[2015] UKUT 0211 (TCC)

Appeal number FTC/96-104/2011
Claim number TCC-JR/06/2012

INCOME TAX –partnerships engaging in sale and leaseback of films and partners claiming losses under film acquisition relief provisions ss130-140 ITTOIA – whether trading - held no - appeal dismissed – if trading, whether business carried on on a commercial basis – amount of acquisition expenditure incurred in respect of original master version of The Queen – whether partnership loss rules s118ZE ICTA restrict use of any loss – whether Proteus's relevant period less than 12 months s138 of ITTOIA – whether expenditure of a revenue nature

JUDICIAL REVIEW – whether claimants had legitimate expectation derived from HMRC's Business Income Manual – whether claimants had legitimate expectation derived from HMRC's settled practice – whether HMRC acted with conspicuous unfairness

IN THE MATTER OF JUDICIAL REVIEW PROCEEDINGS
AND ON APPEAL FROM THE FIRST-TIER TRIBUNAL (TAX CHAMBER)

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN

SAMARKAND FILM PARTNERSHIP No 3

PROTEUS FILM PARTNERSHIP No 1

THE PARTNERS OF SAMARKAND

THE PARTNERS OF PROTEUS

A PROTEUS PARTNER

Appellants

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

AND BETWEEN

THE QUEEN
on the application of
SAMARKAND FILM PARTNERSHIP No 3

Claimant

- and –

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Defendants

AND BETWEEN

THE QUEEN on the application of PROTEUS FILM PARTNERSHIP No 1

Claimant

- and –

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Defendants

Tribunal: Mr Justice Nugee
Judge Greg Sinfield

Sitting in public at the Royal Courts of Justice, The Rolls Building, Fetter Lane, London EC4 between 17 and 20 June 2014

Michael Furness QC and Conall Patton, counsel, instructed by Freshfields Bruckhaus Deringer LLP, solicitors, for the Appellants

John Tallon QC and Jonathan Swift QC with David Yates and Joanne Clement, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The Appellants appeal against the decision of the First-tier Tribunal (Judge Charles Hellier and Mr John Robinson - **"the FTT"**) released on 20 September 2011, [2011] UKFTT 610 (TC) (**"the Decision"**). Save as otherwise indicated, paragraph references in square brackets in this decision are to the paragraphs in the Decision.

2. The issue in the appeal was whether the partners in two partnerships, Samarkand and Proteus, which acquired and leased films under a sale and leaseback arrangement, were entitled to loss relief in respect of tax losses that, it was claimed, arose from expenditure on the acquisition of films and certain other costs incurred by the partnerships.

3. In summary, Samarkand acquired interests in the films The Queen and Irina Palm in 2006/7 and Proteus acquired an interest in Oliver Twist in 2005/6. In each case, the films were acquired under arrangements that incorporated pre-ordained elements that included the acquisition of the films and a lease back to the seller via a company in return for fixed, increasing, secured and guaranteed rental payments for a 15 year period. The cash flows and intended fiscal consequences of the transactions can be seen from the following simplified version:

> (1) the partners borrowed 8 from the Bank of Ireland (**"the Facility Bank"**);
>
> (2) the partners contributed 10 to the partnership, ie 8 borrowed from the Facility Bank and 2 from their own funds;
>
> (3) the partnership bought a film from the seller for 9;
>
> (4) the partnership leased the film to Haiku Releasing Ltd (**"Haiku"**) for a period of 15 years in return for fixed but escalating rentals;
>
> (5) Haiku licensed the film directly or indirectly back to the seller;
>
> (6) the seller paid or procured the payment of 8 to Haiku (retaining a "**producer's net benefit**" of 1);
>
> (7) Haiku placed 8 on deposit to secure the guarantee of its rental obligations;
>
> (8) the partners' loans and interest were discharged from the rental payments made out of Haiku's deposit; and
>
> (9) the partnership paid a fee of 1 to Future Capital Partners Limited (**"Future"**) who acted as agent for the partnership and negotiated the transaction on its behalf and provided other services.

4. The partners claimed losses under film acquisition relief provisions in sections 130-144 of the Income Tax (Trading and Other Income) Act 2005 (**"ITTOIA"**). The availability of relief for the losses of a partnership, and the allowability of deductions in computing partnership income for expenditure on films depended on the

satisfaction of a number of statutory conditions. In addition, the partners claimed trading deductions for fees paid by the partnerships to Future in computing their profits.

5. The FTT set out the issues in the appeal at [35] as follows:

> "(i) was the partner, through the partnership, carrying on a trade? - s.138(1) and 140(1)(a) ITTOIA;
>
> (ii) if it was, was the trade one of the exploitation of films? - s.136(a) ITTOIA;
>
> (iii) if so, was the relevant expenditure 'incurred on the acquisition of the … film'? - s.130(3) ITTOIA;
>
> (iv) was the expense incurred wholly and exclusively for the purposes of that trade? - s.34(1) ITTOIA;
>
> (v) was the trade carried on on a commercial basis in the relevant year or period? - ss.384 & 381(4) TA 1988;
>
> (vi) was the trade carried on with a view to the realisation of profits or with a reasonable expectation of profit? - ss.384 & 381(4) TA 1988;
>
> (vii) do the partnership loss rules and regulations restrict the use of any loss? - s.118ZE and the 2005 Regulations;
>
> (viii) in the case of Oliver Twist, how long was the relevant period? - s.138."

In order to claim tax relief in respect of their expenditure on the films, the Appellants had to succeed on each of the issues (i) to (vi) in the appeal, issues (vii) and (viii) being relevant to the quantum of any such relief.

6. In relation to the claim to deduct fees paid by the partnerships to Future, the Appellants had to succeed on issues (i), (v), (vi) and (vii) in the paragraph quoted above and, in addition, show that:

> (1) the fees were an expense incurred wholly and exclusively for the purpose of the trade;
>
> (2) the fees were not items of a capital nature; and
>
> (3) the deduction of the fees in computing the profit of the trade in the relevant year was in accordance with generally accepted accounting practice.

7. The FTT held that the partnerships were not carrying on a trade in the relevant periods and, accordingly, the partners were not entitled to any loss relief in relation to their expenditure on the films or to deduct fees paid by them to Future.

8. The Claimants also apply for judicial review. The taxpayers' case, in summary, is that they had a legitimate expectation, derived from representations and assurances made in certain sections of the Business Income Manual (**"the BIM"**) published by Her Majesty's Revenue and Customs (**"HMRC"**), and/or which formed part of HMRC's settled practice. In particular, the taxpayers refer to the "plain vanilla" example in BIM 56455, which is not an extra statutory concession but an exposition of the law, as HMRC see it. The taxpayers say that certain of HMRC's arguments advanced to, and accepted by, the FTT depart from, and are inconsistent with, the treatment in BIM 56455 of the plain vanilla example and that HMRC is precluded, as a matter of public law, from relying on such arguments.

9. We recognise that, logically, it may be said that the judicial review should be determined before the appeals as, if it is well founded, the relief sought is (i) to quash HMRC's decision to issue closure notices to the partnerships denying tax relief (and if the closure notices are quashed it is not clear that there is anything left to appeal); or (ii) to preclude HMRC from advancing certain arguments on the appeal. But as the judicial review and appeals have been argued before us together and we will have to give our answers to both questions, it is more convenient for the purposes of exposition for us to explain and give our decision on the appeals before dealing with the judicial review.

Background to film finance tax relief

10. The background to film finance tax relief, as set out in a witness statement by Mr Martyn Rounding, the Head of the Litigation Team in HMRC's Corporation Tax, International and Anti Avoidance Directorate, can be summarised as follows:

> (1) Expenditure on the production or acquisition of a film would usually have been capital expenditure which formerly qualified for 100% first year capital allowances. This gave rise to substantial tax avoidance and, in 1982, legislation was therefore introduced which deemed such expenditure to be revenue expenditure to be written off over the lifetime of the film against income from the film.
>
> (2) In 1992, a new tax relief was introduced to ease cash flow difficulties faced by film producers, namely section 42 of the Finance (No 2) Act 1992. This allowed expenditure on the production or acquisition of British qualifying films to be written off over 3 years rather than matched against income.
>
> (3) In 1997, a new tax relief was introduced, intended to stimulate the production of films in the UK, namely section 48 of the Finance (No 2) Act 1997. This allowed expenditure on the production or acquisition of British qualifying films with budgets of £15 million or less (a "**limited-budget film**") to be written off fully on completion.
>
> (4) In practice film makers and producers could not normally take advantage of relief under section 42 of the 1992 Act or section 48 of the 1997 Act because they had little income against which to offset the relief

when the film was completed. Instead, the reliefs were normally exploited indirectly through arrangements with third parties, either subsidiaries of banks or partnerships of wealthy individuals.

(5) By the time of the events giving rise to the appeals the statutory provisions were contained in sections 130 to 144 of ITTOIA.

Legislation

11. As explained by the FTT at [13]-[15], the legislation in relation to film acquisition relief changed between the time when Proteus incurred expenditure in relation to Oliver Twist and the time when Samarkand incurred expenditure in relation to Irina Palm and The Queen but transitional saving provisions meant that the change did not affect Samarkand.

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

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

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

(b) insurance, compensation or similar money derived from the original master version."

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

15. Section 136 of ITTOIA provided that:

> "Sections 137 to 140 (certified master versions: certain expenditure) apply for the purpose of calculating the profits of a trade of a relevant period if -
>
> (a) the trade consists of or includes the exploitation of films,
>
> (b) the films do not constitute trading stock of the trade (within the meaning of section 174),
>
> (c) the expenditure in question is of a revenue nature (whether as a result of section 134 or otherwise) …"

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

> "(1) This section applies if -
>
> (a) the person carrying on the trade has incurred … acquisition expenditure in respect of the original master version of a film in, or before, the relevant period,
>
> (b) the film was completed in, or before, that period,
>
> (c) the original master version is a certified master version, and
>
> (d) the film is genuinely intended for theatrical release.
>
> …
>
> (2) A deduction is allowed for the amount of the expenditure allocated to the relevant period, but this is subject to the application of any prohibitive rule.
>
> (3) The person carrying on the trade may allocate up to the permissible amount of the expenditure to the relevant period.
>
> (4) The permissible amount of the expenditure is the smallest amount given by the following calculations.
>
> (5) The calculations [broadly, allow one-third of the expenditure for each relevant period].

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

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

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

> “(1) This section applies if -
>
> (a) the person carrying on the trade has incurred acquisition expenditure in respect of the original master version of a film in, or before, the relevant period,
>
> (aa) the film was completed in, or before, that period,
>
> (b) the acquisition was a relevant acquisition,
>
> (c) the expenditure was incurred before 1 October 2007 …,
>
> (d) the original master version is a certified master version,
>
> (e) the film is genuinely intended for theatrical release, [and]
>
> (f) the total production expenditure in respect of the original master version is £15 million or less …
>
> (2) An acquisition is a relevant acquisition if -
>
> (a) …, or
>
> (b) the acquisition is directly from the producer and the original master version of the film has not previously been acquired directly from the producer,
>
> and for this purpose ‘the producer’ means the person who commissions the making of the film and is entitled to control its exploitation.
>
> (3) A deduction is allowed for the amount of the acquisition expenditure allocated to the relevant period, but this is subject to the application of any prohibitive rule.
>
> (4) The person carrying on the trade may allocate up to 100% of the acquisition expenditure to the relevant period.
>
> (5) But the total amount allocated under this section may not exceed the total production expenditure in respect of the original master version.”

18. Section 130(7) of ITTOIA provides that:

> "… 'any prohibitive rule' means any provision of the Income Tax Acts which -
>
> (a) prohibits a deduction from being made, or
>
> (b) restricts the extent to which it is allowed,
>
> in calculating the profits of a trade."

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

> "(1) In calculating the profits of a trade, no deduction is allowed for-
>
> (a) expenses not incurred wholly and exclusively for the purposes of the trade, or
>
> (b) losses not connected with or arising out of the trade.
>
> (2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade."

20. Section 133 states that:

> "… 'relevant period', in relation to a trade, means -
>
> (a) a period of account of the trade, or
>
> (b) if no accounts of the trade are drawn up for a period, the basis period for a tax year."

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

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

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

Section 384(9) provides that:

> "Where at any time a trade is carried on so as to afford a reasonable expectation of profit, it shall be treated for the

> purposes of subsection (1) above as being carried on at that time with a view to the realisation of profits."

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

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

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

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

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

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

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

Factual background

27. The FTT set out the factual background to the transactions in issue in detail at [44]-[191]. The findings of fact by the FTT have not been disputed by either party. For the purposes of this appeal, it is unnecessary to rehearse the factual background in the same detail at this stage. Reference will be made to the FTT's findings of fact where relevant when discussing the issues in the appeal and judicial review.

The FTT's Decision

28. The FTT held that the partnerships were not carrying on a trade. The FTT started their consideration of this question by saying, at [197], that the question to be asked was whether the business conducted after adherence (that is the adherence of the individual partners) was a trade. This was because the statutory question was whether a trade was being carried on at the time that the expenditure was incurred. The FTT also held that as a partnership is a relationship between persons and a partnership consists of the partners from time to time, it follows that the business carried on by a partnership is the business carried on by the partners for the time being. That means that if a new partner is admitted, the business thereafter carried on is the business he carries on with his partners after his admission: see at [198]-[199].

29. The FTT then set out their approach to the issue of trading at [200]-[210]. The FTT stated that their task was to assess the business of the partnership and not that business together with the separate individual affairs of the partners. This meant that the borrowings by the partners and the ability of partners to obtain tax relief were irrelevant to determining whether the business of the partnerships was a trade.

30. The FTT, at [202]–[203], drew a distinction between the Appellants' situation and that in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* 76 TC 446 ("***BMBF***") on the ground that the business of BMBF encompassed its financing arrangements and the use of tax reliefs and the payment of tax. The FTT observed that there was unchallenged evidence in *BMBF* that the transactions were part of its finance leasing trade.

31. At [204], the FTT stated as follows

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

32. The Appellants also relied on *Ensign Tankers v Stokes* [1992] STC 226, *HMRC v Micro Fusion 2004-1 LLP* [2010] STC 1541, *HMRC v Halcyon Films LLP* [2010] STC 1125 and *BMIF v Melluish* [1990] STC 314. The FTT did not find these cases helpful.

33. In *Ensign Tankers*, which concerned the acquisition and leasing of a completed film, the issue of trading was only argued before Millett J in the High Court and the FTT observed that he was clearly dealing with a speculative venture where the later distribution or exploitation was a hope or intention and not an integral part of the transaction of acquisition. The FTT acknowledged that, when *Ensign Tankers* reached the House of Lords, Lord Templeman had said:

> "The production and exploitation of a film is a trading activity ... it is true that Victory Partnership only engaged in the film trade for the fiscal purpose of obtaining a first-year allowance but that does not alter the purpose of the expenditure."

The FTT observed, however, that the question of trade was not argued before him.

34. Nor did the FTT find *Micro Fusion* or *Halcyon* helpful because the legislation in those cases, section 42 Finance (No 2) Act 1992, referred to "trade or business".

35. The FTT accepted, in [208], that the leasing of a single asset could be a trade, as in *Bennett v Rowse* 38 TC 476 which concerned the lease of an aircraft. The FTT distinguished that case from the present appeals on the ground that the acquisition and hiring out of the films by the partnerships were accomplished by a single composite transaction.

36. Having considered the principles set out by Millett J in *Ensign Tankers* as relevant in determining whether a transaction associated with the obtaining of a tax advantage was a trading transaction, the FTT held at [210]:

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

37. The FTT then turned to consider the application of the principles that it had identified as relevant in assessing whether the partnerships were trading. At [216]-[218], the FTT found as follows:

> "216. Once the investing partners adhered, what did the partnerships do? The answer is:

> (1) they received certifications such as that from DCMS for Irina Palm;
>
> (2) through Future they set the levels of rental payments by reference to LIBOR and the amount eventually agreed as the price of the film; and
>
> (3) they completed the sale and lease back agreements by making payments under them.
>
> 217. The activities were confined to and centred on the financial closing of the sale and lease back agreements. Thereafter for 15 years the activities of the partnerships were to be limited to the management of their fixed guaranteed receipts under those agreements.
>
> 218. In our view this activity cannot be treated, for the purpose of assessing whether it was a trade, as a separate acquisition of the film and its later leasing. These transactions were part of a whole, and the whole was different from the sum of its parts."

38. The FTT concluded at [220] that:

> "The commercial nature of these agreements was the payment of a lump sum in return for a series of fixed payments over 15 years. That type of transaction carried out on its own is not in our view an adventure in the nature of trade."

39. The FTT compared the composite transaction against the "badges of trade" described by Sir Nicolas Browne-Wilkinson VC in *Marson (Inspector of Taxes) v Morton* [1986] STC 463 at 470-471 as follows:

> "(1) That the transaction in question was a one-off transaction. Although a one off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.
>
> (2) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.
>
> (3) The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realisation, such as referred to in the passage that the chairman quoted from *Reinhold*? For example, a large bulk of whisky or toilet paper is essentially a subject matter of trade, not of enjoyment.

