated the question of law which arose from the facts found by the Commissioners as follows:

> "…Where a partnership enters into a commercial transaction with a view of profit, can it fairly be regarded as carrying on a trade even if (i) it obtained the necessary finance from investors who are primarily motivated by the hope of obtaining a fiscal advantage rather than a commercial profit; and (ii) the transaction itself was deliberately structured in order to secure the fiscal advantage without ceasing to be commercial or jeopardising the prospects of profit?"

170.He then answered that question in the affirmative.

171. At page 768g to 769a Millett J dealt with an argument that the limited partnerships were not trading at all but merely investing in films to be made and distributed by others. That argument was rejected on the basis that the partnerships each purchased an uncompleted film and arranged for it to be completed on its behalf with a view to its commercial exploitation. He went on to say:

> "The transaction had all the characteristics of a typical though speculative trading transaction, and none of the characteristics of an investment."

172. The issue of trading remained alive in the higher courts, although the focus was mainly on the purpose with which the transactions have been undertaken, and the relevance of the taxpayers' motives, in deciding whether the composite transaction was genuinely commercial in nature.

173. In the House of Lords, Lord Templeman analysed the situation as being trading involving expenditure of 25% of the cost of making the film: see page 671B. At page 677D he said that Victory Partnership expended capital for the purpose of producing and exploiting a commercial film, and that the production and exploitation of a film is a trading activity. At page 680A he said that the legal effect of the transaction was a trading transaction whereby the limited partnership expended $3.25 million towards the production of a film in which it had a 25% interest. Lord Goff expressed the position slightly differently at page 684C, concluding that the limited partnership was trading, but only to the extent of its investment and no more. At page 682D he placed little emphasis on the fact that the title to the master negative of the film vested in the limited partnership, because the distribution arrangements deprived that legal ownership of any meaningful effect. However, in our view those comments must be viewed with some caution given that the claim for capital allowances, which was the subject matter of the appeal, depended fundamentally on the master negative belonging to the limited partnership. Lord Jauncey's analysis at page 685D was that the investment made by the limited partnership was expenditure for the purposes of trade.

174. On the commercial purpose issue, the Inland Revenue had placed much reliance on Lord Morris's statement in *Lupton*, quoted by Millett J in the passage set out at [164] above, but Lord Templeman did not find *Lupton* to be a useful precedent. He said at page 671C that neither the taxpayer nor the Revenue should be deprived of the fiscal consequence of the taxpayer's activities properly analysed. At page 676H he observed that the principles of *Ramsay* do not compel or authorise the court to disregard all the fiscal consequences of a single composite transaction read as a whole on the grounds that it appears that the transaction is a tax avoidance scheme. He criticised the reasoning of the Court of Appeal to the effect that the Revenue had to weigh the paramount fiscal intention against the non-fiscal elements and decide as a question of fact whether in essence the transaction constituted trading for commercial purposes, saying this at page 677D:

> "… I do not consider that the commissioners or the courts are competent or obliged to decide whether there was a sole object or paramount intention nor to weigh fiscal intentions against non-fiscal elements. The task of the commissioners is to find the facts and to apply the law…. The facts are

> undisputed and the law is clear. Victory Partnership expended capital of $3.25 million for the purpose of producing and exploiting a commercial film. The production and exploitation of the film is a trading activity. Expenditure of capital for the purpose of producing and exploiting a commercial film is a trading purpose. By section 41 of the Act of 1971 capital expenditure for a trading purpose generates a first-year allowance. The section is not concerned with the purpose of the transaction but with the purpose of the expenditure. It is true that Victory Partnership only engaged in the film trade for the fiscal purpose of obtaining first year allowances but that does not alter the purpose of the expenditure."

Lupton was also considered in some detail by Lord Jauncey at pages 684 to 685, where he concluded that it did not require the trading transaction undertaken by Victory Partnership to be denatured.

175. We accept the LLPs' submission that, on the basis of the findings as to what the Victory Partnership in *Ensign Tankers* actually did following its entering into the arrangements and the findings made by the FTT in this case, the LLPs (or at least Ingenious on their behalf) carried out substantially more activities in relation to the production of the films than Victory Partnership did in the *Ensign Tankers* arrangements, and with substantially more by way of organisation.

176. The LLPs also rely on *New Angel Court v Adams* [2004] STC 779. In that case the Court of Appeal considered whether a company had acquired properties from its fellow subsidiaries as "trading stock" within the meaning of s 173(1) of the Taxation of Chargeable Gains Act 1992, with the result that the company was entitled to elect that the loss on the sale of the properties be taken into account in computing its trading profits.

177. Jonathan Parker LJ, who gave the leading judgment, said at [93]:

> "… the mere fact that a group of companies sets out to avail itself of the opportunity of obtaining a fiscal advantage which Parliament has itself provided says nothing as to whether the requirement which Parliament has imposed as the condition of obtaining that fiscal advantage – that is to say that the asset in question must be acquired *"as trading stock"* – has been fulfilled. It would, as it seems to me, be strange if it were otherwise. Indeed, I find it hard to conceive of a situation in which an asset is acquired under an intra-group transfer *"as trading stock"*, and an election made to convert the capital loss into a trading loss, where fiscal considerations have not played some part in the thinking of those concerned in planning or executing the transaction."

178. He then said at [94]:

> "… fiscal considerations (whether they be described in terms of motive, purpose or object) must be put entirely on one side in considering whether an asset was acquired "as trading stock" for the purposes of s 173(1)."

179. He then concluded at [98] that s 173(1) does not require the absence of fiscal considerations as elements in the acquisition of the asset in question: rather, it requires

the presence of a trading purpose. He made reference to Megarry J's statement at first instance in *Lupton* (referred to by Lord Morris in that case at page 621) that the existence of fiscal considerations will not "de-nature" a trading purpose, just as the existence of fiscal considerations will not prevent what would otherwise be a trading transaction from being regarded as such for the purposes of s 173(1). Finally, at [99] he said:

> "at the heart of the matter, as it seems to me, is the need to recognise that in the context and for the purposes of s 173(1) a trading transaction may be dictated entirely by fiscal considerations, without losing its character as a trading transaction…"

180. Although *Ensign Tankers* is clearly of some assistance to us in determining the Trading Issue, there have been many more recent cases on the issue, and in our view it is important to consider how those cases, a number of which deal with film finance schemes, have dealt with the question as to what activities as a matter of law are capable of amounting to a trade.

181. The first of those cases is the Court of Appeal's judgment in *Eclipse,* which we have already referred to briefly at [118] to [120] above.

182. Eclipse 35 was a limited liability partnership which contended that it carried on the trade of acquiring and exploiting film rights. The essence of the arrangements in that case were that a limited liability partnership raised money from individual investors and entered into arrangements with Disney whereby it acquired a licence of rights to a number of films pursuant to which it was obliged to pay royalties to Disney, and then immediately sub-licensed the rights to another Disney entity. As well as an entitlement to predetermined royalties, the limited liability partnership became entitled to highly speculative additional payments ("Contingent Receipts") if the films performed particularly well. There were also another series of agreements under which the limited liability partnership was said to have undertaken obligations to assist Disney in marketing and distributing the films.

183. The question was whether Eclipse 35's activities amounted to a trade, the basis for that contention being that the receipt of the income streams from the royalties, the marketing activities and the possibility of receiving Contingent Receipts was sufficient to constitute a trade.

184. At [109] to [117] Sir Terence Etherton C set out some observations on the relevant legal principles to be applied when determining whether particular activities constitute the carrying on of a trade. As already noted, at [111] he observed that it is necessary to stand back and look at the whole picture and, having particular regard what the taxpayer actually did, ask whether it constituted a trade. He then said this at [112] and [113]:

> "112. The Income Tax Acts have never defined trade or trading further than to provide that (in the words of TA 1988 s. 832(1) which was applicable to the relevant tax year) trade includes every trade, manufacture, adventure or concern in the nature of trade. As an ordinary word in the English language "trade" has or

> has had a variety of meanings or shades of meaning. Its meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation, depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular factual characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles. To that extent the conclusion is one of fact, or, more accurately, it is an inference of fact from the primary facts found by the fact-finding tribunal.
>
> 113. It follows that the conclusion of the tribunal of fact as to whether the activity is or is not a trade can only be successfully challenged as a matter of law if the tribunal made an error of principle or if the only reasonable conclusion on the primary facts found is inconsistent with the tribunal's conclusion. These propositions are well established in the case law*: Edwards v Bairstow* [1956] AC 14, 29-32 (Viscount Simonds), 33, 36, 38-39 (Lord Radcliffe); *Ransom v Higgs* [1974] 3 All ER 949, 955 (Lord Reid), 964 (Lord Wilberforce), 970-971 (Lord Simon); *Marson v Morton* [1986] 1 WLR 1343, 1348 (Sir Nicholas Browne-Wilkinson V-C). An appeal from the FTT is on a point of law only: Tribunals, Courts and Enforcement Act 2007 s.11."

185.At [114] reference was made to the "badges of trade" set out by Sir Nicholas Browne-Wilkinson V-C in *Marson v Morton* [1986] STC 463 at 470-471, but the Chancellor observed that the cases by reference to which the list was compiled were not sufficiently analogous to the facts of the present case to make the list of value in the *Eclipse* proceedings. As we explain later, we take the same view in this case.

186.Reference was made at [115] to the statement of Lord Wilberforce in *Ransom v Higgs* that normally trade involves an exchange of goods or services for reward and pre-supposes a customer. It was observed at [116] that although trading involves a counterparty of some description, the court did not find it helpful in a complex transaction of the kind with which it was concerned to seek to identify whether that counterparty is or is not properly characterised as a "customer", as that word is used in ordinary speech. Again, we take the same view in this case. At [117] it was stated, in reliance on what Lord Templeman said in *Ensign Tankers* at page 677, that the mere fact that a taxpayer enters into a transaction or conducts some other activity with a view to obtaining a tax advantage is not of itself determinative of whether the taxpayer is carrying on a trade.

187.Eclipse 35 argued that on the basis of the contractual documents and the primary facts as to what was actually done by it and on its behalf, a finding that it was trading was the only possible legally correct outcome. It also argued that the acquisition of film rights and the sub-licensing of those rights for profit were inherently and as a matter of law carrying on a trade.

188.The second of those arguments was rejected. At [148] it was held that what was necessary is an evaluation of the precise facts against the background of the meaning of the statute.

189. As regards the first argument, namely whether trading was the only reasonable conclusion for the FTT to reach on the facts that it found, which included that Eclipse 35 acquired a real interest in the film rights, and that there were various marketing related activities, the Court of Appeal held that the FTT was entitled and correct to conclude that the essential elements of the transactions were, first, an element in the nature of an investment which produced a profit unrelated to the success or otherwise of the exploitation of the rights, and secondly, a share of Contingent Receipts which the FTT found was insufficiently significant to characterise the business as one of trade: see [123] and [124] of the judgment. At [138] and [139] the court concluded as follows:

> "138. [Counsel for the taxpayer] made various submissions on the burden of proof, suggesting that the FTT may have misunderstood or misapplied the burden, which he accepted lay on Eclipse 35, of establishing that its business was one of trade. There is simply no proper basis for any such suggestion. After analysing the mass of written and oral evidence adduced over some three weeks the FTT concluded on the facts, and was perfectly justified in concluding, that, reducing the transactions to their core and notwithstanding some contribution by SCI and Mr Salter, the substantial reality was that Disney produced the Films; let the rights in them to Eclipse 35, and immediately took them back again; Disney personnel created marketing plans and implemented them; and they reported back to Eclipse 35 what Disney was doing.
>
> 139.Against that background the FTT's conclusion that Eclipse 35 was not in reality carrying on a trade was justified and indeed correct. Eclipse 35 did not discharge the evidential burden of showing that it was engaged in trade in any realistic or meaningful way. The possibility of obtaining a share of Contingent Receipts did not give the business of Eclipse 35, looking at it as a whole, a trading character: having regard to the business as a whole, the right to Contingent Receipts was no more than a potential additional return on a fixed term investment."

190.At [140] the court held that the FTT's conclusion on the facts was not inconsistent with their finding that the contractual documents were not shams. At [141] it said that the reality of the transaction is something quite different and requires a detailed factual investigation of what actually happened and what the taxpayer actually did, which was the task that the FTT undertook.

191.The Court of Appeal characterised the FTT's substantive conclusion as being that on a realistic view of the facts, Eclipse 35 did not offer to provide any commercially meaningful goods or services to the Disney parties by way of business and that, stripped to its essentials, the relationship between Disney and all its related entities, on the one hand, and Eclipse 35 on the other hand, was one in which Eclipse 35 acquired an investment rather than carried on a trade: see [145] and [146] of the judgment.

192.The second case is the Court of Appeal's judgment in *Samarkand* which we have briefly mentioned at [121] and [123] above.

193. The appellants were film scheme partnerships. They acquired an interest in three films, which were acquired as part of a single transaction that encompassed their acquisition and their associated leaseback in return for fixed, increasing, secured and guaranteed rental payments for a 15 year period. The films were found by a promoter with whom the partnerships had entered into an agency agreement, under which the agent found the films and made arrangements for the acquisition and leasing.

194. Henderson LJ, who gave the leading judgment, took a similar approach to that taken in *Eclipse*. At [59] he said that the question whether what the taxpayer actually did constitutes a trade has to be answered by standing back and looking at the whole picture, following the approach stated by Sir Terence Etherton C at [111] of *Eclipse*. Henderson LJ emphasised that it is never appropriate to extract certain elements from the overall picture and treat them, viewed in isolation, as determinative of the issue. Thus, although the purchase and lease back of a film are capable of forming part of the trade, and in many contexts the only reasonable conclusion would be that they did, when the whole picture is examined, the conclusion will not necessarily be the same. The exercise which the FTT has to undertake is one of multi-factorial evaluation, and the conclusion can only be challenged on *Edwards v Bairstow* grounds.

195. The FTT in *Samarkand* had concluded that the activities of the partnerships were confined to and centred on the financial closing of the sale and lease back agreements, and thereafter for 15 years the activities were limited to the management of their fixed guaranteed receipts under those agreements. It found that the commercial nature of the agreements was the payment of a lump sum in return for a series of fixed payments over 15 years, and that type of transaction carried out on its own was not an adventure in the nature of trade (see the passage sent out at [31] in the Court of Appeal decision). The Court of Appeal found no basis to interfere with that conclusion, saying that the approach and evaluation of the facts by the FTT could not be faulted (paragraphs [60] and [61]).

196. The third case is the Court of Appeal's judgment in *Degorce v HMRC* [2017] STC 2226 ("*Degorce*").

197. The taxpayer was a hedge fund manager who entered into a series of transactions designed by the promoters of a scheme to produce an allowable trading loss in that year which he could claim to set off against his income from other sources. As is the position in this case, this loss was created by a write-off of the net realisable value of the rights the taxpayer acquired. The taxpayer contended that he was carrying on a trade of purchasing and exploiting distribution rights in films. The scheme involved the taxpayer acquiring distribution rights to the films, largely funded by limited recourse debt, which were then assigned to a film distribution company for a term of 60 years. The effect of the elaborate provisions constituting these arrangements, in broad terms, was that the taxpayer would receive no economic return until the studio making the film had recouped its investment, but he would then be entitled to 15% of the net proceeds from inception until the end of the 60 year term. Similar to the position in this case, since only a small proportion of films are a commercial success, the taxpayer was unlikely to make a return on any of his films viewed individually. But if one of his films was a commercial success, he could eventually expect to make

a substantial profit from it, whether by receipt of his share of the receipts or by disposal of his rights to a purchaser for a capital sum.

198. The FTT had found that there was no element of repetition in the taxpayer's transactions, which they regarded as a "one-off". They also found that the taxpayer did not intend to sell the potential income stream and "therefore, in the absence of a customer, the transaction cannot be viewed as having been carried through in a way typical of trade". The FTT inferred from the fact that the transaction took place over a short period of time that the asset subject to the transaction was, in reality, unimportant. It concluded that the taxpayer's activities were, in reality, focused on the close of the financial year, were limited to obtaining fixed receipts which cannot be deemed to be a trade and that the payment of the lump sum in return for a potential income stream was not an adventure in the nature of a trade.

199. Henderson LJ again gave the leading judgment. At [57] he criticised the FTT's finding that the taxpayer did not intend to sell the potential income stream, observing that it was not necessary for the taxpayer to have an intention to sell the income stream at some future date for the transaction to be capable of qualifying as a trading one. He said that on the face of it the immediate assignment of the taxpayer's rights in the two films in return for a potential income stream was, in itself, an obvious way of turning those rights to account, and it involved a counterparty.

200. The Upper Tribunal had regarded that error as immaterial to the FTT's overall conclusion that the taxpayer was not trading and that finding was upheld by the Court of Appeal. The court held that there was no error in the analysis and reasoning of the Upper Tribunal which led it to conclude that the taxpayer was not trading in film rights, but merely acquiring a contingent, or potential, income stream. Although the Upper Tribunal had found that the overall exercise was speculative, in the sense that it was unknown whether, and if so to what extent, the taxpayer would receive income from the exploitation of the rights, there was no element of speculation in the transactions themselves, which were undertaken on a predetermined basis with a predetermined outcome.

201. In the section of his judgment dealing with the meaning of trade (paragraphs [49] to [53]), Henderson LJ followed the approach which he had set out in *Eclipse* and *Samarkand.* In addition, he said it was important to note Lord Templeman's statement in *Ensign Tankers* at page 677 that the mere fact that a taxpayer enters into a transaction or conducts some other activity with a view to obtaining a tax advantage is not of itself determinative of whether the taxpayer is carrying on a trade. He also referred to Lord Templeman's further statement that the production and exploitation of a film is a trading activity and the expending of capital for the purpose of producing and exploiting a commercial film is a trading purpose.

202. The final case is the Court of Appeal's judgment in *The Brain Disorders Research Limited Partnership v HMRC* [2018] STC 2382 ("*Brain Disorders*").

203. The taxpayer limited partnership was established as part of a scheme designed with the twin objectives of allowing substantial capital allowances to be claimed for

expenditure on medical research and obtaining tax relief for the members of the partnership in respect of some £68.6 million of pre-payment of interest included as part of the financing structure of the scheme.

204.The partnership had claimed capital allowances of some £122 million on the basis that it incurred that amount of capital expenditure on research when carrying on a trade. These were refused, *inter alia*, on the basis that a claim for capital allowances could not extend beyond the £7.67 million paid and used for medical research because the wider contractual arrangements (including the bank loans which were part of the financing structure of the scheme) fell to be treated as a single composite transaction under which the only expenditure incurred on medical research was £7.67 million; but even that was not allowable because HMRC contended that the partnership was not carrying on a trade. By the time the case came to the Court of Appeal the partnership had conceded that the expenditure for capital allowance purposes was £7.67 million rather than £122 million. But in order to succeed in their claim they still needed to establish that the expenditure was "qualifying expenditure", and that required the activity to be trading in nature. The partnership argued that for the purposes of determining whether there was qualifying expenditure in that lower amount, rather than none at all, the same approach of looking at the wider arrangements should be taken, rather than taking account of the difference between the contractual positions of the partnership and the entity carrying out the research when considering the question of trading.

205.The FTT had concluded that there was no relevant trading activity at all by the partnership in relation to the research and development carried out, holding that the possibility of fluctuating royalties being received by the partnership was not a significant factor in relation to the purpose of the scheme, which was designed and marketed as a means of securing significant up-front tax relief (see paragraph [18] of the Court of Appeal decision). The FTT accepted HMRC's claim that the prospects of there being fluctuating royalties was highly speculative. Therefore, the payment of the £7.67 million could not have been a trading activity.

206.In the Court of Appeal Patten LJ gave the leading judgment. He referred at [26] to Lord Templeman's statement at page 677D-F of *Ensign Tankers* that the limited partnership in that case had expended capital for the purpose of producing and exploiting a commercial film, that the production and exploitation of the film is a trading activity, and that although the partnership only engaged in the film trade for the fiscal purpose of obtaining a first-year allowance that did not alter the purpose of the expenditure, which was "real and not magical expenditure".

207.By way of qualification to what Lord Templeman had said, Patten LJ referred to the following statement of Lord Reid in *Iswera v IRC* [1965] 1 WLR 663 at page 668:

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

208.He then concluded at [29] that there can be a transaction in the nature of trade contained within scheme arrangements and that "the intentions or motivation of the taxpayer may be close to irrelevant if the purpose of the transaction was clearly that of trade".

209.At [30] and [31] Patten LJ contrasted the scheme in *Brain Disorders* with that in *Ensign Tankers*; as regards the latter he said that even when one strips away the loan arrangements the partnership had still directly expended $3.25 million on the project, and it was not therefore difficult to conclude that the purpose of the expenditure was a trading one. As regards the former, the £7.67 million paid for research and development was only qualifying expenditure if it was incurred by the taxpayer at a time when he was carrying on a trade in respect of it. He then said:

> "The issue of trading calls, in my view, for an assessment of the actual arrangements which the parties put in place and the wider context in which the £7.67m came to be paid. It is a different question from what sum was actually expended on research and development for the purposes of s.437(1) and the court is not restricted to considering only those parts of the contractual arrangements which qualify for relief."

210.Patten LJ recognised the limitations of the *Ramsay* approach. He said at [32]:

> "Although the *Ramsay* approach to construction has undoubtedly involved the courts in looking at the commercial realities of the transaction and ignoring financial components of a scheme which are circular or have no purpose other than to produce a tax loss in order to identify whether and, if so, which parts of the transaction engage the relevant tax provisions, it does not enable the courts to fix the taxpayer with a contract which under the scheme it does not have. The actual transactions remain the same."

211.The LLPs in this case rely on that passage in their contentions that the analysis undertaken by the FTT in this case involved rewriting the terms of the contractual arrangements, an argument to which we will return later.

212.In *Brain Disorders*, the partnership's argument that it had spent money on research depended on it ignoring parts of the overall contractual arrangements and effectively rewriting them so that they had the effect that the partnership had directly spent the money on research that was in fact carried out by a sub-contractor. Effectively they were seeking to eliminate the role of the entity with which the partnership had actually contracted, and replace it with a direct arrangement with the sub-contractor.

213.In deciding that the FTT was correct to concentrate on what the partnership had spent on research as part of a trading activity, Patten LJ rejected at [35] the partnership's basic submission that the court was required to "ignore the totality of the actual contractual arrangements". He held that the FTT was entitled to conclude from the arrangements as a whole that they did not include an adventure in the nature of trade and that the only significant returns from its point of view were the fixed royalty payments which secured the repayment of the losses and the prepayment of interest

necessary to obtain interest relief. Those returns were not generated by the research carried out and were financially independent of it.

Whether the film LLPs were trading – the Decision

214. The FTT started its analysis, correctly in our view in the light of the case law that we have reviewed above, by asking "What did the LLPs do?", and set out its conclusions in that regard at [348] to [356]. This analysis followed from the conclusions it reached on the construction of the contractual arrangements, so:

> (1) At [349] it concluded that the obligation of the LLP to deliver the film to the CD was "almost meaningless" since all the material rights in the film were held by the CD or the PSC at all times.
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> (2) At [350] it concluded that the contracts gave effective creative control over the production of the film to the CD (through the LLP) and provided an incentive for the LLP not to interfere.
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> (3) At [351] it found that IFP2 was in effect buying interests in the income streams from the films rather than the right or obligation to produce them and that the negotiation of the agreements would not have been a simple process; they were complex arrangements not analogous to buying an investment.
>
> (4) At [352] it found that in practice Ingenious regarded the creative aspects of the production of the film as settled at the time the agreements were signed. After that people making the film would not want the LLP to interfere, and in practice the LLP did not interfere in any substantial way.
>
> (5) At [354] it found that the Operator's activities in finding films could not be attributed to the LLPs but the activities of negotiation were undertaken by the LLPs through the Operator.
>
> (6) At [356] it concluded that the portfolio of films in which the LLPs had an interest included an increasing proportion of Studio films, and that the work involved in putting together a deal for Studio film and finalising its documentation was less than for an independent film. The Studios had all the requisite resources to produce films without reference to anyone else; they wanted the involvement of the LLPs for their money and to lay off risk; the LLPs and Ingenious had no role in putting the film together, what they did was by comparison closer to buying an income stream in a complex way.

215. At Appendix 1 to the Decision the FTT set out in meticulous detail the conclusions it drew from the evidence on what activities of Ingenious staff could be regarded as being conducted by the LLPs through those persons (via the Operator) and what activities were carried out for the benefit of Ingenious. It summarised its conclusions about the former activities at [355] as follows:

> "(a) Considering for green-lighting films proposed by Ingenious entities. In that context we note here that we do not regard the LLPs as having gone out to search for new films save perhaps in the discussions Mr Clayton had with Fox

close to 5 April when new films were sought to mop up subscribed capacity, or a "valve" operated to cope with situations in which subscriptions were insufficient.

(b) Complex, serious and detailed negotiation of the commercial terms of agreements for the making of films.

(c) Entering into contracts for the making of films and in relation to their exploitation under which substantial sums were put at risk.

(d) Keeping an eye on what was going on in the making of the films and in particular paying some attention to the costs of production but without any significant involvement in the creation of the films.

(e) Receiving revenue and reviewing revenue statements from films;

(f) Accounting and administration."

216. We note that at [1282] the FTT recorded Mr McKenna's evidence that in some cases Ingenious played an important part in finalising the financing package for an independent film, but it did not conclude that this was an activity undertaken by the LLPs. At [1317] it concluded that Ingenious's activity in relation to independent films could be substantial, mainly in relation to bringing together the necessary finance from other sources to meet its requirement that 70% of the necessary finance would be provided through that route. But selecting films and putting finance packages together was not found by the FTT be to be an activity of the LLPs. In our view, given that a key object of the Commissioning Distributor Model was to identify films where the majority of funding was in place so that the LLP would just step in at that point, that conclusion was one that the FTT was obviously entitled to reach. On that basis, the findings of the FTT indicate that the main additional work on behalf of the LLPs in relation to independent films as compared to Studio films was work on the negotiation of the contractual documents, as it found at [1329].

217. The FTT's summary of its findings in the Decision contained in the Further Decision illustrates that in essence the FTT regarded the LLPs' activities as being of a financial nature. It summarised those findings at [2] of the Further Decision, so far as relevant to the Trading Issue, as follows:

"(i) we held that the "relevant agreements" for any particular film or game were entered into at the same time as a single package and should be construed as a composite;

(ii) that under those agreements the LLPs acquired no meaningful interest in a film, and had limited involvement in its making;

(iii) that as a result of the relevant agreements and the payment made under them, the LLPs acquired as asset which was the right to payment of a portion of the proceeds of distribution of a film;

(iv) that an LLP's financial activity was the exchange of a sum of money paid to one party for a potential future financial reward from another;

(v) that an LLP did not intend to dispose of the right it acquired under the relevant agreements although the right was realised (so in effect consumed) as monies flowed from the right;

(vi) that these were speculative, organised, repeated transactions;

…"

218.At [39] of the Further Decision the FTT said that it had found that the nature of the LLPs' trade was financial. It said that the trade was "the speculative activity of choosing and laying out money on rights in the hope of monetary receipts from them".

219.At [357] to [384] of the Decision the FTT discussed the legal principles as regards what constitutes a trade. The analysis drew heavily on what was said in *Ensign Tankers* in the light of the prominence that the parties had clearly given to that case in the arguments before the FTT. At [379] the FTT observed that the decision in *Ensign Tankers* did not require the acquisition of film rights and their exploitation in return for a share in receipts to be treated as a trade, but it was a strong indicator that transactions such as that undertaken by the Victory Partnership in that case may be a trade. At [383] the FTT observed that while some form of ownership of the master negative of the film was relevant to the claim for capital allowances, the difference in ownership rights between the limited partnership in that case, which Lord Goff had described as being without meaningful effect, and what it had found to be the LLPs' limited ownership rights in this case, was not of significance.

220.At [385] to [396] the FTT carried out a comparison of the LLPs' case against the findings that were made in *Eclipse, Samarkand* and *Degorce*. At the time of the Decision, only *Eclipse* had reached the Court of Appeal.

221.At [387] the FTT distinguished *Samarkand* on the basis that whereas the transactions in that case had the nature of the payment of a lump sum in return for a series of fixed payments, the return on the LLPs' outlay on any film is uncertain and speculative.

222.At [391] the FTT distinguished *Eclipse* on the basis of the nature of the LLPs' receipts; Eclipse 35 received a fixed royalty the amount of which was independent of the success of the film and had the right to Contingent Receipts: the only element of its return which could be called speculative was the right to the Contingent Receipts and that was nugatory, but the LLPs' whole return was speculative and substantial.

223.At [395] the FTT characterised *Degorce* as a "complex packaged scheme" sold to reduce the taxpayer's tax bill and put into effect over the course of a few days. It said at [396] that by contrast the LLPs through the Operator conducted complex negotiations for their contracts, in varying degrees evaluated the films and were concerned about the size of the budgets, so that the nature of what they did was different.

224.At [403] to [436] the FTT addressed a number of factors which the precedents indicated may be relevant to the assessment of whether an activity is a trade, including the *Marson v Morton* badges of trade. It appears that the FTT put significant weight on the factors of organisation and repetition being present, together with the work done on behalf of the LLPs and the element of speculation. At [416] the FTT rejected HMRC's submission that the mere acquisition of rights to possible future revenue could not amount to a trade, giving the example of the fact that a bank trades in making loans and a bookmaker trades in money and risk, tending to carry out those activities over a long period and with a degree of organisation.

225.The FTT also considered whether there was a genuine commercial purpose to the transactions. Its conclusions on that point were set out as follows:

> "435. We find this requirement is satisfied. In commercial substance the LLPs paid and were obliged to pay 30% (35%) of the budgeted cost and received and were entitled to receive 30% (35%) of GDI. That was a genuine commercial deal.
>
> 436. If we were wrong and the legal effect or commercial substance of the transactions was that the LLPs bought the film or game for 100% of budget and became entitled to at best 54.45% of GDI we would find that the deal was not commercial, and that this test was not satisfied."

226.The FTT then gave its overall conclusion on the Trading Issue at [438] as follows:

> "438. In relation to Independent films there was more substance to the LLPs' activities; for Studio films the activities had more of the characteristics of arranging and monitoring investments in an income stream (that was particularly the case where an LLP came into the picture at a very late stage when almost all the elements of the film had been pulled together and principal photography was about to start). But the two activities were part of the one business.
>
> Taking all this together we conclude, on balance, that the LLPs were trading: the Operator did more than act as an investment manager of a portfolio of investments: through its actions and those of its agents the LLPs engaged in speculative, organised, repeated transactions in a way which involved work beyond that which would have been involved in the mere making of an investment."

227.Finally, at [439] to [456], the FTT considered the relevance of fiscal motive, correctly noting that if the taxpayer's acts were equivocal his purpose may be a material factor in weighing the total effect of all the circumstances.

