[2020] UKFTT 0128 (TC)

TC07629

INCOME TAX – loss relief – whether appellants carrying on a trade – no – whether any trade carried on on a commercial basis with a view to profit – no – whether loss calculated in accordance with generally accepted accounting practice – no – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2009/10952
TC/2009/10957
TC/2010/03799

BETWEEN

RODNEY SHERRINGTON
PAUL WAITE
JOHN METCALFE **Appellants**

-and-

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

TRIBUNAL: JUDGE GREG SINFIELD
TRIBUNAL MEMBER ELIZABETH BRIDGE

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 25 – 28 September, 3 – 5 October, 8 – 10 October and 15 – 16 October 2018

Watkin Gittins of Montpelier Group (Tax Consultants) Limited, for the Appellants

Sadiya Choudhury and Quinlan Windle, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. The Appellants appeal against closure notices issued by the Respondents ('HMRC') in which they refused the Appellants' claims for loss relief made in their self-assessment tax returns for 2004-05. The losses arose on certain contracts ('Pendulum Contracts') that the Appellants had entered into with Pendulum Investment Corporation ('Pendulum'), a company incorporated in the Seychelles. Pendulum was not regulated in the UK or in the Seychelles and had "paid up capital and reserves" of €1,000. HMRC considered that the Appellants had not been carrying on a trade on a commercial basis with a view to profit or, alternatively, that the Pendulum Contracts were not part of the trade and, thus, the Appellants were not entitled to claim loss relief.

2. The Pendulum Contracts, which are more fully described below, provided for the possibility of a profit by reference to the designated issue value of the contract and movements of the Financial Times Stock Exchange 100 index ('FTSE 100'), potentially over a 25-year period. The Pendulum Contracts are described on their face as "contracts for difference" ('CFDs') but, in opening, Mr Gittins, who represented and gave evidence for the Appellants, accepted that this description is not correct. The Pendulum Contracts were not CFDs in the strict sense: they were not, as CFDs are, based on a movement in a share price or an index multiplied by the stake. The Pendulum Contracts were a simple bet that the FTSE 100 would have moved up or down from its level at the date of the contract by a specified range of points ('the swing') at specified dates in the future.

3. The periods between the start of the Pendulum Contract and the first specified date and between subsequent dates were described as phases. The first phase ended seven days after the date of the Pendulum Contract. Subsequent phases ended two, seven, fifteen and twenty five years after the date of the Pendulum Contract. If the Appellant was unsuccessful at the end of the first or any subsequent phase, save the last, the Pendulum Contract continued to the next phase. If the FTSE 100 was above or below the relevant pre-determined values at the end of a phase, Pendulum would pay the Appellant a profit based on percentages set out in the contract. If Pendulum was required to pay an amount at the end of any phase then the Pendulum Contract terminated. If it had not ended before, the Pendulum Contract would end 25 years after its start date.

4. Each Appellant's payment to Pendulum under the Pendulum Contract was made in two stages. The first (the 'Initial Margin') was payable on entering into the Pendulum Contract. The second and larger part of the payment (the 'Margin Call Balance') was payable at the start of the second phase. In each case, the Appellants' liability to pay the Margin Call Balance was satisfied by Bayridge Investments LLC ('Bayridge'), a limited liability corporation incorporated in Delaware USA, providing loans to the Appellants. The Bayridge loans were interest free, unsecured loans which were repayable at the end of any phase of the Pendulum Contract in respect of which the Appellant became entitled to a payment from Pendulum or, if the Appellant was unsuccessful in every phase, in 50 years, ie 25 years after the end of the relevant Pendulum Contract.

5. All three Appellants were unsuccessful in the first two phases of some or all of their Pendulum Contracts and maintain that, as a consequence, they made losses in the course of their self-employment as a derivative trader that could be set against their other taxable income. The losses were calculated by reference to the value at which Pendulum was prepared to buy back the unsuccessful Pendulum Contracts.