> (4) In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature?
>
> (5) What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.
>
> (6) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? For example, the purchase of second-hand machinery which was repaired or improved before resale. If there was such work done, that is again a pointer towards the transaction being in the nature of trade.
>
> (7) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? If it was broken down it is again some indication that it was a trading transaction, the purchase being with a view to resale at profit by doing something in relation to the object bought.
>
> (8) What were the purchasers' intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer towards a pure investment as opposed to a trading deal. On the other hand, if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some indication against concluding that the transaction was by way of investment rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.
>
> (9) Did the item purchased either provide enjoyment for the purchaser (for example, a picture) or pride of possession or produce income pending resale? If it did, then that may indicate an intention to buy either for personal satisfaction or to invest for income yield, rather than do a deal purely for the purpose of making a profit on the turn. I will consider in a moment the question whether, if there is no income produced or pride of purchase pending resale, that is a strong pointer in favour of it being a trade rather than an investment."

It should be noted that Browne-Wilkinson VC emphasised that the badges of trade are not a comprehensive list of conclusive factors but simply common sense guidance as to whether a trade is being carried on. At [222], the FTT concluded that only one, namely (3) the nature of the subject matter, of the nine badges pointed towards trading in this case.

40. At [223], the FTT summarised, and found superfluous, HMRC's argument based on the decision of the House of Lords in *F.A. & A.B. Ltd v Lupton* [1972] AC 634 in the following terms:

> "The essence of that argument is that the mere presence of elements of trading will not suffice to translate a transaction, the greater part of which is explicable on fiscal grounds, into the realms of trading (see Lord Morris quoting Megarry J). We have not got even that far. Looking at what the partnership did we do not see elements of trading: there is no need therefore for us to consider whether the transaction can be viewed as a whole as entered into for the purposes of establishing a claim against the Revenue."

41. At [225], the FTT accepted HMRC's argument that the nature of the relationship between the parties to the partnership deed before the investors adhered was not one of partnership because the original partners did not have a view of profit for themselves as parties in the venture.

42. At [226]-[228], the FTT decided that their conclusion would be the same even if they considered the question of trade by reference to the activities of the business prior to the signing of the agreements. The FTT concluded that, even on that basis, there was no trade because, until the agreements were signed, all the partnerships did was to retain Future and that was not a trade. The real business only started when the agreements were signed.

43. The FTT also considered whether their conclusion would be different if, instead of regarding the transactions as a composite whole, each element of the transactions were considered separately. At [229], the FTT stated that "we may have concluded that the elements taken individually had a trading nature, but Millett J in *Ensign Tankers* [as quoted in [209] above] suggests that the transaction may be a transaction in the nature of trade only if it has a commercial purpose." The FTT concluded, in [230], that the sale and lease back transactions would not be prevented from being part of a trade because they were uncommercial in the sense used by Millett J.

44. At [232]-[244], the FTT concluded that the ability of Proteus and Samarkand to retain rights in the films after the end of the 15 year lease period for an annual rent of £100, the right of Samarkand to extra net profits in relation to Irina Palm and The Queen and the rights in relation to Oliver Twist were all essentially immaterial and did not make the transactions trading.

45. That was sufficient to dispose of the appeals but, in case they were wrong, the FTT went on to consider the remaining issues on the assumption that the partnerships were trading.

46. The effect of sections 381(4) and 384(1) ICTA 88 was that relief from losses incurred by the partnerships was only available if the trades were being carried on on a commercial basis and, in the case of section 384(1), with a view to the realisation of

profits in the trade or, in the case of section 381(4), in such a way that profits in the trade could reasonably be expected to be realised in that period or within a reasonable time thereafter. The FTT decided that, if there was a trade, the businesses of the partnerships were not carried on on a commercial basis in the relevant periods although the FTT did find that the trade was carried on with a view to the realisation of profits or with a reasonable expectation of profit.

47. In relation to the commerciality of the trades, the FTT cited, at [251], the following passage from the judgment of Robert Walker J, as he then was, in *Wannell v Rothwell* [1996] STC 450 at 461:

> "A trade may be conducted in an uncommercial way either because the terms of the trade are uncommercial (for instance, the hobby market gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable costs of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby art gallery or antique shops where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit and the amateur or dilettante."

48. Applying the same approach, the FTT concluded that "the serious interest in a profit is at the root of commerciality" but that profit was not merely an excess of receipts over expenditure, especially where there were long-term cash flows. The FTT took the view, at [256], that:

> "… if an entity enters into a transaction which has a negative net present value the transaction cannot be described as commercial unless there are other collateral benefits expected or hoped for which are expected to outweigh the negative effect of the transaction. If you buy an asset for £10 and exchange it for something worth £7 that is not a commercial transaction unless you have a collateral hope for at least £3 profit elsewhere."

49. The FTT then went on to find that the purchase and leasing of the rights in The Queen was not a commercial transaction because, in present value terms using an appropriate discount rate, Samarkand made a loss of £1.35 million on the acquisition and leasing of the film. The FTT also found that the purchase and leasing of the rights in relation to Irina Palm and Oliver Twist would result in losses which meant that those transactions could not be regarded as commercial unless there were collateral benefits that outweighed the commercial loss. The FTT decided, at [288], that the tax reliefs which the individual partners hoped to obtain could not be considered to be collateral benefits accruing to the partnerships. The FTT observed, at [297], that disorganisation does not necessarily make something uncommercial but, in this case, the way the partnerships had carried out the transactions showed that:

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

50. The FTT also considered whether, if there was a trade, the partnerships were carrying it on with a view to the realisation of profit for the purposes of sections 381 and 384 ICTA. For this purpose, the FTT considered only whether the transactions produced an excess of cash received over expenditure without regard to the value of money over time because they formed the view, see [309], that "profit" in the legislation referred to a simple excess of receipts over expenditure. The FTT decided, in [308], that the trades were run with a reasonable expectation of profits because the gross receipts from the leases would, as a matter of arithmetic and the application of the discount rate, always exceed the initial outlay on the purchase of the film over the periods of the leases.

51. The FTT approached the issue of whether, if there was a trade, it consisted of or included the exploitation of films by applying the comments of Sir Andrew Morritt C in the Court of Appeal in *Micro Fusion*. The FTT set out their conclusions in relation to this issue at [325] as follows:

> "We find that the leasing of their rights in the films by Proteus and Samarkand was the exploitation of those rights. It was not argued that these rights did not constitute "films" for the purpose of section 136 and indeed *Micro Fusion* makes clear that they did. We thus conclude that Proteus and Samarkand were exploiting films under the lease agreements, and so, if they were conducting a trade, that it was a trade which consisted of or included the exploitation of films."

There is no appeal in relation to the FTT's finding on this point.

52. In relation to the issue of whether the partnerships incurred relevant expenditure on the acquisition of the films, the FTT accepted the partnerships' submission that the correct question was what was the money paid for, not how the proceeds were used by the vendor. The FTT concluded, at [335], that, leaving aside the question whether what was acquired was a film subject to and with the benefit of the leases, the full amount of the expenditure was incurred on the relevant film.

53. The FTT found that the price paid by Samarkand for Irina Palm was incurred on the acquisition of the film. There is no appeal in relation to the FTT's finding on this point.

54. In relation to Oliver Twist, the FTT found that the price of £45,760,000 paid by Proteus in accordance with an opinion provided by Malde & Co that the price would qualify for relief under section 42 Finance (No 2) Act 1992 was incurred on the

acquisition of the film. Proteus also paid an additional £1,215,000 (mistakenly referred to in [339] as £1.1 million). The FTT had found, at [143]-[144], that Future had arranged to increase the purchase price because it had discovered that more capital had been subscribed than the amount in the Malde & Co opinion. The FTT found that the additional £1.215 million was not incurred on the acquisition of Oliver Twist. There is no appeal in relation to the FTT's finding on this point.

55. In relation to The Queen, the FTT found, at [186], that Pathé Slate had no right to receive and did not actually receive any monies representing net profits from the film. Accordingly, the rights transferred by Pathé Slate to Samarkand were worthless. From that finding, the FTT concluded, at [347], that Samarkand did not incur expenditure of £8,162,791 on the acquisition of The Queen. The FTT considered that the amount incurred in acquiring The Queen was no more than 1% of the amount paid.

56. The FTT dealt with the question of whether the expenditure was incurred wholly and exclusively for the purposes of the trade at [348]-[356]. The FTT concluded that the partnerships paid the amounts payable under the agreements for the purpose of their businesses (or trades). The FTT noted that even though they had found that the £8 million paid by Samarkand for The Queen was not expenditure incurred on the film, save to a small extent, it was still for the purposes of the business of the partnership because it was incurred to set the income stream going. There is no appeal in relation to the FTT's conclusion on this issue.

57. The FTT considered the issues that related specifically to the claims by the partnerships to deduct the fees payable to Future at [357]-[435]. The FTT observed that section 33 of ITTOIA prevents the deduction of expenses of a capital nature but that section 134 of ITTOIA provides that expenditure on the acquisition of a master version of a film should be treated as revenue in nature.

58. In [380], the FTT drew a distinction between the cost of creating, enlarging or acquiring the permanent structure of a business of which income is the fruit and the cost of earning income or of income earning operations.

59. In [381]-[384], the FTT concluded that certain of Future's activities were capital in nature, namely:

(1) structuring (in particular in relation to Proteus);

(2) arranging finance for the partners;

(3) identifying a film to acquire and a counter party to which it would be leased; and

(4) negotiating the terms of the sale and leaseback.

60. The FTT held, at [395]-[396], that expenditure on identifying films and negotiating and drafting the agreement to acquire the films was expenditure on the acquisition of films and treated as expenditure of a revenue nature by section 134 of ITTOIA. The FTT concluded that expenditure on the leasing of films was not

expenditure on their acquisition. Accordingly, section 134 did not apply to treat it as expenditure of a revenue nature.

61. The FTT decided, at [397], that expenditure on arranging finance for the partners was not expenditure on the acquisition of films and section 134 did not apply to treat it as expenditure of a revenue nature. The FTT also concluded, in [398], that expenditure related to structuring (in particular in relation to Proteus) was not expenditure on the acquisition of the film and could not be treated as expenditure of a revenue nature.

62. In [407], the FTT apportioned the fees on a percentage basis between various services provided by Future to the partnerships. In summary, the FTT concluded that the partnerships were entitled to treat the fees paid to Future in relation to administration services, identifying the films and negotiating their purchase as revenue expenditure. The FTT determined that the fees paid by the partnerships should be apportioned to these items as follows:

> (1) of the fees paid by Proteus, 5% related to administration services, 15% related to identifying the films and 15% related to negotiating their purchase;
>
> (2) of the fees paid by Samarkand, 10% related to administration services, 17.5% related to identifying the films and 17.5% related to negotiating their purchase.

Accordingly, the FTT found that 35% of fees paid by Proteus to Future and 45% of fees paid by Samarkand were revenue in nature. There is no appeal against the FTT's allocation of fees to identifying the films and negotiating their purchase or their classification as revenue in nature.

63. In relation to the question whether the expenses were incurred wholly and exclusively for the purpose of the trade, the FTT, applying the approach adopted by the Special Commissioner in *Micro Fusion* and the Upper Tribunal in *Icebreaker1 LLP v HMRC* [2010] UKUT 477 (TCC), focussed on the partnerships' trade rather than on how Future dealt with the payment. The FTT concluded that all of the fees paid by Samarkand to Future were incurred by Samarkand wholly and exclusively for the purpose of its trade but only 7/9ths of the fees paid by Proteus to Future were so incurred. The FTT considered that only 7/9ths of the fees paid by Proteus were incurred wholly and exclusively for the purpose of the trade because the fee paid was more than twice the amount due, the amount of the fee was in reality decided by Future rather than negotiated and it paid for arrangements that had already been put in place so there was no need to pay for them. The FTT found that 7/9ths of the fees could be related to amounts payable by Future for legal and banking fees and so those would have formed part of any negotiated fee. The FTT found that the balance was not paid for the purposes of the trade.

64. The FTT considered whether, assuming that the partnerships were trading, the partnership loss rules and regulations restricted the use of any loss at [436]-[489]. The rules restrict the amount of loss relief that a non-active partner, such as the

Proteus and Samarkand partners in this case, may claim for the amount of the individual's contribution to the trade as at the end of that year of assessment. The regulations provide that, where an individual has taken out a loan to finance all or part of the contribution, the amount of the contribution to the trade does not include any part of the financial cost of repaying the loan that is or will or may be borne or ultimately borne by another person. HMRC contended that this condition was satisfied in relation to both Proteus and Samarkand because clauses 2.2 to 2.4 of the Charge over Cash Deposit and Account (under which Haiku charged a cash account with the Facility Bank as security for the payment of rentals under the Leases and the Loans to the partners) had the effect that the partners' obligations to repay their loans might be met by payment from the cash deposited by Haiku, and that was an arrangement under which the financial cost of repaying the loan might be borne by another person.

65. The FTT concluded at [469] and [470] that the potential application of the provisions of clause 2.2 of the Charge did not result in the reduction in the contribution to the trade by the amount which could be so paid and the payments by Haiku which were received by the Facility bank were payments of lease rentals and did not mean that Haiku bore the financial cost of repaying the loans.

66. HMRC also contended that the condition was satisfied by clauses 20.5 to 20.7 of the Partnership Deeds. Those clauses provided that if a partner ceases to be UK resident then that partner "shall in consideration of the payment by the Managing Partner of a sum equal to the outstanding amount of the loan [from the Facility Bank] transfer and assign to the Managing Partner" his partnership share. HMRC's position was that the managing partner would bear part of the financial cost of repaying the loan to the extent that the value of the partner's share acquired was less than the amount of the loan at the time of sale. The FTT agreed and held, in [477], that regulation 4(2) (the Decision mistakenly refers to regulation 4(3) at this point) requires the question of how much of the financial cost of repaying the loan may be borne by another person to be considered at the end of the relevant year of assessment and not merely at the time that the arrangement was entered into. The FTT held, at [475], that, as the value of the partner's share was the value of the right to receive future rentals and that depended on interest rates, a change (increase) in interest rates would mean that the value of the share was less than the outstanding amount of the loan. To that extent, the managing partner would bear the financial cost of repaying the partner's loan. The FTT also found, in [488], that the charge over the partnership assets given by the partnerships to the Facility Bank did not mean that there was an arrangement under which the partnerships might bear the financial cost of the loans and thus did not satisfy the condition.

67. The final issue considered by the FTT was whether the amount of acquisition expenditure allocated to Proteus' commencement period that may be deducted was reduced by section 138(6) of ITTOIA because the relevant period was less than 12 months. Section 133 of ITTOIA defined "relevant period" as a "period of account of the trade" and section 832(1) of ICTA defined "period of account" in relation to a trade as "any period for which accounts of the business are drawn up". At [498], the FTT held that the period of account of the business could not include any period when

the trade was not carried on. The FTT concluded that, assuming that Proteus carried on a trade, as that trade started after 6 April 2005, the accounts drawn up for Proteus for the 12 month period to 5 April 2006 were not accounts of the trade. No accounts had been drawn up for the period from commencement of the trade until 5 April 2006. Accordingly, the relevant period was the basis period determined by section 199 ITTOIA which was a period of less than 12 months. The FTT concluded that the amount of expenditure allocated to Proteus' commencement period was reduced by section 138(6) of ITTOIA because its relevant period was less than 12 months.

68. The FTT summarised its conclusions at the end of the Decision as follows:

> "(1) Summary
>
> *(a) The partnerships*
>
> 502. We have found that the partnerships were not trading in the period in question. If we were wrong and trade was being carried on, we found that it was a trade which included or consisted of the exploitation films.
>
> 503. Samarkand incurred expenditure on Irina Palm equal to the price paid under the sale and purchase agreement. That expenditure was incurred wholly and exclusively for the purposes of its partnership business.
>
> 504. Samarkand did not incur expenditure of £8,162,791 on The Queen. At most some 1% of that sum was so incurred. But the whole of that sum was paid wholly and exclusively for the purposes of the partnership's business.
>
> 505. All but £1.1 million of the price paid by Proteus for Oliver Twist was incurred on the film. The whole amount was expended wholly and exclusively for the purposes of the partnership business.
>
> 506. 35% of the fees paid by the Proteus to Future, and 45% of the fees paid by Samarkand to Future were, or are to be treated as, revenue in nature. The remainder of such fees were capital in nature and therefore not deductible.
>
> 507. Any loss arising to Proteus in its first period would be restricted by the application of section 138(6) because its relevant period was less than 12 months.
>
> *(b) The partners*
>
> 508. The partners were not entitled to sideways loss relief because the businesses of the partnerships were not carried on on a commercial basis with a view of profit.
>
> 509. There were circumstances in which Reg 4(3) of the Partnership Loss Rules could apply to restrict the availability of relief for losses of the partnerships.

(2) Conclusions

510. We dismiss the Proteus appeal. We have concluded that Proteus did not trade in the period.

511. We dismiss the Samarkand appeal. We have concluded that Samarkand did not trade in the period.

512. We dismiss Sample partner E's appeal. Since Proteus had no trade it had no trading losses for which the partner could claim relief in the period to 5 April 2006.