228.At [452] the FTT rejected HMRC's submission that fiscal considerations informed almost the entirety of the design of the Commissioning Distributor Model, holding that such analysis could not stand in the light of *Ensign Tankers*, and noting that when the "clothes of the dressed up transaction" in that case were removed, the transaction which remained was a trading transaction and the attempts to dress it up did not denature it.

229.At [453] it said the same was true in this appeal; the ordinary transaction was a 30% investment for a 30% share of GDI, dressed up to look like a 100% investment for a share of GDI of no more than 54.55%[5]. At [454] the FTT held that the transaction had not been denatured by the "dressing up" and could fairly be described as a trading transaction, having at its core a 30% investment for 30% of GDI. The shape and structure of that (30:30) transaction was not determined by the fiscal purpose.

230.However, at [456] it said that if the legal effect of the agreements was as the LLPs contended, then it would conclude that the transactions lacked commerciality and that the fiscal motive of the LLPs when taken in the balance would mean that they were not trading.

Discussion

Introduction

231.The LLPs say that the only conclusion reasonably open to the FTT on the evidence was that the LLPs were trading regardless of whether the 30:30 Basis or the Ingenious Basis is correct. They contend that each film LLP produced a slate of feature films for theatrical release, and on a proper analysis of the contracts sold each completed film to a distributor in return for a share of GDI, the precise terms of which were the subject of detailed contractual provision between the parties. The films were produced through a sub-contractor as is normal practice in the industry, and the activities carried out by the PSC as sub-contractor for the LLPs should be attributed to the LLPs for the purposes of assessing whether the activities of the LLPs amounted to a trade, as was accepted by Millett J in *Ensign Tankers*. They also rely on a statement by Eveleigh LJ in *Floor v Davis* [1978] STC 436 at page 446 c-d that "a man may act through the hand of another whose conduct he manages to manipulate in some way".

232.The LLPs submit that even if the FTT was correct in holding that the film LLPs simply acquired rights to payments from the CD which they then retained, nevertheless in view of the FTT's findings at [348] to [356], as summarised above, about the activities of the film LLPs, the FTT was right to find that ITP and IFP2 were carrying on a trade.

233.Notably, in *Ensign Tankers* the taxpayer partnerships held their rights indefinitely, with no intention of resale, yet were still held to be trading, not investing, and in *Degorce* Henderson LJ criticised the FTT's reliance on the fact that the taxpayer did not intend to sell the potential income stream he obtained.

234.The LLPs submit that HMRC are wrong to contend that the LLPs had no "customer" and as such cannot have been trading. Even if the FTT was correct in its finding that there was no sale of the film by each LLP to the CD, the absence of a "customer" is of itself of limited or no relevance to the identification of whether a

[5] Strictly 54.45%

given transaction amounts to a trade in the type of circumstance here in question. As Henderson LJ said in *Degorce* at [57], referring to *Eclipse* at [115], it is necessary to treat the references in *Ransom v Higgs* to the need for a "customer" with care in cases of this type. Likewise, as the Court of Appeal said in *Eclipse* at [114], contrary to the submissions of HMRC, an analysis of the badges of trade is of limited value in cases of this type.

235.The LLPs submit that the FTT's finding that ITP and IFP2 had a genuine commercial purpose only if profit fell to be determined on the 30:30 Basis was a perverse conclusion; whether the LLPs had such a purpose cannot possibly depend upon the basis on which profit is to be determined.

236.The LLPs do not accept HMRC's contentions in its grounds of appeal that the presence of a fiscal purpose on the part of the individual members of the LLPs entails a necessary conclusion that the trade was denatured, neither can the existence of a fiscal motive operate so as to denature the transaction if it was to be characterised on the Ingenious Basis rather than the 30:30 Basis.

237.Our findings on the Trading Issue are informed by our conclusions on the reality of the arrangements entered into by the LLPs. To recap:

(1) the LLPs only ever had an obligation to pay 30 to acquire the rights that they did and were never exposed to the risk of paying any more than 30;

(2) the LLPs never had any substantive legal or equitable right to income receipts beyond 30 as they did not acquire any substantive legal or equitable rights to BDR;

(3) the LLPs had a mere shell of ownership rather than any meaningful rights in the films; and

(4) the LLPs had a limited role in relation to the production of films

238.We therefore agree with the FTT's summary of its own findings at [2] and [39] of the Further Decision, as set out at [217] and [218] above, subject to our reservations about the manner in which the FTT came to its finding that the arrangements were to be construed as a composite agreement.

Errors of law on the part of the FTT

239.HMRC's position is that, based on the facts found by the FTT, all the LLPs did was to acquire and hold interests in future income of films and games, in consideration for funding provided to the PSCs. Since the FTT rejected the conclusion that the LLPs were producers or played any substantive part in making or developing films, the activities of the LLPs must be investment and not trading activities, and that was the only conclusion reasonably open to the FTT on the facts which it found.

240.It appears to us that what tipped the balance in favour of the FTT's finding that the film LLPs were trading was what was done in relation to independent films: see [438] as set out at [226] above. The FTT noted that in relation to Studio films the activities

had more of the characteristics of "arranging and monitoring investments in an income stream" in contrast to independent films where the activities had more substance. It reached its "on balance" conclusion that the film partnerships were trading on the basis that the Operator did more than act as an investment manager of a portfolio of investments, and that "through its actions and those of its agents the LLPs engaged in speculative, organised, repeated transactions in a way which involved work beyond that which would have been involved in the mere making of an investment". HMRC say that this wrongly attributed activities to the LLPs which the FTT had not found were their activities, as opposed to those of Ingenious. In addition, HMRC's case is that such work as was undertaken was largely due to the fiscal character of the transactions.

241. We may only interfere with the Decision if there has been an error of law. We have concluded that the FTT did make errors of law, in the sense of errors of principle (as referred to in *Eclipse* at [113], cited at [184] above) in reaching its conclusion that the film LLPs were trading. We have also concluded that those errors are so material that we should set aside and remake that part of the Decision. We will summarise the errors before explaining in more detail what we consider to be the correct approach.

242. We agree with HMRC that the FTT made an error of principle by concluding that the activity in relation to independent films was such as to transform what was fundamentally investment into a trading activity.

243. Whilst, as we have said, the FTT undertook a very careful analysis in Appendix 1 of the Decision as to the activities carried on respectively by the LLPs and Ingenious, we do not consider that it properly applied that analysis in relation to independent films, or, if it did, it made an error of law as to the significance of the activities in question. Those activities, which were described at [1404] to [1409] and summarised at [355], as set out at [215] above, are all consistent with the acquisition of investments rather than trading activities. The FTT found that sourcing of films was not attributed to the LLPs. Green-lighting, that is the process by which an LLP's involvement in a film would be approved, was found by the FTT to have been undertaken on behalf of the LLPs through an executive committee (the "Green-lighting committee"). Negotiation was also found to have been undertaken on behalf of the LLPs, but whilst in relation to independent films the FTT found that the negotiations were trickier, we do not consider that that feature alone can be sufficient as a matter of law to transform an investment activity into a trading activity.

244. As we have said, although the FTT recorded Mr McKenna's evidence at [1282] that in some cases Ingenious played an important part in finalising the financing package for an independent film, it did not conclude that this was an activity undertaken by the LLPs. Its conclusions related to the selection of independent films, set out at [1317], include a finding that Ingenious's activity in relation to such films could be substantial, mainly in relation to bringing together the necessary finance from other sources to meet its requirement that 70% would be provided from such sources. However, selecting films and arranging finance packages was found by the FTT not to be an activity of the LLPs. As we have said, such a finding was one that the FTT would obviously have been entitled to reach, bearing in mind its finding that

a key object of the Commission Distributor Model was to identify films where the majority of funding was in place before the relevant LLP participated in the arrangements. Consequently, the main additional work to be undertaken by the LLPs in relation to independent films was work on the negotiation of the contractual documents, as found by the FTT at [1329] and [1399]. However, difficult and complex negotiations can be a feature of any bespoke investment transaction, such as the complex negotiations that are typical and necessary where a private equity fund makes an investment.

245.HMRC relied on *Ransom v Higgs* to support the proposition that it is not possible to characterise the activity of one person as trading by reference to the activities of another. Mr Gammie submitted that what is critical is what the person actually does, distinguishing the position of an agent or sub-contractor, where a person is responsible for some task (being the provision of goods or services) and contracts with someone else to undertake all or part of the task, and a case where a person contracts with another to provide a service to it, such as identifying suitable investments or assembling a financing package in relation to an investment that the person wishes to make.

246.We do not entirely accept HMRCs criticisms of the Decision in this respect. The FTT made findings at [354] as to the role of the Operator, as set out in clause 2.1 of the Operator's Agreement, which included identifying suitable films for the Green-lighting committee and negotiating and entering into agreements on behalf of the LLPs. In general, the FTT carried out a careful analysis in Appendix 1 as to which activities were undertaken on behalf of the relevant LLP and which were to be regarded as activities undertaken on behalf of Ingenious. Clearly, the terms of the Operator's Agreement envisaged that the Operator would undertake specified activities on behalf of the LLP. However, if the FTT had correctly applied its factual findings as to the activities which the Operator undertook on behalf of the LLPs in relation to independent films, then we do not see how it could have concluded that more complex negotiation alone was sufficient to turn what on the face of it was clearly an investment activity into a trading activity. In our view, in reality Green-lighting and negotiation, like sourcing films and assembling finance, were not reflected in any provision of goods or services for reward *by* the LLPs. They were simply services provided *to* the LLPs that facilitated the making of investments by them.

247.We also consider that the FTT made errors in its assessment of "commercial purpose". As is clear from Patten LJ's statement in *Brain Disorders* at [29], quoted above, the intentions or motivation of the taxpayer "may be close to irrelevant", echoing the approach taken in both *Ensign Tankers* and *New Angel Court* in the passages we have quoted from those cases above. It is clear from the cases that tax motivation does not prevent a conclusion that there was a trading transaction unless it so infects the structure that the transaction is inconsistent with trading.

248.In particular, we cannot see how it is legitimate to conclude that tax motivation so infected the structure of the activities of the LLPs that it is not possible to say, as the FTT did at [436], that the LLPs were trading on the Ingenious Basis, which was

clearly the basis on which the parties sought to transact, but that it is possible to say that the LLPs were trading on the 30:30 Basis, a finding which reflects a joint venture structure which the parties did not in terms sign up to. As was held at [32] of *Brain Disorders*, quoted above, it is not possible to ignore all the contractual terms. The LLPs were either trading on the basis of a realistic view of the facts and the contractual framework, or they were not. As was submitted to the House of Lords in *Ensign Tankers*, partial trading is unknown to the law: either the LLPs were trading or they were not and it is not possible to say that they were trading but only to a limited extent.

249. That does not mean that tax motivation is necessarily irrelevant. As we discuss below, the tax motivation of the LLPs is part of the factual context and it may be relevant if the nature of the activities carried on is equivocal.

250. The FTT made further errors as follows.

251. First, we do not consider that its reliance on the badges of trade was particularly helpful in this case, and we think it may have led the FTT into error by obscuring the key significance of the nature or character of the activity undertaken, as opposed to the manner in which it was undertaken. In particular, focus on organisation and repetition as indicators of trading, plus the amount of work involved, can lead to error: building a portfolio of investments can involve repetition and significant organisation, but it is still investment. Contrary to the suggestion by the FTT at [1351], investing in, for example, unquoted shares and securities, particularly private equity, real estate and infrastructure investments, can involve a significant amount of complexity, work on legal documentation and subsequent monitoring.

252. We therefore do not accept the FTT's statement at [419] that the effort involved in arrangement and negotiation is in itself a significant factor pointing towards trading, nor its statement at [424] that the work done by the LLPs was akin to work done on an object to be sold.

253. Secondly, the FTT considered at [417] that the transaction in point in *Ensign Tankers* was not substantially different from many of the film transactions carried out by the LLPs, so that the fact that the LLPs did not acquire and dispose of films or games did not point away from trade. As we discuss in more detail below, we consider that the FTT wrongly concluded that there was no material distinction from *Ensign Tankers* in that respect.

254. Finally, we consider that the FTT was wrong to suggest at [430] that an investment should normally have a residual value. There are a number of examples of wasting assets which are commonly acquired as investments, such as the acquisition of an annuity, an income bearing share in a split capital investment trust, often called an "annuity share" where there is little if any right to the distribution of capital on a winding up, or indeed an investment in a film library.

255.We regard these further errors as also being material. Consequently, we can and should interfere with the FTT's conclusion that the LLPs were trading on the 30:30 Basis and, as we set out below, we shall remake the Decision on this issue.

Whether the film LLPs were trading

256.Without the benefit of authority (especially *Ensign Tankers* and the recent confirmation in *Brain Disorders* and *Degorce* of its continued relevance on the trading issue) we would readily conclude that the LLPs were not trading. *Ensign Tankers* and the subsequent authorities require careful consideration, but we have decided that *Ensign Tankers* can and should be distinguished, and that the correct conclusion is that none of the film LLPs were trading.

257.As has been repeatedly said in the authorities, it is necessary to look carefully at the facts found, standing back and looking at the whole picture. Once the activities carried out by Ingenious that the FTT found could not be attributed to the LLPs are stripped out, and account is taken of the reality of the insignificance of the LLPs' ownership rights of the films, what is left is negotiation of and entry into a series of speculative investment in financial assets, and little serious ongoing involvement in the production of the films.

258.There are a number of findings of the FTT that support that conclusion, as follows:

(1) at [356] which describes the activity as buying an income stream in a complex way;

(2) at [405] which describes the activity as the exchange of a sum of money paid to one party for a potential future financial reward from another;

(3) at [418] which describes the structure as not one for dealing in a film but one for the acquisition of an interest in the proceeds of exploitation of a film;

(4) at [428] which states that in reality the right acquired was the right to income and the LLP did not intend to dispose of it;

(5) at [453] which describes the transaction as a 30% investment for a 30% share of GDI; and

(6) at [39] of the Further Decision, which summarised the trade as financial, namely the speculative activity of choosing and laying out money on rights in the hope of monetary receipts.

259.As regards ongoing activity once the investment had been made, the LLP's role as "producer" (in any sense) was not significant once film deals had been signed up, and the FTT had also found that activity relating to the sourcing of films could not be attributed to the LLPs.

260.What the FTT found that the LLPs actually did, as summarised at [355], was Green-lighting, negotiation, entry into documents and some ongoing monitoring.

Some decision-making was needed on financial aspects, but that could be consistent with the transaction being one of investment, such as being asked for additional finance or to approve a change in a business plan.

261. The fact that transactions carried out were bespoke deals requiring complex negotiations does not mean that the activity is trading, and neither does taking a serious, business-like approach or doing something in an organised way. Agreeing the terms of documents represents no more than establishing the terms on which an activity will be undertaken, rather than being determinative of the nature of the activity. As we have said, we do not think that the approval process, the negotiation and entry into the deal documents, and limited work thereafter, is trading.

262. Neither does the fact that the activities carried out are repetitive mean that there is a trade. Building up a portfolio of investments requires a number of acquisitions and can be done in a more or less business-like fashion. As we have said, the absence of residual value cannot be determinative, and in any event at least some films are expected to produce income over a lengthy period.

263. We do not consider that the fact that the income was contingent and to a high degree speculative tips the balance. As a matter of principle, it is of course quite possible for investments to be highly speculative. The fact that they are does not mean that what is done amounts to a trade, the focus being on what the activity is, that is what is being done.

264. As regards the LLPs' submission that the activities of the PSC can be attributed to the LLP so that it can be regarded as a producer, that analysis was clearly not accepted by the FTT and no appeal is made against that finding. The FTT found that the obligations in the CDA were essentially mirrored in the PSA and that the result of Clauses 16.2 and 16.3 of the CDA and the mirroring arrangements meant that an LLP's exposure was so cut down that it did not take on any meaningful "production" role at all. Neither did it have any real control of the production process. In reality the LLP was inserted between the CD and the PSC with the CD's agreement on the basis that the LLP would part fund the film. That insertion was a requirement of its investment, rather than something needed by the CD, whose only requirement was for finance. The PSC was not independent but in reality was associated with the CD, and the restrictions imposed by the CDA would also have prevented the LLP engaging anyone other than the PSC. Whilst the same may be true of the position in *Ensign Tankers*, as discussed below the nature of the trade relied on there was different. The position is also not like that described in *Floor v Davis* (see the reference at [231] above): there was no control being exercised by the LLPs. Furthermore, as we have stressed, the LLP had no meaningful ownership rights in the film.

265. We therefore agree with HMRC's characterisation of the LLPs' activities as the acquisition and holding of rights in a potential income stream from a film. That is what the FTT in essence found and, as we shall see, the basis of its conclusion, in relation to games, that IG was not trading. For the film LLPs, the activities in relation to independent films appear to have tipped the balance but, as we have said, the additional complexity of those transactions cannot in principle make any difference,

and any role in assembling the financing was not found to be an activity of the LLPs. We accept HMRC's submission that the position found to be the case in relation to IG exposes the whole business model, for both films and games, for what it is.

266. Our conclusion that the LLPs were not trading is reinforced by the FTT's findings in the Further Decision that the expenditure on the rights acquired was capital rather than revenue in nature. That makes perfect sense in the context of an investment transaction but does not appear to us to make sense in the context of a purported trade which in essence involves no more than the acquisition and holding of rights to income, without any further exploitation of them. In the Further Decision the FTT struggled to reconcile its finding that the LLPs were trading with its finding in the Further Decision that the expenditure on the films was of a capital rather than income nature.

267. In reaching our conclusions as to the nature of the activities carried on by the LLPs, we have not found it necessary to place any significant weight on the question of fiscal motivation. As Patten LJ said at [29] of *Brain Disorders*, motivation may be close to irrelevant if there is clearly a transaction in the nature of a trade. In our view, the opposite must also be true: there is no need to consider fiscal motivation if an activity is clearly an investment and not a trading transaction. However, as Patten LJ points out by reference to *Iswera*, motivation may be relevant if the nature of the acts as trading or otherwise are equivocal. It was recognised in *Lupton* that some transactions may be so affected by fiscal considerations that their shape and character is no longer trading: see the judgments of Lord Morris at pages 619 to 620 and Lord Simon at page 631.

268. In this case we are concerned with the characterisation of the activities of the LLPs, and it is important to bear in mind that they are distinct legal entities from the individual members. Therefore, any tax motivation of the individual members is not directly relevant. However, it may be of indirect relevance. In this case, the tax motivation of the individuals is part of the wider factual context and, in reality, explains why the LLPs, and the individual transactions that they entered into, were structured as they were. That included, as found by the FTT at [550], the 70:30 divide in the model, which was designed to obtain the expected accounting and tax losses.

269. It also explains the related uncommercial non-recourse loan arrangement (linked to a reduction of the LLP's share of GDI if the loan was ever paid off), the interposition of the LLP between the CD and the PSC with no obvious role to play beyond investment, and the provisions in relation to the LLP's ownership of film rights. It explains a lot of the complexity of the documents, and the effort that went into them. If the position was otherwise equivocal (which we do not think it was) then it would be appropriate to have regard to the tax context in determining, for example, the significance to be attached to the LLP's role as "producer", whether in (apparently) taking on a commitment to produce a film and acquiring and disposing of film rights, negotiating and entering into the transaction documents, monitoring the production process, or otherwise.

270.HMRC also rely on what they say is the LLPs' inability clearly to articulate what their trade was. We accept the LLPs' submission that there is no requirement that a taxpayer identify the nature of its trade in order to establish that it is trading: see *Anderson v HMRC* [2018] UKUT 159 at [67], but HMRC's submission highlights what is at the heart of this dispute. The LLPs have continually maintained that they were producers of films, albeit emphasising now that this was in a financial rather than creative sense, expressing their activities in terms of being "involved in the production" of films. However, the FTT did not accept that the LLPs were producers of films, nor did they accept that the LLPs acquired and sold films. There was no provision of goods or services that might be regarded as a normal, albeit not universal, feature of a trade. Instead, the FTT found that the LLPs acquired and held financial assets, which the FTT also found were capital assets.

271.We now turn to consider whether our conclusion is affected by anything that has been said in the various authorities that we have reviewed.

272.In our view, *Ensign Tankers* can be distinguished on the facts. In that case, it was found that the nature of the trade was the production and exploitation of the film by means of acquiring and exploiting the rights to the film, including attributing to the limited partnership its sub-contractor's acts, which the partnership commissioned in its capacity as owner of the rights in order to enable it to exploit the film. In contrast, in this case the LLPs simply acquired financial assets and had no meaningful production role. Lord Goff's comment in *Ensign Tankers* that the distribution arrangements deprived the limited partnership's legal ownership of any meaningful effect did not prevent a finding that what the limited partnership did was production and exploitation. The House of Lords' conclusion that capital allowances were available rested fundamentally on the basis that the limited partnership acquired and owned the master negative to the film, which Lord Goff was prepared to accept had occurred (page 682D). The source of the partnership's income was the master negative that it had acquired and was exploiting.

273. In contrast, in this case, the FTT concluded that in reality the LLPs never had any ownership rights in respect of films and simply acquired financial assets, which were the source of its income. Although, as the LLP submitted, there were aspects of the trade in *Ensign Tankers* which appear to be distinctly uncommercial, including but not limited to the fact that the limited partnership arrived on the scene after the production of the film was well advanced, the nature of the claimed trade, and what the limited partnership did, was different. The case is not authority for the proposition that any level of involvement or investment in film production in return for a share of receipts gives rise to a trade.

274.Nothing in *Eclipse* casts doubt on our conclusion. On the contrary, its conclusions at [145] and [146] as referred to at [191] above, that the transactions in reality involved the acquisition of an investment rather than the provision of any commercially meaningful goods or services by way of business, is supportive of our conclusion. Whilst in that case the licensing and sub-licensing arrangements, with their related cash flows, were respected, the FTT found there to be no substance to Eclipse 35's role in the marketing and distribution arrangements entered into, and the

position was not saved by the possible entitlement to Contingent Receipts. It does not follow from this that a transaction where receipts are contingent but not remote must be a trading transaction. Although a contrast was drawn by the Court of Appeal at [151] with *Ensign Tankers* on the basis that Eclipse 35 did not pay for production or make a significant contribution towards exploitation, it is important to bear in mind what the nature of the activity was in each case: in *Ensign Tankers* it was found to be production and exploitation, whereas in *Eclipse* it was found to be licensing and sub-licensing of valuable rights (which is also a form of exploitation) in a way that the FTT respected. Either was capable of being a trading activity. In contrast, in this case the LLPs simply acquired and held financial assets.

275. Similarly, the conclusions in *Samarkand* are not inconsistent with the approach we have taken here, and indeed are supportive of it. It was accepted that the sale and lease back of films could have amounted to a trading activity, but the Court of Appeal found that the FTT's evaluation of the arrangements as not amounting to a trade could not be faulted: see [195] above.

276. *Degorce* involved contingent receipts, but there was not only a one-off nature to the arrangements but a finding that the subject matter of the arrangements was unimportant to the taxpayer, which therefore gave much less indication of a serious approach to trading. Although the FTT's reliance on there being no intention to sell an income stream was criticised by the Court of Appeal at [57], that does not assist the LLPs here. The nature of the activity in *Degorce* involved both an acquisition and sale of rights, namely an activity that could in principle be trading, and the absence of a further sale of rights could not prevent that being a trade if it otherwise was. In this case, there was a mere acquisition of an income stream.

277. As regards *Brain Disorders*, Mr Milne relied on what Patten LJ said at [30] in his characterisation of the arrangements in *Ensign Tankers* as being, when the loan arrangements were stripped away, expenditure of $3.25 million by the limited partnership on the project, so that it was difficult not to conclude that the purpose of the expenditure was a trading one. Mr Milne submits that similarly in this case, putting HMRC's case at its highest, 30 was being unequivocally used by the LLPs for the purposes of a trade of making films and exploiting them.

278. However, in our view Patten LJ was intending to do no more than distinguish *Ensign Tankers* from the facts of *Brain Disorders*. It does not follow from what he said that contributing financing to the production of films for a share of receipts is necessarily a trading activity. In justifying the FTT's decision that there was no trade in that case, Patten LJ took account of the fact that the partnership incurred no further costs after the arrangements were entered into, that it had no active involvement with the research entity and that there was no agency arrangement: see [33] and [34] of the judgment.

279. Neither do we consider that the reference at [32] of the judgment to the need not to fix the taxpayer with a contract which under the scheme it does not have assists the LLPs. What the limited partnership in *Brain Disorders* was trying to do was to ignore parts of the overall contractual arrangements and effectively rewrite them so that it

appeared that the limited partnership spent money on research. At [35] Patten LJ rejected the limited partnership's basic submission that the court was required to "ignore the totality of the actual contractual arrangements", and said that the FTT was "entitled to conclude from the arrangements as a whole that they did not include an adventure in the nature of trade." In this case, as our analysis of the contractual arrangements demonstrates, there is no question of any part of the contractual arrangements being ignored or rewritten.

280.Finally, for completeness we deal briefly with a provision of the CDA that Mr Gammie relied on in support of his submissions. Clause 31 of the CDA for *Hot Fuzz* provided:

> "Notwithstanding their form, the parties to this Agreement agree (i) to treat the transactions and arrangements pursuant to this Agreement and the related agreements according to their substance (namely, as a transfer by the Studio to the Producer of an equity interest in the future profits of exploitation of the Film) for all United States tax purposes, including, without limitation, for depreciation/amortisation purposes and (ii) not to take any position inconsistent with such United States tax treatment for United States tax purposes."

281.Mr Gammie submitted that although the clause was inserted for US tax purposes, it conveys exactly what was the substance of the deal between the parties, and there was no reason why the same recognition of the substance should not apply for UK tax purposes.

282.We have not found it necessary to rely on this clause in coming to our conclusion that the film LLPs were not trading, but we note that what is said in that clause is consistent with our conclusions as to the substance and reality of the transactions.

Conclusion on the film LLPs

283.For the reasons set out above, we set aside the conclusion in the Decision that the film LLPs were trading. We remake the decision on the basis of the facts found by the FTT by concluding that neither ITP nor IFP2 were trading in the tax years in question.

Whether IG was trading

284.In the light of our analysis of the position as regards the film LLPs, the FTT was not only entitled on the evidence to conclude that IG was not trading but correct to do so for the reasons that we have set out above. However, in case this matter goes further, we shall deal briefly with the differences between IG and the film LLPs and the submissions made by Mr Vallat on behalf of IG.

The Decision

285.IG's business was structured in essentially the same manner as the film LLPs. It entered into a Commissioning and Publishing Agreement ("CPA") which was akin to a CDA, with a Publisher, which was akin to a CD, pursuant to which IG would produce a game and sell it on completion to the Publisher in return for a share of

receipts determined under a contractual waterfall. IG also entered into a Development Services Agreement ("DSA"), which was akin to a PSA, with a Development Services Company ("DSC"), which was akin to a PSC, pursuant to which it sub-contracted the production of the game to the DSC. The other contractual documents were similar to those entered into by the film LLPs.

286.The evidence shows that IG's business was an attempt to extend the Commissioning Distributor Model to the games industry.

287.The FTT set out its findings of fact as regards the Trading Issue at [1203] to [1223]. In particular, at [1212] it found that IG had no significant involvement in putting together a package for a game, and there was no indication that it had any input into the framework or specifications for the making of the game. The FTT found that IG was effectively inserted into a process which was already going on.

288.At [1213] the FTT referred to the fact that IG employed a video game specialist, Mr Williamson, but concluded that his input into the creation of the game was not as significant as his counterpart in relation to films.

289.At [1222] the FTT found that the development of three of the four games entered into by IG had already begun when contracts were signed.

290.The FTT set out its conclusions as to whether IG was trading at [1224] to [1233].

291.At [1224] it found that the activity of IG shared many of the characteristics of the Studio films rather than the independent films part of IFP2's business, repeating its comment about IG being inserted into an existing project. At [1226] the FTT found that the research undertaken by Ingenious in the preparation for the launch of IG lacked depth and at [1227] that there was less "depth and grit" in IG's involvement in games than there was in the involvement of IFP2 in films, particularly independent films.

292.At [1228] the FTT found that IG's activity in relation to the games appeared to be mainly that of a financier. Whilst it accepted that an entity may engage in a financial trade, it said that it would normally expect such a trade to involve more than a few transactions.

293.At [1229] the FTT found that Mr Williamson's interaction with the publishers did not indicate any participation in the progress[6] of making the game. It then concluded at [1232] and [1233] as follows:

> "1232. The difference between IG on the one hand and ITP and IFP2 on the other seemed to us to have some similarity with the difference between a person placing a bet and a bookmaker, or between an individual making a loan and a bank. Both deal in money and take risks, but the bookmaker and the bank undertake more transactions and have an organisation devoted to setting terms

[6] Possibly a slip for "process".

(or odds) and appraising the market and its risks and rewards. IG's activity had more in common with that of Mr Degorce.

1233. The activity of IG involved some organisation, some modest repetition and was speculative in nature, but overall and on balance it seems to us to have been more the acquisition of a few financial assets dressed in a complex contractual framework than the conduct of trade."

Discussion

294.We can summarise the challenges made by the LLPs to the FTT's findings in their submissions as follows:

(1) the FTT should have attributed the activities of the DSC as sub-contractor to IG;

(2) the FTT failed to take any or appropriate account of the evidence relating to IG's activity as regards the selection of games;

(3) the FTT failed to recognise what "development" of a game involved, erring in attaching significance to the fact that IG might only be involved after development had started, and reaching a conclusion contrary to the evidence that IG stepped into projects which were already underway; and

(4) the only conclusion open to the FTT was that IG played a role in relation to games development of comparable depth and breadth to that played by the film LLPs in relation to film production.

295.In the light of our conclusions on the sub-contracting issue relation to films, we must reject the first of IG's submissions. As regards the second and third submissions, those are challenges to the FTT's findings of fact and they come nowhere near to satisfying the very high hurdle that is necessary to interfere with those findings. There was clearly evidence before the FTT on these matters which entitled it to reach the conclusions that it did. As far as the fourth submission is concerned, we have concluded that the role played by the LLPs in relation to the production of films was insufficient to turn what was otherwise an investment activity into a trading activity.

Conclusion on IG

296. For the reasons set out above, there is no basis to interfere with the FTT's findings on the Trading Issue as it relates to the business of IG.

IV. THE VIEW TO PROFIT ISSUE

Legal Test

The nature of the test, and whether it is purely subjective

297. We start by considering the correct test to be applied in order to determine whether it can be said that a business is being carried on "with a view to profit". To recap, for income and corporation tax purposes an LLP is treated as a partnership (and

its members as partners) provided it is carrying on a trade, profession or business "with a view to profit": see s 863(1) ITTOIA 2005 and s 1273 CTA 2009.