6. In his self-assessment tax return for 2004-05, Mr Sherrington claimed a trading loss for the year of £893,874 of which £888,300 related to the Pendulum Contracts. He claimed that £469,743 of the loss should be set off against other income for 2004-05 and that the remainder (£424,130) should be carried back and set against income of the preceding years.

7. Mr Waite claimed a trading loss of £1,506,284.99, of which £1,341,977 related to the Pendulum Contracts, in 2004-05. In his self-assessment tax return for the year, Mr Waite claimed £604,115.74 should be set against other income for 2004-05, £415,775 should be carried back and set against income of the preceding years and £486,394.25 should be carried forward to be set against income of subsequent years.

8. In his self-assessment tax return for 2004-05, Mr Metcalfe claimed a trading loss of £348,739, of which £343,053 related to the Pendulum Contracts, which he claimed should be set against his income in previous years.

9. HMRC opened enquiries into the Appellants' self-assessment tax returns for 2004-05 under section 9A of the Taxes Management Act 1970 ('TMA 1970'). On the completion of the enquiries, HMRC concluded that the derivative trading losses were not allowable and made amendments to the returns in question by means of closure notices pursuant to section 28A TMA 1970. Section 31(1)(b) TMA 1970 provides that an appeal may be brought against any conclusion stated or amendment made by a closure notice under section 28A. All three Appellants appealed separately against the closure notices issued by HMRC.

THOMSON APPEAL AND APPLICATION TO STRIKE OUT

10. At the start of the hearing, HMRC made an application to strike out part of the Appellants' case, namely the ground that the Pendulum contracts were part of the trade carried on by the Appellants. Ms Choudhury, who appeared with Mr Windle for HMRC, submitted that, even if (which was denied) they were carrying on a trade on a commercial basis and with a view to the realisation of profits and/or a reasonable expectation of profit, the Appellants' case on this point was unarguable and had no reasonable prospects of succeeding. Accordingly, that part of the case should be struck out under rule 8(1)(c) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009.

11. The foundation of the application to strike out was the decision of the First-tier Tribunal ('FTT') in *Thomson & ors v HMRC* [2018] UKFTT 396 (TC) ('*Thomson*'). *Thomson* concerned Pendulum Contracts which the appellants in that case entered into at or around the same time as the Appellants using the same or similar versions of the relevant contracts. The appellants in *Thomson* claimed loss relief in respect of their contracts with Pendulum which HMRC denied by amendments to their tax returns. The FTT in *Thomson*, after applying the law to the findings of fact it had made on the evidence, dismissed the appeals. The appellants in *Thomson* have appealed to the Upper Tribunal primarily challenging the findings of fact made by the FTT on *Edwards v Bairstow* grounds.

12. In essence, Ms Choudhury's submission was that the facts and circumstances in which the appellants in *Thomson* entered into their Pendulum contracts were materially similar to the facts and circumstances in this appeal. Ms Choudhury contended that, assuming we found in favour of the Appellants on the other issues, there was no reasonable prospect of this tribunal coming to a different conclusion from that of the FTT in *Thomson* in relation to the issue of whether the Pendulum Contracts in this case were part of the Appellants' trade. In substance, Ms Choudhury contended, we were bound to find that, as in *Thomson*, the Appellants' activities amounted to no more than trying to give an appearance of trading as opposed to being actual trading.

13. In response, Mr Gittins, who appeared for the Appellants, submitted that this appeal concerned different appellants who were not in the same position as the appellants in *Thomson*. They did different things and entered into different trades. This tribunal should hear their evidence about what they were trying to achieve and their purpose in entering into the Pendulum Contracts.

14. In considering the application to strike out, we bear in mind the guidance given by the Upper Tribunal in *The First De Sales Ltd Partnership & Ors v HMRC* [2018] UKUT 396 (TCC). We follow the same approach of applying the principles in respect of applications for summary judgment set out by Lewison J, as he then was, in *Easyair Ltd (t/a Openair) v Opal Telecom Ltd* [2009] EWHC 339 (Ch) at [15], subsequently approved by the Court of Appeal in *AC Ward & Sons v Caitlin Five Limited* [2009] EWCA Civ 1098. In particular, we note the caution against conducting a 'mini-trial' in order to determine whether a party's case has a reasonable prospect of success.