513. The Samarkand and Proteus referrals:

(1) Regulation 4(3) may apply as a result of clause 20.5 to 20.7 of the Partnership deeds to restrict the availability of partnership losses;

(2) The businesses of the partnerships were not carried on on a commercial basis in the periods in question."

The issues in this appeal

69. The Appellants appeal against the FTT's conclusions in relation to issues (i) and (v) at [5] above. The FTT concluded, at [220], that the Appellants were not carrying on a trade and, at [297], that if there was a trade, the Appellants were not carrying on the businesses on a commercial basis. The Appellants contend that there was a trade and that it was carried on on a commercial basis. The Appellants also appeal against the conclusions on issue (iii) in relation to the expenditure incurred on The Queen and issue (viii) as to the duration of Proteus' first period of account.

70. In relation to issues (iii) and (iv), the Appellants contend that the costs incurred in identifying a lease party and negotiating the lease should have been regarded as revenue in nature on general principles. The Appellants also contend that the FTT should have decided that 100% of fees paid by Proteus to Future were incurred by Proteus wholly and exclusively for the purpose of its trade. The Respondents ("HMRC") appeal against the FTT's conclusion on issue (vii) that the partnership loss provisions did not exclude the whole of the amount borrowed by a partner from loss relief under sections 380 and 381 ICTA.

Did the partners carry on a trade?

71. Mr Furness QC, who appeared with Mr Patton for the taxpayers, submitted that a purchase of an asset and an onward lease of that asset is a classic trading transaction. He also accepted that if the transaction were a purchase of an income stream, like an annuity, then it would be regarded as an investment. The FTT found that the transactions were a single composite transaction in which the Appellants purchased an asset which they leased in return for a fixed income stream. The FTT also found that the transactions in this case could be viewed as a single pre-ordained transaction and the Appellants did not dispute this finding, as sale and leasebacks would generally be pre-ordained. The Appellants relied, as they had done in the FTT, on a number of cases (*BMIF v Melluish, Ensign Tankers* and *Micro Fusion*) that

showed that a sale and leaseback which contained pre-ordained elements was still considered to be a trading transaction.

72. Mr Furness submitted that the FTT's approach was contrary to the approach taken by the Court of Appeal and the House of Lords in *BMBF*. The judgments in *BMBF* showed that a sale and leaseback (complete with deposit of the sale proceeds to guarantee the repayment of the rent) is a trading transaction even where it is tax-driven.

73. BMBF carried on a trade of finance leasing. BMBF purchased a gas pipeline from BGE and immediately leased the pipeline back to BGE. BGE sub-let the pipeline to a UK company, BGE UK, which then covenanted to make payments which, broadly speaking, corresponded to the rent to BMBF. BGE placed the purchase price on deposit with a bank in Jersey which, in turn, deposited it with Barclays Isle of Man. Barclays Isle of Man deposited the money with Barclays Bank which had lent the purchase price to BMBF at the outset. The rental payments were guaranteed and the guarantee was secured by a charge over the deposit. Mr Furness submitted that the transaction was very similar to the sale and leaseback of the films in this case. In *BMBF*, it was found by the Special Commissioners that BMBF paid more for its borrowings than it received in rent. The difference was to be made up by the capital allowances claimed and neither the Court of Appeal nor the House of Lords considered it precluded there being a trade.

74. Mr Furness accepted that there was some truth in the FTT's point, in [215], that the prices paid for the films had little commercial effect as the higher the price paid by the partnerships for the films, the greater the rentals that would be received by the partnerships. He also acknowledged there was some truth in the FTT's findings, in [219], that it did not matter what asset was being bought and leased and nor did it matter what profits might be made by distributing the film because the returns were fixed by the sale and leaseback transaction. He submitted that the commerciality of the transactions had to be judged in the context of the unrealistic and artificial commercial nature of the statutory scheme intended to encourage taxpayers to engage in this kind of transaction.

75. Mr Furness submitted that the FTT was wrong to conclude, in [220], that the transactions were investments because the commercial nature of the agreements was the payment of a lump sum in return for a fixed income stream for a period of 15 years. In this case, the partners paid real money for the films and leased them back, via Haiku, to the sellers. These were genuine transactions. Certain transactions are, by their nature, trading. In this case, the partnerships bought the films in order to produce income by leasing. The partnerships purchased the films in order to do the deals which is trading. Mr Furness referred to the FTT's statement, at [229], that if each element of the transactions were considered separately, instead of regarding the transactions as a composite whole, they may have concluded that the elements taken individually had a trading nature. He contended that, once the composite transaction approach is set aside, the only permissible conclusion was that the partnerships were carrying on a trade.

76. Mr Tallon QC, who appeared with Mr Yates for HMRC on the appeal, accepted that a one-off transaction could be a trade and that a sale and leaseback of a film was capable of being a trading transaction but it is not necessarily a trade in every case. He submitted that whether an activity is a trade is a mixed question of law and fact and every case depended on its own facts. Whether, on the facts as found, an activity amounts to an adventure in the nature of trade is a question of law but it is very fact-dependent. The FTT carefully reviewed the facts and came to their conclusion that the partnerships were not carrying on a trade. Mr Tallon submitted that there was no reason for interfering with the FTT's conclusion, on grounds such as those described by Viscount Radcliffe in *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14 at 36.

77. The FTT were correct, when considering whether there was a trade, to look at the business of the partnership and not at that business aggregated with the individual affairs of the partners. The FTT were also correct to hold that there was no partnership until the investors had adhered to the partnership. Mr Tallon submitted that the partners were never involved in any negotiations in relation to the purchase and leasing of the films. They were simply presented with a 'take it or leave it' deal. The FTT was correct to consider whether there was a trade at the time when the partners adhered and, at that time, there was a pre-arranged deal. The partners never intended to enter into a speculative transaction. The lease rentals had no connection with the value of the rights granted. The amount of the rentals was simply an arithmetic calculation to return sufficient monies to the partners to enable them to pay off the capital and interest.

78. Mr Tallon also contended that the FTT were correct to take the view that the purchase and leasing of the films were not commercial transactions because, applying the net present value, the partnerships made a loss on the acquisition and leasing of the films. The fact that the partners benefited in their own personal capacity by obtaining tax relief against their private income did not make the transactions by the partnership commercial. He contended that the legislation requires the taxpayers to carry on a trade.

79. Mr Tallon contended that the Appellants' reliance on cases such as *BMBF*, *BMIF v Melluish*, *Ensign Tankers* and *Micro Fusion* was misconceived as none of the cases decided whether a certain set of transactions was a trade. There was a discussion of the point in *BMBF* in the High Court where Park J held there was not a trade but that was overturned in the Court of Appeal where Peter Gibson LJ accepted, in paragraph 46, that there was trading in *BMBF*. The FTT found, at [220], 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, which did not on its own give rise to an adventure in the nature of trade. The FTT further found, at [231], that their conclusion was not affected by the possibility of contingent receipts because they were immaterial.

80. Mr Tallon also submitted that the FTT erred in rejecting HMRC's alternative argument that there was no trade based on the manner in which the transactions were carried out. Essentially, Mr Tallon submitted that the way in which the partnerships,

or Future on their behalf, conducted the activities was so careless or cavalier that it could not be said that sound commercial principles had been employed with the result that the activities were deprived of the necessary commercial character which is the foundation stone of a trade. Mr Tallon submitted that the partnerships had no serious interest in making a profit and so could not be said to be trading at common law. The FTT set out these submissions at [294]-[295] and rejected them at [297] where the FTT observed that disorganisation does not necessarily make something uncommercial.

81. The tax legislation does not contain any definition of what constitutes trading. At the time of the events with which this appeal is concerned, section 832(1) of ICTA, now repealed, defined trade to include "every trade, manufacture, adventure or concern in the nature of trade". The badges of trade are helpful indicators and none of them is decisive.

82. In considering the appeal against the FTT's finding that the partnerships were not trading in the period in question, we note that, in *Marson v Morton*, Sir Nicolas Browne-Wilkinson VC described how the General Commissioners (the predecessors to the FTT) should approach the badges of trade and the question of whether a person is trading on page 471g:

> "I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question - and for this purpose it is no bad thing to go back to the words of the statute - was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?
>
> If that approach is right, then it seems to me that this is essentially a case which falls in the no-man's-land where different minds might reach different conclusions on the facts found."

83. We gratefully adopt the approach taken by Sales J, as he then was, in *Eclipse Film Partners (No.35) LLP v HMRC* [2013] UKUT 639 (TCC) at [41] and [43]:

> *"Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14 is the leading authority on the approach to be adopted on an appeal on a point of law in respect of a question of categorisation of an activity as in the nature of trade, and has been for a long time. The law derived from *Edwards v Bairstow*, in particular as explained by Viscount Radcliffe at p. 36, was aptly summarised by Millett J in *Ensign Tankers* at [1989] STC 705, 761; [1989] 1 WLR 1222, 1231:
>
>> 'Whether a given transaction or series of transactions is in the nature of trade is a question of fact for the commissioners

> [now, the FTT]. An appeal from their decision can succeed only if they have misdirected themselves in law or if the only true and reasonable conclusion from the facts found by them is contrary to their determination.'
>
> …
>
> It may be that some issues of evaluative judgment in tax cases may be found to lend themselves to a more intrusive policy-based classification as questions of law (amenable to appeal) rather than as questions of fact, in circumstances where the Upper Tribunal can be confident that it really will be making a contribution to the coherent development and consistent application of the law applicable in its specialist field by doing so. However, I think that in the tax field such cases are likely to be unusual. The Tax Chamber of the FTT is staffed by very experienced and expert judges. A particularly clear policy-based reason would need to be shown to justify the Upper Tribunal departing on any particular issue from well-established principles of classification of questions of fact and questions of law in the tax field, which are well understood by taxpayers and the Revenue alike."

84. Mr Furness accepted that the transactions were all pre-ordained transactions in which the partnerships bought films to be leased back to the sellers, via Haiku. He also accepted that if the partnerships had bought an income stream then the transactions should be regarded as an investment. If, however, the partnerships had bought a film and exploited it by leasing then that should be regarded as trading. Mr Furness submitted that the purpose of the transaction was to enable the partnerships to dispose of the film by leasing it back to the seller. The FTT was wrong to consider that as a composite transaction. The partnerships were, in the words of Sir Nicholas Browne-Wilkinson VC in *Marson v Morton*, "doing a deal". Mr Tallon contended the opposite.

85. The issue for the FTT was how should the transactions in this case be characterised: were they the purchase of a film to lease or were they the payment of an amount of money in return for a guaranteed income stream? As Sir Nicolas Browne-Wilkinson VC said in *Marson v Morton*, this is a case where different minds might reach different conclusions on the facts found. In this case, the partnerships bought an asset, a film, and intended to lease it back to the seller. The FTT found that the purchase and lease back were part of a pre-ordained single composite transaction. The partnership could not acquire a film without an obligation to lease it back to the seller. The effect of the purchase of the film being combined with the lease back was that the partnerships paid a capital sum and, in return, received a guaranteed income. The amount paid for the film was not affected by the likely commercial success of the film. The amount of the rentals paid under the lease was calculated by an arithmetical formula that depended on the amount paid for the film. The FTT accepted that transactions such as those in this case could be trading transactions, even if they consisted of a single purchase and leasing of an asset but concluded, at [204] and

[222], that the transactions in this case were not trading in nature. They reached that conclusion because they found, at [220], that the commercial nature of the transactions was the payment of a lump sum in return for a series of fixed payments over 15 years. At [231], the FTT decided that the existence of rights to possible profits after or in addition to the right to fixed payments were "froth on the top of the rather boring fixed guaranteed secured rental [payments]" that did not convert a non-trading activity into a trading one because they were immaterial.

86. In our view, the FTT were entitled to conclude that the partnerships were not carrying on a trade:

(1) We agree with the FTT (indeed it was not disputed by Mr Furness) that when a new partner is admitted to a partnership, there is in law a new partnership. Since the relief under section 138 or section 140 of ITTOIA applies if "the person carrying on the trade has incurred acquisition expenditure…", it follows that the FTT was correct to say that the relevant question is whether the partnership as constituted after the adherence of the individual partners was carrying on a trade, and was doing so at financial close when the acquisition expenditure was incurred.

(2) That requires a close focus on what that partnership actually did. The question whether a transaction is an adventure in the nature of trade is not to be answered by asking whether the transaction is of a type which may in other cases have been held to constitute trading (is it a sale and leaseback?), but by examining the particular transaction in question.

(3) This is what the FTT did. There is no identifiable error of law in their statement of the principles at [200]-[210]. There they accepted in terms that a single purchase and leasing of an asset can be a trade (at [204]); that the purchase of a film with a view to its distribution or exploitation for profit was a typical transaction of a commercial nature (at [205]); and that a single leasing can be a trade (at [208]). None of this, however, was determinative of the question whether the partnerships were trading in this case, which depended on what the partnerships actually did.

(4) Nor do we consider that it can be said that the only true and reasonable conclusion from the facts was that the partnerships were trading. On the contrary, the FTT very clearly found as a fact that the leasing agreements could not be divorced from the sale and purchase agreements: see, for example, [45(8)] ("the purchase was conditional on the lease agreement and vice versa"), [59] ("There was no doubt in our minds that the SPA agreement was not contemplated and would not have been completed without the lease and vice versa….They were legally and commercially one transaction") and [67]; see also [331]-[332] ("The partnerships never acquired the film without the burden and the benefit of the lease. Without the film they never would have had the lease, but also without the lease they could and would never have acquired the film."). This justified their conclusion at [208] that "the acquisition and hiring out were accomplished by a single composite transaction", and their findings at [216] as to what

the partnerships actually did once the investing partners adhered (see at [37] above). In these circumstances, the FTT's description (at [212]) of the lease and acquisition as "one transaction whose material features were the payment and receipt of monies" and (at [220]) of the commercial nature of the agreements as being "the payment of a lump sum in return for a series of fixed payments over 15 years" seem to us to be factual conclusions that they were fully justified in reaching. Having done so, we see no error of law in their characterisation of such a transaction as not being an adventure in the nature of a trade.

87. We should add that we had reached this conclusion before the Court of Appeal handed down its judgment in *Eclipse Film Partners No 35 LLP v HMRC* [2015] EWCA Civ 95, but nothing in the judgment of the Court of Appeal has caused us to alter our views. On the contrary the references in [111] to an "unblinkered approach to the analysis of the facts", a "realistic approach to the transaction" and to it being "necessary to stand back and look at the whole picture and, having particular regard to what the taxpayer actually did, ask whether it constituted a trade" seem to us to be exactly in point, and to be the approach that the FTT correctly took. In the circumstances, we did not think it necessary to invite any further argument as a result of that decision.

88. Before leaving the issue of whether the partnerships were trading, we should record that Mr Tallon submitted before the FTT and before us that even if the activities of the partnerships amounted to a trade, which HMRC did not accept, that, applying *Lupton*, the activities were so affected by considerations of obtaining tax relief for the investors that they could not be regarded as trading. The taxpayer in *Lupton* had an established trade as a share dealer and the disputed transactions in that case were transactions in shares. The issue in *Lupton* was whether transactions that would otherwise have been trading transactions in the course of the taxpayer's trade lost their character as trading transactions when viewed in context and seen as a device to obtain a tax advantage. In *Lupton*, the taxpayer entered into a dividend-stripping transaction. It bought the issued shares of another company under an agreement in which the sellers warranted that the company's profits would be such as to allow a dividend of a specified amount to be declared. The dividend having been paid, the value of the company fell, on the strength of which the taxpayer claimed to have incurred a trading loss. Lord Morris of Borth-y-Gest said (at p647) that, while the presence of a motive of securing tax recovery may not cause a transaction to be no longer a trading transaction, "some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction". Lord Guest, agreeing with Lord Morris, said at p651 that "[t]he shares were not bought as stock in trade of a dealer in shares but as pieces of machinery with which a dividend-stripping operation might be carried out".

89. At [223], the FTT stated that, as they did not regard the transactions as trading, they did not need to consider the *Lupton* argument. In our view, the FTT were right to adopt that approach in this case. The facts of *Lupton* and the facts of this case are very different. As discussed above, whether an activity is a trade is a mixed question of law and fact and every case turns on its own facts. Lord Templeman observed in

Ensign Tankers, at 236g, that "in dividend-stripping cases the tax avoidance scheme negatives trading because on the true analysis of the transaction the trader does not trade at all." That suggests that the decision in *Lupton* also depended on its facts and not some broader doctrine that tax avoidance is not trading. The FTT found that the partnerships were not carrying on any trade without needing to have recourse to the approach taken by the House of Lords in *Lupton*. As they stated in [223], the FTT did not even get that far. In those circumstances, we consider that the FTT were right not to speculate whether, if they had been wrong to hold that the partnerships were not trading, the transactions would have lost their character as trading transactions by applying *Lupton* to the facts of this case. For the same reason, we consider that it is not necessary for us to decide whether, had the FTT found that the partnerships were engaged in what would otherwise have been trading transactions, the transactions were so affected or inspired by fiscal considerations that could not be regarded as trading transactions.

90. Our conclusion on this ground of appeal means that the Appellants' appeals must be dismissed. As we heard argument on the other grounds of appeal, which assume that the partnerships were carrying on a trade, we consider the other grounds below.