298. In summary, the parties' contentions on the test were as follows.

299. The LLPs contend that for the purposes of s 863 ITTOIA 2005 the issue of whether a business is carried on with a view to profit imports a subjective test, namely did the controlling minds of the business intend to make a profit, with an objective override, namely was there a realistic possibility of profit. "Realistic possibility" simply meant something more than entirely fanciful. Mr Saini gave an example of a person who sought to establish a business to manufacture saddles for unicorns: even if he had deluded himself into having a subjective intention to make a profit, clearly there would be no realistic possibility of such a business making a profit. The LLPs submit that the only conclusion open to the FTT on the basis of the evidence was that the LLPs were trading with a view to profit, whether looked at on the Ingenious Basis or the 30:30 Basis.

300. HMRC say that the test is one of subjective intention, which is not to be equated with purpose. Thus they say that whereas, for example, expenditure may serve a sub-conscious purpose (and a tax deduction may be denied for that reason), the view that a person has in relation to profit is different and is limited to the consciously subjective. However, HMRC accept that in a case such as the present, involving sophisticated and experienced businessmen, an objective analysis of the likelihood of profit constitutes a useful cross-check for the FTT in testing the protestations of subjective intent. They submit that in this case, unless the relevant LLP made a genuine assessment of the likelihood of its business actually making a profit for the LLP itself, it is difficult to see how the LLP could have been found to be carrying on its business with the requisite subjective, positive intention to make a profit.

301. The phrase "with a view to profit" is clearly derived from s 1(1) of the Partnership Act 1890, which defines the relation of partnership as being that which subsists between persons "carrying on a business in common with a view of profit". We see no difference between the phrase "view to profit" and the phrase "view of profit". That derivation clearly makes sense given that the legislation that enabled limited liability partnerships to be established in the United Kingdom, the Limited Liability Partnerships Act 2000 ("LLPA 2000"), was intended to provide a business vehicle which could operate in the same way as a traditional partnership while at the same time giving the entity the benefit of limited liability. We also note that the language is reflected in s 2(1)(a) of the LLPA 2000. This sets out the requirement that, to incorporate an LLP, there must be "two or more persons associated for carrying on a lawful business with a view to profit".

302. Consequently, in the context of the operations of an LLP the question is not solely a tax question. Furthermore, such authorities as there are on the definition of partnership in the Partnership Act 1890 and its Commonwealth equivalents, bearing in mind that the definition has been adopted in a number of Commonwealth jurisdictions, are of assistance in interpreting the phrase "with a view to profit".

303. It was common ground that "profit" means an excess of (actual) income over expenses, that is the net amount remaining after paying out of the receipts of the business all the expenses incurred in obtaining those receipts, and that it is not determined by reference to particular methods of accounting computation. It was also common ground that profit can be realised over a period rather than immediately. We agree with these points.

304. Lindley & Banks on Partnership, 20th Edition, states at 2-09 that the intention to make a profit (even if a profit is not actually realised) lies at the very heart of the partnership relation, although the amount of the profits intended to be realised by the venture does not matter unless it is, on a true analysis, *de minimis*.

305. As Lindley & Banks go on to state at 2-10, it is where the profit motive can be identified as subsidiary to some other purpose that difficult questions can arise: in such cases it is necessary to ask whether there is in fact any genuine "view of profit" at all. Nevertheless, even if the partnership is formed with some other predominant motive, such as tax avoidance, but there is also a real, albeit ancillary, profit element, it may be permissible to infer that the business is being carried on "with a view of profit".

306. We were cited three judgments of the Canadian Supreme Court which in our view provide clear support for the test being a subjective one. They also support the proposition that the question is whether there is an intention to make a profit over some future period, rather than necessarily immediately.

307. In *Continental Bank Leasing Corporation v Canada* [1998] 2 SCR 298, in interpreting words in the Canadian statute identical to those in the 1890 Act (except using "view to profit" rather than "view of profit"), the court at [43] specifically approved the statement in Lindley & Banks referred to at [305] above to the effect that the making of profit as an ancillary purpose is sufficient to satisfy the definition. At [45] Bastarache J, with whom other members of the court agreed on this issue, gave particular weight to the terms of the partnership agreement, saying:

> "The respondent argues that intending to constitute a valid partnership is not the same thing as intending to carry on business in common with a view to profit. I agree. The parties in the present case, however, set up a valid partnership within the meaning of s 2 of the Partnerships Act. They had the intention to and did carry on business in common with a view to profit. This conclusion is not based simply on the parties' subjective statements as to intention. It is based on the objective evidence derived from the Partnership Agreement entered into by the parties."

308. It appears to us that the court was referring to the objective evidence obtained from the partnership agreement in order to check the genuineness of the parties' subjective statements.

309. In *Backman v Canada* [2001] 1 R.C.S 367 the court said at [22] that a determination of whether there exists a "view to profit" requires an enquiry into the intentions of the parties entering into an alleged partnership. It then made the point,

however, that it is important to distinguish between motivation and intention, the latter being the object or purpose (the former may be, for example, the tax benefits sought by the arrangements). The court observed that tax motivation will not derogate from the validity of a partnership where the essential ingredients of a partnership are otherwise present.

310. The court also approved at [23] the statement in *Continental Bank* that it will be sufficient for a taxpayer to show that there was an ancillary profit-making purpose, but said at [24] that in determining whether there is a view to profit the court should not adopt or employ a purely quantitative analysis. The amount of the expected profit is only one of several factors to consider. The court also observed in the same paragraph that the law of partnership does not require a net gain over a determined period in order to establish that an activity is with a view to profit, noting that a partnership may, for example, incur initial losses during the start-up phase of its enterprise. It is sufficient that the enterprise is carried on with a view to profit in the future.

311. In contrast to the approach taken in *Continental Bank*, the court did not place much weight on the partnership agreement and other documentation. Although it said at [27] that the documentation indicated an intention to form a partnership, it said that that was not sufficient because the fundamental criteria of a valid partnership must still be met.

312. In *Spire Freezers Limited v Canada* [2001] 1 R.C.S [391] the court said at [27] that the intention to make a profit cannot only be judged merely subjectively, it must also be based on objective evidence. The court placed little weight on the finding that the only intention of the appellants was to obtain a tax benefit.

313. In *Newstead v Frost* [1980] 1 WLR 135 at 140 Viscount Dilhorne referred to the 1890 Act test, concluding that whilst it was clear that in the case with which he was concerned the business was carried on with a view to avoiding tax:

> "…it must also have been formed with a view of profit. It was intended that profits should be made, for if they were not made as a result of the taxpayer's activities there would have been no tax to be avoided."

314. Again, this reference makes it clear that whether there is a "view to profit" is a question of intention: in other words, a subjective test.

315. Whilst we accept that the question of whether there is a "view to profit" is not only relevant for tax purposes, it is worth noting that a subjective test fits with the overall scheme of the tax rules. In relation to sideways loss relief, s 66 ITA 2007 restricts trade loss relief against general income unless the trade is carried on both on a commercial basis and with a view to the realisation of profits of the trade. The section also provides that if at any time a trade is carried on "so as to afford a reasonable expectation of profit" it is to be treated as carried on at that time with a view to the realisation of profits (which we note is a form of statutory objective override). The "commercial basis" requirement prevents inappropriate use of losses by someone who has little prospect of profit on an objective basis, and would thus

prevent the hypothetical manufacturer of unicorn saddles in Mr Saini's example from obtaining sideways loss relief.

316. As to the wider (non-tax) relevance of the question, whilst we do not think that this is a case where the wording is ambiguous so that the principles in *Pepper v Hart* [1992] STC 898 are engaged, we note that HMRC drew the FTT's attention (and Mr Saini drew our attention) to the debate on the amendment that introduced the "with a view to profit" requirement into s 2(1)(a) LLPA 2000. The rationale was explained by the Minister as being to make it clear that limited liability partnerships are unsuitable for charitable organisations and to discourage not-for-profit organisations, for example members' clubs, from using the limited liability partnership vehicle. That is also consistent with a subjective approach. These are organisations that, in principle, do not have profit-making as an aim.

317. More generally, a natural reading of the words is indicative of a subjective test. "View to" naturally refers to what the relevant person or persons have in mind – whether they are aiming for, or intending, profit.

318. Mr Saini placed some reliance on what was said by the Court of Appeal (and approved in the House of Lords) in *MacDonald v Dextra Accessories Limited & Others* [2004] STC 339. That case concerned the interpretation of s 43 Finance Act 1989, and in particular the definition of the expression "potential emoluments" in s 43(11)(a). In broad terms, the provision was concerned with the time at which an employer, in computing its liability for corporation tax, may make a deduction in respect of emoluments provided or to be provided to its employees. The legislation defined "potential emoluments" as "amounts or benefits reserved in the accounts of an employer, or held by an intermediary, with a view to their becoming relevant emoluments".

319. The issue which fell for determination was whether contributions made by the taxpayer to an employee benefit trust (EBT) fell within the statutory provision. That in turn depended on whether those contributions, when received by the trustee, constituted "potential emoluments" as being "amounts… held by an intermediary with a view to their becoming relevant emoluments".

320. Jonathan Parker LJ, who gave the leading judgment, rejected at [63] the interpretation given in the courts below to the words "with a view to" as meaning "for the sole purpose of" or "with the principal or dominant intention of". He then said at [64]:

> "It seems to me that three general points may be made about the expression '*with a view to* ....'. In the first place, it is a less specific expression than '*for the sole purpose of* ....' or '*with the principal or dominant intention of* ....'; and (as the judge rightly acknowledged in paragraph 28 of his judgment) it suggests a degree of flexibility of meaning and application. That said, the word '*view*' plainly connotes some element (albeit undefined) of purpose, intention or contemplation. Secondly, in the particular context of section 43(11)(a) (and in contrast to the similar expression in section 44(1) of the Bankruptcy Act 1914) it is looking to the future: the relevant '*view*' is a view as to a particular future

> event, viz. '*potential emoluments*' becoming '*relevant emoluments*'. Thirdly, the expression '*with a view to*', when coupled with the word '*potential*', indicates to me that the future event in question is one which may or may not occur: it is enough that it should have the potential to occur."

321. At [65] Jonathan Parker LJ referred to the "general flexibility" of the phrase "with a view to". At [68] he observed, when returning to the facts of the particular case, that the purposes or intentions of the trustee (to the extent that it had any) as to how and in whose favour it would or might exercise its discretionary powers in the future could not be a relevant consideration in determining whether the funds in question were held "with a view to .... their becoming potential emoluments", the sole criterion in making that determination being the terms on which the funds were held by the trustee.

322. At [70] and [71] he turned to what he regarded as the "crucial question", namely whether the fact that the EBT empowered the trustee to apply funds subject to the EBT otherwise than in the provision of emoluments had the effect of taking contributions to the EBT outside the definition of '*potential emoluments*' in section 43(11)(a). He said that to reach that conclusion would be to place an unwarranted restriction on the unspecific and flexible expression which Parliament had chosen to use, accepting that, on the facts of the instant case, the expression "with a view to" was apt to embrace "the whole range of realistic possibilities available to the trustee, acting in accordance with the EBT". At [73] he said that the meaning of the expression in other statutory provisions did not significantly assist.

323. In the House of Lords ([2005] STC 1111) Lord Hoffmann observed at [17] that the Court of Appeal had decided that the funds were held with a view to becoming relevant emoluments if they were held on terms which allowed a realistic possibility that they would become relevant emoluments. At [18] he observed that the phrase "potential emoluments" was a defined expression and the definition might give the expression a meaning different to its ordinary meaning. At [19] he pointed out that the words "with a view to their becoming relevant emoluments" applied both to a reserve held for amounts payable only on a contingency and to amounts payable on the exercise of a trustee discretion, and that it must have a similar meaning in both contexts. A reserve would properly be made for amounts payable on a contingency, and amounts held by an intermediary could similarly be regarded as held for the payment of emoluments on a contingency, namely the exercise of trustee discretion. In that context, he agreed with the Court of Appeal that the question was whether there was a realistic possibility of the funds in question being used to pay emoluments.

324. Mr Saini relies, in particular, on Jonathan Parker LJ's references to the "general flexibility" of the expression and the embracing of "realistic possibilities" within its scope, as indicating the presence of an objective criterion.

325. We agree with the statement by Jonathan Parker LJ at [64] that "with a view to" connotes some element of purpose, intention or contemplation. Beyond that, we do

not find the case to be of any material assistance due to the very different context in which the phrase was being considered.

326. In particular, the conclusion that the expression encompassed the whole range of realistic possibilities was affected by (i) the fact that the test had to apply both to a reserve in the employer's accounts and the position of trustees of a discretionary trust, where it was found that the subjective intentions of the trustee could not be relevant and instead it was necessary to look at the terms on which funds were held by the trustee; (ii) the need to look at the term in the context of the definition of "potential emoluments"; and (iii) the point made by Lord Hoffmann that it was clearly contemplated that a reserve held for amounts payable only on a contingency should be covered, and that amounts payable on the exercise of a trustee discretion should be treated the same way. In addition, Jonathan Parker LJ expressly recognised that the meaning of the expression in other statutory provisions did not significantly assist.

327. We therefore conclude that *Dextra* does not provide any material support for the proposition that the expression "with a view to profit" when used in s 863 ITTOIA has an objective element.

328. Mr Saini also placed some reliance on the decision of Nugee J in *Seven Individuals v HMRC* [2017] STC 874. That case concerned seven individuals who were members of the "Icebreaker" partnerships. They had contributed some of their own money and a larger amount of borrowed money to limited liability partnerships in order to provide finance for a range of creative projects. Each LLP claimed to have made a significant trading loss in its first year, which the individual members sought to claim as an allowable loss against their income tax liability. Those claims were rejected by HMRC. The FTT allowed the appeal of the limited liability partnerships to a limited extent but largely rejected the contentions of the individual members. The Upper Tribunal was concerned with those contentions in so far as they related to the question of whether the individuals could obtain sideways loss relief. That in turn depended on whether the relevant limited liability partnership's trade was carried on on a commercial basis and with a view to profit. It was accepted by HMRC that the limited liability partnerships in question were carrying on business with a view to profit, so that the only issue before Nugee J was the question of commerciality.

329. At [53] Nugee J referred to the FTT's findings in this appeal on the question as to whether the Ingenious LLPs were carrying on business with a view to profit. Without specifically approving it, he summarised the FTT's view that an LLP could not be said to carry on business with a view to profit if, objectively, there was no realistic possibility of profit. He also noted the FTT's statement at [492(i)] of the Decision that this objective test was not to be equated with whether the conduct of the business was business-like or commercial.

330. He then said at [54] that it may not make commercial sense to carry on a trade, even if it is likely to make a profit in the crude, everyday sense that its income exceeds its expenditure. He said that it was unlikely that anyone with a serious interest in making a commercial success of a trade would regard a trade which lays

out 100 in year 1 and recovers 101 in year 10 as being a satisfactory return, even if it were virtually certain to happen. He then said:

> "… when assessing whether a trade is being carried on on commercial lines, the likelihood of profit seems to me to be central to an assessment of its commerciality. The question is whether the trade is being carried on in a way that a person seriously interested in commercial success would carry it on. Such a person would be unlikely to regard a trade which had a remote possibility of a small profit as worth carrying on as a commercial venture, even though it could be said that there was a realistic possibility of profit."

331. Mr Saini relies on this statement as illustrating that the concept of "realistic possibility" is relevant, but that it requires no more than a remote possibility of a small profit.

332. We reject that submission. Nugee J was considering a different test in that case, and was not deciding whether an objective override formed part of the "with a view to profit" test in s 863 ITTOIA, or indeed what was meant by "realistic possibility". He assumed for the purposes of his decision that the FTT in *Ingenious* was correct in its formulation of the test, without deciding the point. In addition, where he says "it could be said that there was a realistic possibility of profit", the "could" is possibly a qualification rather than an endorsement, and "remote" could relate to the point Nugee J made about the possibility of a profit in year 10, that is a temporal point rather than being a descriptor of the chance of profit. We therefore place no reliance on what was said in *Seven Individuals*.

333. We consider the better view to be that the test is a purely subjective one. There is no need for profit to be the predominant aim. As is noted in Lindley & Banks, difficult questions can arise when any profit-making aim is subsidiary to other purposes. In those circumstances, it is necessary to consider at what point the line is crossed and there is in fact no view to profit. Some sort of "reality check" is needed. It is necessary to identify whether there is a "real" intention rather than something that was not, in fact or reality, aimed for. The question as to whether a trade was carried on "with a view to profit" also cannot be answered in isolation, divorced from the context of the business in question. The context of "carries on a trade…" directs attention at least to some extent to the way in which the trade is conducted. Furthermore, an indifference to whether a profit is realised is not sufficient to meet the test. In this case, therefore, the FTT would have had to have been satisfied that the LLPs had genuinely intended to seek a profit from their activities.

334. The LLPs submit that the "view" can be sub-consciously held, as is the case where it is necessary to consider whether an expense was "wholly and exclusively incurred for the purposes of the trade": see in this context *Mallalieu v Drummond* [1982] STC 665, where the House of Lords held that the taxpayer barrister could have a sub-conscious purpose of clothing herself for warmth and decency, regardless of whether she regarded her court clothes as only purchased for the purposes of wearing the correct dress in court. Similarly, in *Vodafone Cellular v Shaw* [1997] STC 734 ("*Vodafone*") Millett LJ said at page 742h that in considering whether an expense was incurred wholly and exclusively for the purposes of a trade the purpose was not

limited to the conscious motives which were in mind at the time, some consequences being so inevitably and inextricably involved in the payment that they must be taken to be a purpose for which the payment was made. The LLPs submit that having regard to the sub-conscious resolves the tension between the subjective nature of the test and "profit" having an independent meaning, the point being that there might otherwise be a difficulty in showing a person had a "view to profit" where he did not have a correct understanding of what "profit" was.

335.HMRC disagree. They say that the subjective nature of the test prevents resort to the sub-conscious.

336.We would not go so far as HMRC in saying that the sub-conscious can never be relevant. We note that Millett LJ at page 742h of *Vodafone* said that "subjective intentions" were determinative in that case: subjective intentions can in principle include the sub-conscious. But we agree that ordinarily the sub-conscious will not be relevant in the context of "view to profit". The limitation of what Millett LJ said is important. It will not usually be the case, and is not the case here, that profit is a "consequence" that is so "inevitably or inextricably involved" with the activity that the LLPs must have had a view to it, in the same way as Ms Mallalieu must have had a view to clothing herself for the purposes of warmth and decency.

337.The LLPs' point as to the independent meaning of profit seems to us to be theoretical rather than real. There will ordinarily be little doubt about whether a trader is or is not intending or aiming for receipts to exceed expenses, whatever label he or she applies at the time that the activity is undertaken. If the issue arises for determination by the tribunal it can be dealt with in the normal way, through evidence. The obvious answer that most businessmen would give to the question whether they were aiming for receipts to exceed expenses would be "of course", and in an ordinary case there would be no doubt about that answer because it will be supported by other evidence, often including the fact that they were risking their own or investors' funds in the venture and clearly want a positive return. We do not think that there is any inherent problem with the test being subjective but applied to a concept that has an independent meaning.

338.The test is also to be applied at the level of the LLP. An LLP is a body corporate, and therefore a separate legal entity from its members. For the purposes of s 863 ITTOIA 2005 it is necessary to focus on the LLP, its business and the individuals who conduct that business on its behalf, rather than on the position of the LLP's members. This is in contrast with the position under s 2(1)(a) LLPA 2000, where the focus is on what view the members held at the point of incorporation (see [301] above). We therefore place no reliance, as Mr Saini submitted that we should, on the fact that the designated members who signed the incorporation statement for each LLP made statements that the business was to be carried on with a view to profit.

The relevance of probability of profit

339.There are suggestions in the Decision that there is an element of probability in test. For example, at [516] the FTT seemed to suggest that 16 out of 65 films being

forecast to be profitable (a ratio of approximately 1 in 4) might be a threshold for whatever test they applied, but not 9 out of 65. The FTT also made a reference to a 1 in 4 chance of a film making profit as a "realistic possibility" at [1621] when referring to Mr Olsberg's evidence in contrast to that of Mr Finney.

340.In our view, that approach, and indeed any mathematical approach, is not correct. The test is a qualitative rather than a quantitative one and it would be wrong to prescribe a minimum percentage of probability of profit. The question is whether there is a real and serious intention to make a profit. As noted at [344] and [345] below, the likelihood of profit may be an element of relevant evidence, but no more.

The significance of witness and other evidence

341.It is obvious that there must be evidence to support the contention that an entity genuinely had a subjective intention to carry on its business with a view to profit. Whilst the stated intention of the controlling minds of the entity is highly relevant, the tribunal is entitled to examine their witness evidence critically and decide what weight to attach to it, and in particular to decide whether that stated intention reflected the reality of the situation in the light of other available evidence and the inherent probabilities.

342.In particular, a tribunal might prefer contemporaneous documentary evidence to the oral evidence of the controlling minds. Leggatt J warned about the unreliability of evidence based on recollection in *Gestmin v Credit Suisse* [2013] EWHC 3560 (Comm) at [15] to [22] as follows:

> "15. An obvious difficulty which affects allegations and oral evidence based on recollection of events which occurred several years ago is the unreliability of human memory.
>
> 16.While everyone knows that memory is fallible, I do not believe that the legal system has sufficiently absorbed the lessons of a century of psychological research into the nature of memory and the unreliability of eyewitness testimony. One of the most important lessons of such research is that in everyday life we are not aware of the extent to which our own and other people's memories are unreliable and believe our memories to be more faithful than they are. Two common (and related) errors are to suppose: (1) that the stronger and more vivid is our feeling or experience of recollection, the more likely the recollection is to be accurate; and (2) that the more confident another person is in their recollection, the more likely their recollection is to be accurate.
>
> 17.Underlying both these errors is a faulty model of memory as a mental record which is fixed at the time of experience of an event and then fades (more or less slowly) over time. In fact, psychological research has demonstrated that memories are fluid and malleable, being constantly rewritten whenever they are retrieved. This is true even of so-called 'flashbulb' memories, that is memories of experiencing or learning of a particularly shocking or traumatic event. (The very description 'flashbulb' memory is in fact misleading, reflecting as it does the misconception that memory operates like a camera or other device that makes a fixed record of an experience.) External information can intrude into a witness's

memory, as can his or her own thoughts and beliefs, and both can cause dramatic changes in recollection. Events can come to be recalled as memories which did not happen at all or which happened to someone else (referred to in the literature as a failure of source memory).

18.Memory is especially unreliable when it comes to recalling past beliefs. Our memories of past beliefs are revised to make them more consistent with our present beliefs. Studies have also shown that memory is particularly vulnerable to interference and alteration when a person is presented with new information or suggestions about an event in circumstances where his or her memory of it is already weak due to the passage of time.

19.The process of civil litigation itself subjects the memories of witnesses to powerful biases. The nature of litigation is such that witnesses often have a stake in a particular version of events. This is obvious where the witness is a party or has a tie of loyalty (such as an employment relationship) to a party to the proceedings. Other, more subtle influences include allegiances created by the process of preparing a witness statement and of coming to court to give evidence for one side in the dispute. A desire to assist, or at least not to prejudice, the party who has called the witness or that party's lawyers, as well as a natural desire to give a good impression in a public forum, can be significant motivating forces.

20.Considerable interference with memory is also introduced in civil litigation by the procedure of preparing for trial. A witness is asked to make a statement, often (as in the present case) when a long time has already elapsed since the relevant events. The statement is usually drafted for the witness by a lawyer who is inevitably conscious of the significance for the issues in the case of what the witness does nor does not say. The statement is made after the witness's memory has been "refreshed" by reading documents. The documents considered often include statements of case and other argumentative material as well as documents which the witness did not see at the time or which came into existence after the events which he or she is being asked to recall. The statement may go through several iterations before it is finalised. Then, usually months later, the witness will be asked to re-read his or her statement and review documents again before giving evidence in court. The effect of this process is to establish in the mind of the witness the matters recorded in his or her own statement and other written material, whether they be true or false, and to cause the witness's memory of events to be based increasingly on this material and later interpretations of it rather than on the original experience of the events.

21.It is not uncommon (and the present case was no exception) for witnesses to be asked in cross-examination if they understand the difference between recollection and reconstruction or whether their evidence is a genuine recollection or a reconstruction of events. Such questions are misguided in at least two ways. First, they erroneously presuppose that there is a clear distinction between recollection and reconstruction, when all remembering of distant events involves reconstructive processes. Second, such questions disregard the fact that such processes are largely unconscious and that the strength, vividness and apparent authenticity of memories is not a reliable measure of their truth.

22.In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all

> on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

343.A tribunal can certainly reject the evidence of witnesses without a finding that they were dishonest. A failure to accept witness evidence can be for a number of reasons other than a conclusion that the witness was giving evidence that he or she did not believe. To take just one example, the controlling minds in this case might have honestly persuaded themselves that they did have a view to profit, in circumstances where the FTT was not persuaded that they actually did: they might have convinced themselves of something which was not in fact the case. We have certainly found nothing in the Decision to suggest that the FTT rejected the controlling minds' evidence on the grounds that their evidence was dishonest, and there was no suggestion before us that the FTT did make any of their findings on that basis.

344. In determining whether there is the requisite subjective intention, all the evidence must be considered. As mentioned in *Gestmin v Credit Suisse* at [22] which we have cited at [342] above, contemporaneous documentary evidence will always be highly relevant. Objective evidence is also relevant and, depending on the context, it may be significant. This may include evidence about whether there was, in fact, a real potential for, or likelihood of, profit. This is not because there is an objective test or override. Rather, the potential for profit is one part of the evidence that may be relevant to determine whether the requisite subjective intention exists.

345. Where the intention being tested is that of experienced businessmen, the lack of any realistic potential for or likelihood of profit on an objective basis may call into question whether there is a (subjective) view to profit. Experienced businessmen of course take risks, and different individuals will be willing to take differing levels of risk, but businessmen will generally seek to satisfy themselves that the risks are worth taking for the potential return on capital employed, at least if they are risking their own funds. The dynamics may differ where it is someone else's money that is at risk of being lost. HMRC repeatedly submitted that this was a case where the investment was being made with other people's money, namely that of the Exchequer in the form of the monies that the investors expected to receive from HMRC by way of tax repayments. And the extent of the risk taken may depend not only on the risk appetite of the investors but on the degree to which the individuals making the decisions are answerable for any failure, or incentivised by success.

346.Finally, the burden is on the LLPs to show that they carried on their business with a view to profit. It is well-established that the raising of an assessment by HMRC imposes on the taxpayer the burden of proving that it is wrong: see *Brady (Inspector*

of Taxes) v Group Lotus Car Companies [1987] STC 635, per Mustill LJ at page 642c. That principle clearly applies in this case. The burden is on the LLPs to displace the findings in the various closure notices, which are based on HMRC's determination that none of the LLPs were carrying on a trade with a view to profit. Consequently, if a tribunal is not positively satisfied on a balance of probabilities that there was a view to profit, the issue must be determined in favour of HMRC. For example, if the FTT was not satisfied that the LLPs had any more than indifference to profit (in the light of the real commercial drivers, namely to obtain tax losses for investors in respect of which they could claim sideways relief, and fees for Ingenious) then the LLPs must fail on the View to Profit Issue.

Whether the film partnerships were trading with a view to profit – the Decision

The test applied by FTT

347. At [478], the FTT accepted that the ordinary meaning of "with a view to" contains "some element of subjective intention". It then set out its description of the test at [492] as follows:

> "492. We come to the following conclusions in relation to the nature of the "view":
>
> (a) the test requires some element of purpose, intention or contemplation. That is apparent from the word "view" and the approach to it by other courts and tribunals;
>
> (b) whether or not a taxpayer has a subjective intention depends on all the evidence: a mere assertion of intention may not be enough;
>
> (c) The test does not require an overriding objective of making profit or its pursuit to be the main or predominant purpose of the activity. As Lord Hoffmann said in *Dextra*, had that been intended Parliament would no doubt have used such expressions "which are by no means unfamiliar in tax legislation".
>
> (d) Thus the existence of other hopes or intentions in the conduct of the business need not prevent the carrying on of the business having a view of profit.
>
> (e) Having an intention to make profit is not enough; the taxpayer must *conduct* the business with a view to profit. The nature of the conduct of the business is relevant. The test is about how the trade is carried on and how the taxpayer intends to carry it on. That focuses on the activities of the business and their possible future income, and that focus is a counterweight to a purely subjective analysis of the taxpayer's motives or hopes.
>
> (f) A "view" looks to the future – to the intentions as to the conduct of the business and the results which will flow from it. The taxpayer's

intentions as to the conduct of the business are part of the subjective elements of the test.

(g) *Dextra* indicates that there may be some objective element in "with a view to" although in a different statutory context. In the present context "profit" has a meaning independent of what the taxpayer considers it to be: that indicates an objective element in the test: an assessment of whether the intended conduct of the business has a realistic possibility of delivering a profit.

In *Vodafone* Millett LJ said (742J) that the determination of purpose in section 74 TA 88: "… does not involve an enquiry of the taxpayer whether he consciously intended to obtain a trade or personal advantage by the payment. The primary enquiry is to ascertain what was the primary object of the taxpayer in making the payment. Once ascertained, its characterisation as a trade or private purpose is a matter for the commissioners, not the taxpayer". The same principle applies in relation to the question of whether something is done with a view to profit. The enquiry as to the object of the activity is not into the way in which that object is described at the time or later by the taxpayer.

(h) As a result, if the conduct or intended conduct of the business is such that there is no realistic possibility of profit, the business cannot be said to be carried on with a view to profit, no matter what the subjective intentions of the taxpayer as to profit are.

(i) That objective test is, however, about whether the conduct is such as to give a realistic possibility of profit, not about whether it is businesslike or commercial.

(j) If the conduct of the business is such that it is inevitable or almost certain that a profit will be made that will be the carrying on of the business with a view of profit. We accept Mr Milne's submission that Lord Millett's dictum that purpose is not limited to conscious purpose and that some consequences are so inevitable that they must be taken as a purpose applies here. If it is true for "purpose" it seems to us that it must also apply to "view". If Miss Mallalieu had bought her black clothes with a view to satisfying the court dress rules, it seems inevitable that she must also have bought them with a view to decency and warmth. If a person intends to travel in an aeroplane from London to New York it is inevitable that they will travel with a "view" to crossing the Atlantic Ocean whether or not they consciously considered it when buying a ticket.

(k) Between the two extremes, no realistic possibility of profit and almost inevitable profit, there is a hinterland in which the hopes and expectations of the taxpayer will be a significant factor and where the flexibility of the phrase "with a view to" permits the weighing of the subjective intentions of the taxpayer as to the financial results (not the "profit") of the business and the likelihood of the intended conduct and so those results yielding a profit."