Commerciality

91. Assuming that the partnerships were carrying on a trade, the FTT decided that the partnerships were not entitled to relief for any loss because they did not carry on their trades on a commercial basis in the relevant periods as required by sections 384(1) and 381(4) ICTA.

92. In deciding whether the trades were conducted on a commercial basis, the FTT, applying the dicta of Robert Walker J in *Wannell v Rothwell*, held that the serious interest in profit is at the root of commerciality. The FTT concluded that the trades were not carried on on a commercial basis because the transactions had a negative net present value when the partnerships entered into them. The FTT held, at [256], that a transaction in which a person buys an asset for £10 and exchanges it for something worth £7 is not a commercial transaction unless there are other collateral benefits elsewhere which match the £3 loss. The FTT held, at [288], that the tax reliefs that might have accrued to the partners could not be taken into account as such collateral benefits in deciding whether the partnerships' trades were conducted on a commercial basis.

93. Mr Furness submitted that the FTT adopted the wrong approach to the question of whether the trades were conducted on a commercial basis. He stated that the FTT considered whether the profit to be derived from the transactions was large enough to be considered commercial. He contended that such an approach was a misreading of the legislation in both section 381 and section 384 ICTA which provided for two tests, namely a commerciality test and a profitability test. Mr Furness submitted that the legislation provided for two distinct tests and if the FTT's approach were correct then the profitability test would be redundant. He contended that the commerciality test is concerned with the way in which the trade is carried on and, in particular,

distinguishing the serious trader from the hobby or amateur trader. The profitability test considers whether there is a view to the realisation of profits or a reasonable expectation of profit. Mr Furness submitted that, unlike the FTT in this case, Robert Walker J in *Wannell v Rothwell* looked at the way in which the taxpayer carried on the trade, including matters such as the taxpayer's professionalism, application and diligence, rather than on whether or not the trade generated enough profit to be considered commercial. Mr Furness accepted that a serious interest in making a profit was a factor in assessing the commerciality of a trade but submitted that it related to the distinction between the serious trader and the hobbyist or dilettante.

94. Mr Tallon submitted that the FTT had reached the right conclusion on the question of commerciality for the right reasons. He also submitted, as he had done before the FTT, that the partnerships did not conduct their activities on sound commercial principles but had a careless and/or cavalier approach that meant that the trade could not be regarded as carried on on a commercial basis for the purposes of section 381 and 384 ICTA. As stated above, the FTT set out these submissions at [294]-[295] and observed, at [297], that disorganisation does not necessarily make something uncommercial but, in this case, showed that the partnerships were not seriously interested in making profits and that showed a lack of commerciality. Mr Tallon also submitted that the FTT were right to decide, at [288], that the fact that the partners might obtain loss relief was not relevant in deciding whether the partnerships' trades were conducted on a commercial basis. He maintained that whether the trade carried on by the partners collectively was carried on on a commercial basis must be judged without regard to the partners' own personal situation. The issue was the commerciality of the trade and the fact that the partners obtained a benefit, in the form of a relief against their own personal income, arising out of that trade did not indicate whether that trade was conducted on a commercial basis.

95. In our view, the FTT clearly identified the right question when it said at [248] "the question for us is whether the activities of the partnership were carried on on a commercial basis". The FTT were correct, in [293], to state that the statutory test is to be applied by reference to the trade carried on, not by reference to individual transactions. They were also, in our view, correct to state that, where transactions are the substance and essence of that trade, if the transactions are uncommercial then the trade is not carried on on a commercial basis.

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

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

98. We accept that the mere fact that a trade or business is only worth undertaking because of the availability of a tax relief does not by itself mean that the trade or business is not being carried on on a commercial basis. The FTT referred at [194] to a submission by Mr Peacock for the Appellants that a tax relief could make the difference between a commercially attractive and economically unattractive transaction, citing Lord Millett in *Peterson v CIR* (2005) STC 448 at [44]:

> "tax relief often makes the difference between profit and loss after tax is taken into account"

and Vinelott J in *Barclays Mercantile Industrial Finance Ltd v Melluish* (1990) STC 314:

> "it is probable that BMI would not have been able to offer a lease back to the company … at an acceptable rent unless it could obtain a capital allowance and unless it had spare capacity in the group sufficient to absorb it."

99. So the question is squarely raised whether the FTT were right to conclude that the tax reliefs which might accrue to the partners individually should not be taken into account in considering whether the partnerships, ie the partners acting collectively, carried on their trades on a commercial basis. Their reasoning at [246]-[247] was as follows:

> "The 'trade' in these appeals is the trade carried on by the relevant partner as a partner in the relevant partnership. In our view this confines attention to the activities carried on in common by the partners in the partnership. The activities which the partner carries out in association with his participation in the partnership are not activities of the trade he carries on in common with the other partners and are not relevant to the assessment of the business of the partnership.
>
> …It may well be that a partner's borrowing, investment in the partnership and use of tax reliefs is as a whole commercial, but that is irrelevant to the assessment of the commerciality of the partnership's business."

The FTT returned to this point at [288]:

> "We should make clear here that we distinguish the position of a company whose business may include taking the benefit of tax allowances either against its own profits or by seeking payments for group relief from that of these partnerships which does not include dealings in the tax benefits which may accrue to its partners. In the case of such a company the expectation of the benefit from such allowances may be taken into account in assessing its business; we do not believe that the tax reliefs which may accrue to the partners may be so taken into account in these appeals."

100. Mr Furness said that it was a misconception to draw a distinction between the partnership and the partners. A partnership is not a legal entity, it is a label given to a number of legal persons who agree to carry on an enterprise together; moreover s. 848 of ITTOIA expressly provides that a firm is not to be regarded for income tax purposes as an entity separate and distinct from the partners.

101. It is no doubt right that a partnership is a way of referring to the partners and that the trade of a partnership is the trade of the partners making up that partnership. But this does not seem to us to answer the FTT's point. When assessing the trade of a partnership, one is looking at what the partners do *qua* partners in the firm, that is collectively. Anything that a partner does individually, not as one of the partners in the firm, does not form part of the partnership's business. And it seems undeniable that the sideways loss relief that individual partners claim is something that an individual partner does individually, not as part of the partnership.

102. So the question resolves itself into this: can a trade carried on by the partnership, which would otherwise be uncommercial, be said to be carried on on a commercial basis not because of extra benefits accruing to the partnership as part of its business but because of extra benefits accruing to the individual partners? We have not found this entirely easy, but we consider that the FTT was right to answer this question "No". We do not ultimately see any answer to the point that however commercial the individual partners were being (or thought they were being) in accessing the tax reliefs, they did so by deliberately causing the partnerships to trade in an uncommercial manner. We appreciate this may have the consequence that Mr Furness identified, namely that it may make it difficult if not impossible for partnerships to access relief of this sort; and we say nothing about the way in which the FTT distinguished corporate bodies, a matter on which we heard little argument. But the logic of the FTT's conclusion on partnership seems to us to be unassailable.

103. The FTT found, at [297], that the partnerships were not seriously interested in making profits from the transactions but were focussed on ensuring that the partners obtained tax relief and Future obtained its fee. There was no challenge to the FTT's finding on *Edwards v Bairstow* grounds and we consider that the FTT were entitled to make that finding. The finding supported the FTT's conclusion that the trades lacked commerciality. In our view, the FTT were entitled to conclude that the partnerships were not entitled to relief for any loss because they did not carry on their trades on a

commercial basis in the relevant periods as required by sections 384(1) and 381(4) of ICTA.

The Queen quantum issue

104. Section 140 of ITTOIA required the person carrying on the trade to have incurred “acquisition expenditure in respect of the original master version of a film”. In relation to The Queen, the FTT found that Samarkand had acquired the master negative and certain rights to distribute and exploit it from Pathé Slate. The relevant issue for this appeal was whether the amount of £8,162,791 paid by Samarkand was expenditure on the acquisition of the negative and rights in respect of The Queen or expenditure on something else.

105. Under the pre-release sale and purchase agreement dated 11 September 2006 (**“the PRSPA”**), Pathé Slate agreed to deliver the master negative and to license certain rights in The Queen to Samarkand. The PRSPA provided that the rights were to be granted by a licence subject to and with the benefit of the “Prior Agreements”. The Prior Agreements were defined in another document, the Lease dated 12 December 2006, which was the same date as the licence of the rights to Samarkand. The Prior Agreements included agreements that conferred distribution rights in relation to every territory on various persons, not including Pathé Slate. By clause 3.5 of the PRSPA, Pathé Slate agreed to pay Samarkand 1% of the share of the net profits of The Queen “accruing to and actually received by” Pathé Slate, after deduction of amounts payable to others for services in connection with the production of the film.

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

107. In [346], the FTT found, on the balance of probabilities, that Samarkand, through Future, either knew or had means of knowledge that Pathé Slate had no right to receive any share of the net profits from The Queen. The FTT considered that the

ownership of the negative and the residual rights did not confer any economic power on Samarkand. The FTT considered that, notwithstanding that the agreement expressed the payment as being for the film, the expenditure must have been to obtain some other benefit because the film was worth very little. The FTT concluded that Samarkand did not incur expenditure in relation to the film but on the benefits of the leasing arrangement which was the only thing of real value that Samarkand received. In [347], the FTT concluded that Samarkand did not incur expenditure of £8,162,791 on the acquisition of The Queen. The FTT considered that the amount incurred in acquiring The Queen was no more than 1% of the amount paid which could be said to relate to the limited rights that it obtained.

108. Mr Furness made two submissions in relation to this issue, namely that:

> (1) the FTT failed to construe the pre-transaction documentation properly and were wrong to conclude that the rights acquired by Samarkand were worthless because the persons (Pathé Productions and Granada) who were entitled to the money for the rights had authorised Pathé Slate to enter into the sale and leaseback; and
>
> (2) even if the rights were worthless, the FTT was wrong to hold that Samarkand did not incur the amount paid in acquiring the film in the absence of any finding that Samarkand knew that it was paying more than the asset was worth when it did so.

109. In relation to the first point, Mr Furness submitted that the prospective sale and leaseback transaction was embedded into all of the relevant agreements, namely the Collection Account Management Agreement, the Production Financing Distribution Agreement and the Interparty Agreement, which were all dated 22 September 2005. These agreements were not included in the list of Prior Agreements for the purposes of the PRSPA. Mr Furness stated that the agreements showed that Pathé Slate was authorised by all the interested parties to enter into a sale and leaseback transaction in relation to the master negative and the rights. Mr Furness contended that it was sufficient for the purposes of the legislation that the sale and leaseback was undertaken with the consent of the owners of the beneficial rights. Mr Furness also submitted that Samarkand acquired the master negative and the rights on the basis that they would be leased back to Pathé Slate and that would benefit the persons who authorised the sale and leaseback. It followed that the value of the rights acquired should be assessed taking into account Pathé Slate's obligation to take an indirect leaseback of the film.

110. In relation to the second point, Mr Furness submitted that, even if the rights were worthless, Samarkand acquired them and the fact that there was a discrepancy between the value of the asset acquired and the amount paid for it did not justify the inference that the amount paid was not incurred in acquiring the asset unless Samarkand knew that it was paying too much for the rights. He contended that there was no evidence that Samarkand or Future knew that the rights were overvalued.

111. In relation to this submission, Mr Furness relied on *CIR v George Guthrie and Son* 33 TC 327. In *Guthrie*, the taxpayer company paid valuable consideration for a

motor car but, owing to a fraud, did not obtain title to the car. The issue was whether the taxpayer had incurred capital expenditure on plant and machinery for capital allowance purposes even though it had not acquired title to the plant. The Court of Session upheld a decision of the Special Commissioners that the taxpayer had incurred expenditure on plant and machinery. The Lord President said at p330:

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

112. Mr Furness contended that Samarkand's case was a stronger case than that of *Guthrie* because Samarkand acquired title to the asset in respect of which the expenditure was incurred. The FTT found that Samarkand had acquired the rights but found that they were worthless. A parallel in *Guthrie* would be if the taxpayer obtained title to the car but was unaware that it had a defect that made it worthless. Mr Furness contended that, in such a situation, it was inconceivable that the Court in *Guthrie* would have said that the taxpayer had not incurred expenditure on an approved purpose, when it had concluded the opposite in a case where no title at all had been obtained.

113. Mr Furness also relied on *Stanton v Drayton Commercial Investment* 55 TC 286, which concerned an acquisition of shares for a consideration of £3.9m to be satisfied by an issue of shares by the acquirer, for the proposition that HMRC could not go behind the value which the parties had agreed to place on the consideration shares. On the issue of value, the FTT said, at [346], that *Tower MCashback LLP1 v HMRC* [2011] UKSC 19, [2011] STC 1143 indicated that the value of what is received is not irrelevant to the question of what the expenditure was on. Mr Furness accepted that, in deciding what money is being paid for, the value of the asset on the other side of the transaction is relevant but it is not determinative. Mr Furness contended that Samarkand paid money for the rights in The Queen and, even if they are worthless, it is what was paid for the acquisition of the rights and the FTT should not go behind that.

114. Mr Tallon submitted that, as acknowledged by the Appellants, the value of the film is in its distribution rights. Ownership of the master negative without the distribution rights is of no value. In relation to the first point, Mr Tallon accepted that Pathé Slate was authorised to enter into a sale and leaseback but he submitted that Pathé Slate did not have any rights of value to transfer to Samarkand. Mr Tallon also accepted that Pathé Slate transferred and Samarkand acquired the master negative but, as already stated, contended that ownership of the master negative without the distribution rights was of no value. Pathé Slate owned the master negative but it did not own any rights of value. Such rights as Pathé Slate had did not entitle it to any gross receipts or a share in the net profits of The Queen, which accrued to Granada and Pathé Productions.

115. In relation to the second point, Mr Tallon submitted that Samarkand's contention that statutory provisions affording tax relief should be applied to a case where substantial expenditure had been made on worthless assets failed to take account of the purpose of the legislation. Mr Tallon stated that *Tower MCashback* demonstrated that the value of an asset is clearly relevant to determining whether money has been expended for a specified statutory purpose, such as the acquisition of a film. In *Tower MCashback*, Lord Walker, commenting on the judgment of the High Court, said at [67]:

> "I cannot accept that the question of valuation was totally irrelevant in the context of a complex pre-ordained transaction where the court is concerned to test the facts, realistically viewed, against the statutory text, purposively construed."

Mr Tallon contended that, if Samarkand were right, tax relief would be given to any taxpayer who chose to accept assurances from a vendor which ultimately turned out to be unfounded, which could not be right.

116. The issue is whether Samarkand incurred expenditure of £8,162,791 in acquiring the original master negative, which included the residual rights, of The Queen or whether the expenditure was in respect of something else. The FTT considered that, notwithstanding that the agreement expressed the payment as being for the film, the expenditure must have been to obtain some other benefit because the film and the rights were worth very little. We do not accept Mr Furness's submission that, because the persons (Pathé Productions and Granada) who were entitled to the income from exploiting the rights had authorised Pathé Slate to enter into the sale and leaseback, Samarkand received valuable rights. Such authorisation was an empty gesture. Pathé Slate had no valuable rights to transfer and, in the absence of any evidence that Pathé Productions and Granada appointed Pathé Slate as their agent or otherwise authorised the transfer of their rights, the FTT were entitled to conclude that Samarkand did not receive any valuable rights.

117. In relation to the second point, we have different views: Mr Justice Nugee considers that the FTT came to the wrong conclusion for the reasons set out below at [118] - [123]; Judge Sinfield considers that the FTT were entitled to reach their conclusion on this point for the reasons set out at [124] - [125].

118. The starting point must be the factual findings of the FTT. They accepted that, by the time of financial close, Pathé Slate was entitled to the negative of the film and the rights to distribute and exploit the film (other than in France and in relation to sequels and spin-offs) but subject to the rights conferred by prior distribution agreements [178]-[180]; that because of the arrangements in relation to the collection account, Pathé Slate had no right to receive (and did not actually receive) any monies in respect of the film [186]; and that it seems likely that Samarkand, through Future, "knew or had means of knowledge" that Pathé Slate had no right to receive income. There is however no finding that Future or Samarkand actually knew that Pathé Slate had no right to receive income, or actually appreciated that the rights which Samarkand acquired were of only nominal value. It does not seem possible on these

findings of fact to conclude that Samarkand was acting other than *bona fide* in the belief that it was acquiring valuable rights, however careless this belief may have been.

119. *Guthrie* establishes that on the wording of the legislation there considered, namely section 15(1) of the Income Tax Act 1945, a person "incurs capital expenditure on the provision of machinery or plant…" if he spends money "in order to provide" the machinery or plant (see the approval by the Lord President at p330 of the Special Commissioners' opinion), or in other words that the subject of the inquiry is "the fact and object of the expenditure." The relevant provisions of ITTOIA refer to a person who has "incurred acquisition expenditure" which itself means "expenditure incurred on the acquisition of" the original master version of a film. These words cannot sensibly be given any different meaning.