348. We do not take issue with sub-paragraphs (a) to (f) of the FTT's analysis; it is consistent with the test that we have formulated above and there was common ground between the parties on those points. However, in our view the FTT fell into error in sub-paragraphs (g) to (k). That follows from our finding that there is no objective element in the test, either as an override which applies even if there is the requisite subjective intention (as suggested by the FTT at sub-paragraph (h)) or as a stand-alone test which has the effect that inevitable or almost certain profit will result in the test being satisfied irrespective of subjective intention (as suggested by the FTT at sub-paragraph (j)). Neither does the test require there to be weighing up of subjective intentions and the likelihood of profit as referred to by the FTT at sub-paragraph (k).

The 30:30 basis

349. We return later to the evidence on which the FTT based its conclusions at [827] and [828] that it was not proved that the subjective intentions of the LLPs were to deliver a profit on the Ingenious Basis. It did however find at [833] that the business conducted by the LLPs was conducted with a view to obtaining a "30:30 result" when the Ingenious personnel procured that the LLPs entered into the film contracts, with the result that the business conducted by the LLPs was conducted with a view to obtaining that result and with the hope of a profit on that basis.

350. We do not consider that the FTT was correct to look at the question on the 30:30 Basis. The controlling minds approached the transactions on the Ingenious Basis and the documents were drafted with the intention of reflecting that approach. The business was therefore "carried on", as referred to in s 863 ITTOIA 2005, on that basis.

351. The controlling minds of the LLPs knew that the tax test required a view to profit on the Ingenious Basis. The suggestion that the LLPs intended to make a profit on the 30:30 Basis is at odds with the LLPs' case and with all the evidence. The fact that the controlling minds understood that the LLPs were really putting up 30% of the funds for 30% of the revenue does not mean that they intended that the LLPs would make a profit on that basis. The only serious driver for profit was to meet the tax test, and intending to make a profit on the 30:30 Basis was inconsistent with the desired tax treatment.

352. At [820] the FTT gave a number of examples which they said were indicative that Ingenious personnel, and those who dealt with Ingenious, knew that in commercial and economic terms the film deals were deals in which the LLP put up 30% of the cost and received 30% of the net revenue. The FTT said that this knowledge was indicative that those persons knew that any economic profit derived from a comparison of those amounts. From those examples, at [821] the FTT concluded that the Ingenious personnel procured the LLPs to enter into transactions which had that effect, must have known that this was the result, must have intended this effect, and must have had a view to the effect those transactions created. At [825] the FTT, relying on a finding that "profit" in s 863 has a meaning independent of the understanding of the person whose subjective view is being tested, concluded that the LLPs had the hope and intention of carrying out, and carried out, transactions (the

film contracts) which would give rise to a realistic possibility of making a profit on the 30:30 Basis.

353.In our view there is an impermissible leap in the logic in those paragraphs, which is reflected in the conclusions that follow at [830] to [834]. The fact that the parties knew that the economic effect of the transactions was 30:30, and the existence of a realistic possibility of profit on that basis, are not by themselves legitimate bases to infer that there was a view to profit on a subjective basis. The FTT's conclusion cannot be saved, as the LLPs suggested it could, by saying that a sub-conscious intention can be enough. In our view, the achievement of a profit was not inevitable or inextricably bound up with either the Ingenious Basis or the 30:30 Basis.

354.Accordingly, the FTT's conclusion at [834] that the LLPs conducted their business with a view to profit on the 30:30 Basis, but not on the Ingenious Basis, is based on an error of law.

Whether to remake the Decision

355.We consider that the errors of law that we have identified on the part of the FTT are material and therefore that we should set aside the Decision as it relates to the View to Profit Issue in relation to the film LLPs.

356.As we stated at [48] above, since the LLPs' challenge to the denial of the trading losses fails on the trading issue, we do not strictly need to decide whether we are in a position to remake the Decision on the View to Profit Issue, or whether it should be remitted to the FTT. However, given its potential continued relevance to the tax treatment of the LLPs and their investors (and taking account of the possibility of an appeal), we have considered this question. In doing so we have been mindful of the fact that the test to be applied is a subjective one, and the fact that although the hearing before us was very lengthy and we were taken to a considerable amount of evidence, we have neither heard evidence from any witnesses, nor reviewed documentary evidence to the extent to which it was reviewed by the FTT, in hearings lasting a total of nearly 50 days.

357.However, we have also taken into account the considerable potential difficulties that would be involved in remitting the case to the FTT to reach a fresh decision on this issue. It is approaching five years since the FTT heard the bulk of the evidence. Any further hearing would not be immediate, and could be further delayed by any appeal against our decision. It is by no means clear that it would be possible to remit to an identically constituted FTT. It would be unsatisfactory, given the nature of the issue, for a differently constituted FTT to be required to reach a decision based on a review of transcripts and documentary evidence, unassisted by oral evidence. Even if the FTT was identically constituted, the significant time that has elapsed would give rise to real challenges.

358.In the circumstances it is appropriate to consider carefully whether the findings of fact made by the FTT are in fact adequate to support a conclusion by this Tribunal as

to whether the LLPs were operating with a view to profit, applying the correct legal test that we have set out above.

359. The FTT did make findings of fact about subjective intention. It correctly recognised at [493] that, for those purposes, it needed to consider the subjective intention of the controlling minds of the LLPs. It also correctly recognised at [492(b)] that all the evidence was relevant in determining what that intention was. In its conclusions at [827] and [828], to which we refer in more detail later, the FTT was mindful that the burden was on the LLPs to satisfy it that they had the requisite intention. At [827] it said that it was "not persuaded" that the intention of those managing an LLP was to conduct its business so as to make a profit on the Ingenious Basis or that their "view" was that it would be so managed. At [828] it said that the requisite intention was "not proved".

360. At [639] to [641] the FTT set out its conclusions on the evidence of the individuals that it found to be the controlling minds of the LLPs, namely Mr McKenna, Mr Reid and Mr Clayton, as follows:

> "639. We agree with Mr Gammie that the first two considerations lessened the commercial pressure on Ingenious to seek profit for the LLPs, but set against that was the undoubted knowledge which all the relevant people had that the LLPs had to have a view of profit in order to deliver the tax benefit. That too was a commercial pressure. The question is whether Ingenious took steps to alleviate the pressure rather than just persuading themselves that they had that objective.
>
> 640. We have addressed the question of tax motivation in Chapter VI: Trade. We agree that obtaining the advertised tax results for the investors was a real concern of those at Ingenious and that it resulted in income (on the Ingenious basis) at a level which made it much harder for the LLPs to make a profit and easier for them to make a loss.
>
> 641. Taking this together with our earlier evaluation of the evidence of Mr McKenna, Mr Reid and Mr Clayton, we were not convinced that the controlling minds' evidence was enough to conclude that the LLPs had a material intention that the business would be so conducted as to have a realistic chance of making a profit on the Ingenious basis."

361. We should explain that the "first two considerations" referred to at the start of [639] are the fact that profit for the LLPs was unnecessary for the financial performance of Ingenious (see [625]), and the fact that there was no pressure from investors for the LLPs to make profits (see [629]).

362. Having considered the extensive evidence on the View to Profit Issue, the FTT set out its overall conclusions on the issue at [826] to [834].

363. At [829] the FTT set out its conclusions on whether it was "unrealistic to hope for profit" calculated on the Ingenious Basis, thus considering the issue on an objective basis. As we have already indicated, the FTT erred in taking that approach.

364.At [830] to [834] the FTT set out its conclusion that the LLPs conducted their businesses with a view to a profit on the 30:30 basis. As we have said above, the FTT erred in that conclusion.

365.It is the FTT's reasoning at [826] to [828] which is relevant to the question of subjective intention. Those paragraphs are as follows:

> "[826] We accept that the LLPs were managed with the intention of securing tax benefits for the investors and in the knowledge that the structure provided substantial benefits for Ingenious. We also agree that the IFP LLPs were managed with an intention of securing income and delivering it to investors, but we do not regard the existence of those objects as meaning that the conduct of the LLPs' business could not also have had a view of profit. That is because the statutory test does not require the view to be the only or the paramount object of the taxpayer.
>
> [827] We were not persuaded however that the intention of those managing an LLP was to conduct its business so as to make a profit on the Ingenious basis or that their "view" was that it would be so managed. That is because, bearing in mind the existence of the other objects, the evidence of the controlling minds and of the activity of the green-lighting committee was not strong enough to convince us that they managed the business with a realistic hope of intention [sic] of making such a profit. In particular reliance on a 2x or 2.2x multiple, the imposition of the EP fee, the apparent willingness to accept that a Studio would break even first, and above all the imposition of the model which purported to give rise to a 100% investment for less than 55% of GDI, weighed heavily against a conclusion that such was the view they had of the outcome of the conduct of the LLPs' businesses.
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> [828] Thus if the relevant test were simply whether the subjective intentions of the LLPs were to deliver a profit on the Ingenious basis we would find that it was not proved that such was the case."

366.The FTT correctly recognised at [826] that the intended tax benefits, fees for Ingenious and the intention of securing income did not preclude the business being conducted with a view to profit, because profit did not need to be the only or paramount object. It then gave reasons at [827] for its finding at [828] that it was not proved that there was the requisite subjective intention. That appears to be a clear finding of fact. However, Mr Saini challenged the finding at [828] on the basis that it could not be read in isolation. In particular, he said that the comments at [827] indicated that this was not a straightforward finding about subjective intention.

367.Mr Saini submitted that the FTT appeared to prevaricate and there was no clear, or at least consistent, statement of the test it applied. He pointed out that the language used in the Decision varies, and includes references to "likelihood", "expectation" and similar words. Mr Saini submitted that whilst [827] and [828] can be read as a finding in HMRC's favour on the subjective test, the references in [827] to "other objects" and "realistic" made it unclear what test was being applied, and the reasons given in the second half of [827] were more consistent with an objective test. He said that the FTT conflated the subjective and objective tests, and this vitiated the conclusion at

[828]. There was a particular error in the reference to "realistic" hope [or] intention, echoing the reference to "realistic chance" in [641] (see [360] above), which indicated that the FTT was applying a test of probability.

368. Mr Saini relied on the absence of any explicit rejection of the controlling minds' evidence that the LLPs did have a view to profit. He said that the FTT should have addressed that point and given reasons if it did not accept their evidence. There were indications that an incorrect standard may have been used in assessing their evidence, for example at [613] and [620], which refer to the likelihood of profit rather than the potential for or realistic possibility of profit. The FTT appeared to have failed to take account of the fact that the evidence of the controlling minds was that they were aiming for films that would make worldwide box office ("WWBO") of at least 2.2x budget and had failed to attach proper significance to the most significant contemporaneous supporting evidence, which was the Information Memoranda and supporting analysis. The illustrative financial projections in the IFP2 Information Memorandum were based on a spreadsheet, LS202, which demonstrated that the LLP would be profitable if films performed at the 2.2x budget level on average (albeit that the Studio films in the illustration were assumed to perform at 2.9x budget). The FTT had also ignored a "break even" analysis prepared in 2010 which also demonstrated that the LLPs would break even if films performed at around that level on average. In addition, the FTT failed to pay real regard to "second-cycle" income (being income after the first 10 years), or indeed any income after the first five years, in contrast to their approach in the Further Decision, and contrary to expert as well as factual evidence as to its significance.

369. We have concluded that the FTT did make a finding of fact that the LLPs had not established a view to profit on a subjective basis, that they were entitled to make that finding on the evidence, and that the finding was not materially infected by any lack of appreciation of what subjective intent meant or by any other misunderstanding, or by any ignoring of relevant evidence. Accordingly, it is appropriate that we remake the Decision by concluding that the LLPs did not conduct a trade or business with a view to profit.

370. In reaching this conclusion, we have been very mindful of the need to read the FTT's decision as a whole: see *Revenue and Customs Commissioners v London Clubs Management Ltd* [2012] STC 388 at 74. As explained there, a judgment is not to be interpreted like a statute, and its reasoning and sense are to be gathered by a fair reading of its entirety. The Decision is a careful, and very detailed, decision produced by an experienced panel. We cannot possibly do justice to the FTT's in-depth consideration of the evidence, so we will restrict ourselves to some relatively limited remarks, which are no substitute for the full detail considered by the FTT.

371. There is no indication that the FTT ignored any evidence. In a very lengthy section devoted to view to profit, it conducted a detailed assessment of the evidence at [500] to [825] including among other things the Commissioning Distributor Model, the operation of the Green-lighting committee, the evidence of the controlling minds, the Information Memoranda, the 2.2x multiple, the Waterfall, and the expert evidence. Significant additional detail is contained in Appendices 2 to 8, at [1411] to [1734].

The FTT made comments about the evidence of Mr McKenna, Mr Reid and Mr Clayton which are not consistent with a straightforward acceptance of that evidence. On the contrary, there are clear indications both at [46], which contains general descriptions of the witnesses and their evidence, and elsewhere in the Decision that the FTT did not accept everything that these witnesses said. For example, at [548] to [550] the FTT rejected evidence from Mr Clayton about the justification for the 70:30 ratio, and at [246] criticised evidence from Mr Reid about the Studio "step" participation and the failure to reflect it in the IFP2 Information Memorandum. Specific reservations about the controlling minds' evidence on the View to Profit Issue are discussed further below.

372. We have no doubt that the FTT also understood very well what the concept of subjective intention was. It drew a clear distinction between subjective intention and the objective test that it went on to consider at [829]. The fact that it referred to a number of aspects of the evidence, including objective elements, at [827], does not indicate that it was mixing up the subjective and objective, but rather correctly applying its earlier recognition at [492(b)] of the fact that all the evidence is relevant in determining subjective intention, and mere assertion of intention is not enough.

373. It is the case that a number of elements of the evidence support not only an awareness by the controlling minds of the importance from a tax perspective of there being a view to profit, but the adoption of a serious approach, seeking to maximise revenue. Ordinarily, maximising revenue would be indicative of a view to profit. At the very least it is consistent with it. The supporting evidence includes aspects of the Commissioning Distributor Model, the Green-lighting process (focusing on identifying "best of breed" projects, aiming to choose the best performing films in commercial terms, and involving the use of a formal committee with experienced external appointees for later partnerships), the slate approach with less well-performing films potentially still contributing to revenue (including for later partnerships the effect of the "gross corridor"), and some evidence that Ingenious approached negotiations aggressively. The Information Memoranda also provide contemporaneous evidence of a stated desire to choose films capable of profit.

374. It is clearly possible to seek revenue without intending to make a profit: a classic example of that might be a charity or other non-profit making organisation which seeks to cover its costs but is not aiming for profit, albeit that it may in fact make a surplus in some years. However, where an entity is going about business seriously, with no obvious cap on its ambition, and where (even on the LS202 spreadsheet, as it was adjusted by the FTT, looking at a five-year period) a profit might be forecast, then an intention to achieve profit should not readily be dismissed. There is, at least, no reason why profit would not have been desired. That is in contrast, for example, to the position in *Ensign Tankers* where the limited partnership did best if a loss was made.

375. In our view the FTT understood this. However, it also recognised that this was an unusual business. In particular:

(1) At [625] and [626] it recorded HMRC's submission that for Ingenious, profit for the LLPs was unnecessary because it received its Operator's fee and the EP fee upfront. So its return was dependent upon the level of overall subscriptions and not upon LLP profit. In the IFP structure the CM's profit participation was a spur to get as much income as possible for the LLP, but that was different from having a view that such income (in aggregate) would exceed the LLP's expenses. The FTT accepted that this required a guarded approach to the evidence of the controlling minds, because it was not the case that the LLPs had to aim for profit if they wanted to continue in business; they were vehicles set up to deliver returns to investors which would be good even if they did not make profits.

(2) At [632] the FTT accepted HMRC's submission that the LLPs did not have to recoup their costs before the investors started to make a positive after-tax return, and that almost any amount of income from a film's Waterfall secured a profit for an investor. It supported that observation with a reference at [633] to an internal email to Mr Clayton which referred to the key point being that investors "just need partnership receipts to be profitable anyway as they are already at cash break even" because of their tax recovery.

376.It is clear from the FTT's findings that the key drivers were losses for investors, fees for Ingenious and achieving some level of revenue. The tax benefits and fees explain why the activities were undertaken – this was not a normal business motivated by the desire for profit. Maximising losses was not of itself obviously consistent with a view to profit, given that the scale of the losses was driven by the extent to which a write down in NRV could be justified. The fees Ingenious earned were in large part not dependent on the financial results of the LLPs[7]. Revenue was consistent with seeking profit but, in circumstances where investors were not staking their own funds and almost any revenue would produce a post-tax profit, profit for the LLPs was neither necessary nor otherwise a clear driver. There was no pressure from investors to achieve it.

377.Whilst the controlling minds professed a desire for profit, the FTT noted the lack of supporting evidence, for example the absence of any detailed financial analysis in the papers provided to the Green-lighting committee, and even a lack of clarity among the controlling minds about what the threshold was. For example, at [602] the FTT noted that, apart from the illustrations in the Information Memoranda, it saw little evidence of serious or detailed consideration of the profitability or otherwise of an LLP on an overall basis as opposed to the position film by film.

378.In contrast, significantly more work seems to have been done on NRV calculations, as discussed in Appendix 9 of the Decision at [1735] to [1826]. The FTT was also entitled to remark that Ingenious personnel clearly regarded the film

[7] We accept that there was an element of results related return, via the terms of a performance-based Operator's fee for ITP and the profit element for the corporate member for later partnerships (see [267] and [268] in the Decision).

partnerships as successful, even though none of them have been profitable and, even on Ingenious' own projections (which HMRC do not accept), only one of them is projected ever to be profitable. The absence of actual profit from a business conducted by experienced businessmen does call into question whether profit is really an aim.

379. A profit for an LLP would doubtless be welcome, but that does not mean that the business was conducted with a view to profit. Take the example of an amateur runner entering the London Marathon. Victory would doubtless be very welcome, but for most it would not be an aim. In contrast, the runner's aims might be or include beating a target time, doing better than one or more running colleagues, raising a target amount for a charity, or simply crossing the finishing line. None of these is inconsistent with winning the marathon, but winning is not (at least realistically) one of the aims.[8]

380. Turning to Mr Saini's specific comments on the factors listed at [827], he criticised the reference to "other objects" (being, we think, the objects referred to in [826]), bearing in mind that the FTT had apparently accepted that the existence of those objects did not prevent there being a view to profit. We do not think that this criticism is justified. As already indicated, those objects may not be inconsistent with the pursuit of profit, but they do provide an alternative explanation for activities which would ordinarily be driven by a desire for profit.

381. The FTT went on at [827] to refer to the evidence of the controlling minds and the activity of the Green-lighting committee. We do not agree with Mr Saini's submission that because it made no finding that it rejected the controlling minds' evidence it must be taken to have accepted it. It is clear that the FTT took a guarded approach to their evidence, as is apparent from [626], referred to above. In relation to Mr Clayton the FTT expressly found at [619] that he hoped as an investor to get something more than his tax back, but not to invest in an LLP which recouped more than its original investment. In relation to Mr McKenna it noted that he was aware of the tax test but expressed various reservations at [599] to [605], including that he spoke mainly of the capability for rather than likelihood of profit, that his rule of thumb of 2x budget at the box office did not recognise the additional measure of success needed for profit on the Ingenious Basis, and that there was little evidence of serious or detailed consideration of overall profitability. Similar reservations were expressed about Mr Reid's evidence at [612] to [616]. In relation to Mr McKenna, we also note for example the email from him referred to at [635(e)] which described an opportunity to participate in "gross sales income (not, non-existent profit!)".

382. We should comment specifically that we do not think that it was inappropriate for the FTT to refer to the likelihood of profit here: an experienced businessman aiming for profit would, as already discussed, ordinarily pay at least some regard to how likely or otherwise profit would be. Lack of serious consideration of the likelihood of profit may indicate that the requisite intention is not present.

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[8] We should emphasise that we are not comparing winning the London Marathon to making a profit on a film. The example is simply intended to illustrate the point we are making.

383.At [634] the FTT also commented on the fact that some of the controlling minds' evidence conflated profits with revenue (whilst recognising at [636] that profit might be sought as well as revenues). At [635] the FTT set out an instructive list of evidence which indicated the importance of receipts rather than profits. That evidence was clearly part of what the FTT took into account in reaching the conclusions it did at [639] to [641] (as set out at [360] above) about the controlling minds' evidence.

384.As regards evidence of the Green-lighting committee, the FTT was entitled to make the findings it did at [587] to [592], including that there was no evidence that the committee considered the expected range of financial outcomes for any film, and that there was limited consideration of the prospect of profit for an LLP overall. There was no clear indication that the committee considered that films approved were capable of achieving WWBO of 2x (or 2.2x) budget, or that any rigorous quantitative assessment had been conducted by Ingenious staff before a film was considered by the committee. The break-even analysis relied on by the LLPs was prepared in 2010, well after the transactions were undertaken. As already mentioned, the contrast with the approach to NRV calculations is notable.

385.The FTT found at [592] that the evidence of the Green-lighting committee's process did not support a conclusion that there was any "intention or reasonable hope" that the LLP would make a profit overall. That was an explicit rejection of the proposition that the existence of the process assisted the LLPs on the question of subjective intention. In reaching this conclusion the FTT took account at [589] among other things of the committee's role in relation to the Avatar Hedge (arrangements which were designed to ensure there was no overreliance on the receipts from that film) and we reject the LLPs' submission that the existence of that hedge was only consistent with an aim for profit. Avoiding over exposure to one film is consistent with an aim for revenue, but not necessarily profit.

386.The next factor referred to in [827] is the reliance on the 2x or 2.2x multiple. Mr Saini submitted that the FTT found as a fact that the controlling minds of each LLP subjectively believed that they would in general terms realise profits from a film if it achieved WWBO revenues equal to twice budget. He refers to [745] and [756]. We disagree. At [745] the FTT merely describes the evidence on this point (and the same applies, for example, to the first part of [590] and to [623]). In the case of Mr Clayton, it is clear from [750] that the FTT did not actually accept that he relied on achieving WWBO of 2.2x budget. That is clear from the FTT's statement in that paragraph that "if" that was the rule of thumb he applied it was unlikely to result in profitability for the LLP, and also the earlier questioning of his evidence on this point at [567]. In our view, [756] also provides no support: it records a doubt as to whether the Green-lighting committee and those who put films to it applied a test enabling them to have a realistic hope of profit for the relevant LLP on the Ingenious Basis.

387.The 2.2x multiple is considered in some detail at [745] to [756], as well as elsewhere. In those paragraphs the robustness of the multiples said to be used by each of Mr McKenna, Mr Reid and Mr Clayton is doubted. The overall impression from the Decision is that the controlling minds did not seriously apply their minds to what was actually needed across a slate of films to ensure profit for an LLP. This included

a requirement, by reference to the illustrations in LS202 (and even accepting that those illustrations were otherwise appropriately prepared), that Studio films perform on average at 2.9x budget at the box office, and therefore materially better than the 2.2x multiple, to ensure overall profit.

388.The FTT found at [726] that it was "unlikely" that Studio films would on average achieve the 2.9x multiple assumed by LS202, and earlier at [720] that the expectation of an overall average box office to budget ratio of 2.2x was "somewhat unrealistic". These conclusions were ones to which the FTT was entitled to have regard in determining whether it was persuaded that the controlling minds, who were experienced businessmen professing expertise in the film industry, were actually intending the LLPs to be profitable.

389.It is convenient to consider here Mr Saini's more general criticism that the FTT failed to identify the significance of the Information Memoranda, together with LS202. He said that the Information Memoranda provided the most relevant contemporaneous evidence of subjective intention, and that the terms of those documents were only consistent with a conclusion that there was a subjective intention to generate profit. We disagree. The FTT expressly found at [738] to [740] that the IFP2 Information Memorandum did not indicate that there was an intention to conduct the business with a view to profit, and that the financial illustration included in it was merely an indication that Ingenious personnel considered profit to be possible. The financial illustration was an illustration of what might happen, and not of expectation or intention: see the express finding to that effect at [660]. LS202 was prepared on a "bottom up" basis, starting with a modest profit and working backwards, rather than starting with expected revenues. The FTT had also noted earlier, at [519], that whilst that illustration suggested a modest profit over a five-year period, the actual figures showed that even after seven years no LLP was actually in profit, and that this called for a careful examination of the illustration and the evidence. Having weighed the evidence carefully, as it did, the FTT were fully entitled to make the findings they did as regards the Information Memoranda and LS202.

390.Returning to Mr Saini's submissions on [827], the next factor listed is the imposition of the EP fee. Mr Saini submitted that this ignored that it was standard practice to include EP fees in film budgets, the amount was not excessive, and the break-even point was not materially affected. We do not accept these criticisms. As discussed further below, the FTT was entitled to reach the conclusions it did on the EP fee, which it found at [818] was a real extra cost in the budget. It is also clear from [832] that the fee did not by itself preclude a conclusion that the business was conducted with a view to profit. But it was a factor that the FTT was entitled to take into account. It made profit harder to achieve.

391.The FTT then refers to the apparent willingness to accept that a Studio would break even first, and "above all" to the imposition of a model which purportedly gives rise to a 100% investment for less than 55% of GDI. The LLPs criticise the comparison to the position of the Studio on the basis that the Studio bore (often abortive) development costs and fixed overheads to which the LLPs were not exposed

under the Commissioning Distributor Model, as well as incurring expenditure on distribution, and it was therefore commercially unsurprising for the Studios to expect to break even first. They also point out that out of a total of 65 films, there were only 7 in respect of which the Studios made a profit and the LLP did not, 8 where both were profitable, and 50 where both made a loss (see [514] in the Decision).

392.We do not consider that this criticism is justified. It is indeed commercially unsurprising that the Studios expected to break even first. This was not only by reference to the production side of the business to which these figures refer. In practice they might also expect profit from their distribution activities, as referred to by the FTT at [523]. But the fact that an arrangement may be arm's length or commercial in nature does not assist in determining whether the LLPs were actually conducting their activities with a view to profit. The fact that it is more difficult for an LLP to break even than it is for a Studio to do so is a factor that the FTT was entitled to take into account.

393.As regards the share of GDI, Mr Saini said that this was based on an assertion at [749] that other film financiers would invest x% of the film's budget for x% of the income after distribution and talent participation costs and fees. This was criticised as ignoring other inputs such as the value of intellectual property and development costs. Mr Saini also submitted that it was contradicted by HMRC's expert witness, Mr Finney.

394.In our view this was again a factor that the FTT was entitled to take into account. Development and creative costs might be expected to be reflected in the budget. The FTT's finding that others would invest x% of budget for x% of income was directly supported by the shortfall financing arrangements that are referred to at [324], [325] and [820(b)] and summarised at [344(c)(ii)]. It also reflects the reality that the LLPs were entitled to 30% of GDI for their 30% contribution – a reality acknowledged in some of the contemporaneous email correspondence we were shown. The FTT illustrated at [758] and [759] how much harder it would be to make a profit on the Ingenious Basis than the 30:30 Basis.

395.We have considered Mr Finney's evidence carefully but do not think that it provides support for the LLPs' submission. The relevant part of the transcript that records Mr Finney querying why the LLPs' revenue share was not higher discusses sharing of revenue rather than GDI. It also focuses on the position following repayment of the CM loan and compares that with the effect of repaying a "real" loan, which would ordinarily lead to the enjoyment of more income.

396.Mr Saini also submitted that the FTT wrongly failed to pay real regard to second-cycle income, contrary to expert as well as factual evidence. This included the evidence of the LLPs' expert Mr Briggs, who estimated second-cycle revenue at 30% of the first cycle, as recorded by the FTT at [1474]. The FTT accepted Mr Briggs' expertise in relation to the ratios used at [1467], whilst at the same time expressing "real doubts" about the likelihood of significant second-cycle revenues arising. These doubts are raised again at [1478] and [1479], where the FTT notes the use of a five-year horizon in the IFP2 Information Memorandum and concludes that the prospect of

significant second-cycle income was too remote to be taken into account in determining what could realistically be hoped for.

397.It is unclear to what extent, if at all, the FTT's views on subjective intention were influenced by its consideration of second-cycle income. It is not listed as a factor in [827] and, of course, input from Mr Briggs was obtained well after the transactions were entered into. His evidence is relevant only as an indication of what the controlling minds may have considered. To the extent it was or may have been taken into account by the FTT, however, our view is that the FTT was entitled to take the approach it did on second-cycle income, taking account of the approach in the Information Memorandum. That not only used a five-year period to illustrate projected profit but also included a statement that "peak profitability" was projected in the fourth year of trading, by which time the majority of costs would have been recouped on successful films.

398.In our view Mr Saini's most weighty objection to the way in which [827] is worded is the reference to "realistic" hope or intention. The same applies to [641] (also set out above), which refers to a "realistic chance". If there was a genuine subjective intention to make a profit, then it would not matter whether that was realistic. The use of the word might suggest that the FTT was applying the wrong test. However, reading the Decision as a whole we are satisfied that the FTT was applying a subjective test in this part of its findings, and the question of whether something was realistic, or indeed likely, was relevant only as part of the evidence to be taken into account in determining whether a subjective intention existed, taking account of the fact that the controlling minds at Ingenious were experienced businessmen who professed expertise in the film industry. As already discussed, whilst profit-making need not be a predominant aim, it must be a real one. The LLPs must have genuinely intended to achieve a profit. In our view the FTT was not persuaded that they did have such an intention.

399.On the basis that the FTT was not persuaded that the controlling minds of Ingenious genuinely intended to achieve the profit, we conclude that we are entitled to remake the decision by determining the View to Profit Issue as it relates to ITP and IFP2 in favour of HMRC.

400.For completeness, we should add that a significant number of the LLPs' Ground 2 challenges related to the FTT's findings of fact on the View to Profit Issue. We have dealt with the most significant of these in responding to Mr Saini's submissions in our discussion above. Of the remainder, in our view, they were either not significant in relation to the overall findings in the Decision as those findings related to subjective intention, or related to findings that would only have been material had an objective test as to view to profit been the correct test.

Expert evidence

401.We have come to our conclusions on the View to Profit Issue without giving any significant consideration to the substantial amount of expert evidence which was available to the FTT as to the likelihood or realistic possibility of particular films or

slates of films, and therefore the relevant LLP, producing particular levels of income or becoming profitable.

402. We have not found it necessary to have regard to this evidence and the challenges that the LLPs made to the FTT's findings on that evidence in any detail. This is because the expert evidence is primarily relevant to the question of whether it was objectively realistic to consider that particular films, slates of films, or the LLPs were ultimately going to be, or could be, profitable. Accordingly, we do not consider the expert evidence to be a material relevant factor in relation to our conclusions on subjective intention.

403. We also bear in mind that our conclusions on the View to Profit Issue are not necessary in order to determine these appeals, and we do not wish to extend what is already a very long decision any more than it is necessary to do so. We will therefore confine ourselves to a number of general comments on the FTT's findings, its approach to the evidence and the challenges made by the LLPs.

404. The FTT's conclusions on the experts' evidence can be summarised as follows:

(1) As regards Mr Sills' evidence it concluded at [768] and [769] that:

(i) it would not have been unreasonable to expect the films he reviewed to have been profitable on the 30:30 Basis;

(ii) the evidence permitted a conclusion that at the time the films were contracted it would have been very optimistic to have expected more than a small proportion of the films to be profitable on the Ingenious Basis;

(iii) the evidence also permitted a conclusion that at the time a film was contracted, it would have been unrealistic to expect that the CM loan would be repaid at any time; and

(iv) Mr Sills concluded that some but not all of the estimates of ultimate receipts for a number of the films in which the LLPs were involved prepared by Ingenious for HMRC in 2010 (the "2010 Ultimates") were reasonable.

(2) As regards Mr Briggs' evidence it concluded at [774] to [778] that:

(i) the sample Ingenious LLP films which he was asked to compare to the performance of a number of previously released films in a "benchmarking" exercise would have been profitable for the relevant LLP on the Ingenious Basis provided they had performed as well as the benchmark films and had made the assumed second cycle revenues, but there was some real uncertainty about the likelihood of second cycle revenues;

(ii) Mr Briggs' calculations as regards the sample films showed what was possible, but not what was likely;

(iii) the benchmark WWBOs required for the profit Mr Briggs illustrated was such that, had the sample films achieved that

WWBO, almost all would have been in the top 10 films of 2006. It was very unlikely that all or even a majority of the films would perform at that level, but it would not have been unreasonable to hope that one (or perhaps more than one) of the films would perform at that level;

(iv) it was unlikely that more than one of the sample films would make a profit under the Waterfall; and

(v) even if one film in the slate of the relevant LLP had performed at the benchmark level, the LLP would not (on the Ingenious Basis) have been profitable.

(3) The FTT also concluded at [772] that Mr Briggs' evidence provided very little support for the reasonableness of the figures for the 2010 Ultimates, but (subject to a caveat) nothing to suggest they were unreasonable.

(4) In relation to Mr Olsberg's evidence, as considered alongside that of Mr Finney, it concluded at [782] that it was not realistically possible that all three of the independent films reviewed by Mr Olsberg would have performed at a level which would have ensured that, on the basis of hypothetical figures as to the amount of receipts that needed to be collected, the film would be profitable for the LLP, but there was a slight possibility that one or other of two of the films might achieve the threshold and there was a realistic possibility that the third film might achieve the threshold.

405. The LLPs submitted that the FTT made a number of findings in relation to the expert evidence which were not open to it on the evidence before it. Absent those errors then the only conclusion open to the FTT was that the expert evidence supported only the conclusion that the LLPs were trading with a view to profit, whether on the 30:30 Basis or the Ingenious Basis.

406. The LLPs submitted that a fundamental criticism of the approach of the FTT in this regard (which infected all of its findings in relation to the expert witnesses) is that the FTT wrongly substituted its own views for those of the experts, and in doing so failed even to canvass its findings with the parties and the relevant experts.

407. The LLPs also challenged the FTT's failure to take due account of the evidence of Mr Briggs as regards the 2010 Ultimates, and the substitution of its own (subjective) views as to the likelihood of the LLPs generating a profit from the films in which they were involved.

408. We do not detect a material error in the FTT's approach to the expert evidence.

409. In particular, as regards Mr Olsberg's evidence, in reply to which Mr Finney gave evidence on behalf of HMRC, it is clear that the FTT considered the opinions of both experts carefully, decided that it was not persuaded by some aspects of Mr Olsberg's evidence, and instead made some findings that were more in accordance with Mr

Finney's evidence. The FTT was of course perfectly entitled to take that course and we detect no error of law on the FTT's part.

410.Neither can we detect any error of approach in relation to Mr Sills' evidence. The FTT was clearly entitled, having considered it carefully in some detail in Appendix 2 to the Decision, to reach the conclusions it drew from that evidence. In particular, in our view the FTT fully considered the challenges the LLPs made to his methodology in relation to ratios used in his calculations (see in particular [1418] to [1422], and the different ratios shown in the tables at [1424] to [1426]).

411.As regards Mr Briggs' evidence, in our view the challenge to the FTT's findings as to Mr Briggs' opinion on the 2010 Ultimates is not material. The 2010 Ultimates were not contemporaneous with the entering into of the relevant transactions and no such exercise was carried out at the time relevant contracts were put into place. The analysis of the 2010 Ultimates is therefore of very marginal relevance.

412.Mr Briggs' conclusions as a result of the benchmarking exercise have some relevance. The FTT's consideration of the evidence on this aspect was arguably infected by its consideration at [775] to [778] of what was likely, but, as we have already said, consideration of the likely outcome is not necessarily irrelevant to subjective intention. Again, no benchmarking exercise was carried out at the time the transactions were entered into, so the exercise must be regarded as being of marginal relevance.

413.Mr Briggs' evidence as regards the likelihood of second cycle income is of some relevance, but in our view the FTT was entitled to conclude as it did at [1479] that the prospect of significant second cycle income was too remote to be taken into account in determining what could realistically be hoped for. In that context, it was a relevant consideration for the FTT that the illustrations in the Information Memoranda approach the question of profit on a five-year basis.

Whether IG was trading with a view to profit

The Decision

414.At [1240] the FTT noted a passage in the minutes of the first Green-lighting committee meeting for IG which commented that 1 million units of a game would need to be sold for the publisher to break even, but 2 million units would need to be sold for IG to break even.

415.At [1245] the FTT concluded that the activity of the Green-lighting committee did not evidence that IG had an expectation or hope of making a profit on the Ingenious Basis, but a comment in the committee's minutes to the effect that investors would receive handsome distributions even at a level of sales that would not generate profit for IG indicated an interest in and desire for revenue as opposed to an interest in profit for IG.

416.At [1246] the FTT found that its conclusions from the evidence of the controlling minds of the film LLPs equally represented the mindset of Messrs Reid and McKenna (and to any relevant extent Mr Clayton) in relation to IG.

417.At [1247] to [1252] the FTT undertook a detailed review of the financial illustrations contained in the IG Information Memorandum, noting that the illustration was prepared in a similar way to that for the IFP2 Information Memorandum, selecting a modest 5% profit for a five-year period. To achieve that profit, the Information Memorandum assumed sales with a weighted average of 4.31x game budget. It found that Ingenious had relied on a report from an industry analyst to benchmark sales, and in particular a multiple derived from that report of 6.25x game cost for sales of games released on two particular platforms, and on that basis Mr Reid asserted that 4.31x was conservative. The FTT found that there was no evidence of an intention to adopt a strategy of contracting for games to be launched on those two particular platforms, and therefore the report relied on provided little support that achieving profit on a 6.25x benchmark was IG's view. It concluded that the report provided "only a little comfort" in relation to the realism or otherwise of the 4.31x ratio.

418.At [1253] the FTT concluded that the illustrations in the Information Memorandum did not provide much comfort that IG had any realistic expectation or hope of making a profit on the Ingenious Basis on games development, or that the illustrated profit indicated that the illustrated result was realistic.

419.At [1254] the FTT set out its conclusions on the expert evidence provided in relation to games as follows:

> (1) Two of the games developed would have had to have sold about 2m units each for IG to break even on them on the Ingenious Basis, but only about 1m units if profit was calculated on a 30:30 Basis.
>
> (2) It would not have been a flight of fancy to hope that one of the games would sell 2m units, but it would have been an unlikely result. It was unrealistic to hope that more than one of four games would so perform.
>
> (3) For the profit on one game to make up for the expected losses on the others it would have to sell more than 2m units. That was really unlikely.
>
> (4) It was not unrealistic to hope for sales of more than 1m units. On the 30:30 basis the games would have been profitable at that level. It seemed possible but unlikely that more than one game could perform at that level, and not unreasonable to hope that one game's sales might so exceed 1m that it made up for the losses on the other games.
>
> (5) There were elements in ordinary publishing and development contracts which provided benefits and protection for the developer which were not present in all the games contracts.

420. At [1255] the FTT in effect applied the same reasoning as it had in relation to films to conclude that the relevant Ingenious personnel (and those who dealt with Ingenious) knew that the commercial and economic effect of the agreements was a

30:30 model and that their common sense view must have been that profit or loss would arise on that basis.

421. The FTT set out its conclusions on the View to Profit Issue at [1256] to [1259] as follows:

> "1256. The games industry was complex and risky. IG had, through Ingenious, conducted some research into it. From the evidence we saw, our impression of that research, the level of IG's knowledge of the games industry and its knowledge of the revenues and expenses which arose, was that it was fairly superficial. IG did not appear to have immersed itself in the detail enough to be able to estimate, with any real hope of being correct, the returns which it might make by contracting for any particular game or combination of games.
>
> 1257. The illustration in the Information Memorandum provided no or minimal support for any hope that IG would make a profit: even though its estimating methodology was crude and not based on particularly sure foundations, it knew that a game had to perform exceptionally well to make a profit on the Ingenious basis, and that this was unlikely. It must have known that for a hit to make up for the losses the hit had to do even better than break even. It must have known that this was very unlikely.
>
> 1258. IG had identified the handicap to profitability presented by the Ingenious basis and the waterfall: it knew its games had to perform substantially better than they would have to perform for an ordinary publisher to make a profit on that basis. In our view it did not have a (realistic) view of profit on that basis and it was not realistic to hope for an overall profit for IG on that basis.
>
> 1259. On the other hand, IG knew that on a 30:30 basis it had a chance of profit on individual games which approximated that of the publisher; the publishers were well regarded entities and the games undertaken had commercially appealing characteristics. If, as seems likely, the publishers could reasonably hope for profit then so could IG on that basis."

Discussion

422. IG's challenges to the FTT in respect of this issue comprise three discrete challenges to the factual findings of the FTT, as follows:

(1) The finding at [1258] as regards the sales performance required as compared to an ordinary games publisher in order for IG to achieve a profit on the Ingenious Basis.

(2) The finding at [1245] that the activity of the Green-lighting committee did not evidence that IG had an expectation, hope or even desire of making a profit on the Ingenious Basis.

(3) The findings at [1252] in relation to aspects of the financial illustrations contained in the IG Information Memorandum.

423. In relation to the first challenge, Mr Vallat submitted that the only conclusion on the evidence (particularly that of Mr Reid) open to the FTT, was that IG had, subjectively, a view to realising profits from its activities.

424. Mr Jones took us to all of the relevant evidence available to the FTT on this point. It is clear that the FTT weighed that evidence against Mr Reid's evidence carefully and discounted the latter. It is important to note that the FTT found at [1246] that its conclusions from the evidence of the controlling minds of the film LLPs equally represented the mindset of the controlling minds in relation to IG.

425. In our view the FTT was clearly entitled to take the view that it did on the evidence and come to the conclusions that it did at [1258]. This challenge comes nowhere near to satisfying the high hurdle that IG has to surmount in order to disturb those conclusions.

426. In relation to the second challenge, we accept Mr Jones' submission that the minutes of the relevant meeting demonstrate that there was no detailed consideration of the proposed titles for the games, no analysis of the projected profitability, and no examination of the proposed deal terms. The FTT was fully entitled to come to the conclusion that it did on what the minutes of that meeting demonstrated, particularly in the light of the inference it drew from the reference to the desire for revenue.

427. In relation to the third challenge, Mr Vallat submitted that the only conclusion open to the FTT was that the 6.25x ratio which underpinned the illustrations in the IG Information Memorandum was appropriate and that the FTT's other criticisms of the figures in the Information Memorandum were unjustified.

428. Again, in our view the FTT weighed up all the available evidence and was fully entitled to reach the conclusion that it did. In no sense could it be said that its conclusion was perverse.

429. It is clear, however, for the reasons we have given in relation to the film LLPs that the FTT made errors of law in relation to its conclusions on the View to Profit Issue in relation to IG. As with the film LLPs, those errors are material and we should therefore set aside the Decision as it relates to this issue.

430. As with the film LLPs, we need to consider whether, in the light of the FTT's errors in its formulation of the correct legal test and in looking at the question of "view to profit" on the 30:30 Basis, which it repeated in relation to IG, the findings of fact made by the FTT are adequate to support a conclusion by this Tribunal as to whether IG was operating with a view to profit.

431. The FTT's conclusions at [1256] to [1259] do not give a very clear finding as to whether IG had a subjective intention of making a profit. The emphasis, in particular in [1258] and [1259], is on the question as to whether objectively there was a realistic possibility of profit. However, as we have said, at [1246] the FTT found that the controlling minds of IG had the same mindset as those of the film LLPs, and on that basis in our view the FTT has made a finding that it was not persuaded that the intention of the controlling minds was to conduct IG's business with a view to profit.

In addition, at [1245] the FTT's finding that the minutes of the Green-lighting committee did not evidence an expectation or hope of profit clearly related to subjective intentions. Likewise, the conclusions at [1253] as regards the Information Memorandum seems to us to focus on the question of subjective intention. Taking all those findings together, we conclude that the FTT made sufficient findings of fact which entitle us to remake the Decision by determining the View to Profit Issue as it relates to IG in favour of HMRC.

Conclusion on the View to Profit Issue

432. For the reasons set out above we determine the View to Profit Issue in favour of HMRC.

V. THE INCURRED ISSUE

Introduction

433. As we mentioned at [50] above, because of the way in which we have determined the Trading Issue we do not need to determine the question as to whether the LLPs' expenditure in relation to their involvement in the production of films and games was "incurred wholly and exclusively for the purposes of the trade" and therefore deductible as expenses in calculating the profits of their trade pursuant to s 34(1) ITTOIA 2005 and s 54(1) CTA 2009 (and their predecessor provision s 74(1) Income and Corporation Taxes Act 1988). In the light of our conclusions on the Trading Issue, we therefore deal with the issue briefly, proceeding on the basis that we were wrong in our conclusions that none of the LLPs were carrying on a trade. We deal first with the question as to whether the relevant expenditure was "incurred" by the LLPs.

434. In summary, we agree with the FTT's conclusion that in this context, the term "incurred" was concerned with whether the taxpayer bore the economic burden of an expense. On the basis of its analysis of the LLPs' obligations, which we have in substance accepted but for different reasons to those given by the FTT, the only economic burden the LLPs suffered was the outflow of 30, and that was all that was incurred.

Legal Test

435. In addition to s 34(1) ITTOIA 2005 and s 54(1) CTA 2009, which provide that in calculating the profits of a trade no deduction is allowed for "expenses not incurred wholly and exclusively for the purpose of the trade", it is relevant to note s 27 ITTOIA 2005 (and the corresponding provision in s 48 CTA 2009) which emphasises the role of accounting entries in determining what constitutes an "expense". Section 27 provides as follows:

> "(1) In the Income Tax Acts, in the context of the calculation of the profits of a trade, references to receipts and expenses are to any items brought into account as credits or debits in calculating the profits.
>
> (2) There is no implication that an amount has actually been received or paid.
>
> (3) This section is subject to any express provision to the contrary."

This should be read with s 25 ITTOIA 2005 (and s 46 CTA 2009), which requires profits of a trade to be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law.

436.We were referred by the parties to a number of cases relating to capital allowances. In that context the emphasis is different to the provisions mentioned above, because in relation to capital allowances the legislation places a particular focus on what the relevant expenditure was incurred *on*, rather than solely on the purpose of the expenditure. However, both sets of provisions require a determination that the expenditure in question (i) was incurred and (ii) was incurred by the trader rather than by anybody else. Therefore, the cases on capital allowances are instructive. In that context, we consider briefly *Peterson v Commissioner of Inland Revenue* [2005] STC 448 ("*Peterson*"), *Tower MCashback v HMRC* [2011] STC 1143 ("*Tower MCashback*"), and *Barclays Mercantile* and *Ensign Tankers*, to which we have already referred.

437.*Peterson* concerned the deductibility of expenditure made by a partnership of investors for the purposes of the production of a feature film. In addition to their own resources, investors had provided finance funded by monies advanced to them under non-recourse loan agreements. The tax authorities had disallowed that part of the expenditure represented by monies advanced under the loan agreements, on the grounds that those monies did not represent expenditure incurred by the partnership at all.

438.At [15] Lord Millett, delivering the majority judgment of the Privy Council, observed that borrowed money belongs to the borrower not the lender, and this is so whether the borrower incurs a personal liability to make repayment or not. Accordingly, the fact that the cost of acquisition is funded wholly or in part by a non-recourse loan ought ordinarily to be irrelevant. He said at [44] that the fact that the investment in that case was funded by a non-recourse loan did not alter the fact that the investors had suffered the economic burden of paying the full amount of the expenditure. Therefore, we accept that it is possible to "incur" expenditure even if it is funded by a non-recourse loan.

439.Lord Millett went on to say at [45] that the circular movement of money sometimes conceals the fact that there is no underlying activity at all, but he added that each of the payments in the circle must be examined in turn to see whether it discharged a "genuine liability" of the party making the payment.

440.In the High Court in *Ensign Tankers* Millett J had also said at page 769h of his judgment that "to incur" means "to render oneself liable to" so that expenditure is

incurred, whether or not there has been any actual disbursement, if the taxpayer has legally committed himself to that expenditure.

441.However, as is clear from what was said by the House of Lords in *Ensign Tankers*, the existence or otherwise of a legal commitment may not be determinative. In that case, self-cancelling payments were made from and to Lorimar: see the summary of the facts at [84(4)] above. At page 665 Lord Templeman held that Victory Partnership was subject to an obligation to pay only 25% of the budget for the film to Lorimar and subject to an obligation whereby any money paid by Lorimar was immediately transferred back to it, so that when all the documents had been entered into, Victory Partnership had a right to 25% of the net receipts from the exploitation of the film. We also observe that Lord Hope analysed *Peterson* at [92] of *Tower MCashback* and said that he would confine the decision to its own facts.

442.In *Barclays Mercantile*, the question was whether the taxpayer was entitled to capital allowances for expenditure under s 24(1) of the Capital Allowances Act 1990, which provided for allowances to a person carrying on a trade who had incurred capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade. The plant in question was a natural gas pipeline, and the taxpayer entered into contracts to purchase the pipeline from an overseas company and then entered into a lease agreement with that company leasing it back on finance lease terms. There was then a sub-lease from the overseas company to its subsidiary in the UK. The complex financing arrangements entered into resulted in the whole of the purchase price for the plant and machinery paid by the UK company being deposited with an offshore company so that the purchase price was not available to the overseas company for immediate use, the monies deposited going round in a circle to discharge all the various obligations when the various rental payments fell due each year. The question was whether the UK company was entitled to writing down allowances in respect of its expenditure on the acquisition of plant and machinery under s 24(1).

443.Therefore, the central issue in the case was whether the taxpayer had incurred capital expenditure by its acquisition of the pipeline for the purposes of its trade. As Lord Nicholls in his speech in the House of Lords observed at [39], when the trade is finance leasing, this means that the capital expenditure should have been incurred to acquire the machinery or plant for the purpose of leasing it in the course of the trade. He also observed at [40] that in the case of a finance lease the statutory requirements were concerned entirely with the acts and purposes of the lessor. Therefore, what happened to the purchase price after the acquisition did not affect the reality of the expenditure by the taxpayer and its acquisition of the pipeline for the purposes of its finance leasing trade. None of the transactions after that acquisition, whether circular or not, were necessary elements in creating the entitlement to the capital allowances: see [41] and [42]. As Carnwath LJ said at [58] in the Court of Appeal's judgment in the case ([2003] STC 66), once one accepts the transfer of ownership, it is difficult to question the reality of the expenditure by which the purchase price was discharged. Therefore, the basis of the decision in that case was that there was a genuine contractual obligation to purchase the pipeline, which the taxpayer discharged.

444.In *Tower MCashback* the taxpayers were limited liability partnerships set up as investment vehicles to raise funding for a software company. That company sold part of its software to the limited liability partnerships by means of software license agreements under which the limited liability partnerships would acquire rights to receive part of the income derived from the exploitation of the software. 25% of the consideration payable under the software license agreements was paid by the investors out of their own funds, and the remaining 75% was provided by interest-free non-recourse loans, which were secured to a large extent by a deposit of the purchase price received by the software company. The question was whether the limited liability partnerships were able to claim first year allowances pursuant to s 45 of the Capital Allowances Act 2001, in respect of expenditure on software rights.

445.At [76] Lord Walker said that it was wrong to concentrate on the terms of the borrowing (interest-free and non-recourse) as an indication of whether there was "real expenditure" on software. He said that the issue was whether there was real expenditure "on the acquisition of software rights". The transfer of ownership indicated the reality of some expenditure on acquiring those rights, but it was not conclusive as to the whole of the expenditure having been for that purpose.

446.At [88] Lord Hope, applying a purposive construction to the legislation, stated that it required it to be demonstrated that the whole of the claimed expenditure was actually incurred on acquiring rights in the software, which was a factual enquiry, the extent and depth of which will always depend on the circumstances of each case.

447.Therefore, the principles that we take from these cases are that in considering whether the taxpayer has incurred the relevant expenditure, the focus must be on the position of the taxpayer and whether it has incurred the expenditure in question. The source of the funds can be a non-recourse loan. The existence of a legal commitment to incur the expenditure is important, but *Ensign Tankers* shows that it is not determinative. Instead, the focus must be on the "reality" of the expenditure by the taxpayer, by reference to what asset has actually been acquired as a result of the expenditure.

448. Some care must be taken in applying these principles to the question of whether expenditure is deductible as a trading expense. As already indicated, the sole focus in the context of trade deductions is the purpose of the expenditure, rather than what the money is spent on. As discussed below, the context is also the determination of the profits of the trade. Furthermore, the emphasis in the capital allowances cases on a legal liability to make the payment is clearly influenced by the fact that capital allowances typically relate to expenditure on the acquisition of an asset, where there will ordinarily be a legal liability to make the expenditure (in the form of an obligation to pay the purchase price of the asset). In contrast, in the context of deductions for trade expenditure, it is clearly not the case that a legal commitment to make the expenditure is essential. A paradigm example is discretionary employee bonuses, being a class of expenditure which is generally deductible but is not incurred pursuant to a legal commitment. However, the emphasis in *Tower MCashback* on whether there was "real" expenditure by the LLP is in our view highly relevant.

449.We should also mention the recent decision in the Upper Tribunal in *HMRC v NCL Investments Ltd and Smith & Williamson Corporate Services Limited* [2019] UKUT 0111 (TCC), which was published after the hearing of this appeal. In that case, the view was expressed that "incurred" in s 54 CTA 2009 did not impose any additional requirements on what might be regarded as an "expense" for the purposes of s 48 CTA 2009 and the related requirement to compute the profits in accordance with GAAP under s 46 CTA 2009 (see [435] above), and was simply there to ensure that expenses which have a dual purpose are not deductible, in accordance with the "wholly and exclusively" principle which we discuss later. At [83] to [86] of the decision, the Upper Tribunal concludes that the inclusion of the items in dispute in that case as debits according to normal commercial accountancy practice was sufficient to enable those items to be treated as an "expense". This is an important point, but given our conclusions on the correct accounting treatment to be applied in this case, as we discuss below, the point makes no difference in this case. We have therefore considered the question of "incurred" by reference to the submissions made to us, rather than simply by reference to the correct accounting principles to be applied.

Incurred – the Decision

450.As the FTT recorded at [838], the argument in relation to this issue was what amount of expenditure was incurred by the LLPs on a film or game, that is whether it was 100 or 30.

451.In determining this issue, the FTT relied on its findings as to the obligations that the LLPs had assumed pursuant to the contractual documentation, namely:

> (1) the LLPs were not obliged under the relevant agreements to pay 100 but only 30, and in fact in pursuance of those obligations paid only 30; and
>
> (2) the CM was not obliged to make a capital contribution, although the parties intended that the CD's payment to the PSC would be treated as a capital contribution by the CM.

452.At [871] the FTT considered that an expense is "incurred" in the sense that the legislation had in mind if the taxpayer bears the economic or financial consequences of the expenditure. It said that the reality of the legal obligations incurred by the taxpayer determines the financial consequences. It then concluded at [882] as follows:

> "It seems to us that the kind of realistic view of the facts which a purposive interpretation of the statute requires is one which, as we have said, recognises that section 34 (74) is set in the context of determining the profit of the taxpayer, and that "profit" is concerned with the commercial and economic consequences of the taxpayer's actions. That is why we view "incurred" as being concerned with whether the taxpayer bore the economic burden of an expense. If the LLP was, contrary to our view, liable to pay 100, then the statutory question is whether realistically it bore the economic burden of that liability. The realism required by that question is a requirement to look at what real economic burden, what outflow of value, affected the LLP. That requires an answer to the question: "leaving aside the rights to the film, how were the assets and obligations of the

> LLP different after the liability to pay 100 was satisfied?" The answer to that question we have already given: it had paid out 30 and lost 30 of cash, it had agreed in some way to recognise a capital contribution, and its obligation to pay drawings to the CM had reduced. Of those the payment of cash was a permanent and real economic burden; any recognition of a capital contribution had no economic effect, and the reduction in the drawings liability was not a benefit of its business. The only economic burden it suffered was the outflow of 30. That is all that was incurred."

Discussion

453. The LLPs rely on their contractual analysis and as a consequence submit that the only conclusion open to the FTT was that the LLPs incurred 100% of the expenditure on each film. They emphasise that there is no rule of tax law that prevents expenditure being "incurred" simply because it is funded by borrowing, even if that borrowing is intended to confer a tax advantage. They also submit that the fact that the loan is non-recourse is not relevant. The LLPs submit that *Tower MCashback* should be distinguished because the expenditure on the software in that case was found to have been artificially inflated well above what the software was worth, and *Ensign Tankers* should be distinguished on the basis that there was no real loan in that case.

454. We have, of course, rejected the premise on which the LLPs' submissions rest, namely that the LLPs were contractually obliged to pay 100% of the production cost of each film. In contrast, in *Barclays Mercantile*, the House of Lords held that the taxpayer was contractually obliged to pay 100% of the purchase price of the pipeline which it discharged. Neither, in our view, does it matter whether it was correct to describe the loan made by the CD to the CM as "genuine" or whether the contractual terms which sought to characterise the payment of the loan proceeds direct to the PSC as the making of a capital contribution by the CM to the LLPs should be respected. As the authorities demonstrate, the focus is on the position of the LLP and whether the LLP has incurred the expenditure in question. In this case, as we have found, the LLP was only liable for 30, and it met the liability in that amount. It was neither obliged to pay, nor in fact paid, more than 30.

455. We accept that the facts are different from *Ensign Tankers*, where there was a series of self-cancelling payments. Here the actual payments in dispute were actually made from the CD to the PSC. But we do not consider that this difference assists the LLPs. As we have previously found, 70% of the expenditure was not incurred by the LLPs at all, either contractually or as a matter of fact. The CD paid 70% of the cost of the production of the film direct to the PSC, and in return retained 70% of the GDI. The 70% was never paid to, or in any sense was at the disposal of, the LLPs and payment of that amount to the PSC did not meet any obligation incurred by the LLPs.

456. As far as *Tower MCashback* is concerned, as we have said the issue in that case was what the expenditure was on: was there real expenditure on the acquisition of software rights? That is not the question to be addressed here. Leaving aside the question of the EP fee, the entire 100 was spent on the production of the film. Instead, the question here is what real expenditure was incurred *by the LLPs*: was it 100 or 30?

457.We agree with the FTT that in determining whether there was real expenditure, it is necessary to consider whether the LLPs bore the economic burden of that expenditure. That approach makes sense given the context of the statutory test, namely the determination of profit. It follows that we accept the FTT's reasoning as set out at [882]. In our view, bearing in mind what we have said about there being no requirement that there should be a legal commitment to make the expenditure in question, and that the focus should be on what expenditure the taxpayer actually laid out (the "reality" of the expenditure), in our view the FTT correctly formulated the statutory question as being whether realistically the LLPs bore the economic burden of the liability in question. In this case, the LLPs clearly only bore an economic burden to the extent of 30.

Conclusion

458.For the reasons set out above, we determine the Incurred Issue in favour of HMRC.

VI. THE WHOLLY AND EXCLUSIVELY ISSUE

Introduction

459.As we mentioned above, we are dealing with this issue on the basis that we are wrong in our conclusions that none of the LLPs were carrying on a trade. We also proceed, as Mr Vallat submitted we should, on the basis that the LLPs incurred expenditure of 100 on the films and games in the course of their trades.

460.There are two points to consider in relation to this issue. The first is whether if 70 of expenditure was otherwise incurred, it was not incurred wholly and exclusively for the purposes of the trade, because it had a purpose of benefiting the CD and CM and had a tax avoidance purpose. The second is that the EP fee was not deductible because it was imposed to provide cash for Ingenious.

Legal Test

461.It was common ground that the FTT correctly identified the legal test to be applied. It was set out succinctly at [839] as follows:

> " … it is well known, and there was no dispute that: (1) by "for the purposes of the trade" is meant for the purposes of enabling a person to carry on the trade and earn profits in it; (2) a dual purpose, where not saved by section 34(2), was not exclusively a trading purpose; as a result an expense incurred both for the purposes of trade and another purpose is not deductible; (3) the purpose referred to is that of the taxpayer subjectively determined; (4) the purpose of the taxpayer must be distinguished from the effect of the expense. Thus a private benefit which is merely a consequence or an incidental effect does not give rise to a dual purpose; (5) although the purpose is to be subjectively determined this does not limit the investigation to the taxpayer's conscious motives; a pinch of salt is necessary – some consequences are so inevitably and inextricably involved in a payment that unless merely incidental they must be taken to be a purpose for which the payment is made."

462.We would just add one further point to that summary. Although the focus of the test is on the object of the expenditure rather than the means of incurring it, in *Scotts Atlantic v HMRC* [2015] STC 1321 the Upper Tribunal observed at [54] that it does not follow that the means by which the expenditure is made cannot be one of the circumstances to be taken into account in determining its purpose.

463.The Upper Tribunal also went on to say at [55] that a trader may have a choice of the way in which it achieves an end which is exclusively for the benefit of the trade, and that choice may be influenced or dictated by the tax consequences. Making such a choice does not necessarily involve a duality of purpose as regards the expense: in each case the question is whether the payment is made exclusively for the purposes of the trade, and that is a question of fact for the FTT.

Deduction for 70

The Decision

464.At [525] to [560] the FTT considered the Commissioning Distributor Model in some detail in the context of its consideration of whether the LLPs were carrying on their business with a view to profit. That consideration is also highly relevant to the Wholly and Exclusively Issue. The FTT did not accept all the evidence of the Ingenious witnesses about the purpose of the CD structure, for example that the structure was to enable the LLPs to be at the heart of production. It concluded at [560] that any advantage of being at the heart of production could have been obtained by a fairly simple joint venture agreement giving the LLP the same quality of involvement as it had under the Commissioning Distributor Model without the complexity of the model occasioned by the provision in relation to the payment of 100% of the budget.