120. That means the relevant inquiry is not what the rights acquired by Samarkand were actually worth, but what was Samarkand's object in spending the money. In one sense the answer to this is obvious: Samarkand spent the money to complete the single composite transaction of sale and leaseback. It did so because otherwise it could not obtain the rentals that it sought to obtain. So in this sense the FTT is correct that Samarkand spent the money to acquire the benefits of the leasing arrangement, as this was the only thing of value it received. But this is true in each of the cases where there is a pre-arranged sale and leaseback – as the FTT themselves say there was no question of the partnerships acquiring a film except encumbered with a lease, so in each case the value to the partnership of the composite transaction lay in the receipt of the rentals, not in the value of the film, or rights in the film, unencumbered with the lease. This therefore does not seem an adequate justification for the conclusion of the FTT that the partnerships incurred expenditure on the acquisition of the film in the case of Irina Palm and Oliver Twist but not in the case of The Queen.

121. That takes one back to the FTT's reliance on Samarkand having knowledge or means of knowledge that Pathé Slate had no right to receive income in relation to The Queen. This is not a case where it can be shown that the acquirer actually knew that the rights were valueless – that would be similar to Mr Guthrie in *Guthrie* knowing that he was not acquiring title to the car - as the FTT made no such finding. The finding that Samarkand had the means of knowledge is an insufficient basis on which to conclude that it did not spend the money with the object of acquiring the film. Samarkand's object was to acquire the film precisely so that it could enjoy the agreed rentals from leasing it; but it needed to acquire the film in order to do that and, on the basis of their findings, it was not open to the FTT to conclude that Samarkand knew that it was paying more for the film, and the rights that it was acquiring with the film, than the film and those rights were worth, or that it spent the money on anything else.

122. It is true that Lord Walker in *Tower MCashback* said that the question of valuation was not "totally irrelevant" (at [67]), but the facts in *Tower MCashback* were very different. In that case, the determining factor in Lord Walker's view was that whatever the loaned amount (£225,000 in his example) was spent on, it was not spent on acquiring software rights from MCashback as it never reached MCashback

(see at [74]). It was not a case where the taxpayer thought he was acquiring something of value but in fact was not.

123. For those reasons, Mr Justice Nugee considers that the FTT was wrong to conclude at [347] that no more than 1% of the sum spent by Samarkand was spent on The Queen.

124. Judge Sinfield considers that, taking account of the circumstances, the FTT were entitled to conclude that a payment of a substantial amount of money for an asset that was worth nothing or almost nothing was not, in reality, a payment for that asset but must be or include a payment for something else. In his opinion, the case of *Guthrie* does not assist Samarkand because the facts are very different. In *Guthrie*, it was an agreed fact that the taxpayer company incurred expenditure with the object of acquiring the car for the purposes of its trade. There was no question of the taxpayer in *Guthrie* buying anything other than or in addition to the car. He does not read the passage from the judgment of the Lord President in *Guthrie* cited above as preventing the FTT from finding, in a suitable case, that a payment in return for a package of benefits relates more to one than another or others. Such a finding would be, if it were based on a correct view of the evidence, a finding as to 'the fact and the object of the expenditure'. Nor does he consider that the reference in *Guthrie* to 'bona fides' as to 'the intended object' implies that the issue of whether a taxpayer has incurred capital expenditure on plant and machinery turns on the subjective knowledge or intention of the taxpayer. The bona fides and intended object of the taxpayer in *Guthrie* were part of the agreed facts of that case and not, in his view, the test to be applied (although such facts may be relevant).

125. In this case, Samarkand intended to buy a film as part of a sale and leaseback transaction which included the right to future rentals. In [346], the FTT concluded that, because the negative and residual rights were worth very little, Samarkand must have incurred the expenditure of £8,162,791 to acquire some benefit other than The Queen even though the payment was said to be for the film. In [347], the FTT found that no more than 1% of the amount paid in acquiring The Queen could be said to relate to the limited rights that Samarkand obtained. The FTT concluded that 99% of the expenditure was incurred by Samarkand in return for the benefits of the leasing arrangement. In [356], the FTT restated its finding on this issue in the context of whether the expenditure was incurred wholly and exclusively for the purposes of the trade. The FTT found that Proteus and Samarkand had paid monies under the sale agreements for the purpose of their businesses and stated:

> "… in the case of Samarkand and The Queen, although we have found that the £8m it paid was not expenditure incurred on the film, it was incurred for the business of the partnership because it was incurred to set the income stream going."

For those reasons, Judge Sinfield considers that the FTT were entitled to reach their conclusion on this issue.

126. Mr Justice Nugee is the presiding member of the tribunal for the purposes of the hearing. In the event of differing views as to a decision on any issue, the presiding

member has a casting vote under Article 8 of The First-tier Tribunal and Upper Tribunal (Composition of Tribunal) Order 2008 (SI 2008/2835). Mr Justice Nugee exercises his casting vote in favour of the decision that the FTT were not entitled to conclude that Samarkand did not incur more than 1% of the £8,162,791 paid by it as expenditure on the acquisition from Pathé Slate of the master negative of and certain rights to distribute and exploit The Queen.

Partnership loss provisions

127. The partnership loss provisions in sections 118ZE ICTA and the 2005 Regulations restrict the amount of sideways loss relief which may be given under section 380 or 381 to a non-active partner in respect of a loss sustained in a trade in a year of assessment to an amount not exceeding the partner's contribution to the trade. There was no dispute that the Proteus and Samarkand partners were non-active partners. The 2005 Regulations apply for the purposes of section 118ZN in computing an individual's contribution to a trade. The relevant regulation, regulation 4, applies where one of four conditions is satisfied. HMRC only relied on condition 1 which is as follows:

> "There is, at any time an agreement or arrangement, under which all or any of the financial cost of repaying the loan is, will or may be borne, or ultimately borne, by any other person."

128. The FTT found, in [471]-[479], that clauses 20.5 to 20.7 of the Partnership Deeds satisfied condition 1. Those clauses provide that if a partner ceases to be UK resident then that partner "shall in consideration of the payment by the Managing Partner of a sum equal to the outstanding amount of the loan [from the Facility Bank] transfer and assign to the Managing Partner" his partnership share. The FTT held that regulation 4 requires the question of how much of the financial cost of repaying the loan may be borne by another person to be considered at the end of the relevant year of assessment and not merely at the time that the arrangement was entered into. The FTT held that, as the value of the partner's share was the value of the right to receive future rentals and the present value of that right depended on interest rates at that time, a change (increase) in interest rates in any year of assessment after the arrangements had been entered into would mean that the value of the share could be less than the outstanding amount of the loan. To that extent, the managing partner would bear the financial cost of repaying the partner's loan. As there was no evidence of the relevant interest rates, the FTT was not able to determine whether regulation 4 applied and, if so, what amount should be excluded in calculating the partner's contribution to the partnership.

129. Mr Furness submitted that the value of the partnership share that is transferred to the managing partner is no less than the value of the unpaid rentals. The FTT found at [45(14)], that "the Partners' loans and interest thereon were discharged from the rental payments emanating from the Haiku deposit". Mr Furness contended that the value of the partnership share was equal to the value of the outstanding loan and it followed that the managing partner would never bear the cost of repaying the loan. If that was not the correct analysis then Mr Furness submitted that the FTT were correct

to hold that the contribution should be limited to the extent that the managing partner would bear a cost equal to the difference in value between the partnership interest and the loan as calculated at the end of the year of assessment and not applied to the whole of each partner's loan. He contended that, on any view, the managing partner could only be liable to pay part of the loan and not the whole of it.

130. Mr Tallon submitted that where a partner, who had borrowed money to finance his contribution to the partnership, became non-resident then the loan was repaid by the managing partner of the relevant partnership. That meant that condition 1 was satisfied and, as a consequence, the whole of the loan must be disregarded when computing the amount of the partner's contribution to the trade.

131. The effect of regulation 4 of the 2005 Regulations is that where a non-active partner has borrowed money to fund his contribution to a trade and all or any of the financial cost of repaying the loan is or will or may be borne by another person then the amount of the partner's contribution is reduced by the amount of the cost borne by the other person. The FTT considered that the position had to be considered at the end of the relevant year of assessment. We agree. The words "at the time in question" in regulation 4(2) must mean the time when section 118ZE of ICTA applies. Section 118ZE applies "at the end of that year of assessment", ie the year for which loss relief is claimed.

132. The issue, in this case, is whether, at the relevant time, the partnerships were or might have been liable to bear any part of the cost of repaying the loans to the partners. Clause 20.5 of the Partnership Deeds provides that where a partner ceases to be UK resident then the partner will transfer his partnership share to the managing partner in return for payment of an amount equal to the outstanding amount of that partner's loan from the Facility Bank. The practical effect is that the managing partner pays to the outgoing partner the outstanding amount of his loan (A) but receives the outgoing partner's right to receive his share of future rentals (B) in return. The FTT held that if, at the end of the relevant year of assessment, interest rates had increased then the value of B (the right to receive future rentals) could be worth less, in present terms, than A (the outstanding amount of the loan).

133. The first question is whether Mr Tallon is right that, in such a case, the managing partner is bearing the full cost of A. It is not clear if this was argued before the FTT (see at [472] where the FTT record the argument put forward by Mr Yates for HMRC in this context as being that the managing partner bears part of the financial cost of the loan to the extent that the value of B falls short of A at the time of the sale); but, in a different context, the FTT said that they did not regard the fact that someone may pay an amount as indicating that he bears the cost associated with that payment: to their minds a person bears a cost if his net assets are diminished as a result: see at [485]. We agree, and therefore reject Mr Tallon's submission that the fact that the managing partner pays A means, without more, that it bears the cost of A. The cost that is borne by the managing partner is not what he pays: the cost is the difference between what he pays and what he receives.

134. That leaves Mr Furness' submission that there is never a cost borne because the value of B is always equal to A. We reject this too and agree with the FTT's analysis on this point. The analysis applies even though the rentals paid from the Haiku deposit were sufficient to meet the partners' obligations to pay the principal and interest in relation to the loans by the Facility Bank. In the case where an outgoing partner leaves, the managing partner actually pays out A. What he receives back is B, the right to future rentals. If interest rates have increased beyond the rate applicable to the Haiku deposit from which the rentals are paid then the present value of the future rentals at the end of the relevant year of assessment could be less than the outstanding amount of the loan. Accordingly, the managing partner could be required to pay an amount (the amount of the outstanding loan) which exceeds the value of the asset (the right to future rentals) acquired. Although the rentals are fixed and are sufficient to repay the loan, at the relevant time, the managing partner has funded the financial cost of repaying the loan to the extent of the difference in value between the outstanding amount of the loan and the future rentals.

135. Mr Tallon in his written submissions also challenged the FTT's decision that a charge over the partnership assets (given by each partnership to the Facility Bank) did not engage condition 1 of regulation 4: see the Decision at [480]-[488]. We received no separate oral submissions on this which seems to us to stand or fall with the proposition that if a person pays a loan he bears the full cost of doing so even if he receives corresponding assets in return. We have already rejected this contention and for the same reason dismiss this aspect of HMRC's criticism of the FTT's decision.

Proteus relevant period

136. Section 138(6) of ITTOIA provides that, where the relevant period is less than 12 months, the amount of acquisition expenditure that may be allocated to that period is reduced proportionately. Section 133 of ITTOIA defines "relevant period" as a period of account of the trade or, if no accounts of the trade are drawn up for a period, the basis period for a tax year. Section 832(b) of ICTA defines "period of account" as follows:

> "(b) in relation to a trade, profession, vocation or other business means any period for which accounts of the business are drawn up;"

137. The issue for the FTT was whether the amount of acquisition expenditure that could be allocated to Proteus' commencement period was reduced by section 138(6) because the relevant period was less than 12 months. The FTT held, in [498], that the "period for which accounts of the business are drawn up" could not include any time when the business, ie the trade, was not being carried on. The FTT decided, in [499], that, as Proteus started trading (assuming there was a trade) after 6 April 2005, any period of account had to start after that date. It followed that the accounts drawn up by Proteus for the 12 month period to 5 April 2006 were not accounts of the trade. The FTT concluded that, as no accounts of the trade had been drawn up for the period from commencement of the trade until 5 April 2006, the relevant period was the basis period for the tax year determined by section 199 of ITTOIA which was a period of

less than 12 months. Accordingly, the amount of expenditure that could be allocated to that period must be reduced proportionately by section 138(6).

138. Mr Furness accepted, for the purposes of this point, that the FTT had found that the trade, if there were a trade, started in December 2005. He submitted that the FTT erred in law when they decided that the period for which Proteus drew up its accounts could not begin before it had started trading. He contended that "period of account" in relation to a trade meant any period for which accounts of the business are drawn up. The use of the word "business" in the definition was significant because "business" has a wider meaning than "trade". He contended that the accounts drawn up by Proteus for the 12 months to 5 April 2006 were accounts for a period that included commercial activity, ie a business, that did not amount to trading until December 2005. He submitted that, in those circumstances, the accounts for the 12 months to 5 April 2006 were accounts for a business within section 832(b) of ICTA even though Proteus was not trading throughout that period.

139. Mr Tallon submitted that the FTT reached the right conclusion for the right reasons which are set out in the Decision.

140. We agree that the FTT was correct on this issue for the reasons they gave. The "period of account" in relation to a trade is defined in section 832(b) of ICTA as "any period for which accounts of the business are drawn up". We agree with Mr Furness's proposition that all trades are businesses but not all businesses are trades but when section 832(b) uses the word "business" for the second time that is not a broadening of the section. It is a reference to whichever of "trade, profession, vocation or other business" is appropriate and, in this case, that is "trade". We consider that the interpretation for which Mr Furness contends lacks logic. It amounts to saying that a period when a business existed but before it started trading must be regarded as a period of account for the trade simply because the accounts are drawn up to cover the pre-trading period. As Mr Tallon suggested, that introduces an element of arbitrariness to the definition of period of account.

Fees paid to Future

141. The FTT found, in [383], that finding a film and identifying the parties to the sale and leaseback were for the enduring benefit of the trade and, accordingly, costs relating to those activities were expenses of a capital nature. The FTT also found that expenditure on leasing the films was not expenditure on their acquisition and so section 134 did not apply to treat it as expenditure of a revenue nature.

142. Mr Furness contended that the FTT erred in law when they failed to categorise the costs incurred in identifying a lease party and negotiating the lease as revenue in nature on general principles. Mr Furness submitted that those costs should be regarded as revenue expenses because they were costs incurred in exploiting the asset by making it income producing. Mr Furness drew an analogy with a person carrying on a widget manufacturing business. The purchase of a machine to manufacture widgets would be a capital expense because, as the FTT observed at [380], the one-off purchase of an asset for the enduring benefit of the trade will invariably be considered

as capital expenditure. Mr Furness contended, however, that costs incurred by the widget manufacturer in obtaining orders for the widgets, which the machine produces, and negotiating the contracts for their sale are a revenue expense of the trade. He submitted that expenditure related to the use of an asset to produce income ought, in principle, to be a revenue expense and not a capital expense. The costs of finding a lessee and negotiating the lease were, similarly, costs of exploiting a trading asset, namely the film, by producing income, namely lease rentals, from it. Mr Furness contended that those costs should be allowed as revenue in nature on general principles.

143. Mr Tallon submitted that the FTT were correct to regard the costs of identifying a lessee and negotiating the lease as capital in nature because they related to a composite sale and lease back transaction. There were no separate negotiations with separate parties: all of the expenses were incurred as part of the cost of the sale and leaseback transaction.

144. Like the issue of whether an activity is trading or investment, whether an expense is revenue or capital is a mixed question of fact and law. Mr Furness did not suggest that the FTT had misdirected themselves in law but that they had wrongly categorised the costs of finding a lessee and negotiating the lease as capital expenditure. The Appellants' appeal on this point can only succeed if they can show that the only true and reasonable conclusion that the FTT could have reached on the facts found by them is contrary to their determination. In our view, the Appellants have not done so. The FTT found, in [383]-[384], that identification of the leaseback counterparty and negotiation of the lease was part of the sale and leaseback of the film which was the only activity of the business. The activity involved the purchase of one or two films that were immediately leased to a person that had already been identified. It did not involve the buying and selling of assets. The costs of finding a lessee and negotiating the lease were not recurrent, as might be expected of revenue expenses, but produced an asset of enduring benefit to the trade, namely the lease under which the partnerships obtained income for a period of 15 years. The FTT concluded that, in the circumstances, the expenditure was capital in nature. We consider that the FTT were entitled to come to that conclusion. The example of the widget manufacturer is not analogous to the situation of the partnerships in this case. The manufacturer did not buy the widget-making machine with a guaranteed income from sales of widgets over 15 years. The manufacturer would have incurred recurrent costs in obtaining orders for widgets and buying materials from which to manufacture them. That was not the situation in this case. The expenses were all incurred at the outset. The costs of the acquisition of the asset and its lease were all part of a single transaction. The partnerships acquired assets that came with a commitment by the seller to take a leaseback for the next 15 years. In our view, the FTT were entitled to conclude that, in those circumstances, the costs of identifying the lessee and negotiating the lease were capital in nature.