465.Furthermore, at [449] the FTT found that the Commissioning Distributor Model was designed at least in a material part to obtain greater loss relief by routing, or purporting to route, the full cost of a film through the LLPs. At [450] it concluded that those managing IFP2's business arranged for the particular 100% contractual arrangement in order to deliver (enhanced) tax losses to the members of the LLP.

466.The FTT set out its conclusions on the question of the purpose for which any expenditure was incurred at [883] to [886] as follows:

> "883. If it can be said that the LLPs incurred the liability of 100 (or expenditure of 100), it seems to us that 70 (65) of that expenditure was not incurred for the purposes of the LLPs' business but for the purpose of providing a benefit to the CD of enabling the CD to reap a share of the benefits from the exploitation of the films.
>
> 884. That share included the elements of GDI to be retained by it. The effect of the agreements was to confer the right to retain 70% (65%) of GDI on the CD. That was not an incidental effect. It was an effect which the CD must have stipulated and to which the LLPs agreed (indeed it was an effect which Ingenious personnel stipulated in their requirement that the CD funded 70 (65) and that the deal was subject to the Commissioning Distributor Model). That retention by the CD was such an inevitable and inextricable consequence of the relevant

agreements that it must have been the purpose of the parties in entering into them to ensure the retention. If the LLPs incurred 100 then they must have had the purpose of enabling the CD to retain 70% (65%) of GDI.

885. For the same reasons, if the Loan Agreement gave rise to real indebtedness between the CD and the CM, the LLPs must have had the purpose of benefitting the CM (through the application of the retention of BDR by the CD in the reduction of any liability the CM had to the CD).

886. On that basis we would find that, as regards 70 (65) of any 100 incurred by the LLP, the LLP could not have had a trading purpose."

467. In relation to whether the FTT's findings that those managing the LLPs had a main object of enabling the individual members to obtain loss relief (which it reiterated at [888]) meant that the entirety of the expenditure had a dual purpose and was therefore not deductible, it came to the following conclusions at [889] and [890]:

"889. …. We accept that the structure of the agreements was designed to deliver tax relief to the investors rather than to advantage the business of the LLPs. We said that we did not regard the advantages of the CD model as requiring that the LLP paid 100 rather than 30. To our minds that feature of the model was added into the contracts in order to deliver an enhanced tax loss to investors.

890. As a result, to the extent 100 was expended under those agreements part of the purpose of that expenditure was to secure the enhanced loss for the investor, and part of the purpose of the debit was the same. That was not a trading purpose; as a result, unless the debit can be severed, none of it is deductible."

468. At [893] the FTT dealt with the effect of those findings on its conclusion that the LLPs had only incurred expenditure of 30 as follows:

"893. The incurring of the liability of 30, and the payment of 30 may have had the effect that the investors would get a tax loss, but that was incidental. It is true that the 30 was spent under an agreement which it was hoped would deliver a loss based on 100. But it was not the obligation to pay 30 which had the tax avoidance purpose but the obligation (assuming there was one) to treat the 70 to be paid by CD to the PSC as an expense incurred by the LLP. The obligation to pay 30 gave rise to the debit. That obligation was matched by rights to 30% of GDI. Its purpose was to secure their benefit."

Discussion

469. The LLPs' principal challenges to the FTT's findings were as follows:

(1) They were based on an impermissible counterfactual of a 30:70 joint venture which was not tested with the parties.

(2) It was a fact of commercial life that a deal may benefit other parties.

(3) The tax benefit was one of deferral and was simply a consequence of the transaction, the Commissioning Distributor Model having been developed without reference to tax.

(4) The 30 which the FTT said had been incurred could not be severed from the 70.

470. We do not agree that the FTT's findings were based on a joint venture counterfactual. We do not take the FTT's references at [560] to similar results being capable of being achieved through a simple joint venture as indicating that was the case. In our view, the FTT based its findings on its characterisation of the actual transactions that took place. Consequently, the FTT's findings at [883] to [890] were findings of fact which it was entitled to make.

471. The benefits to the CD and the CM were not the normal benefits that might be expected to accrue to a counterparty from a trading transaction, or indeed the sort of indirect benefit that would often flow to third parties from such a transaction, for example benefits to shareholders of the parties or to sub-contractors of or suppliers to one or both of the parties. Those benefits to counterparties and third parties are typically consequential effects, not purposes. Another example is provided by *Vodafone*, where the benefit accruing to other group members in that case was found to be a consequential effect of the transaction. We do not consider that the benefit that the FTT found accrued to the CD in this case was merely a consequential effect of the arrangements. The benefit to the CD was a fundamental, defining, feature of the structure and the FTT was entitled to find that to be the case.

472. In our view the FTT was also entitled to conclude that there was a tax avoidance purpose. As illustrated by *Scotts Atlantic*, the question of whether the choice of structure was influenced or dictated by tax to the extent that there was a dual purpose is a question of fact for the FTT. As we have observed in this case, the FTT did not accept all the evidence of the Ingenious witnesses about the purpose of the Commissioning Distributor Model and found that those managing the LLPs had a main object of obtaining tax relief for individual investors. The fact that any tax benefit came to an extent in the form of deferral does not prevent that benefit being a purpose of the expenditure. Neither does the fact that the Commissioning Distributor Model may have had some commercial objectives as well preclude the finding that there was a tax purpose. And the fact that any tax benefit was at the investor level does not preclude a finding of tax purpose in respect of the LLP (a separate legal entity) as determined by its controlling minds, who, as found by the FTT, clearly had the tax benefits well in mind at the time the transactions were undertaken.

473. In those circumstances, we consider that it was open to the FTT to conclude as it did at [890] and [893] that the expenditure of 70 was "infected" by the tax avoidance purpose, rather than regarding the tax benefit as only an incidental consequence.

474. Finally, in our view it was open to the FTT to reach that view in respect of the 70 but not the 30, because the amounts are clearly separable. Section 34(2) ITTOIA 2005 provides that a deduction is not prohibited for any identifiable part or identifiable proportion of an expense which is incurred wholly and exclusively for the purposes of

the trade. The expenditure of 30 was an identifiable part or proportion of the expenditure as a whole.

The EP fee

The Decision

475.The two questions before the FTT on this matter were whether (i) the EP fee was deductible at all and (ii) whether any disallowance should have been limited to 1.5%, that is 5% of 30, the EP fee amounting to 5% of the gross budget of each film.

476.At [894] the FTT referred to fact that the Deed of Acknowledgement etc provided for the fee to be paid directly to the EP by the LLP at the time the LLP paid out the 30, discharging the PSC's contractual obligation to pay the fee and reducing the receipt by the PSC.

477.At [895] the FTT referred to its earlier conclusion that the fee was not paid in return for any service rendered to the PSC in the making of the film, and that it could fairly be described as a fee for bringing the financial support of the LLP to the film.

478.At [898], in rejecting the LLPs' argument that the EP fee was part of the film budget and that the LLP had to pay for that budget in order to get the film made, it said that such argument:

> "…seems to us to ignore the evidence that it was Ingenious personnel who required that the PSC enter into the EP contract and therein agreed to pay the fee. Various emails showed the importance Ingenious personnel attached to Ingenious obtaining the fees it expected. The Operator negotiated the agreements on behalf of the LLP. The correspondence showed that it required the EP contract. The requirement to pay the fee was thus imposed by the LLP through the agency of the Operator. Why did the LLP impose that obligation? It was not to obtain any benefit in the making of the film. We conclude it was not paid for the purposes of making the film."

479.At [899] the FTT concluded that it was not persuaded that the EP fee was paid in order for the LLP to be able to contract for the film, for the following reasons:

> "(a) the terms of the EP contract referred to the rendering of services to the PSC, not the LLP; that might include bringing the LLP to the party, but it does not include bringing the film to the LLP. Regarding the fee payable under that contract as paid for bringing the film to the LLP requires one to treat the contract (which we repeat was imposed by the LLP through the Operator) as not representing what its terms said;
>
> (b) under the Operator's Agreement the LLP acquired the services of the Operator. Those services included the identification of suitable films and the negotiation of agreements. This agreement was in place before the agreements for any film and thus before the EP contract. Any service Ingenious personnel rendered in bringing a film to an LLP or organising for its contract would naturally have been rendered under the Operator's Agreement. Mr Reid accepted that it was the Operator's responsibility to make sure that production was going

> well. There was no need for the same services to be supplied by another entity; and
>
> (c) there was no indication in the oral evidence, besides perhaps the suggestion that at times Ingenious personnel were wearing two hats, that before the EP agreement was signed the Operator had engaged the services of the EP to organise financing and get the film ready when that was part of the Operator's own role. Indeed it is difficult to see how the Operator could have done that on behalf of the PSC for which it held no agency."

480. The FTT therefore concluded at [901] that the obligation to pay the fee was incurred for the purpose of providing cash for Ingenious and therefore was not incurred for the purposes of the LLP's business.

481. The FTT then considered the extent to which the expense of the EP fee should be disallowed on the basis of its finding that the LLP incurred only 30% of the budget for a film. The question was whether the disallowance of the expense of the EP fee should reduce the LLP's allowable expenditure to 30% – 5% (25%) or to 30% – (5% x 30%), that is 28.5%.

482. At [907] the FTT concluded on that point as follows:

> "In our judgement the LLPs incurred 5 out of 30 for the purpose of rewarding a member of the Ingenious organisation and not for the engagement in a film or in return for introducing it to the film, or even for assisting it in raising capital. It was an obligation added to the transaction by the Operator for the benefit of the Ingenious group and not for the purposes of the LLP's business; it was not forced upon the LLP by the CD. We conclude that 5 out of the 30 was not incurred wholly and exclusively for the trade of the LLP."

Discussion

483. The LLPs challenge the FTT's conclusions on the basis that the FTT ignored the fact that the EP fee was payable to the EP by the PSC, and not the LLP. They say that the LLP's contractual obligation was to advance or cause to be advanced 100% of the film's budget to the PSC, which used part of the budget to discharge its obligation to the EP, and that the LLP assumed and discharged this obligation in order to have the film made, that is for the purposes of the LLP's business. Furthermore, they say that the FTT was wrong to conclude that the EP fee was paid gratuitously and not in return for any service rendered to the PSC in the making of the film.

484. In our view the FTT was entitled to conclude that the EP fee was not deductible because it was not incurred "wholly and exclusively" for the purposes of the trade for the reasons it gave at [894] to [901]. It did not ignore the fact that it was the PSC that entered into the EP contract, or that the fee formed part of the film budget. The FTT found that the fee was not paid for the purposes of making the film or to arrange the LLP's contract for the film, but was imposed by the Operator to provide cash for Ingenious. That purpose is inconsistent with a conclusion that the expenditure was incurred wholly and exclusively for the purposes of the LLP's trade, and the FTT was fully entitled to make that finding on the basis of the evidence before it.

485.As regards the amount to be disallowed, we are not convinced that the FTT's reasoning at [907] was correct. The fee was added to the whole film budget and, as we have concluded, the LLP incurred 30% of that budget. In our view the question to be answered is who incurred the 5, not whether the 5 was "wholly and exclusively" incurred. As found by the FTT, in accordance with the provisions of the Deed of Acknowledgement etc the PSC directed the LLP to withhold the EP fee from the first instalment of the initial funding it provided under the PSA, and the Deed also provided that the fee was dependent on the LLP paying its full 30% share of the film's budget. On that basis, only the LLP was in fact liable for, and bore, the EP fee. The 70 provided by the CD for funding the production of the film was never exposed to the expense of the EP fee, either in cash terms or as a matter of legal obligation.

486.Therefore, for reasons different to those given by the FTT, we conclude that the FTT was correct to conclude that the EP fee was not incurred wholly and exclusively for the purposes of the trade of the LLP.

Conclusion

487.For the reasons we have given above, we determine the Wholly and Exclusively Issue in favour of HMRC.

VII. THE GAAP ISSUE

Introduction

488.There were three matters on which the LLPs rely in challenging the FTT's finding that the LLPs' accounts were not prepared in accordance with GAAP. They contend that the FTT was wrong to conclude that:

(1) the accounts incorrectly showed 100 rather than 30 of cost and that there were other errors regarding the capitalisation of the LLPs;

(2) the LLPs acquired fixed intangible assets rather than stock; and

(3) the level of NRV shown in the accounts was inappropriate.

489.The FTT's findings were made having taken account of the considerable amount of expert accounting evidence available to it. In that regard, the FTT heard expert accounting evidence and had reports from:

(1) Peter Holgate, a chartered accountant who had until 2013 been senior accounting technical partner at PwC;

(2) Luke Steadman, a chartered accountant, head of the forensic investigations team at Alvarez & Marsal Global Forensic and Dispute Services LLP; and

(3) Richard Cannon, a chartered accountant employed by HMRC.

490.At [52] the FTT noted that Mr Steadman and Mr Holgate were both instructed by the LLPs and that there was some duplication in their evidence. They went on to say

that they ignored Mr Steadman's evidence where there was duplication, or did not treat it as adding weight to that of Mr Holgate.

491.Much of the LLPs' criticism of the FTT's findings stem from their contentions that the FTT wrongly rejected the evidence of the LLPs' expert witnesses and that, in some respects, it adopted an impermissible approach to the expert evidence by failing properly to explain why it disregarded certain evidence or incorrectly substituting its own hypothesis in relation to the evidence.

492.The approach to be taken by both the FTT and the Upper Tribunal when considering expert accountancy evidence was summarised by the Upper Tribunal in *Ball UK Holdings Limited v HMRC* [2018] UKUT 0407 (TCC) at [40] to [42] as follows:

> "40. In our view the question of what is generally accepted accounting practice, as well as the question whether a particular set of accounts are prepared in accordance with it, is a question of fact to be determined with the assistance of expert evidence. Professional accountants are best placed to understand accounting statements in their context, and in particular their "spirit and reasoning"….
>
> 41. What is a matter for a court or tribunal, however, is the proper assessment of expert evidence. Clearly a judge may prefer the evidence of one expert to that of another, but this should be fully reasoned and the judge should not simply "develop his own theory" (see for example *Devoran Joinery Co Lt v Perkins (No. 2)* [2003] EWCA Civ 1241 at [24]).
>
> 42. …The role of this Tribunal is to determine whether the conclusions reached by the FTT were ones that could properly be reached on the evidence."

The Decision

493.At [916] the FTT summarised the way in which the LLPs accounted for the film transactions as follows:

> "(a) Amounts paid by ordinary members for their membership interest in an LLP were treated as capital of the LLP however they were financed.
>
> (b) The CM was treated as having contributed capital equal to 70% of the budget of each film. To the extent that what had been 'contributed' had not been paid by the CD to the PSC the balance was treated as a debtor due from the CM.
>
> (c) On signing the relevant agreements the LLP recognised a liability equal to the amount receivable by the PSC (100) and a corresponding asset, being stock or work in progress ('WIP') of the same amount.
>
> (d) Cash payments made by the LLP to the PSC under the PSA reduced the recorded liability to the PSC.
>
> (e) When the Lender paid amounts to the PSC, the CM's debtor balance to the LLP would be reduced *pro tanto* as would the recorded liability to the PSC.

(f) If at the end of an accounting period the film had not been completed the amount carried in the accounts in respect of it as stock/WIP was written down to the value of the 'virtually certain income' expected from the film. This gave rise to a corresponding expense in the profit and loss account.

(g) The computation of virtually certain income treated the amount of BDR/BR payable to the Lender as part of the LLP's income.

(h) When the film was completed the balance shown as stock/WIP in respect of the film was effectively transferred to debtors. In terms of discrete accounting entries the figure for stock/WIP was transferred to costs of sale and turnover was recognised equal to a debtor representing the then expected value of virtually certain income, that debtor being generally equal to the cost of sales figure.

(i) When a distribution became receivable under the CDA the full amount of the distribution (ie including any amount of BDR/BR which was to be retained by the Lender) was, to the extent it exceeded the debtor in respect of the film, recognised as turnover (and thus profit) with a corresponding increase in the amount of the debtor.

(j) When a distribution was received by the LLP the amount received together with the amount retained by the Lender decreased the debtor balance. The BDR/BR retained by the Lender was, we understood, treated as drawings paid to the CM and debited to the CM's drawings account.

(k) If, at the end of any accounting period, the amount of the future virtually certain income in respect of a film was considered to be less than the amount of stock or the debtor in respect of that film the carrying value of the stock or debtor was adjusted accordingly, and expense realised. No upward adjustments to the debtor were made."

494. The FTT noted at [917] that the effect of these accounting practices was that, in the period in which the documents were signed, the LLP would recognise a loss equal to the difference between the budget amount of 100 and the value of the virtually certain income. In succeeding years the LLP would recognise a profit to the extent that the total distributable amount, including BDR/BR, exceeded the previously recognised virtually certain income.

495. At [918] the FTT recorded that stocks were stated at the lower of cost and net realisable value, the latter being based on estimated selling price less all further costs to completion and all relevant marketing, selling and distribution costs.

496. At [922] the FTT observed that each of the three accounting experts referred to the rights and obligations of, and the effects on, the LLP which arose under the relevant contractual arrangements, and to a greater or lesser extent considered that those rights, obligations and effects were relevant in the determination of the economic substance of the transactions.

497. At [934] the FTT summarised the findings of Mr Holgate in his written report as follows:

"(a) Capital

GAAP requires the reporting of the entire capital of an entity regardless of its source or the nature of the investor's funding. The LLP's treatment was consistent with that principle. Consideration did not have to be received in cash. It was appropriate to account for capital represented by an outstanding liability.

(b) Expenditure

The LLP's expenditure should be reflected in its accounts. The source of the funds for that expenditure did not affect the amount of the expenditure. In particular he said that he was instructed that the CM's contribution to the film went indirectly to the PSC through actions with three elements: (a) the Lender lends to the CM, (b) the CM invests in the LLP, and (c) the LLP provides funds to the PSC. Each step was a commercial transaction supported by contractual documentation. It did not matter that cash did not move from entity to entity.

(c) The Asset

The first question was the nature of the asset which arose as a result of the expenditure. The LLP contracted for the delivery of a film and agreed to deliver it to the CD. The film should therefore be treated as a current asset because the film was, in the terms of the Companies Acts definition, an 'asset not intended for use on a continuing basis in the company's business'. The proper sub-classification was WIP, a sub-category of stock since: (a) it was, before delivery, a 'product ... in intermediate stages of production'; and (b) 'all copyright to the film whilst it is being produced as well as when production is finished, rests with the LLP until sale to the CD'.

Because the film was sold at a single time to the CD, rather than gradually over a period, the Long Term Contract provisions of SSAP 9 were not relevant.

(d) Stock/WIP should be carried at Net Realisable Value ('NRV'). Each film should be considered separately. The estimation of NRV as equivalent to the value of virtually certain income complied with GAAP having regard to the guidance in SSAP 9 and FRS 12.

(e) The LLPs' contracts with the CD and the PSC were executory contracts. A commonly accepted practice is to account for such contracts on the basis of the things which have occurred at the accounting date (a 'net' basis) rather than including in the carrying values all future rights and obligations (a 'gross' basis). By accounting for the full 100 of the budget the LLPs had adopted a gross basis. In circumstances where the recoverable amount for a film could be much less than the 100 budget, a write down to NRV effectively required the gross amount of the film to be recognised initially; if a net approach were adopted the need to recognise the reduction in stock value could be met only by recognising an onerous contract – a presentation which he did not believe would be informative. Gross accounting was therefore a more suitable basis. In practice it made no difference to the profit or loss for a period."

498. At [938] the FTT recorded Mr Holgate as stating in his oral evidence that he started from the position that the LLP had issued capital and the question was then

what were the assets and liabilities it had as a result of the transactions in which it used that capital, assuming that the capital had been used in the acquisition of the film. He said that the FRS 5 substance over form requirement permeated that analysis and recognising 100% of revenue and 100 of stock followed from recognising 100 of capital.

499.At [940] the FTT criticised Mr Holgate's evidence on the basis that he was "blinded by the story the draftsman of the relevant agreements wished to tell". In other words, the FTT was criticising Mr Holgate for accepting what he was told about how the agreements had described the obligations that had arisen under them, with the result that the assumptions he made were "coloured by this error". At [946] the FTT observed that FRS 5 does not direct attention to legal form, the overriding objective of the standard being regard for substance. It also recorded at [947] that Mr Holgate had said that the film was not an asset intended for use on a continuing basis in the company's business, that all copyright in the film rested with the LLP until sale and that the film was not sold gradually over a period.

500.At [951] the FTT set out its conclusions on Mr Holgate's analysis. It stated that the analysis rested on unjustified assumptions as to the effects of the relevant agreements and thus rejected his conclusion that the LLPs accounted for the transactions correctly in recognising stock as an asset and treating it as having an initial value of 100.

501.The FTT records at [1038] its understanding that it was implicit in both Mr Holgate's and Mr Steadman's analysis that the capital subscribed partook of the nature of a liability which was to be balanced by an asset which was the cost of the film. At [1046] it also records both experts as initially regarding the recognition of the CM's capital as the starting point for the valuation of the LLP's liability. However, at [961], [962] and [970] it also records Mr Steadman as having apparently changed his mind on that point. In any event, the FTT rejected Mr Steadman's written evidence on that point at [1038] as a result of its analysis of the provisions of the Members' Agreements.

502.At [974] the FTT records that Mr Cannon was not instructed to offer an opinion on the correct treatment of the LLP's capital. The FTT summarised Mr Cannon's written report at [974] as follows:

> "…The LLP did not get the benefit of the monies paid to the PSC by the Lender. [Mr Cannon] regarded the LLP as being liable to pay only 30 since its obligation to make payment was subject to the PSC receiving the funds from the Lender: it did not have to make any transfer of value until the Lender had paid its 70. Thus he regarded the LLP as incurring expenditure of only 30. Even if there could be said to be a legal obligation to transfer 100 he regarded the LLP as not being required to transfer economic benefit of more than 30. This he regarded as consistent with the LLP acquiring an asset – the right under the CDA to payment from the CD – which was limited to 30% of the distributable income.

> …The obligation of the LLP to pay 30 gave rise to the corresponding recognition of 30 of stock. His preferred designation would be as a long-term contract but he accepted that it made no difference to the GAAP profit.
>
> Mr Cannon accepted that the stock should be written down to NRV and that it was correct to use an estimation technique for so doing, but he regarded the LLP's practice of taking into account projected future income as insufficiently prudent. He would reduce the turnover and profit (and implicitly also the carrying value of the debtor or stock) accordingly."

And in relation to distributions from a film:

> "Mr Cannon did not consider that the LLP should have recognised that part of the distributable income (BDR/BR) which was required to be paid directly to the Lender – either as part of its turnover or in assessing the NRV of its interest in a film."

503.At [975] to [979] the FTT recorded Mr Cannon's oral evidence. In summary, Mr Cannon said that the LLP was only ever obliged to transfer economic benefit of 30 because the LLP was obliged to make payment only if, and after, 70 been paid by the Lender to the PSC.

504.At [980] the FTT found that Mr Cannon's analysis was based on an assumption that the LLP was not obliged to deliver even 30 to the PSC unless the lender had paid 70 to the PSC, and that the LLP had no obligation to ensure the payment of the 70 to the PSC. It agreed with this and accepted Mr Cannon's conclusion that the lender's payment of 70 did not discharge a liability of the LLP to transfer economic benefit because there was no such liability. The FTT did not regard as material the absence from Mr Cannon's analysis of consideration of the economic burden arising from the recognition of capital contributions, on the basis that there was no such burden ([981]).

505.At [1011] to [1020] the FTT considered the terms of FRS 5, which deals with reporting the substance of transactions. It came to the following conclusions at [1020]:

> "In summary, it seems to us that these provisions require that the assets and liabilities arising to an entity from a group of transactions intended to achieve an overall commercial effect must be determined by considering what legal rights and obligations arise from those transactions, and therefore what economic benefits can be controlled or suffered by the entity by recourse to law, and then considering those as a whole *together* with any other features of the transactions or the setting in which they take place (including the position of third parties if relevant) to determine what is the commercial or economic substance of the economic benefits and obligations of the entity."

506.At [1029] to [1106] the FTT set out in great detail its conclusions on the various accounting issues. It also set out in Appendix 9 an examination of the manner in which the LLPs calculated the figures which appeared in their accounts for the NRVs of the films.

507.As regards the substance of the transactions and the terms of FRS 5, the FTT found at [1030] that the substance of the transactions was in essence consistent with its findings as to the correct analysis of the contractual documents. In particular, it found that 30 was the extent of the obligation of the LLP to the PSC. Any capital contribution made gave rise to no obligation on the part of the LLP to transfer economic benefits to the CM, and was not used by the LLP to pay for any rights in relation to the film which accrued to it. It also found that during the making of the film the LLP had none of the substantive benefits of ownership of the film and no asset of substance was transferred on completion of the film. Following completion, the LLP became entitled to amounts determined by deducting BDR/BR from the Waterfall computation, and that was the only economic benefit it controlled.

508.At [1038] the FTT rejected the evidence of Mr Holgate and Mr Steadman to the effect that the capital subscribed by the CM partook of the nature of a liability which was to be balanced by an asset, namely the cost of the film, in the light of the provisions of the Members' Agreements. It therefore concluded that GAAP did not permit the LLP to accord to such capital the nature of a liability, and there was no reason to treat the recognition of any contribution as giving rise to the recognition of an asset, with the result that the accounting entries made did not represent the substance of the transactions.

509.At [1047] to [1050] the FTT rejected the evidence of Mr Holgate, and to the extent relevant, that of Mr Steadman regarding the recognition of the CM's capital as the starting point for the valuation of the LLP's liability. It held, among other things, that the effect of any recognition of the CM's capital contribution did not give rise to a liability on the part of the LLP because it gave rise to no obligation to transfer economic benefit, and under the contractual arrangements the LLP had consented to BDR/BR being retained by the CD for the benefit of the CD and the CM agreed to reduce drawings. It then reiterated its finding that in substance the LLP had no liability of 70 in respect of the film or relating to its delivery to the CD. Accordingly, in commercial and economic substance the liability of the LLP in relation to the CDA and the PSA was 30.

510.At [1053] the FTT rejected Mr Holgate's analysis that the film was an asset of the LLP for GAAP purposes which it held and then transferred to the CD, on the basis that it failed to take into account the fetters on the LLP's rights in the film imposed by the contractual agreements. For the same reason, it rejected at [1054] Mr Holgate's analysis that the copyright in the film was an asset of the LLP for those purposes.

511.Accordingly, it made the following findings at [1057] and [1058]:

> "1057. In our view, there was in substance no sale of rights in the film by the LLP to the CD: for FRS5 purposes the LLP only ever had one asset of substance, namely its rights against the CD. That right was held "for use on a continuing basis in the …business". It was therefore not a current asset.
>
> 1058. We conclude that intangible asset treatment is correct, and that the recognition of the film (the right against the PSC) as stock or WIP is not permitted by GAAP since it does not reflect the substance of the transactions."

512.As a result of that analysis, the FTT concluded at [1075] and [1076] that GAAP required either a write-down of the intangible asset to NRV or a provision to be made of the difference between NRV and cost.

513.At [1077] to [1096] the FTT considered whether, by applying the virtually certain income method of estimation, the LLPs pursued a correct accounting policy for stock and work in progress and also addressed the amount of any provision which should have been made if the CDA and the PSC were together regarded as giving rise to a fixed intangible asset and an onerous contract.

514.At [1078] the FTT recorded Mr Cannon's view as being that in its recognition of possible future income in the calculation of revenues (and implicitly of the NRV of the stock or debtor) the LLP was insufficiently prudent and to that extent overstated the value of the asset.

515.At [1081] the FTT recorded that the relevant statement of accounting practice (SSAP 9) defined net realisable value to be determined by reference to the estimated selling price, and that there was no reference to a policy of writing down to "virtually certain income", the approach preferred by Mr Holgate on the basis that otherwise there would not be prudent income recognition.

516.At [1083] the FTT observed that there was a difference between what is virtually certain and what may be expected or what is likely, recording that in his oral evidence Mr Holgate described the SSAP 9 requirement in relation to stock in terms of what was likely to be realised on the sale of the asset.

517.At [1090] the FTT concluded that because the experts had focused on the film as the asset, they had not fully considered the principles to be applied to the valuation of the asset that had arisen under the relevant agreements, namely the rights against the CD under the CDA. At [1091] the FTT observed that the standard required a reasonable estimate of the realisable value of the relevant asset and stated that the LLPs' valuation method ignored the possibility of selling the rights they had acquired to the Studio.

518.At [1092] the FTT accepted that such a possibility was not canvassed with the experts but followed from the provisions of the standards and the tenor of the experts' evidence, particularly what it had recorded Mr Holgate as saying at [1083].

519.At [1095] it held that there would have been a reasonable expectation that for 30 put into the film by an LLP a Studio would pay at least 20 to buy out the LLP's rights to payment under the relevant agreements. In coming to that conclusion, it observed at [1094] that one of the Studios, Fox, made available shortfall funding to the LLP, effectively taking over what would otherwise have been liabilities of the LLP, which the FTT said demonstrated that Fox would not have ruled out of court an approach by the LLP to sell its interest in a film back to Fox. It also observed that two films were the subject of an "unwind letter". Accordingly, it concluded at [1096] that it would not be in accordance with GAAP to make a provision for more than 33% of the carrying value of a Studio film.

520. At [1101], based on its analysis that the LLP could not treat payments made in respect of BDR as its assets and therefore could not treat those payments as its income, the FTT concluded that the LLP was incorrect to include BDR/BR in its calculation when accounting for the value of the stock or debtor.

521. At [1826] the FTT set out its conclusions following its examination of the manner in which the LLPs calculated the figures which appeared in their accounts for the NRVs of the films as follows:

> "(a) Minimum income or virtually certain income was understated by the effect of:
>
> (i) the reduction of 50% applied to sales agents' low estimates;
>
> (ii) the discount for the time value of money applied in the ITP estimates for Independent films and in the IFP2 estimates for Studio films;
>
> (iii) the application of a ratio of P&A expenditure to box office exceeding 60%.
>
> (b) The deduction for Participations should have been calculated using the actual rates applicable in the film documentation. 12% was excessive.
>
> (c) Neither ITP [nor] IFP2 operated a policy of determining NRVs at about 20% of budget, but in practice the decisions taken by both entities were biased in favour of elements of the calculations which would deliver NRV closer to 20%.
>
> (d) This practice resulted in the understatement of NRVs when measured against a policy of calculating NRV as minimum income or virtually certain income."