145. The FTT also concluded, in [424], that they could not find that the whole of the fee paid by Proteus to Future was incurred wholly and exclusively for the purpose of the trade because the FTT considered that the fee paid was more than twice the amount due; the amount of the fee was in reality decided by Future rather than

negotiated; and the fee was paid for arrangements that had already been put in place so there was no need to pay for them. The FTT found that 7/9ths of the fee could be related to amounts payable by Future for legal and banking fees and so those would have formed part of any negotiated fee. The FTT found that the balance was paid for structuring and was not for the purposes of the trade.

146. Mr Furness submitted that the FTT's conclusion was based on their mistaken view that the fee paid by Proteus to Future was more than twice the amount due. At [420], the FTT state "the fee paid was twice the amount due: the words 'approximately 9%' do not extend in our view to 'over 20%'." The Proteus business plan stated that Future would be paid a fee of approximately 9% of partnership capital. At the time that the partners subscribed capital to the partnership, there was no agreement for a specific fee only an obligation to pay Future "a fee to be negotiated in good faith within the terms of the Agency Agreement". Mr Furness stated that the FTT appeared to have overlooked the fact that the capital was contributed in three tranches. Although the fee was more than 20% of the first tranche of capital, Mr Furness stated that the fees paid to Future represented 9.2% of the capital contributed to the partnership over the first three years. He submitted that a fee of 9.2% of the capital raised was in line with the Proteus business plan and was entirely reasonable and the FTT should not have concluded that it was excessive.

147. Mr Tallon submitted that Proteus had overlooked the fact that, in [425], the FTT said that 2/9ths of the fee, which was not found in the fee paid by Samarkand, related to structuring to accommodate changes in the relevant tax provisions. He contended that the FTT's conclusion was one that they were entitled to reach.

148. We accept Mr Furness's submission that the FTT appear to have been mistaken in their conclusion that the fee paid by Proteus was double the amount agreed. However, that was not the only reason that the FTT concluded that not all of the fee was paid for the purpose of the trade. The FTT gave three reasons in [420]-[422]. The first was that the fee was twice the amount due which we accept was not correct. The second was that there was no evidence that the fee had been negotiated in good faith. The FTT concluded that Future decided what amount was to be paid as a fee and Proteus simply accepted it. The third reason was that Future got a greater fee because of the special 3 year structure that it brought to the deal. The FTT had found, in [381], that the expenses in relation to structuring, in relation to Proteus in particular, might be said to be capital in nature and, in [398], that expenditure related to the structuring of Proteus was not expenditure on the acquisition of the film. At [407], the FTT apportioned 20% of the fee Proteus paid to Future to structuring. Comparing the fee paid by Samarkand, which did not involve such structuring, with the fee paid by Proteus, the FTT found, in [425], that the difference (2/9ths of the fee) was paid by Proteus to Future for structuring and was not paid for the purposes of the trade. In our view, the FTT was entitled, on the basis of the evidence and for the second and third reasons that they gave, to conclude that 2/9ths of the fee paid by Proteus to Future related to structuring and was not paid for the purposes of the trade.

Conclusion on the tax appeals

149. For the reasons we have given, we dismiss the tax appeals.

Judicial review

150. The taxpayers' judicial review claims are founded on the contention that HMRC has sought to deny tax relief to the transactions on a basis that is entirely at odds with HMRC's published guidance (in successive editions of the BIM) and its settled practice. Their case is that the BIM and HMRC's settled practice contained assurances that HMRC would allow claims for relief in certain circumstances, that the taxpayers had a legitimate expectation that HMRC would act in accordance with those assurances and that HMRC has wrongly departed from the assurances by denying relief. They also contend that HMRC's conduct is so conspicuously unfair as to amount to an abuse of power.

Doctrine of legitimate expectation

151. The doctrine of legitimate expectation is well established in public law and although we were referred to a number of authorities there was no significant dispute between the parties as to the law. For a convenient summary of the principles we were referred to the statement by Leggatt J in *R (GSTS Pathology LLP & Ors) v Revenue and Customs Commissioners* [2013] EWHC 1801 (Admin) at [72]-[73] as follows:

> "72 The principle that legitimate expectation should be protected is now well established as a ground for judicial review. For this principle to apply, the general requirements are: (1) the claimant has an expectation of being treated in a particular way favourable to the claimant by the defendant public authority; (2) the authority has caused the claimant to have that expectation by words or conduct; (3) the claimant's expectation is legitimate; (4) it would be an unjust exercise of power for the authority to frustrate the claimant's expectation. Although it has sometimes been said to be a requirement also that the claimant has relied to its detriment on what the public authority has said, the law now seems to be clear that such detrimental reliance is not essential but is relevant to the question of whether it would be an unjust exercise of power for the authority to frustrate the claimant's expectation (see, eg, *R (On Application of Bancoult) v Secretary of State for Foreign & Commonwealth Affairs (No 2)* [2009] AC 413 , paragraph 6, per Lord Hoffmann).
>
> 73 As originally developed, the doctrine protected legitimate expectations of a procedural kind, in other words, expectations that a particular procedure would be followed, for example, that the claimant would be consulted or given a hearing before the public authority takes a decision. But it is also now established that English law will sometimes protect a substantive legitimate

> expectation, that is an expectation that the claimant will receive a particular substantive benefit. One area in which that principle is clearly recognised is tax law. It is well established that a taxpayer who receives a ruling from HMRC as to the application of the law to his or her particular case may acquire a substantive legitimate expectation to be taxed according to that ruling."

152. Leggatt J refers to a "ruling" from HMRC because that was the position in the case before him; and in *R v IRC ex p MFK Underwriting Agencies Ltd* [1989] STC 873, Bingham LJ said (at 892c-h) that where a taxpayer relied on such a ruling it should be "clear, unambiguous and devoid of relevant qualification." That was also in the context of a taxpayer approaching the Revenue for a ruling on a specific proposed transaction, but in *R (Davies) v Revenue and Customs Commissioners* [2011] UKSC 47 the Supreme Court held that it equally applies to a case where the taxpayer relies on statements formally published by HMRC to the world (in that case a booklet, IR20, on residents and non-residents): see per Lord Wilson at [29]. He said:

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

153. In the present case, the taxpayers rely on statements in the BIM. Unlike IR20 this is not a booklet written with the primary aim of giving guidance to taxpayers: it is an internal manual containing guidance for HMRC staff. But it has for some years been the practice of the Inland Revenue, and subsequently HMRC, to make such manuals available to the public generally (and they are now available online). Mr Rounding refers to an Inland Revenue Code of Practice on Information and Advice dating from 1999 which said:

> "We publish the internal guidance manuals our staff use. These manuals cover the interpretation of tax law and the operation of the tax system. From the manuals, taxpayers and their professional advisers may gain a better understanding of how we determine tax liabilities and collect tax due."

154. We were also referred to the Introduction to HMRC's Guidance Manuals (which includes the BIM) (**"the Introduction"**) which includes the following explanation:

> "These manuals contain guidance which has been prepared for HMRC staff. It is being published for the information of

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

155. The BIM was designed to bring together in one place the Inland Revenue guidance material on the computation of trading profits for tax purposes. It was first published in complete form in October 2003 (although a section on Film and Audio Products was in fact published before the rest of the BIM in April 2003), and was updated from time to time. Mr Rounding accepts in his evidence that although the BIM was written primarily for HMRC staff, it is also intended to assist customers and their professional advisers. In these circumstances Mr Swift QC, who appeared with Ms Clement for HMRC on the judicial review, did not dispute that the principles set out in *MFK* and *Davies* apply to statements in the BIM, while drawing attention to the requirement (referred to by Lord Wilson in *Davies*) that the statements in the BIM must be read as a whole.

156. Reverting to Leggatt J's summary of the principles, we add three further comments. First, it can be seen that he refers to the public authority having caused an expectation "by words or conduct." In the present case the taxpayers rely not only on HMRC's words in the form of statements in the BIM, but as already mentioned also on HMRC's conduct, in the form of what they say was its settled practice in dealing with claims for tax relief by film partnerships. We will revert to this below after considering the case based on the statements in the BIM.

157. Second, Leggatt J refers to the requirement that the claimant's expectation is legitimate, without further explanation. We received some submissions on what this requirement consists of, from which it appears that the force of the word "legitimate" is that the expectation is one that has consequences to which effect will be given in public law: see the explanation given by Lord Diplock in *Council for Civil Service Unions v Minister for Civil Service* [1985] AC 374 at 408H-409A for preferring "legitimate" to "reasonable", with which Lord Fraser expressly agreed at 401C; and *R v Secretary of State for Education and Employment ex p Begbie* [2000] 1 WLR 1115 at 1125C per Peter Gibson LJ:

> "But the question for the court is whether those statements give rise to a legitimate expectation, in the sense of an expectation which will be protected by law."

From this, one can no doubt safely conclude that the law will only protect an expectation if the law regards it as a legitimate one, but it does not tell one much, if anything, about what type of expectations the law will regard as legitimate.

158. Third, Leggatt J refers to it being a requirement that it would be an unjust exercise of power for the authority to frustrate the claimant's expectation. Abuse of power has been described as the root concept governing general principles of public law (per Laws LJ in *Begbie* at 1129F), and it is established that even in cases where a clear, unambiguous and unqualified representation has been made, a departure from the representation may be justified (and hence not abusive) by an overriding public interest: *Begbie* at 1131B per Laws LJ, *R (Bancoult) v Secretary of State for Foreign and Commonwealth Affairs (No 2)* [2008] UKHL 61, [2009] 1 AC 453 at [60] per Lord Hoffmann. In the present case, Mr Swift relied on such an overriding public interest, although very much as a fallback to his primary submission that the necessary quality of representation could not be found in the BIM.

The BIM

159. With that introduction, we can now refer to the particular parts of the BIM relied on by either side. Mr Furness addressed his submissions by reference to the 2006 version of the BIM, which was the one in force at the time of the Samarkand transactions. The version in force at the time of the Proteus transaction was in fact an earlier version dating from 2005 and, in at least one respect, was significantly different in that it did not contain the "plain vanilla" example referred to below. But neither party suggested that the outcome of the judicial review turned on any differences between the two versions and Mr McAndrew (the officer of HMRC who investigated both Proteus and Samarkand) in fact worked from the 2006 version in considering both cases. We will therefore consider the 2006 version for the sake of convenience.

160. The section of the BIM dealing with film and audio products starts at 56000. Our attention was drawn to the following passages in particular:

(1) 56015 (history and purpose of relief)

> "In 1982 plant and machinery was subject to a 100% first year allowance. So all expenditure on the master versions of films and audio products could be written off immediately, which gave rise to substantial tax avoidance. To prevent this legislation was introduced in 1982…
>
> The purpose of these reliefs [ie s. 42 Finance (No 2) Act 1992 and s. 48 Finance (No 2) Act 1997] is to encourage investment in qualifying British films with the aim of building a profitable and self sustaining industry. While the reliefs have contributed to a significant increase in the number of British films since 1997, the accelerated relief of expenditure is rarely accessed directly by the producer as the producer has no immediate income to set the relief against. Instead the reliefs are usually accessed through

third party financiers (banks or partnerships of wealthy individuals) using tax deferral arrangements involving sale and lease back or production and licence schemes. These schemes allow financiers to use the reliefs to shelter other sources of income from tax while deferring taxable income from the film, thus creating a tax advantage. Unfortunately this has been accompanied by a considerable amount of tax avoidance, where the reliefs have been used in ways that were not intended.

Since 1997 a number of new measures have been introduced to tackle tax avoidance using the film reliefs. The main measures are listed below…

FA04 – prevented individuals who had used the film relief to obtain a tax deferral from turning this into an outright gain ('exit charge') …

FA05 – prevented groups of companies who had used the film relief to obtain a tax deferral from turning this into an outright gain ('exit charge')…"

(2) 56305 (deductions for qualifying British films: overview)

"In practice the reliefs for qualifying films are rarely accessed directly by film producers themselves, but are usually claimed by financial intermediaries (for example, banks or partnerships of wealthy individuals) using sale and lease back or production and licence schemes. The involvement of these third party financiers has been accompanied by a great many complex and artificial tax avoidance schemes, based on the tax reliefs for qualifying British films."

(3) 56325 (write-off over three years: overview)

"There is often an interval between the completion of a film and its release during which no relief for expenditure is due under either the income matching or cost recovery methods. Section 42 was intended to be more beneficial by allowing a producer to begin to write off expenditure as soon as the film had been completed and trading had commenced, at a rate of one third of the cost each year. In practice, this deduction is rarely of direct use to the producer, who has no income to set it against. Instead, the relief is usually accessed by selling the master version of the film to a third party which does have taxable income to shelter (usually a bank or partnership of wealthy individuals, and sometimes an associated company), and leasing the film back over a period of 15 years. Unfortunately this has been accompanied by extensive tax avoidance."

(4) 56330 (write-off over three years: basic rules)

"To deduct expenditure under Section 42 a person must be carrying on a trade or business that consists of or includes the exploitation of films."

(5) 56380 (write-off where production expenditure is £15m or less)

"Section 48 piggy backs on Section 42 … and the underlying requirements for Section 48 relief are the same as for Section 42."

(6) 56405 (tax deferral schemes for qualifying films: overview)

"The accelerated deductions for qualifying British films at F2A92/S42, F2A97/S48 and ITTOIA/S138 to 140 are rarely accessed directly by film producers. Instead, producers usually obtain a cash benefit from the reliefs indirectly through arrangements with third party investors, who are usually partnerships of wealthy individuals or subsidiaries of banks, and who have taxable income to shelter.

The most common arrangements are sale and lease back schemes, although other schemes have also been marketed which purport to achieve a similar effect through production and licence arrangements. The schemes enable third party investors to defer their tax liabilities for up to 15 years in return for making an investment in films. Broadly the schemes work by the investor incurring expenditure on the acquisition (or production) of the master version of a film and then leasing (or licensing) the film back to the film producer or a distributor for up to 15 years, with the lease rentals (or licence fees) providing an income stream which is spread over this period. The investor obtains the benefit of a relievable loss through the accelerated deduction, which it uses to shelter other income and gains from tax.

The investment is usually funded by cash (of an amount proportionately less than the marginal tax rate of the investor) and a secured loan. The producer has to provide security for the loan – usually by making a balancing deposit. The producer is able to keep the difference, less arrangement and administration costs, between the security deposit and the amount paid for the film. The investor obtains a cash flow benefit after claiming loss relief, but must pay tax on the income stream, which also has to be used to repay the loan – the net result being a deferral of tax, which is financially equivalent, from the investors perspective, to a low interest loan over the period of the lease or licence…

The remainder of this chapter looks at the tax treatment of these arrangements, and highlights particular avoidance issues to look out for."

(7) 56425 (tax deferral schemes for qualifying films: security arrangements)

> "In film sale and leaseback tax deferment schemes, the lessee is often required to place sufficient funds on deposit with a bank to guarantee, and pay, the lease rentals over the period of the lease. Where the third party lessor is a partnership of wealthy individuals, those individuals normally take out a loan to fund the lion's share of their investment in the film partnership, and those loans are usually secured on the lease rentals. Indeed normally the bank lending to the partners will take a charge over the lease income that the partnership receives, and this is used to pay off the individual loans of the partners. However the rentals/licence fees are nonetheless the taxable income of the partnership, and the individual partners must pay tax on their shares of the income. It is in this way that the Exchequer recoups the tax which the partners have deferred."

(8) 56430 (tax deferral schemes for qualifying films: terms of lease or licence)

> "Film sale and finance leaseback arrangements are tax deferral schemes. In these schemes the tax benefit to the investor from the expenditure arises in either the first year or the first three years following the investment, whereas tax arising from the lease arises in later years. In most schemes most or all of the income arising under the lease is guaranteed irrespective of whether the film is successful or not, and (providing there is no avoidance) the future tax liability is similarly guaranteed…
>
> In practice we have normally accepted lease periods of up to 15 years … with an annual escalation of lease rentals of up to 5%."

(9) 56445 (tax deferral schemes for qualifying films: exit schemes)

> "A number of complex avoidance schemes have been designed to enable investors (both individual partners and groups of companies) to 'exit' from the schemes, so turning a tax deferral into an overall tax gain….
>
> 'Exit' is a generic term to describe any set of arrangements whereby an investor obtains the benefit of loss relief (or a tax deduction) through using the film tax reliefs which becomes greater than the amount which is actually lost. Although specific rules were introduced to counter this in FA04 and FA05, we have successfully challenged some exit schemes before this. It is important to continue to monitor the returns of any individuals or companies that have benefited from film tax reliefs. Cases should be referred to Anti-avoidance Group (Films) where:
>
> an individual who has claimed losses from a film partnership or trade ceases to show taxable income, or shows reduced income, from that partnership or trade…
>
> a film partnership claims to be, or becomes, non-resident."

(10) 56455 (tax deferral schemes for qualifying films: partnership example) – this is the so-called “plain vanilla” example.