Discussion

Whether the accounts should show 100 rather than 30 of cost

522. The LLPs' challenge to the FTT's findings was based on their contentions that the FTT misunderstood the true legal and financial effects of the contractual arrangements entered into between the parties. In essence, they contended that the FTT should have accepted Mr Holgate and Mr Steadman's evidence in preference to that of Mr Cannon because Mr Holgate and Mr Steadman's evidence was based on a proper understanding of the contractual position.

523. Given our analysis of the contractual position, the FTT was clearly entitled to conclude as it did at [1050] that in commercial and economic substance the liability of the LLP amounted to no more than an obligation to pay 30, and accordingly the accounts of the LLP did not comply with GAAP by recording the liability as being 100. As we have described above, this was consistent with Mr Cannon's evidence. In those circumstances, the FTT was clearly entitled to prefer Mr Cannon's evidence and reject that of Mr Holgate and Mr Steadman. It gave very clear and detailed reasons for doing so.

524. We have dealt in some detail in the Appendix to this decision with the LLPs' challenges to the FTT's findings as regards the obligation of the CM to make capital contributions and have rejected them. The context, and relevance to the question of

whether the accounts incorrectly recorded 100 of cost, is that Mr Holgate regarded recognition of the CM's capital as the starting point for valuing the cost of the film and Mr Steadman also started with this view (the FTT explaining the point in double entry terms at [1038]). As we have said at [501] above, the FTT record Mr Steadman as having apparently changed his mind on this point. The LLPs challenge that finding by reference to the evidence, but it is clear to us that Mr Steadman at least qualified his initial conclusion by agreeing that there was no direct link between capitalisation and expenditure. In any event, the FTT was entitled on the basis of its contractual analysis to disagree with Mr Holgate (and, to the extent relevant, Mr Steadman) as it clearly did at [1038] and at [1047] to [1050] as we have described above at [508] and [509].

Stock

525.The LLPs challenge the FTT's findings at [1057] and [1058], as set out at [511] above, on the basis that the assets owned by the LLPs were rights in the films.

526.In our view, whatever the strict position as regards the legal or equitable ownership of the film rights, the FTT was entitled to conclude as it did on this issue given its findings as to what FRS 5 required as to the substance of the rights acquired by the LLPs. It is clear that the FTT put the issue squarely to the experts (see [991] to [993]) and its conclusions at [1057] and [1058] were made after having considered the experts' responses.

527.We should add for clarity that our understanding is that, strictly speaking, the correct label to be given to the asset acquired by the LLPs in accounting terms is that it is a "financial asset" rather than an "intangible asset", although the latter is the correct legal description. However, it was not suggested that anything turned on the correctness or otherwise of the label that the FTT attached to the asset concerned.

528.We also find that the FTT was entitled to reach the conclusion it did about the recognition of income at [1101]. That conclusion was supported by Mr Cannon's evidence.

NRV

529. The FTT's approach to the calculation of NRV was strongly challenged by the LLPs. The most significant challenge was to the conclusion that for Studio films NRV should be determined on the basis that the relevant asset could be sold for two thirds of its cost. The LLPs say that this conclusion was not based on the evidence but on a theory developed by the FTT and not put to the witnesses. Mr Vallat also criticised the FTT's reliance on the shortfall financing and unwind letter fallbacks as indicators of what might realistically happen or be contemplated commercially, and submitted that the FTT took Mr Holgate's evidence in cross-examination out of context at [1083].

530. Mr Vallat also placed some reliance on the FTT's findings at [974] and [1078] that Mr Cannon said that the LLPs' approach to taking account of future income was insufficiently prudent.

531.There is some force in these points. However, the FTT's conclusions on these issues were findings of fact and were not without evidential foundation. Overall, we do not consider that there is enough in these challenges to get over the high hurdle which it is necessary for the LLPs to surmount in order for the FTT's factual findings to be disturbed.

532. Dealing first with the specific point relating to Mr Cannon, having reviewed Mr Cannon's report we think the FTT may have been mistaken in reaching the conclusions it did in relation to his comment about insufficient prudence at [974] and [1078]. Mr Cannon's comment was made in the context of his examination of the results of IFP2 for the year to 5 April 2007, where he said that account should not be taken of projected receipts. That was the financial year following the year in which the NRVs of the films were established. His comment seems to us to relate to the timing of revenue recognition rather than NRV. He referred to NRV separately earlier in his report, in a section dealing with the year to 5 April 2006, where he said that he was not a valuation expert and could not comment (other than in relation to the treatment of BDR). We are therefore somewhat doubtful that the FTT could properly infer that his prudence related comment was also implicitly relevant to NRV. However, we do not believe it affected the FTT's conclusions.

533. Turning to the most substantive challenge, the definition of NRV in SSAP 9 refers to the estimated proceeds of sale, and the FTT was seeking to apply that definition to the facts. Accordingly, we reject the submission that the FTT made up its own theory. The shortfall financing and unwind letter arrangements were not irrelevant, and the FTT was entitled to take account of Mr Holgate's evidence in cross examination which also referred to likely sale proceeds: see [1092] in the Decision and [516] and [518] above. We also note that Mr Steadman had accepted in cross examination that virtually certain income was a higher threshold test than a test using estimated proceeds.

534.The LLPs also submitted that the approach taken in the accounts, and confirmed by Mr Holgate, did in fact look at likely proceeds, namely the proceeds of sale of the film under the CDA (being the deferred consideration payable under that agreement). However, that assumes that the effect of the documents was that there was such a sale as a matter of substance. As we have determined, the FTT was entitled to conclude that the LLPs acquired and held a financial asset, rather than acquiring and selling stock.

535.The LLPs also made detailed criticisms of the FTT's approach in Appendix 9 which led it to conclude at [1826] that minimum income or virtually certain income was understated in a number of respects. Mr Vallat sought to persuade us that the conclusions reached by the FTT either had no evidence to support them, were contradicted by the evidence, resulted from the FTT misunderstanding the evidence or were based on figures that had not been canvassed with the expert witnesses.

536.Again, these are all challenges to the FTT's findings of fact and we are not persuaded that the LLPs have surmounted the high hurdle which would justify us interfering with the FTT's conclusions on these points. For example, in our view the

FTT's conclusion that there was a bias towards reaching a figure of 20% of cost for NRV is one that we consider it was amply justified in reaching on the evidence.

537.Finally, Mr Vallat made some challenges to the FTT's accounting-related conclusions in relation to IG. In respect of NRV, we note that the publishers were in a broadly equivalent position to the Studios, and the conclusion reached by the FTT was bolstered not only by the publisher's majority funding of the games but by the examples of games that had already been commissioned from a third party developer with what must have been a 100% commitment by the publisher, prior to IG's commitment. We therefore conclude that the FTT was entitled to reach the conclusions it did as regards GAAP in relation to IG.

Conclusion

538.For the reasons set out above, we determine the GAAP Issue in favour of HMRC.

VIII. THE INCOME/CAPITAL ISSUE

Introduction

539.We deal with this issue briefly on the basis that we are wrong in our conclusions that none of the LLPs were carrying on a trade.

540.The question that fell to be determined by the FTT was whether the sums which the FTT determined to be properly deductible for GAAP purposes were not deductible in computing taxable profits as a result of s 33 ITTOIA 2005 because those sums were capital or of a capital nature.

The Further Decision

541.At [2] the FTT summarised the main findings it arrived at in the Decision. In particular, it referred to its findings that as a result of the relevant agreements and the payments made under them, the LLPs acquired an asset which was the right to payment of a portion of the proceeds of distribution of a film, that an LLP's financial activity was the exchange of a sum of money paid to one party for a potential future financial reward from another, and that an LLP did not intend to dispose of the right it acquired under the relevant agreements although the right was realised (so in effect consumed) as monies flowed from the right. It also referred to its finding that for accounting purposes the rights were held "for use on a continuing basis in the business", and so were not current assets for those purposes. The FTT had held that in substance the rights were not stock and should be treated as fixed intangible assets which should be accounted for at cost less any impairment.

542.The FTT referred to a number of cases cited to it by the LLPs concerning petrol ties, in which petrol companies paid lump sums to garage owners in return for agreements to sell only the company's brand of petrol for a specified period. The question in each of the cases was whether the payments in question were of a revenue or capital nature. In one of these cases, *Strick v Regent Oil* (1965) 43 TC 1, Lord Upjohn said at page 53 that whether the payment in question was of a capital nature

"is a question of fact and degree and above all judicial common sense in all the circumstances of the case". The other cases were *BP Australia v Commissioner of Taxation (Australia*) [1966] AC 224 (PC) and *Bolam v Regent Oil* (1956) 37 TC 56.

543.At [14] the FTT recorded the LLPs' submission that the factor which tipped the scales in *Strick* was the presence of a lease which gave the petrol company an interest in land, but other factors were relevant, including the length of the ties and the contracts being "ordinary commercial contracts".

544.At [15] the FTT referred to the following passage from *BP Australia* at 265-266 relied on by the LLPs, which indicated that the distinction between circulating and fixed capital can be relevant:

> "The test of whether these sums were payable out of fixed or circulating capital, referred to for example in *John Smith & Son v. Moore*[9] tends in the present case in favour of regarding these payments as revenue expenditure. Fixed capital is prima facie that on which you look to get a return by your trading operations. Circulating capital is that which comes back in your trading operations. The sums in question were sums which had to *come back penny by penny* with every order during the period in order to reimburse and justify the particular outlay." (italics added)

545.At [25] to [38] the FTT considered the circulating and fixed capital distinction and an argument by the LLPs that the rights under the relevant agreements could be regarded as raw material, that is the rights were not merely the means of obtaining raw materials, but were exhausted as they were exploited and were therefore the raw materials of the trade. The FTT considered that this analogy did not assist.

546.At [39] the FTT referred to its finding that the nature of the LLPs' trade was financial in the sense of being a speculative activity of choosing and laying out money on rights in the hope of monetary receipts from them. It said that the monies deployed on the rights could be regarded as circulating over the period the rights remained in existence, indicating that over the economic cycle of the LLPs' trade the rights were revenue in nature.

547.At [40] and [41], however, the FTT observed that the nature of the business was to engage in a number of speculative transactions, to await (and monitor) their outcome and distribute the income arising. There was therefore no circulation of capital. Furthermore, it observed that the case law indicates that there is a length of business cycle which is "so long that the business cycle cannot displace the attraction to the annual nature of profit".

548.At [44] and [45] the FTT rejected the LLPs' argument, which relied on the passage from *BP Australia* quoted at [544] above, that the sums laid out by the LLPs were circulating capital because they came back "penny by penny" with every ticket and DVD sale.

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[9] [1912] 2 AC 13, 19

549. At [46] the FTT concluded that the nature of the trade weighed in favour of the rights being of a revenue nature but that this was balanced by the lack of circulation, and that the balance lay in the question of whether the rights in context had too long a life to be revenue.

550. The FTT went on to consider aspects of this question, including whether there was an "enduring benefit", whether the payments were "once for all", whether the contracts were ordinary commercial contracts, accounting practice, whether the contracts were part of the structure of the business and the question of how long a period could be while still being consistent with revenue treatment.

551. At [57] the FTT concluded that recurrence of expenditure was not part of the business model, bearing in mind that the LLPs intended to return money to members and generally only one LLP was open for subscription each year.

552. At [59] the FTT observed that the rights under the relevant agreements were the ordinary commercial contracts of the LLPs' trade and they did not regulate the LLPs' activities. It said that the nature of the contracts in the context of the trade pointed to a revenue nature.

553. At [75] the FTT observed that the rights extended over too large a tract of time to escape from the idea that profits are "annual" and the idea that things which last a long time must be capital. In reaching this conclusion the FTT had commented that it would not have regarded an asset which lasted for only five years as capital, but in this case receipts were possible over a much longer period. Although the majority of the income was expected to come in over five years and the LLPs were marketed as five-year vehicles, the rights should be regarded as having a life of more than five years (see in particular [50], [53], [69] and [74]).

554. At [79] the FTT summarised the factors present in the LLPs' business which were relevant to its determination of the issue as follows:

> "(i) the advantage sought by the LLPs from the rights under the relevant agreements was the receipt of future income, and whether or not this was an enduring benefit depended upon how long a shadow the nature of the business cast;
>
> (ii) the payments did not have recurrent nature in the sense of being continuously demanded by the business;
>
> (iii) the rights had a length which could not escape from the primitive concept that revenue items had an annual or at least a short term nature;
>
> (iv) ordinary commercial accounting principles would nowadays require deduction of part of the cost from the profit and loss account, and
>
> (v) the monies were not expended on, and the rights were not part of the structure of the business."

555.It then concluded at [80] that those considerations were finely balanced but overall weighed in favour of the payments being of a capital nature, and at [88] came to its overall conclusion that the rights were capital in nature. It stated that the period over which the rights were to play a part in the business of the LLP was the factor which had weighed most heavily in reaching that conclusion, despite the fact that the rights were ordinary commercial contracts and were the source of income rather than the setting in which it was generated.

Discussion

556.The LLPs challenge the FTT's findings on the basis, first, that if they are right in their analysis of the contractual arrangements then the LLPs acquired and sold beneficial interests in films, and those rights were stock and therefore on revenue account. But even if that were incorrect then:

> (1) the rights acquired by each LLP against the various CDs were in each case not simply means of generating the raw material of the trade carried on by the LLP but instead were the raw material itself; and
>
> (2) the contracts were ordinary commercial contracts and the sums laid out were circulating rather than fixed capital; the rights acquired by each LLP against the various CDs were in each case not an asset put to work by the LLP to generate income but were without more the immediate source of each LLP's income.

557.We have concluded that the rights were not stock. The LLPs acquired and held financial assets. We are also not convinced by the raw material analogy. The financial assets acquired by the LLPs were not assets which were worked on, used or incorporated into something else.

558.As regards the circulating capital argument, although the monies expended by the LLPs were returned to them in the form of the income receipts, as the FTT found at [44] and [45], that does not mean that the expenditure was of a revenue nature. In any event, the funds were not intended to be recycled in this case. Once they were received, they were distributed to the investors. In addition, the length of the cycle as found by the FTT is unhelpful to the circulating capital argument.

559.In our view, there was a once and for all acquisition of rights, for the enduring benefit of the trade. The FTT was therefore correct to conclude that the rights were capital in nature.

Conclusion

560.For the reasons set out above, we determine the Income/Capital Issue in favour of HMRC.

IX. CONCLUSIONS

561.We conclude by summarising our conclusions as follows:

(1) None of the LLPs were carrying on a trade.

(2) None of the LLPs were carrying on a trade with a view to profit.

(3) ITP incurred only 35% of the contracted budget cost of each film and IFP2 and IG incurred only 30% of the budgeted cost of each film and game respectively.

(4) If, contrary to our conclusion at (3), the LLPs had incurred 100% of the budgeted cost of each film and game, then the FTT was entitled to conclude that 70% of the expenditure (65% for ITP) was not incurred wholly and exclusively for the purposes of the trade. The 30% incurred by IFP2 and IG (35% for ITP) was incurred wholly and exclusively for the purposes of the trade or business, apart from an amount equal to 5% of the budget which was incurred to provide the EP fee.

(5) The FTT was entitled to conclude that profits and losses of the LLPs were not computed in accordance with GAAP. Those profits and losses should have been computed by reference to expenditure of 30% (35%) of budgeted cost and income which excluded BDR. The FTT was also entitled to reach the conclusions it did in relation to stock and NRV.

(6) The expenditure incurred by the LLPs was capital rather than income in nature.

X. DISPOSITION

562. HMRC's appeal is allowed. The LLPs' appeal is dismissed.

563. Any application for costs in relation to these appeals must be made in writing within one month after the date of release of this decision. As any order in respect of costs will, if not agreed, be for a detailed assessment, the party making an application for such an order need not provide a schedule of costs claimed with the application as required by rule 10(5)(b) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

APPENDIX

Analysis of the contractual arrangements relating to funding and distribution of income

564.We deal in this Appendix with the LLPs' main challenges to the FTT's construction of the contractual documents in respect of the provisions dealing with the funding of the PSC, the associated arrangements for the funding of the LLP and the CM and the repayment of the loan made by the CD to the CM through the distribution of BDR to the CD pursuant to the terms of the Waterfall. We have used as an example the documentation relating to *Hot Fuzz*, as both parties agreed that that suite of documentation was representative of the arrangements entered into in relation to films.

565.In undertaking this analysis, we have had regard to the principles of contractual construction summarised in *Wood v Capita* as set out at [79] above. We have also had regard to the factual matrix, which, as we observed at [108] to [110] above, requires the existence of the other contracts entered into as part of a single transaction to be taken into account when construing terms of any particular one of those contracts which implements the transaction, as well as the contract itself as a whole.

Obligation to fund only 30

Construction of clauses 3.1 and 3.5 of the PSA, and impact of Approved Cashflow

566.Recital (B) to the CDA provides that in consideration of the LLP agreeing to enter into the CDA the CD has agreed to provide to the CM the "Studio Loan" so as to enable the CM "to make a capital contribution to the [LLP] and thereby enable the [LLP] to produce, complete and deliver the Film to the [CD]". Recital (C) refers to the LLP having commissioned the [PSC] "to provide production services in connection with the Film" pursuant to the PSA.

567."Studio Loan" is defined as "the amount of the loan facility under the Loan Agreement outstanding at any time and from time to time" and "Loan Agreement" is defined as the loan agreement "dated the date hereof" between the CM and the CD (as lender) pursuant to which the CD has agreed to make available "a loan facility to the [CM]" for the purposes described in Recital (B).

568.The recitals to the Loan Agreement state that in order to enable the CM to make a capital contribution to the LLP the CD "has agreed to make available to the [CM] a loan facility…".

569.However, the loan is not available to be drawn down in one tranche so as to make that capital contribution. Clause 4.1 of the Loan Agreement provides that it is to be drawn down in accordance with the Approved Cashflow for the film, and in the same clause the CM "irrevocably" directs the CD that all sums drawn down shall be paid to the Production Account for the film in the name of the PSC in accordance with the Approved Cashflow.

570. Clause 3.1 of the PSA provides, relevantly:

> "… the [LLP] shall, subject to receipt by the [CM] of funding under the Loan Agreement and opening of the Production Account, advance, or cause to be advanced, the Production Funds to the Production Account to be disbursed in accordance with the Approved Production Budget and the Approved Cashflow…"

571. The Production Account is a bank account of the PSC into which the Production Funds, defined as the cost of production of the film in an amount equal to the Approved Production Budget, is paid following the signing of the PSA. The Approved Cashflow is a schedule attached to the PSA which phased the receipts of money into the Production Account over the period of the making of the film. The definition of "Loan Agreement" is substantively to the same effect as the corresponding definition in the CDA.

572. The FTT's analysis of clause 3.1 of the PSA is summarised at [133] as follows:

> "On its own clause 3.1 might appear to create a contingent obligation for the LLP to pay or procure the payment of the full amount of the Production Funds (100) to the PSC. But the contingency is the receipt of funding by the CM under the Loan Agreement and that agreement expressly provides for such funding to be advanced by payment to the Production Account. Thus the obligation in clause 3.1 arises only if 70 (65) has been paid to the Production Account by the Lender. As a result this clause cannot oblige the LLP to pay more than 30 (35)."

573. The LLPs rely primarily upon clause 3.1 of the PSA to establish their contention that the expenditure that the LLPs undertook to make on the production of the film was 100 and not 30. Mr Saini submitted that the FTT's analysis was wrong. He says that "funding" as used in clause 3.1 means the grant of the facility, and that it was at the point of grant (combined with the formality of the opening of a Production Account) that the LLP's obligation to provide funding was engaged. Clause 3.1 does not say that the obligation to provide funding is engaged once the entirety of the loan sums had been received and paid into the Production Account.

574. We reject those submissions. It is apparent from the terms that we have quoted that the Loan Agreement was an agreement to provide a facility that contemplated a series of drawdowns in accordance with the Approved Cashflow, with payment irrevocably directed to the Production Account. Clause 3.1 of the PSA gives rise to an obligation to advance Production Funds in accordance with the Approved Cashflow, so it must contemplate staged payments in accordance with that agreement.

575. The only reasonable construction of clause 3.1 is that the LLP does not accept any exposure if funding was not in fact provided under the terms of the Loan Agreement. That might occur for a number of reasons, for example the insolvency of the CD or the CM or a breach of the terms of the Loan Agreement. Giving the words used in clause 3.1 their normal meaning, "receipt of funding" must mean receipt of the monies advanced from time to time in accordance with the requirements of the Approved Cashflow. Taking account of the factual matrix and clause 4.1 of the Loan

Agreement it must also mean receipt by having been paid directly into the Production Account. That leaves no scope for any obligation on the LLP to pay 70: that sum will already have been paid.

576.Neither do we accept Mr Saini's submission that the CD and the CM could agree to vary the Loan Agreement so as to direct payment elsewhere, with the consequence that the PSC could then still insist on receiving 100 from the LLP. That scenario is in our view unrealistic and in any event we must interpret the PSA against the factual matrix of the other documents as they were entered into, the cross reference in the PSA to the Loan Agreement being to that agreement in the form in which it was entered into. Furthermore, any variation to that agreement would appear to be contrary to the notice of assignment and deed of acknowledgement documents to which we refer below.

577.As demonstrated by the definition of "Loan Agreement" contained in the PSA, which refers to the loan agreement of the same date under which the CD "has agreed" to make funds available, the drafting of the PSA presupposes that the Loan Agreement is already in existence at the time the PSA is executed. In reality, the factual matrix was that the conditions precedent to the grant of the facility, set out in clause 3.1 of the Loan Agreement and which in broad terms were the delivery of the other agreed form documents for the transaction, would also have been satisfied at or around the time that the transaction documents were entered into. In that factual matrix, it was clear that the parties contemplated that the facility was already in place, rather than it not having been granted by the time the PSA was entered into. That is inconsistent with Mr Saini's submission that it is the grant of the facility which gives rise to the obligation of the LLP to make the payment of 100. However, funding, in the normal sense of funds actually having been provided pursuant to the terms of the facility agreement, would not have occurred at that point. It is also not certain that in all cases the Production Account would have been opened at that point, and clause 3.1 makes it clear that that is also a condition precedent to the obligation to make payment.

578. If it was intended that there was an obligation to make a payment of 100 pursuant to clause 3.1 which was subject to the obligations under the Loan Agreement having become unconditional, the clause could easily have said so.

579.It is another aspect of the factual matrix that neither the LLP on the one hand nor the CD and the PSC (who are associated with each other) on the other would take the risk of non-payment by the other. Thus, clause 3.2 of the Loan Agreement makes it a condition precedent to the advance of any part of the loan that the LLP is not in breach of its obligation under the PSA to pay 30 to the Production Account. Clause 3.2 of the Loan Agreement is clearly a continuing condition precedent that could operate in relation to any drawdown and it offers no support to Mr Saini's submission as regards the effect of clause 3.1 of the PSA. The LLP's obligation is in turn conditional as set out in clause 3.1, and in the case of *Hot Fuzz* (though not all films) also under clause 3.5 of the PSA. That clause contains a further express stipulation that the LLP will pay 30%, subject to having received evidence that the CD has advanced 70% to the Production Account. We should add here that we do not agree

with the LLPs' argument that the reference to 30% in clause 3.5 emphasises that the obligation under clause 3.1 is to pay 100%. In contrast, in our view clause 3.5 simply underlines the true extent of the obligation under clause 3.1.

580. We should also clarify that we do not agree with the FTT's conclusion that the PSA imposed no obligation on the LLP at all until the full 70 was paid. It clearly contemplated staged payments in accordance with the Approved Cashflow. But it does not follow from this that, as soon as the first tranche of loan funding came in, the LLP then took on an obligation to pay the whole of the remaining balance of 100. The Approved Cashflow document, to which clause 3.1 refers, is set out in a way which specifies the precise amounts to be derived from the loan and the LLP's capital respectively, and the dates of payment. The only sensible construction of clause 3.1 is that the LLP was obliged to pay the amounts to be funded by it (30 in aggregate), subject to funds having been provided under the loan, insofar as those funds were required to be so provided up to that date under the Approved Cashflow. The CD also agreed that it would pay a total of 70 in accordance with the terms of the same Approved Cashflow attached to the Loan Agreement.

581. We do not accept the LLPs' contention that the payment of monies direct from the CD to the Production Account was simply a convenient shortcut so the monies were received directly by the PSC rather than having to be routed through the CM. As we have said, it is clear from the documents that the CD was not prepared to take any risk on the LLP and the LLP accepted no risk as regards the payment of 70. Furthermore, clause 22.2 of the PSA provides, as "an overriding provision" of the agreement, that the PSC shall have no recourse against the LLP in respect of any default by the CD under, among other things, any "Relevant Agreement", which includes the Loan Agreement. Whilst in theory funds might fail to be advanced for reasons other than a default by the CD (see further below), the express limitation on the LLP's obligation to pay in clause 3.1 of the PSA applies in all circumstances, irrespective of whether clause 22.2 is engaged.

Whether the CDA imposes an obligation to pay 100

582. Clause 4.1 of the CDA provides:

> "The [CD] hereby commissions the [LLP] to produce the Film and the [LLP] hereby agrees to proceed with production of the Film…and shall ensure that it will be…produced in accordance with…the Approved Production Budget, [and] Cashflow…"

583. Clause 4.4 of the CDA provides:

> "The [LLP] shall in accordance with the appropriate allowance provided within the Approved Production Budget (and the [LLP] confirms that there is sufficient allowance for this purpose)…bear responsibility for all expenses incurred in connection with Delivery provided that…it is hereby agreed that the Producer shall not have any obligation to provide any expenditure in excess of the Approved Production Budget…"

584.The LLPs submit that the plain meaning of these provisions is that the LLP was obliged to produce and deliver the film and was obliged to ensure the provision of the necessary funds up to the level of the Approved Production Budget, that is 100% of the film's budgeted cost.

585.The FTT accepted at [139] that under clause 4.1 the LLP had agreed to procure the making and delivery of the film, but noted that under clause 16 of the CDA the LLP is absolved from all liability which arises as a result of a failure to comply with the CDA as a result of the failure of the CD to comply with the provisions of the Loan Agreement. The FTT therefore concluded that the CDA does not provide "a back door obligation on the LLP to pay 100".

586.The LLPs submit that the FTT's reasoning is founded on a flawed premise, since there are many circumstances in which the CD could refrain from advancing some or all of the loan monies without defaulting on the Loan Agreement. Clause 9 of the Loan Agreement identifies a long list of situations (e.g. insolvency of the CM) in which the CD would be entitled to serve a notice, whereupon the CD's obligation to make available the loan would cease immediately. They submit that in such circumstances: (i) there would be no default by the CD on the terms of the Loan Agreement; and (ii) the LLP would therefore be unable to rely on clause 16.2 of the CDA (the provision to which the FTT was referring at [139], see above) to escape its obligation to ensure provision of 100% of the film's budgeted cost, notwithstanding the withholding of monies under the Loan Agreement.

587.We reject those submissions. It is unrealistic to contemplate that the CM, a special purpose vehicle for each LLP with no other activities apart from being a member of the LLP and party to a non-recourse loan, could become insolvent. Even if it could be said that the LLP might in that situation be responsible for the production of the film (and possibly at the risk of a damages claim if it failed to meet that obligation) it has still not in fact taken on a liability to pay 100. That is underlined by clause 16.3 of the CDA, which provides that the liability of the LLP for any default on its part in complying with its obligations under the CDA is limited to the amount of its share of the gross receipts pursuant to the Waterfall. We also note that, somewhat unusually, clause 16.2 provides an exclusion of liability for the LLP which derives directly or indirectly from a default not only of the CD, but also of the PSC (which under the PSA is appointed a sub-contractor by the LLP) and the Completion Guarantor. This further underlines the limited nature of the LLP's obligations under the CDA, bearing in mind that the entire responsibility for production was sub-contracted to the PSC, and that the Completion Guarantor's role was to ensure that the film was completed or the transaction unwound.

588.Furthermore, the Approved Production Budget, attached as Schedule 1 to the CDA, specifically refers to the "Ingenious Contribution" as being 30% of the budget. Clause 4.1 makes it clear that the LLP's obligations to produce the film is subject to the terms of the Approved Production Budget. There is also a cross-reference in that clause to the agreed cashflow, which also clearly distinguishes the Production Funds derived from partnership capital and from the loan.

Relevance of the Completion Guarantee and Notice of Assignment

589.As we referred to at [82] above, a guarantee agreement, known as the Completion Guarantee, was, in relation to a Studio film, given by a member of the CD's group pursuant to which the guarantor agreed to complete the film if it ran over budget (or to abandon it and return monies to the parties).

590.Clause 8 of the Completion Guarantee provides that the guarantee is subject to the LLP "not being in default of its obligation to deposit funds in the amount of thirty per cent (30%) of the Approved Budget into the… Production Account…. in accordance with the Approved Cashflow". In our view this underlines the common intention that the LLP's obligation to fund the film is limited to 30; if the remaining 70 was not provided the guarantor would provide the balance.

591.Furthermore, construction of the Completion Guarantee and the terms of the Deed of Acknowledgement etc. referred to at [82] above when read together is that on abandonment the 30 paid by the LLP is to be returned to the LLP. The remaining 70 is to be paid directly to the CD in its capacity as lender under the Loan Agreement, to be applied towards repayment of the loan to the CM. Mr Saini disputes that analysis; he submits that as the Completion Guarantee provides that upon abandonment the guarantor shall return to the LLP "all amounts paid by [the LLP] pursuant to clause 3.1 of the [PSA]" the obligation was to return 100 to the LLP. We have already determined however that 70 of the 100 was not paid by the LLP under the PSA. Mr Saini's submission seems to assume that when the Deed of Acknowledgement etc. refers to the abandonment amount to be repaid it is also referring to 100, but that does not help him because the Deed makes it clear that the abandonment amount is to be applied as to 30 to the LLP and 70 to the CD as lender.

Obligation of the CM to make capital contributions, funded by the CD's loan to the CM

592.It is not immediately obvious to us how the question as to whether the CM was obliged to make a capital contribution to the LLP is relevant to the issues that we need to decide. However, what the LLPs say is that the payments made by the CD to the Production Account satisfied (i) the CD's obligation to provide a loan to the CM, (ii) what they say is the CM's obligation to contribute capital to the LLP and (iii) the LLP's obligation under the CDA to make the payments to the Production Account which are necessary in order to fund the making of the film. It appears that the LLPs are concerned that if they cannot establish an obligation on the part of the CM to contribute capital to the LLP (or at least that capital contributions were in fact made) then their ability to demonstrate that any more than 30% of the expenditure of the LLPs was "incurred" is weakened. Furthermore, in relation to the GAAP Issue, the LLPs rely on the existence of an obligation on the part of the CM to contribute capital and on the part of the CD to make a loan to the CM to challenge the rejection by the FTT of the expert evidence from the LLPs' accounting experts, Mr Holgate and Mr Steadman, which the LLPs say relied on the existence of capital provided by the CM and funded by the loan from the CD to support the experts' conclusions that there was

a requirement to recognise a liability of 100 on the part of the LLPs rather than 30 under the film and game transactions.