> “This example is illustrative of a sale and leaseback arrangement which accesses relief for qualifying British films to obtain a tax deferral. The example is for a partnership using films costing less than £15m to produce to which F2A97/S48 or ITTOIA/S140 … applies, although partnerships can and do fund more expensive films to which F2A92/S42 or ITTOIA/S138A … applies…
>
> The example is simplified to show the key elements of what is often described as a ‘plain vanilla’ sale and leaseback scheme, although particular details and amounts may vary on a case to case basis. We do not give pre-clearance on any film schemes, and, owing to the high prevalence of tax avoidance involving film schemes, each case should be examined carefully on its own facts. The experience of Anti-Avoidance Group is that schemes that depart radically from the structure described, and in particular are more complex, are likely to carry a high risk of tax avoidance.
>
> (1) A film production company (C) spends £10m on making a film, which is then certified as a qualifying British film.
>
> (2) C sells the master version of the film to a partnership of wealthy individuals (P) for £10m.
>
> (3) P immediately leases all the rights in the film back to C for a period of 15 years.
>
> (4) Lease rentals are payable by C to P over the period of the lease on an annual basis. C may taper these lease rentals slightly so that less is payable in the early years, and more towards the end of the lease, provided the rentals increase by no more than 5% each year.
>
> (5) In order to secure the lease rentals, C places about 82% of the £10m it has received for the sale of the film on deposit with a bank. It keeps about 14% (which is usually used to pay off loans taken out to make the film) and gives about 4% to the scheme organiser.
>
> (6) C has a taxable receipt from sale of the film of £10m. However, under F2A92/S40B it is able to set off all the costs of production against this disposal; - generating neither a profit nor a loss. It should be noted that the treatment in the accounts of C may be radically different from the tax treatment and full tax computations to reflect this are required.
>
> (7) C is able to set the lease rentals that it must pay as a deduction against any income it receives from exploitation of

the film. It is important to note that any grants or subsidies received by C towards the cost of making the film will be taxable receipts, as will any pre-sales received.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(11) 56505 (avoidance: overview of what to look out for)

"These reliefs give a fixed and accelerated deduction for expenditure and are normally accessed through tax deferment schemes… A large number of investment schemes have been set up which use these reliefs legitimately in the way that they were intended, and have led to substantial increases in the numbers of British films produced. Unfortunately, in parallel to this a very aggressive tax avoidance industry has developed, which has devised a large number of artificial schemes based around expenditure on films, and which has required substantial amounts of anti-avoidance legislation, principally in FA02, FA04 and FA05…

We believe that these measures should be effective in stopping most avoidance activity in the film industry. However, tax avoidance can be a very lucrative business for those devising schemes – even where the schemes do not work under law – and we are aware that new avoidance schemes are still being devised and marketed.

Most film tax avoidance falls into one of two broad categories:

Tax gain. In film tax deferral schemes the overall effect once the scheme has unwound is that overall the investor receives tax relief on losses equal to the actual amount that he has lost. In tax avoidance schemes such as the exit schemes…a tax gain is achieved by either attributing greater amounts than actual losses to the investor or by reimbursing the investor for expenditure in a non-taxable or capital form…

If you come across any film schemes or arrangements where you think that tax avoidance of any description is apparent, and which are not covered elsewhere in this guidance, you should make a report outlining the facts of the case to CT&VAT (Technical).

A dedicated nation-wide film team under the auspices of Anti-Avoidance Group has also been set up to deal with film partnerships. If you receive details of a film partnership that is not already dealt with by the film team or you need to make a report on a partnership you should notify Anti-Avoidance Group (Films)…"

(12) 56605 (avoidance: individual exit schemes)

"We have also learnt that schemes are being marketed for non-domiciled individuals which purports to avoid the legislation. If you come across such a scheme a report should be made to Anti-avoidance Group."

161. Although these are quite extensive extracts, they form only a small part of the section of the BIM dealing with film and audio products (which extends from 56000 to 56725), and this is itself only a small part of the BIM. But they suffice to indicate the general nature of the guidance in the BIM. It is, as they show, addressed to staff of HMRC to explain what to look for when considering a claim for tax relief in relation to films. At various points, the staff are invited to refer schemes with particular features to Anti-Avoidance Group or to CT&VAT (Technical): there are many other examples of this in the parts we have not cited such as where the acquisition price of a film appears to be artificially inflated (56335), where the same film has been used to access relief more than once ("double dipping") (56360, 56365, 56375), where schemes use production and licence arrangements (56405, 56455), where sums claimed to have been paid by the taxpayer are returned directly or indirectly to them (56520), and where schemes involve other features such as partnership loss manipulation, transfer pricing, licence exploitation or guaranteed income (56525 to 56575).

What representations did the BIM contain?

162. Mr Furness submitted that five key representations could be derived from the BIM, as follows:

> (1) You as a taxpayer will not lose the tax relief just because your objective is to access the relief.
>
> (2) HMRC will not take the point that you are not trading just because you have taken no risk because of the guarantee arrangements.
>
> (3) HMRC will not take the point that an activity is not trade or is not carried on commercially simply because of the net present value point.
>
> (4) HMRC accepts that tax benefits to partners can be taken into account in assessing the commerciality of the trade.
>
> (5) HMRC accepts that a single transaction partnership will not fail to be trading merely because it has no trading activity.

163. These representations need to be looked at with some care. The BIM is not primarily addressed to taxpayers at all, and does not set out to tell taxpayers what points will or will not be taken. What it sets out to do is tell HMRC staff how to apply the legislation. We entirely accept, of course, that it is also published to the world, with the intention that taxpayers and their professional advisers "may gain a better understanding of how we determine tax liabilities"; but that understanding, as Mr Swift submitted, cannot be found by picking out particular statements in the BIM and treating them as a definitive statement of what points HMRC will or will not take in all circumstances. It is necessary to have regard to the relevant parts of the BIM as a whole.

164. We can pass over representation (1). In effect, it seeks to prevent HMRC from arguing the *Lupton* point, but although HMRC argued the *Lupton* point both before the FTT and us, it was always a fallback point and the FTT decided that it was unnecessary to consider it. We have agreed: see paragraphs [88]-[89] above.

165. We also put on one side representation (5). Mr Furness said that it can be found in the BIM, pointing to the plain vanilla example which he said appears to contemplate that the partnership has no other business (see step (9) which refers to the partnership having no overheads). The introduction to the plain vanilla example, however, refers to the partnership "using films costing less than £15m to produce" which does not suggest a single transaction partnership. Mr Furness also said that it was inherently likely that special purpose partnerships would be formed for the purpose of accessing the relief; and that the use of special purpose partnerships represented current industry practice. Both of these latter statements may be true, but that does not change the nature of the representations made in the BIM. We are not persuaded that anything is said in the BIM about single transaction partnerships as such. The whole of this section of the BIM is subject to 56330 which says that a person must be carrying on a trade or business to access section 42 relief (and 56380 which says that the same applies to section 48 relief); and extensive general guidance as to what constitutes a trade is given elsewhere in the BIM (in 20000 onwards). We were not referred to this part of the BIM but Mr Rounding describes it as containing,

as one would expect, an overview of trading principles, an outline of the relevant case law and a statement that all the facts must be carefully considered.

166. That leaves representations (2) to (4) which can be taken together. We accept that the guidance given to HMRC staff is that a scheme can qualify for relief despite the presence of these features. This is, for example, implicit in the treatment of the plain vanilla example at 56455. This is put forward as an example of a scheme which "accesses relief … to obtain a tax deferral" and that description of it, and the detailed analysis of the various steps which follows, show that, in such a case, HMRC are prepared to accept that the scheme is effective and relief can be given, despite the fact that the rentals are secured by the deposit made by the film production company (see steps (5) and (11)); see also the reference in BIM 56425 to the lessee being often required to place sufficient funds on deposit with a bank to guarantee the lease rentals. It is also inherent in the way the plain vanilla example is structured that the net present value of the rentals (secured by deposit of 82% of the purchase price) will inevitably be less than the value of the purchase price; and that, therefore, the only consideration that makes the transaction financially worthwhile for the partners is that they will be able to access and enjoy the relief. Since they can only do this if (i) the partnership is trading and (ii) the trade is being carried on on a commercial basis, we accept that it necessarily follows that this is an example where HMRC accept that the partnership can be trading (see step (9)) and doing so on a commercial basis even though these features are present.

167. What, however, the BIM does not say in terms is that HMRC agrees that it will never take such points. Mr Swift placed particular reliance on that part of the Introduction which says that, although taxpayers could assume that the guidance would be applied "in the normal case", in any case where HMRC considered that there was or might be tax avoidance they reserved the right not to apply the guidance. Then when one comes to the parts of the BIM dealing with film finance reliefs, one finds repeated statements that there has been a great deal of tax avoidance in connection with these reliefs: see for example 56015 ("a considerable amount of tax avoidance, where the reliefs have been used in ways that were not intended"), 56305 ("a great many complex and artificial tax avoidance schemes") and 56325 ("extensive tax avoidance"). This is combined with instructions to HMRC staff to refer possibly contentious cases to specialist teams (CT&VAT (Technical) or Anti-Avoidance Group). He submitted that the overall representation made by the BIM included clear statements that HMRC was concerned that the relief provisions could be used to avoid tax, and that if HMRC considered that avoidance was a possible objective of any particular set of transactions then they reserved the right to scrutinise those transactions closely, and would not necessarily apply the guidance.

168. We accept this submission which seems to us to be undeniably correct.

169. Mr Furness pointed out that the BIM was not said to be by way of concession (which could be withdrawn in a case of suspected abuse); he said it contained HMRC's understanding and interpretation of the law and, in effect, what HMRC were saying was that they would apply one interpretation of the law to taxpayers they approved of but a different interpretation of the law to taxpayers they did not approve

of. That, he said, could not be a reasonable approach. He said that the legitimate expectation which the taxpayers had was that, provided they complied with the essence of what the BIM required and did not depart radically from any of its relevant requirements, then they would have its protection and that HMRC would be restricted simply to taking points where there was a departure from the BIM. So for example if HMRC suspected that the partnerships, or some of the partners, might seek to avoid tax by becoming non-resident, this might enable HMRC to challenge the effectiveness of the schemes on grounds relating to residence, but did not enable HMRC to challenge the schemes on grounds that had nothing to do with it and which they had accepted as acceptable features in the plain vanilla example. But HMRC had nowhere in the appeals relied on the residence or domicile of the partners which were not relevant considerations under the statutory provisions. What HMRC were seeking to do was say "If we don't like some aspect of your transaction then all bets are off".

170. Mr Swift did not dissent from this characterisation of HMRC's position as "all bets are off". He accepted in terms that it did not matter how clear the statements in the BIM were as to how the scheme worked in the plain vanilla case, HMRC were saying that if they thought there might be tax avoidance, they could apply the law as vigorously as they chose, even if that meant arguing for an interpretation of the law which was different from the one that they were prepared to accept in a plain vanilla case. He said it was entirely reasonable for HMRC to say that, in a straightforward case, they would give the taxpayer the benefit of the doubt on various points but, if they thought a scheme was aimed at some form of avoidance, they would feel free to take any point available.

171. But, quite apart from that being a reasonable attitude for HMRC to take, he had a more fundamental answer to the legitimate expectation claim so far as based on statements in the BIM. A legitimate expectation claim depends on the representations that have actually been made, not on representations that might or should have been made but were not. There was no challenge to the legality of the BIM as such. The taxpayers therefore had to take it as it stood, and that included the statement which said that HMRC regarded themselves as free not to apply the guidance in a case where avoidance was suspected. The taxpayers might not like that statement, but they could not say that they derived a legitimate expectation that was at odds with it.

172. We accept this submission. It is clear, and obvious, that the statements in the BIM have to be read as a whole, including any relevant qualification. The taxpayers could not take out the plums they liked and ignore the duff they did not. HMRC made it clear in the BIM that they regarded film reliefs as designed for tax *deferral*: see the repeated references to tax deferral or deferment in 56015, 56405, 56425, 56445 etc and the explanation in 56455 at steps (14) to (22) of the plain vanilla example, which sets out how the initial tax repayment of £20,000 is more than offset by tax on the lease rentals totalling £32,000 which is payable as the scheme unwinds. HMRC also made it clear in the BIM that they regarded film reliefs as having been the subject of a significant amount of tax avoidance. The contrast with the tax deferment for which the reliefs were designed shows what is meant by avoidance in this context: it is, or includes, obtaining the relief upfront but then not paying the tax as the scheme unwinds (see the explanation under "Tax gain" in 56505). One example of such

avoidance was exit schemes where the taxpayer was reimbursed in a non-taxable form (56505). HMRC also made it clear that staff should refer any case where avoidance was suspected to specialist teams. When one combines this with the statement in the Introduction that HMRC would not necessarily apply the guidance in the manuals (including the BIM) to cases where it considered that there was or might have been avoidance, we think the only proper interpretation of the BIM is that in such a case all bets were indeed off. We do not think that it is a reasonable interpretation of the BIM, read as a whole, that even in a case where HMRC decided to challenge a scheme because they thought it might involve tax avoidance, nevertheless they were confined to taking points that were not at variance with the guidance for the normal case. If that was the taxpayers' expectation, it does not seem to us to have been a legitimate one.

Did HMRC (reasonably) think there might be tax avoidance ?

173. As Mr Swift submitted, that in effect means that the next question is whether HMRC did suspect there might be tax avoidance in the present cases and, if so, whether there were reasonable (in the familiar public law sense of *Wednesbury* reasonableness or rationality) grounds for that.

174. The relevant evidence is contained in the first witness statement of Mr McAndrew. He explained that there were a number of features of both Proteus and Samarkand that led him to the view that, in each case, the schemes departed from the plain vanilla model. For Proteus, these were (a) the fact that it was subject to two successive claims (double-dipping); (b) the fact that the lease to Haiku was a lease-on rather than a leaseback; (c) details of the rights in fact acquired and the commercial justification for the price paid; and (d) features suggesting that it planned to migrate from the UK.

175. Mr Furness made the point that to describe some of these features as "radical departures" from the plain vanilla model may seem to be overstating it – a lease-on is not very different from a leaseback for example. But it is not necessary to consider them all in turn. Mr Furness submitted that it was only the offshore features which gave any basis at all for withdrawing the BIM, so we will concentrate on those.

176. Proteus had told Mr McAndrew, in answer to a query, that the partnership was resident in the UK for tax purposes and that "there are no exit arrangements in place". But Mr McAndrew thought that a number of features suggested that Proteus planned to migrate from the UK to allow partners to avoid tax on income. These were that the partnership agreement was subject to Jersey law; a Jersey company was used as its Managing Partner; Haiku was a Jersey company; partners' loan facilities were channelled via the Bank of Ireland in the Isle of Man; and defeasance arrangements for the partners' loans were made with a Bank of Scotland branch in Jersey, with rental payments in fact being made by the Bank of Scotland to the Bank of Ireland and thereby going from Jersey to the Isle of Man without passing through the UK. Those features contributed to his initial suspicion that the arrangements were offshore to allow a later claim that the partnership business was outside what he calls 'the UK tax sphere'. That would amount, in his view, to tax avoidance and hence be a radical departure from the BIM which was concerned with relief on tax deferment schemes.

177. Mr McAndrew's further enquiries did nothing to dispel this suspicion. On the contrary, he refers to various material which strengthened it, namely:

(1) An e-mail chain from April 2005 where when it was proposed to write in a summary for investors that it was:

> "a Jersey based General partnership, which could be especially attractive for UK based Non Domicile investors"

One of the promoters added:

> "don't mention this, it smells of pre-ordained".

And again, where it was proposed to mention that Oliver Twist was a

> "co-venture between Future Films and Jersey based Pegasus who are a firm that specialises in the Non Domicile market"

he had written

> "Do not mention".

(2) An e-mail from April 2005:

> "I don't think Oliver S&L will appeal to domicile investors with the high entry price and hurdle rate. Therefore, will only be relevant for Non Doms … I don't suppose that the Non Doms are too worried by the higher hurdle rate if they are being sold the idea of exporting the Partnership to Jersey after a few years."

(3) An e-mail from August 2005:

> "The loans are offshore as well as the lessee to ensure that any loans repayments are not treated as remittances to the UK and adversely affect the tax advantages the investors might enjoy"

(4) An e-mail from November 2006:

> "… this is to cover off any possibility that the Revenue might contend that the source of Partnership capital together with the application of that capital has affected the offshore tax status of the income flowing into the Partnership. The point is an important one for the tax position of the individual investors who are all non domiciled."

(5) An e-mail January 2006 referring to the possibility of restriction of the uses of losses from the partnership:

> "I think we should discuss on a timeline basis what happens in such scenarios for certain events. For example a migration after three years might cause this problem but a migration after seven may be out of time."

178. Mr McAndrew says that, on the basis of these indications, he concluded that Proteus had been structured for investors to claim relief but then to avoid tax on the later income. In our judgment, there is no reason to doubt that he did consider on the basis of these matters that there might be tax avoidance. Nor do we think his

conclusion could possibly be characterised as *Wednesbury* unreasonable. Indeed, although it is logically irrelevant to this question, his witness statement (made in March 2013) said that he had recently been advised that, in December 2012, Proteus had appointed a new Jersey based managing partner and was then located in Jersey, indicating that the migration he had expected was said to have taken place.