593.The FTT undertook a careful analysis of the terms of the Members' Agreements for ITP, IFP2 and IG.

594.The starting point is the Members' Agreement for each LLP. As the FTT found at [88], one of the founding members of the LLP was the CM and individual investors acceded to membership thereafter. The agreements provided for capital contributions, and rights in relation to profits and drawings.

595.It was common ground that the individual members funded 30 of the 100 budget for a particular film or game through the individual capital contributions they made to the LLP and which were passed on to the PSC under the terms of the PSA.

596. At [101] the FTT observed that each individual member's capital contributions affected his or her share of the profits and drawings and rights on a winding up, but that the CM's capital contribution had no effect on such matters and neither the amount nor the existence of such capital affected the CM's rights to drawings. The FTT also observed that the amount of any contribution treated as having been made by the relevant agreements did not affect the CM's rights on the winding up of the LLP.

597.At [103] to [114] the FTT found as follows:

> "(i) The ITP Members' Agreement
>
> 103. "Ordinary Members" are defined to mean individual members and the CM. The agreement defines a member's "Contribution" as "any money paid into the account of or transferred to the ownership of the LLP by an Ordinary Member". It provides that it is to be credited to his capital account. Thus, prima facie, Contributions are limited to monies paid or transferred directly to the LLP.
>
> 104. There is no express requirement in the agreement for the CM to make a contribution, but clause 2.3 provides that no investment shall be made in any film unless the Operator is satisfied:
>
>> "that the [CM] has entered into contractually binding commitments such that the [CM] will finance its agreed Contribution in respect of that film" in accordance with the agreed Cashflow and budget.
>
> 105. One construction of this is that the CM's "Contribution" means a contribution to the cost of the film, not a contribution to the capital of the LLP, and accordingly that the CM's contribution to the film, however made, is not a contribution to the LLP. That would be consistent with the definition of "Contribution" in the LLP agreement as limited to money "paid or transferred to the ownership" of the LLP, and would be supported by clause 11.10(f) of the Members' Agreement, which requires a supermajority of individual members to alter any provision of the agreement.

106. The alternative argument it is that the capitalised "Contribution" in clause 2.3 of the Members Agreement indicates that its contribution to the budget of the film would be treated as a capital contribution to the LLP.

107. On the second construction the Loan Agreement between the CD and the CM (of which the Operator plainly had knowledge) may be regarded as evidence that, in relation to a particular film, the Operator could be satisfied as required in clause 2.3 of the Members' Agreement. That is because it recites that the CM "has agreed" to make a contribution to be utilised for the film, and therefore is evidence of an "agreed" contribution, and it is a contractually binding agreement which could be regarded as being "such that" the contribution would be financed.

108. However, whichever construction is adopted, there is no provision in the ITP Members' Agreement requiring the CM to make a contribution. Any agreement by the CM to make and for the LLP to accept a contribution could only have arisen on signing the suite of agreements for the film and therefore cannot be regarded as a pre-existing obligation of the CM which was changed or satisfied by those agreements. And there is no provision by virtue of which any sum due to be paid pursuant to the loan agreement becomes a capital contribution before it is actually paid.

(ii) The IFP2 and IG Members' Agreements

109. "Capital Contributions" are defined in the Agreement as "money contributed" to the LLP as capital by Ordinary Members. Ordinary Members in these agreements are defined to *exclude* the CM. Ordinary Members become such on application and paying their capital contribution; the CM became a member on the making of the agreement.

110. Having defined Capital Contributions by reference only to Ordinary (individual) Members only, the Agreement then provides in clauses 8.3 and 8.4 that:

> (a) The CM is entitled to make Capital Contributions at its discretion, but they may not exceed the aggregate of the Ordinary Members' capital contributions (Cl 8.3).
>
> (b) If at any time the Operator issues a written demand or if a winding up order is made, the CM becomes obliged to "pay" by way of Additional Corporate Member's Contribution an amount equal to the excess of the aggregate of the ordinary members' capital contributions over the CM's Capital Contributions at that time (Cl 8.4).

111. We asked the Appellants if the Operator had made such a demand. Mr Milne told us that they did not believe that one had. We conclude that none was made. A winding up order had not been made at any relevant time. As a result we find that no liability to contribute arose under clause 8.3 or 8.4. As a result any contribution to capital was purely voluntary. The CM had no obligation to contribute.

112. We also note that the definition of "contribution" as "money contributed" by individual members, which, although applicable only to individual members, suggests that a contribution otherwise than in cash to the LLP was not intended to be a contribution. If that is right then a variation of the Agreement would have been required to permit it to have been so made.

113. There is nothing in the Members' Agreements which provides that a payment to the PSC by the Lender is to be treated as a (voluntary) contribution of capital by the CM or as satisfying an obligation created by an Operator's notice, had one been given, for the CM to contribute capital or make payment. However, as was the case for ITP:

(a) in the Loan Agreement (between the Lender and the CM) the recitals contain a statement that the loan is made to enable the CM to make a capital contribution to the LLP (and clause 4.1 provides that "The [CM] hereby irrevocably directs the Lender that all sums drawn down by the Borrower shall be paid to the Production Account for the film)", and

(b) recital (B) to the CDA (between the LLP and the CD) is a statement that the CD has agreed to make the loan to enable the CM capital contribution.

114. We conclude that the parties to those agreements intended that a payment by the Lender to the Production Account would be treated as a (voluntary) capital contribution by the CM, but did not make any express provision in the agreements to that effect. Further, whether or not that payment would be so treated by the LLP was governed by the pre-existing provisions of the Members' Agreements, which as we have noted may have required amendment to have that effect. Although it was possible for the CM to agree with the LLP to renounce rights under the Members' Agreement (as we conclude it did in relation to drawings) it was not possible for an agreement between the LLP and the CM to amend the Members' Agreement so as to create rights in the LLP in the CM's favour. We proceed on the basis that the LLP agreed to recognise some form of capital contribution from the CM as a result of the CD's payment…"

598. The LLPs challenge the FTT's findings that there was, on the facts, no obligation on the CM to contribute capital. They rely on provisions in the Members' Agreements (clause 2.3 in the case of IFP2 and clause 2.4 in the case of ITP) which contain undertakings by the parties, "insofar as they are respectively able" to procure that the business of the LLP is conducted in accordance with the terms of the Information Memorandum relating to that LLP. In the Information Memorandum relating to ITP there is a statement that films will be financed by capital from individual members and the CM, normally in the ratio of 35% to 65%. Similarly, in the Information Memorandum for IFP2 there is a statement that the CM "will commit an amount equal to the total capital contributed by investors"[10].

[10] This total contributed by the CM in IFP2 was affected by the so-called non-production activities referred to in the FTT decision, and not material to this appeal. In relation to film financing the proportions were 70:30.

599.We do not accept that the provisions in the Members' Agreements which contain the undertakings relating to the Information Memorandum establish an obligation on the part of the CM to contribute capital. As we have stated, the obligation is only so far as the relevant party is able, and the CM was clearly not in a position to provide capital absent it receiving funding from the CD for a particular film through the Loan Agreement for that film. The provisions of the Information Memorandum make it clear that funding will provided on a film by film basis, and the reference in the Information Memorandum for IFP2 that it "will commit" capital is in our view a description of what is intended to happen rather than an undertaking to make a contribution. In the absence of funding from the CD the CM was simply not in a position to give an undertaking. The same applies in our view to a later statement in the IFP2 Information Memorandum that the CM "will be committed to contribute an amount of capital equal to the capital contributions contributed by the investors".

600.Neither do we accept Mr Saini's submission that the discretion given to the CM in clause 8.3 of the Members' Agreement for IFP2 related only to the timing of the contribution and its upper limit. In our view the wording of clause 8.3 makes it absolutely clear that the CM has a discretion to make Capital Contributions up to the amount made by individual members, and there is nothing in its wording to indicate that discretion is limited as Mr Saini submitted. There was an obligation under clause 8.4 to make a contribution if there was a demand to that effect or a winding up, but the FTT found that there had been no such demand. Once a film was identified, any capital contribution recognised as having been made by the CM had the effect that, to that extent, the obligation under clause 8.4 fell away. The FTT made a finding to that effect at [1036]. Therefore, in relation to the particular transactions entered into by IFP2 as regards the production of films, clause 8.4 had no application. Consequently, in substance, and for the purpose of determining the nature of the activities that the LLPs actually carried out, the FTT's conclusion on the facts that there was no obligation on the part of the CM to commit capital to IFP2 was correct.

601.Mr Saini also sought to argue that there was an obligation, but it did not crystallise until a particular film was identified. He suggested that if the CM did not obtain a loan at that stage then the CM would be in repudiatory breach of its obligations under the Members' Agreement. However, in reality, as found by the FTT, films were only identified and committed to where the desired funding structure was available from the CD. The reality was that individual investors made their contributions, either when they committed to the Members' Agreement, or at the latest by the long stop date provided in the relevant agreement: see clause 24.3 of the IFP2 Members' Agreement and clause 21 of the Members' Agreement for ITP.

602.In relation to ITP, Mr Saini also relied on clause 2.3 of the Members' Agreement, as quoted by the FTT at [104] and set out at [597] above. However, in our view the correct interpretation of clause 2.3 is that no film will be committed to by the LLP unless the Operator is satisfied that the CM has obtained the benefit of a contractual commitment enabling it to finance its agreed contribution. In other words, the LLP will not finance a film without the CM having obtained that commitment. The reference in the clause to the "agreed" contribution means the particular contribution

which it is treated as making in respect of that film in accordance with the agreed cashflow and budget.

603.Finally, Mr Saini referred to clause 2.2 of the ITP Members' Agreement which required all Ordinary Members (thus including the CM) to maximise the profitability of the LLP's business, but in our view, this is referring to the position once the LLP commences its activities in relation to the production of films and is clearly insufficient to impose any obligation on the CM to contribute capital.

604.Therefore, we find ourselves in complete agreement with the FTT's conclusion that there was no obligation on the CM to contribute capital in respect of ITP.

Effect of any capital contribution

605.In relation to ITP, the FTT made no specific finding that although it had no obligation to do so, in fact the CM did make a capital contribution to the LLP. We are prepared to proceed on the assumption that, once the CD advanced monies pursuant to the Loan Agreement, the parties intended to recognise a capital contribution from the CM, as recorded in ITP's accounts.

606.However, at [116] the FTT concluded that the making of a capital contribution by the CM did not affect its rights on a winding up because clause 19.4 of the ITP Members' Agreement provides that any surplus on a winding up shall be "payable to the Individual Members pro rata to their respective Contributions". We agree with that conclusion; there is nothing in the Members' Agreement that provides for any surplus on a winding up to be paid to the CM.

607.In relation to drawings, the FTT analysed the position as regards ITP at [197] to [199] as follows:

> "197. In relation to drawings, clause 9.6 provides that aggregate receipts for a year be distributed between the individual members and the CM in the Drawings Proportion, (see below). Clause 9.5 provides that the "Operator shall be entitled *but not obliged*" to make to the CM an advance distribution of the receipts in respect of any film. By clause 9.6(a):
>
> > (a) "as soon as practicable after the end of each accounting year … an amount equal to the aggregate Receipts received in that year as shown on the Individual Film Accounts for each film shall be allocated for distribution, net of any deductions to be made in accordance with this agreement, by way of drawings between the [individual] members and the [CM] in the Drawings Proportion for that film".
>
> 198. By clause 9.6(b) if the amount of advance distributions to the CM exceeds the CM's entitlements under 9.6(a) the CM "shall use its reasonable endeavours" to repay the excess within 10 days and in any event before the year-end distribution is made.
>
> 199. The Drawings Proportion for a film is defined to be the proportion to be determined by the Operator under the Operator's agreement. The definition of

> Net Individual Members' Entitlement in the Members' Agreement indicates that individual members will get at least 40%, so that the maximum that could be allocated to the CM is 60%, but there is no further determination. There is thus no determination of Drawings Proportion in that agreement. The Drawings Proportion is not made dependent upon any capital contribution by the CM."

608.At [200] the FTT concluded that no determination of the Drawings Proportion for any film had been made before the signing of the relevant agreements. It therefore concluded at [201]:

> "...apart from anything which could be derived from the terms of the film agreements negotiated by the Operator, there was no express or implied entitlement for the CM to drawings under the Members' Agreement equal to 50% of the receipts of the LLPs from any film or otherwise. There was thus no pre-existing right of the CM to a particular amount or proportion of drawings which was capable of being assigned or alienated by the relevant agreements."

609.Mr Saini submitted that the CM would have the right to require the LLP to consider whether payments by way of drawings should be made and that the discretion given to the LLP in that regard would have to be exercised rationally. He relies on *Braganza v BP Shipping Ltd and another* [2015] UKSC 17 where Baroness Hale observed at [18] that in relation to contractual terms in which one party to the contract is given the power to exercise a discretion, there is to be implied a term as to the manner in which such power may be exercised. In particular, there will be an implied term that the power should be exercised not only in good faith but also without being arbitrary, capricious or irrational: see the authorities referred to at [22] of the judgment and the conclusion at [30] of the judgment.

610.Mr Saini submitted that the existence of a capital contribution made by the CM will clearly be a relevant factor to be considered by the LLP when deciding whether to exercise its discretion. However, in our view any such right to be considered has not been clearly linked under the terms of the ITP Members' Agreement to the making of any capital contribution. There is nothing in clause 9 of the Members' Agreement to that effect when read together with the definition of "Drawings Proportion".

611.Consequently, in our view the FTT properly concluded that even if a capital contribution was recognised in the books of ITP, it did not lead to any material rights being created, whether on a winding up or in respect of drawings.

612.In relation to IFP2, the FTT seems to suggest at [109] that the term "Capital Contributions" does not include payments made by the CM because the term only embraces money contributed to the LLP as capital by Ordinary Members, a term which is defined in the IFP2 Members' Agreement so as to exclude the CM. We think that this must be simply a drafting slip, and that it was intended that the term did include payments made by the CM. This is demonstrated by a number of other provisions in the Members' Agreement, such as clause 7.1, which provides that the funding requirement shall be met out of both the Ordinary Members' and the CM's aggregate Capital Contributions, clause 8.1 which sets out the maximum Capital

Contributions that the LLP shall accept from "Ordinary Members and the Corporate Member", and clause 8.3, which we have referred to at [600] above.

613. The FTT found at [119] that although clause 8.3 of the Members' Agreement requires the amount of the CM's capital contribution to be credited to its capital account, that in itself imposed no economic right on the CM or obligation on the LLP. In relation to rights on a winding up the FTT analysed the position at [120] to [124] as follows:

> "120. Clause 22 of the IFP2 Members' Agreement deals with rights on a winding up. Clause 22.1 provides for the application of any surplus first to individual members in respect of and up to part of their capital contributions, then to the CM in respect of its "Additional Corporate Member's Contribution", then for interest on part of the individual members' capital contribution, then to the CM up to part of the balance of its "Capital Contributions", then for interest on part of the CM's Capital Contribution and then as to any balance equally between the individual members and the CM.
>
> 121. But clause 22.2 provides that for the purposes of clause 22:
>
> > "Capital Contributions shall be treated as made only when the amount of such Capital Contribution is actually received in freely transferable funds by the [LLP]."
>
> It is clear to us that the LLPs never received any monies in from the CM "in freely transferable funds". Thus the monies paid by the CD to the PSC did not give rise to a Capital Contribution for the purposes of clause 22.
>
> 122. As noted earlier, "Additional Corporate Member's Contribution" is defined in clause 8.4 of the agreement to mean the sums the CM undertakes to pay on 14 days' notice from the Operator (which notice was not given) or on the winding up of the LLP by way of:
>
> > "capital contribution…equal to any difference between the aggregate Capital Contributions made by the [CM] (including for the avoidance of doubt any payment made under this clause 8.4) and the aggregate Capital Contributions made and committed by the [individual] members".
>
> 123. Not only does the drafting of this clause and clause 22 suggest that an Additional Corporate Member's Contribution must be a Capital Contribution and so not relevant for the purposes of clause 22.1 unless received in freely transferrable funds, but no notice was given by the Operator requiring any contribution and there was no winding up in prospect.
>
> 124. Thus any capital contribution treated as made as a result of the agreements would not be an Additional Corporate Member's Contribution or a Capital Contribution, and, as a result, would have no effect of the CM's *rights* on a winding up."

614. Mr Saini submitted that although, as we have indicated above in relation to a number of provisions in the Members' Agreement, the term "Capital Contribution"

must on a proper interpretation cover contributions made by the CM, it does not do so in clause 22.2, which provides that Capital Contributions are treated as made for the purposes of entitlement on a winding up only if received in freely transferable funds. He says that this was because the parties knew that the CM's funds would be made available by an advance of the loan monies paid directly to the PSC.

615. We reject that submission. There is no reason not to interpret the term "Capital Contribution" consistently throughout the Members Agreement and, as we have said, in our view it was intended that the term should cover such contributions as were actually made by the CM. In our view clause 22.2 simply modifies the definition for the purposes of the operative part of clause 22, namely clause 22.1. It follows that the FTT was right to conclude at [121] that the CM acquired no rights on a winding up of IFP2, because it made no Capital Contribution for the purposes of clause 22.

616. In relation to drawings, the FTT analysed the position at [210] and [211] as follows:

> "210. The drawings allocations are in clause 10 (it is to be noted that the CM's rights to drawings are independent of whether or not it has made a capital contribution of any sort):
>
> > "10.1 The Ordinary Members (taken as a whole) and the corporate member shall each be entitled to draw 50% respectively of all Partnership Income (defined as the income received by the LLP *less operating expenses*) … Such drawings shall be paid … from time to time during the course of each accounting period at the direction of the Operator.
> >
> > 10.2 When the Operator has elected to allocate 100% of the profit [to the Ordinary Members] pursuant to clause 9.8, the drawings entitlement set out in clause 10.1 shall be altered such that the Ordinary Members shall be entitled to draw 100% of such Partnership Income …".
>
> 211. Thus, unless the Operator makes an election, the CM is entitled to be paid drawings equal to 50% of receipts after deducting expenses at such times as the Operator in its discretion shall decide. So, absent such an election, Borrower's Receipts will be the same amount as the CM's entitlement to drawings *before* its reduction by expenses. But if the Operator made such an election the CM's drawings entitlement would be to nothing."

617. In our view the FTT correctly concluded that under the IFP2 Members' Agreement the CM had a right, defeasible at the election of the Operator, to drawings equal to half the net receipts from the relevant film, before taking account of BDR (see also [228] in the Decision). However, in practice, as we shall see, the effect of the security arrangements was that BDR was paid directly to, or retained by, the CD so that the question as to whether the CM had a right to drawings is not material in that respect. Payments of BDR would give the CM a benefit in the sense that the amount of the outstanding loan would be correspondingly reduced. Insofar as there was a profit element for the CM in excess of BDR, no doubt the Operator would in practice ensure that the CM (a member of the Ingenious group) received it.

618.Mr Saini also relied on the *Braganza* case in relation to drawings by the CM from IFP2. We make the same comment on this as we do in relation to ITP, namely that there was no clear link between any right to be considered for drawings and the making of a capital contribution.

Rights to BDR

619.The FTT set out at [147] to [151] a succinct summary of the relevant contractual provisions as follows:

> "147. Clause 11 of the CDA provides that the CD shall pay the LLP the entitlement to Gross Receipts set out in schedule 7. The CDA provides for the CD to pay the amount of the Gross Receipts determined by schedule 7 "to or at the direction of" the LLP.
>
> 148. The allocations in schedule 7 make reference to the Loan Agreement, in particular paragraph I(I) provides:
>
> > "Until repayment in full of the [CM loan] from the sums directed to the Studio by the CM pursuant to the payment instruction agreed between the [CM, the LLP and the CD], the [CD] shall pay…100% of the remaining Gross Receipts to or at the direction of [the LLP]."
>
> 149. The "Irrevocable Payment Instructions" referred to in that paragraph of schedule 7 to the CDA are annexed to the IFP2 Deed of Acknowledgement and provide that "Partnership Receipts (defined as amounts to which the LLP is entitled under the CDA) shall, until the loan… has been repaid in full …be paid…as to an amount equal to Borrower's Distributable Receipts… at the direction of the CM and as to the balance to the [LLP's bank account]". The ITP instructions refer to BR but are otherwise the same.
>
> 150. The "Irrevocable" Payment Instructions are given effect in the Notice of Assignment in which the CM gives notice to the LLP (copying the CD) that the CM has assigned "its right title and interest in the Borrower's Distributable Receipts" to the Lender "by way of security", and gives "irrevocable" authority to the LLP to "pay the Borrower's Distributable Receipts in accordance with the Payment Instruction".
>
> 151. The Deed of Acknowledgement is from the LLP and the Operator to, *inter alia*, the Lender, the CD and the PSC. In it the LLP:
>
> > (a) acknowledges the notice of assignment and undertakes to comply with it,
> >
> > (b) consents to the assignment of the right to receive BDR (BR in the case of ITP) to the Lender and agrees that the Lender is "now entitled to receive" BDR "*in place of the corporate member*",
> >
> > (c) "irrevocably" instructs the CD to make all distribution payments under clause 11 of the CDA in accordance with the payment instructions,

(d) makes provision for the repayment of the Initial Funding if the Guarantor abandons the film.

The Deed includes the agreement of the Lender and PSC to this arrangement."

620. The FTT concluded at [152] to [154] that the effect of these provisions was as follows:

> "152. A cursory reader of the relevant agreements might conclude that the LLP is first given an entitlement to 100% of the remaining Gross Receipts and that it then directs that part of its entitlement is to be paid to the Lender: indeed the documents themselves encourage that conclusion.
>
> 153. But such a reading is dependent on an assumption that the agreements be read as taking effect sequentially with a pause between each, so that rights might accrue and then be alienated. That assumption, however, is not justified: the agreements were made as part of a package, they were executed on the same day, they refer to each other as agreements which have been made – thus for example, clause I(I) of schedule 7 of the CDA expressly acknowledges the existence of the payment instructions and therefore evidences that they were contemporaneous with, or preceded, the CDA.
>
> 154. The documents must be read as coming into force together and must be read together. Reading the documents together, the effect of their payment provisions is that, from the time of execution of the documents, the Lender and not the LLP is entitled, together with any other entitlement under the CDA, to retain that portion of the receipts equal to BDR (BR) and the LLP entitled to receive the balance, and that there was never a time when the LLP was entitled to receive more."

621. At [157] the FTT emphasised its conclusion as follows:

> "157. In our judgement the effect of the Deed of Acknowledgement etc. and the CDA is that the only payment right the LLP acquires under the suite of documents is the right to the payment of the balance of GDI after deducting the amount of BDR (BR). Together these documents confer no right on the LLP to receive the amounts in schedule 7 without deducting the amount of BDR (BR). The LLP could not, after the coming into effect of these documents, compel the payment to it of schedule 7 amounts without the deduction of BDR (BR); and the Lender could resist any action to prevent it retaining BDR (BR)."

622. The LLPs' case is that they were contractually entitled to the amounts identified as due to them under the Waterfall. Mr Saini submits that the Deed of Acknowledgement and the accompanying "Irrevocable Payment Instruction" do not cancel out or alienate any of the LLPs' rights under the Waterfall but rather represent the exercise of the relevant LLP's right to direct the CD as to the payment of sums to which the relevant LLP was entitled. It is clear from the wording of clause 11.1 of the CDA that the obligation on the CD is to pay to the LLP its entitlement to the Gross Receipts and that entitlement was set out in and payable in accordance with Schedule 7. Mr Saini submits that the other contracts do not in any way cause that right to disappear. Furthermore, the Deed of Acknowledgement etc. is expressly concerned

with the payment of "amounts to which the [LLP] is entitled" under clause 11.1 of the CDA. The Deed represents an exercise of the LLP's right to direct the CD as to the payment of the sums to which the LLP is contractually entitled.

623.Mr Saini submits that the security agreements likewise do not cause the LLP's rights under clause 11.1 to disappear. Indeed, the assignment by way of security of the LLP's right to receive BDR reflects the fact that the LLP had such a right under the CDA. The security assignment does not cause the LLP to lose its right to BDR; it merely secures the performance of certain obligations. Still less does the security assignment mean that the LLP had no right to BDR under the CDA.

624.Mr Saini submits that the FTT's error is further highlighted when it is noted that the CM had the right pursuant to clause 5.4 of the Loan Agreement to repay the CM loan at any time. The CD's entitlement to retain BDR is predicated on the loan not already having been repaid at the time of the relevant receipts. Paragraphs 1 and 3 of the Irrevocable Payment Instruction only apply until the loan is repaid in full, and paragraph 2 of that document provides that the amounts payable to the LLP under the CDA after the repayment of the loan shall be paid as to 100% to the LLP's account. Therefore, the FTT's analysis of the effect of the agreements as read together is predicated on the assumption that the CM would not exercise its contractual right to repay early because if the CM did exercise that right, the CD would have no entitlement to retain BDR.

625.Mr Saini also submits that the LLP's instruction to pay BDR to the CD would not be effective against a liquidator of the LLP, relying on *ex parte Nicols, In re Jones* [1883] Ch 782 at pages 786 to 787 where the Court of Appeal held that an assignment of future business receipts would not give the assignee good title to the sums in question as against the trader's liquidator. Mr Saini referred to a discussion in Smith and Leslie on the Law of Assignment, 3rd ed., at 30.37, drawing a distinction between whether the right purported to be assigned has been "earned", where the assignment would bind a liquidator, and where it had not been, referring to a judgment of Wynn-Parry J in *Re Tout and Finch Ltd* [1954] 1 All ER 127 (ChD).

626.Mr Saini further submits that if the CD committed a repudiatory breach of the Deed of Acknowledgement etc. and the LLP (along with the other parties to the Deed) elected to accept that repudiation, the parties would be relieved of further performance of their obligations under the Deed, but the LLP and the CD would remain bound by the CDA. He submits that reflects the contractual distinctiveness of the agreements – the Deed gives rise to its own set of rights and obligations but does not appear to affect the rights and obligations which arise under the CDA.

627.We accept that the effect of the drafting in Schedule 7 to the CDA is that BDR forms part of the amounts allocated to the LLP under the Waterfall, or at its direction. We also accept that the effect of the Notice of Assignment and Irrevocable Payment Instruction and the Deed of Acknowledgement is that there is a direction to pay the CD the relevant amounts until the loan is paid off in full: as Mr Saini submitted, paragraph 2 of Irrevocable Payment Instruction states that the amounts payable to the LLP under the CDA after the loan has been repaid shall be paid as to 100% to the

LLP's account. In our view Mr Saini was also correct to say that the LLP did alienate its rights to BDR, although given that all the relevant documents were signed at the same time these were rights that the LLP would otherwise have but for the assignment, rather than rights it actually held for its own benefit at any stage.

628. However, in our view that analysis does not help Mr Saini. The loan was interest-free and with no recourse to anything other than BDR in order to fund its repayment. There is therefore no commercial reason why the CM would seek to prepay it. The suggestion that the loan might realistically be prepaid from another source is fanciful and the FTT made a finding of fact at [226] that a prepayment was never realistically contemplated. Even if the LLP wanted the CM to prepay the loan, it is not clear that it could procure that the CM did it. The LLP's position in relation to the loan is purely as guarantor, rather than as a direct holder of rights under it, and the LLP's grant of security over BDR secures that guarantee. Separately, the CM assigns its "rights" to BDR by way of security for its own obligations under the Loan Agreement, and the Notice of Assignment and Irrevocable Payment Instruction is of the CM's assignment of its own rights and does not apply in any sense to the LLP.

629. Therefore, in reality in order for the loan to be repaid an additional assumption would need to be made that the LLP would choose to prepay the loan on behalf of the CM without any objection from the other parties (even though the right to prepay is that of the CM and not the LLP). In reality there would have been no incentive at all to find resources to prepay the loan just to be able to recover BDR that, if it arises, would be used to reduce the loan. This is further reinforced by the fact that, once the loan is repaid, then as provided in Schedule 7 to the CDA, the LLP's share of the Gross Receipts is reduced.

630. Furthermore, the security granted by the LLP, in the form of a Deed of Guarantee, Security Assignment and Charge (the "Deed of Guarantee") secured the LLP's obligations under the CDA as well as the LLP's guarantee of the loan, so it is not necessarily the case that a prepayment of the loan would by itself result in the LLP acquiring the right to BDR. There are also obligations to which the LLP was subject under the CDA that are expressed to continue even after delivery of the film, in particular the continuing warranties and undertakings set out in Clause 7 of the CDA. The assets assigned by way of security include the LLP's rights to income arising under the CDA so far as they relate to BDR (as referred to in a proviso to clause 4 of the Deed of Guarantee), and the undertaking for reassignment contained in clause 11 of the Deed of Guarantee also applies only on payment and discharge of all secured obligations. In reality, therefore, for so long as the CDA exists (which is the source of the LLP's right to receipts under the Waterfall), the LLP cannot unilaterally recover any right to BDR free from security, at least without acceptance by the CD that all the LLP's secured obligations have been discharged.

631. As regards the position against a liquidator of the LLP, in principle BDR would appear to have been "earned" at least once the film income begins to be distributed, which will be after the film has been delivered under the terms of the CDA. On the LLPs' case the CDA is a document which provides for a sale of film rights for

deferred consideration. On that basis, once the film has been delivered the LLP will have performed its principal obligation.

632. In any event, we take a different view of the effect of the documents, namely that they provide for the acquisition by the LLP of rights to future income, rather than providing for the sale of a film by the LLP. In our view Mr Saini's submission in relation to a liquidator of the LLP fails to take proper account of the security granted by the Deed of Guarantee. We see no good reason why that assignment should not be effective against a liquidator. Any rights to future income which were subject to the irrevocable instructions already existed upon the execution of the underlying contractual documents pursuant to which they were payable, and it is well-established that future book debts to which the assignor had an existing right and which could therefore be validly disposed of by deed (including by way of security) will be recognised by a subsequently appointed insolvency officeholder (subject to any challenges on the grounds of validity or pursuant to a statutory avoidance claim). This is not simply a question of assigning rights to future business receipts, or future profits.

633. Finally, we regard the possibility of the CDA staying in place following a repudiatory breach by the CD of the Deed of Acknowledgement etc. as being unrealistic. In reality the CD would wish to retain the security package, and the hypothesis assumes that the repudiatory breach would be accepted by the other parties to the security arrangements. Mr Saini's submission also ignores the fact that the security assignment secures the LLP's obligations under the CDA.

634. For these reasons, we agree with the FTT's conclusions at [154] and [157]. The LLPs were never entitled to receive BDR.

MRS JUSTICE FALK **JUDGE TIMOTHY HERRINGTON**

UPPER TRIBUNAL JUDGES
RELEASE DATE: 26 July 2019