179. So far as Samarkand is concerned, Mr McAndrew again says that he relied on a number of features in his initial assessment, including the fact that it did not acquire the films direct from their makers but, in the case of Irina Palm, from only one of five co-producers and, in the case of The Queen, from a company which was not identified to DCMS as one of the co-producers of the film; the fact that Samarkand had not acquired full rights to exploit the film; the lease-on to Haiku; and, as with Proteus, a number of offshore features which suggested that Samarkand might have planned to migrate from the UK to allow partners to avoid tax on income from the partnership. These were that the partnership agreement was subject to Jersey law; a Jersey company was used as its Managing Partner; the lease was to a Jersey company; and the partners' loan facilities were channelled via the Isle of Man. Further consideration reinforced this suspicion, namely:

(1) An e-mail from October 2005:

> "We would normally want an offshore lessee"

(2) An e-mail from October 2005:

> "I added some language [to an Offer Letter] that would allow us to use an offshore partnership"

(3) An e-mail from August 2006:

> "This obviously depends on raising investor money – which is why I thought we planned to get the I'm *sic* [Information memorandum] out to all the usual Offshore distributors at the start of June."

180. Again, Mr McAndrew says that he considered that these matters indicated that rather than merely seeking the advantage of tax deferral, Samarkand was structured and marketed as an avoidance vehicle primarily for 'non-doms'. Again, we see no reason to doubt that he did consider, on the basis of these matters, that there might be tax avoidance, nor any reason to regard that conclusion as one that could possibly be characterised as *Wednesbury* unreasonable.

181. In reaching these conclusions, we have naturally had regard to the evidence for the taxpayers. This consisted of the following. First, Mr Simon Gough, a solicitor and partner of DLA Piper LLP UK gave evidence of his experience of dealing with HMRC in relation to a large number of film schemes for different clients. His evidence was directed to certain core features of film sale and leaseback transactions which, in his experience, HMRC accepted and would not challenge, such as the use of partnerships as lessors, the economics of the typical transaction with initial losses on which relief could be claimed and subsequent profits on which tax was payable, the fact that the sharing of tax benefits with producers meant that the net present value of

pre-tax cash flows was very likely to be negative, pre-sale agreements and security arrangements. He said that the guidance in the BIM was widely regarded as providing a 'safe harbour' for transactions with these features. None of this in our view was inconsistent with HMRC's position that, in a case where they suspected tax avoidance, they reserved the right not to apply the guidance: indeed, in his explanation of the economics of the typical transaction, Mr Gough himself explained the arrangements as giving rise to a tax deferral with the deferral being reversed over the life of the lease. For reasons we have already given, we do not regard the BIM as giving rise to a legitimate expectation preventing HMRC from not applying such guidance where they reasonably suspected that tax deferment was not the purpose of a film scheme.

182. In his second witness statement, Mr Gough addressed the features relied on by Mr McAndrew, including the offshore features. He said that it was very common to use offshore partnerships; that even though established offshore they would invariably have been managed in the UK so as to be resident for UK tax purposes; that, if asked, he would have advised that it would be difficult to migrate a partnership; that, although he was aware that some partnerships had attempted to do so, this would have no impact on a partner's tax liability if that partner remained UK tax resident and domiciled; and that

> "the only possible benefit would be for a non-domiciled UK resident partner who had elected and paid to take advantage of the statutory remittance rules, and only where the income was not otherwise remitted to the UK."

Far from casting any serious doubt on the reasonableness of Mr McAndrew's conclusion that the film schemes here might have been designed for tax avoidance, this seems to us to illustrate neatly why he was justified in that conclusion. If the schemes were being marketed to non-doms (on the basis that the high hurdle rate made them unattractive to UK domiciled taxpayers) and were so structured that it would be possible for the partnerships to become non-resident and the partnership income to be remitted without passing through the UK, those are precisely the circumstances in which a relief designed for tax deferral could be exploited to avoid tax. The fact now known (albeit with hindsight) that Proteus has indeed migrated to Jersey tends to show that the suspicion was a reasonable one.

183. Evidence was also given by Mr Timothy Levy of Future, again in two witness statements, the first directed to the guidance in the BIM, which Future used as a checklist when putting together their schemes, under various heads (the use of finance leases, partnerships as lessors, loans to partners, lease terms and rental profile, security, valuation of films and pre-sale agreements); and the second dealing with the particular matters relied on by Mr McAndrew. In the latter, he referred to the offshore features relied on by Mr McAndrew which he says were "neither unusual nor necessarily tax driven" and that, since most of the early film sale and leaseback partnerships were Jersey partnerships, he would not have expected HMRC to regard their use as an unusual feature or significant departure from the plain vanilla example. He also said that his understanding was that migrating a partnership was difficult to

do. He confirmed, however, that Future had had its agency agreement with Proteus terminated in April 2012, and that he understood from the Managing Partner that Proteus was currently controlled and managed from Jersey. So far as Samarkand is concerned he said that, as far as he was aware, there were no current plans to migrate Samarkand.

184. Rather unusually, however, for a judicial review, we have the benefit of being able to add to this account in his witness statement some evidence given by Mr Levy under cross-examination in the FTT in which he said:

> "My understanding was that one of the potential opportunities in using Jersey partnerships was that it might be possible for certain types of participant in that partnership to avoid, in future, UK tax on income derived from the fixed lease rentals, in certain circumstances (a) if and when the trade of the partnership in the UK ceased, (b) if there were no remittance to the UK, (c) depending on what the tax rules were at that point in time, and any other relevant factors. And my understanding was that this was something that was talked about by IFAs to their clients as a possible future outcome of the transaction, albeit entirely uncertain."

There are other passages to which we were referred by Mr Swift which are to similar effect. He was asked, for example, whether he thought there was an intention, possibly by the partners, possibly their advisers, that they would take a tax deduction and then seek to escape having to pay tax on the subsequent income stream to which he replied:

> "I think that it would be fair to say that, probably, a number of partners, if they felt they could legitimately do so, would be very keen on identifying that sort of opportunity."

185. There was also a brief witness statement from Mr John Hardy of Matrix Film Finance LLP, another promoter of film schemes. All that he says about offshore features is that the majority of their partnerships were Jersey general partnerships.

186. Again, we do not consider that any of the material in Mr Levy's or Mr Hardy's statements undermines Mr McAndrew's evidence that he considered that the schemes here might be used for tax avoidance, and that this was a conclusion that was reasonable in the public law sense. Taken as a whole, Mr Levy's evidence rather supports the reasonableness of that conclusion than the contrary.

187. In these circumstances, the challenge based on legitimate expectations derived from the BIM, in our view, fails.

188. That makes it strictly unnecessary to resolve a matter on which we heard argument, namely whether HMRC should have permission to adduce a second witness statement of Mr McAndrew's dated 16 May 2014. This was served by HMRC on the taxpayers' solicitors on that day, just over a month before the hearing

began. Mr Furness objected to its introduction on the grounds that there was no provision in the directions that had been given for the service of another round of evidence, that it came very late and without prior warning, that much of it was argumentative, and that his clients had had no real opportunity of dealing with it. We were invited to look at it on a provisional basis. Among other things, Mr McAndrew refers to some other documents which were before him when he made his decisions. This material seems to us to be both relevant and potentially helpful and, since the documents were the taxpayers' own documents (and had been in evidence before the FTT), we do not regard it as putting the taxpayers at any significant disadvantage. In fact, the material concerned did not advance matters very much, although we note that, among other matters, Mr McAndrew refers, in relation to Samarkand, to the marketing pack for investors being described as "our offshore sale and leaseback offer" (and the fact that, in the event, all of the members were non-domiciled) and to the hurdle rate being between 5.61% and 5.99% which he described as making the economics unattractive to investors domiciled in the UK. It seems to us that there is no unfairness in admitting this material and we will do so, although as already said it does not change the view we had come to without it.

Settled practice

189. We can take this quite shortly. It is not disputed that a legitimate expectation can arise from conduct as well as from words and that, in a case where a public body has adopted a settled practice, that can amount, in effect, to a representation by conduct, what Mr Swift referred to as actions as a proxy for words. But such a practice must be:

> "… so unambiguous, so widespread, so well established and so well recognised as to carry within it a commitment to a group of taxpayers … of treatment in accordance with it."

(*R v Davies* [2011] UKSC 47,[2011] 1 WLR 2625 at [49] per Lord Wilson).

190. In the present cases, what the taxpayers relied on were the statements of Mr Gough, Mr Levy and Mr Hardy that HMRC had accepted, as qualifying for relief, numerous schemes with features which are here relied on to challenge the granting of relief. But Mr Furness accepted that the settled practice he relied on in this case reinforced his submissions about the BIM: he was not suggesting that settled practice without the BIM would be enough. This was, in our view, a realistic position and if, as we have, we have rejected the claim based on the statements in the BIM, we do not think the taxpayers can get any further forward by relying on the practice.

191. To take an example, we have accepted that it is implicit in the plain vanilla example in the BIM that HMRC, in such a case, was prepared to accept that the fact that the net present value of the lease rentals was less than the price paid for a film did not, by itself, mean that the partnership was not being carried on on a commercial basis. However, we have found that HMRC was not bound to apply the same approach in a case where they (rationally) suspected that a scheme might be being used for tax avoidance rather than tax deferment. The practice on which the taxpayers rely is, among other things, the practice of HMRC allowing relief on schemes without taking the net present value point. But, in the light of our conclusions on the BIM,

how can this, any more than the plain vanilla example, preclude HMRC from taking the point in a case of suspected avoidance? It seems to us an inevitable conclusion that HMRC's practice cannot put the taxpayers in any stronger position than the statements in the BIM.

192. Mr Furness sought to establish, on the basis of Mr Gough's evidence, that what one could derive from the practice was that, although HMRC might take issue with particular aspects of a transaction, it was not their practice whenever you stepped outside the BIM to say "well now we're free to run any argument we like". But what he would have to show to make this good is a practice (unambiguous, widespread, well established and well recognised) that however much HMRC suspected that film relief might be being used for tax avoidance, they had committed themselves not to take any points which they would not take in the case of a normal (tax deferment) scheme. Such a proposition would be difficult enough to spell out from a practice of in fact granting relief to normal schemes; but, in the face of the representations which we have found to be made in the BIM as a whole (including the unequivocal statement in the Introduction that in cases where HMRC considered that there was, or might have been, avoidance of tax "the guidance will not necessarily apply"), we consider it impossible. Certainly the evidence of practice relied on does not establish it.

193. We were also shown a table which HMRC had produced. This identified 155 other cases where claims to relief had been settled, and showed which of them had certain features. For present purposes we need refer only to the offshore features, of which there were five: (1) a partnership with an offshore managing partner or other offshore indication, (2) an offshore lessee, (3) an offshore lending bank, (4) the partnership bank account being offshore, and (5) evidence that the partnership was marketed to non-doms or expected emigrants. What the table shows clearly is that although there were many schemes where claims have been settled which have one or more of these features (for example 45 with feature (1), 19 with feature (2) etc) there was only one scheme which exhibited all five features – or indeed more than two of the five – and that case was only settled long after Proteus and Samarkand were set up (indeed after the FTT hearing in the present case). We agree with HMRC that evidence that claims to relief have been allowed where one or two offshore features are present cannot be elevated into a practice precluding HMRC from concluding that there might be tax avoidance where all five are present and proceeding to challenge the scheme on whatever grounds they wished.

194. In our view, therefore the taxpayers' claim based on settled practice also fails.

Overriding public interest

195. As already referred to, Mr Swift had a fallback submission for HMRC that even if the taxpayers did have a legitimate expectation derived from the BIM or HMRC's settled practice, HMRC was entitled to depart from it on the grounds that there was a sufficient overriding public interest in doing so.

196. In the light of our conclusions, this question does not arise and we think it would be artificial, and unlikely to be helpful, to try and consider whether we would

have found there to be a sufficient public interest if we had found a legitimate expectation, as it would be likely to depend among other things on the strength of the expectation. We therefore say no more about this aspect of Mr Swift's argument.

Conspicuous unfairness

197. In what Mr Furness admitted to be very much a fallback argument for the taxpayers, they rely also on the principle of conspicuous unfairness. Again, we can take this quite shortly.

198. For the origin of this principle, we were referred to *R v IRC ex p Unilever plc* [1996] STC 681. Here the Unilever group of companies had for about 20 years, and with the agreement of the Inland Revenue, adopted an extra-statutory two-stage procedure for the provisional and final assessment of company profits for the purposes of corporation tax. One of the effects in practice of this procedure was that Unilever was frequently able to set off losses incurred in trading against other profits without making a formal claim to do so within the two-year time limit prescribed by statute. When the Revenue, without warning, sought to disallow such a claim on the ground that it had not been made in time, Unilever successfully applied for judicial review. Sir Thomas Bingham MR accepted the Revenue's submission that there was no clear, unambiguous and unqualified representation such as would satisfy the test in *MFK* (see at 690a-e), but said that "the categories of unfairness are not closed, and precedent should act as a guide not a cage" (at 690f), and that for the Revenue to reject Unilever's claims in reliance on the time-limit without clear and general advance notice "is so unfair as to amount to an abuse of power" (at 691g). He also agreed with the judge that the Revenue's decision not to exercise their discretion in Unilever's favour was so unreasonable as to satisfy the public law test of irrationality, although he did not think this was in truth a separate point (at 691j-692a).

199. Simon Brown LJ also accepted the Revenue's submission that the requirements set out in *MFK* were not satisfied (at 693b-e); but held that to confine all fairness challenges within the *MFK* formulation would be to impose an unwarranted fetter on the broader principle operating in public law, namely the central *Wednesbury* principle that an administrative decision is unlawful if (in the words of Lord Diplock in *Council for Civil Service Unions v Minister for Civil Service* [1985] AC 374 at 410) it is

> "so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it".

(at 694h-j). He continued (at 695a):

> "'Unfairness amounting to an abuse of power' as envisaged in *Preston* and the other Revenue cases is unlawful not because it involves conduct such as would offend some equivalent private law principle, not principally indeed because it breaches a legitimate expectation that some different substantive decision will be taken, but rather because either it is illogical or immoral or both for a public authority to act with conspicuous unfairness

> and in that sense abuse its power. As Lord Donaldson, MR, said in *R v ITC ex parte TSW*: 'The test in public law is fairness, not an adaptation of the law of contract or estoppel'.
>
> In short, I regard the *MFK* category of legitimate expectation as essentially but a head of *Wednesbury* unreasonableness, not necessarily exhaustive of the grounds upon which a successful substantive unfairness challenge may be based."

Later in his judgment, he observed that there was a distinction between "mere unfairness" (conduct which may be characterised as a bit rich but understandable) and

> "a decision so outrageously unfair that it should not be allowed to stand."

(at 697c). Hutchison LJ agreed with both judgments.

200. We were also referred to the judgment of Elias LJ (with whom Sharp J agreed) sitting in the Divisional Court in *R (Lewisham LBC) v AQA* [2013] EWHC 211 (Admin) at [111] where he said that *Unilever* had not formulated a fresh head of review conferring on the court a wide discretion to substitute its own view of the substantive merits for that of the decision-maker. He continued:

> "In order to constitute *conspicuous* unfairness, the decision must be immoral or illogical or attract similar opprobrium, and it necessarily follows that it will be irrational. I would treat this concept of conspicuous unfairness as a particular and distinct form of irrationality, which in essence is how it was viewed by Sir Thomas Bingham in *Unilever*. There are no doubt cases, of which *Unilever* is one, where the concept of fairness, and an allegation of conspicuous unfairness, better captures the particular nuance of the complaint being advanced than the concept of irrationality. Indeed, I think that is typically so in any case where the alleged unreasonable behaviour involves a sudden change of policy or inconsistent treatment. It is more natural and appropriate to describe such conduct as unfair rather than unreasonable. But in my view it is only if a reasonable body could not fairly have acted as the defendants have that their conduct trespasses into the area of conspicuous unfairness amounting to abuse of power. The court's role remains supervisory."

201. It is clear from this guidance that the question for us is not what we think would have been fair but whether we consider that HMRC acted unreasonably in the public law sense, that is in the sense that no reasonable body acting fairly could have acted as they did. Mr Furness submitted that this was so. He said that the taxpayers had been lulled into a false sense of security by the statements in the BIM and HMRC's practice which, for example, gave every impression that HMRC had no objection to sale and leaseback transactions and would accord them the statutory relief; and that it would indeed be outrageous if HMRC were now permitted to contend otherwise.

202. However, it can be seen that this way of formulating the case does not in truth raise any separate issue. If the BIM read as a whole conveys the message (as we have found that it does) that in a case where HMRC consider that there is or may be tax avoidance, HMRC will not necessarily apply the guidance in the BIM, we do not see how it can be unfair, let alone conspicuously or outrageously so, for HMRC in such a case to do exactly what they have said they might do, which is not to apply the guidance in the BIM, leaving themselves free to take whatever points they consider can be made on the legislation.

203. It follows that we reject this ground of challenge as well.

Conclusion on the judicial review

204. We dismiss the applications for judicial review.

Disposition

205. For the reasons set out above, we dismiss the appeals.

Costs

206. Any application for costs in relation to this appeal must be made within one month after the date of release of this decision. As any order in respect of costs will 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.

Mr Justice Nugee

Judge Greg Sinfield

Judge of the Upper Tribunal

Release date: 29 April 2015