15. Applying those principles, we decided to refuse the strike out application and announced our decision at the hearing. In summary, we were not satisfied, on the basis of the submissions and matters that were put before us in support of the application, including the materials that we had read in advance, that it was safe to say that there was no reasonable prospect of the Appellants succeeding in their case that the Pendulum Contracts were part of their trade. We considered that we would not be in a position to give a view to that effect before we had heard more evidence.

16. We state at this point that, having heard the evidence in this case, we find that we agree with many of the conclusions of the FTT in *Thomson* and adopt those conclusions below. That is hardly surprising as much of the documentary and some of the witness evidence in this case are the same or substantially the same as in *Thomson*.

LEGISLATIVE FRAMEWORK

17. Mr Sherrington and Mr Waite (but not Mr Metcalfe) made claims under section 380 of the Income and Corporation Taxes Act 1988 ('ICTA 1988') to set-off their losses against income for 2004-05. For the 2004-05 tax year, section 380 materially provided as follows:

> "380 Set-off against general income
>
> (1) Where in any year of assessment any person sustains a loss in any trade, profession, vocation or employment carried on by him either solely or in partnership, he may, by notice given within twelve months from the 31st January next following that year, make a claim for relief from income tax on
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> (a) so much of his income for that year as is equal to the amount of the loss or, where it is less than that amount, the whole of that income; or
>
> (b) so much of his income for the last preceding year as is equal to that amount or, where it is less than that amount, the whole of that income;
>
> but relief shall not be given for the loss or the same part of the loss both under paragraph (a) and under paragraph (b) above."

18. Section 384 ICTA 1988 set out the conditions that must be met in order for a loss to be relievable under section 380 providing, so far as relevant, as follows:

> "384 Restrictions on right of set-off
>
> (1) Subject to subsection (2) below, 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 or, where the carrying on of the trade formed part of a larger undertaking, in the undertaking as a whole.

> …
>
> (9) 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 with a view to the realisation of profits."

19. Thus, very broadly, the combined effect of sections 380 and 384 ICTA 1988 is that, where a taxpayer incurs a loss in a trade in a particular year, that loss can be set off against other taxable income arising in the same year, or the immediately preceding year, but only where the requirements of section 384 are met. Those requirements are that the trade was being carried on on a commercial basis and with a view to the realisation of profits (which is deemed to be the case if the trade is carried on so as to afford a reasonable expectation of profit).

20. All the Appellants made claims for loss relief in earlier years under section 381 in respect of their Pendulum Contracts. For the year 2004-05, section 381(1) to (4) ICTA 1988 provided as follows:

> "381 Further relief for individuals for losses in early years of trade.
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> (1) Where an individual carrying on a trade sustains a loss in the trade in
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> (a) the year of assessment in which it is first carried on by him; or
>
> (b) any of the next three years of assessment;
>
> he may, by notice given on or before the first anniversary of the 31st January next following the year of assessment in which the loss is sustained, make a claim for relief under this section.
>
> (2) Subject to section 492 and this section, relief shall be given under subsection (1) above from income tax on so much of the claimant's income as is equal to the amount of the loss or, where it is less than that amount, the whole of that income, being income for the three years of assessment last preceding that in which the loss is sustained, taking income for an earlier year before income for a later year.
>
> (3) Relief shall not be given for the same loss or the same portion of a loss both under subsection (1) above and under any other provision of the Income Tax Acts.
>
> (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 (or, where the carrying on of the trade forms part of a larger undertaking, in the undertaking as a whole) could reasonably be expected to be realised in that period or within a reasonable time thereafter."

21. In summary and so far as material, section 381 ICTA 1988 provides that relief is available for losses incurred in the first four tax years of a trade which, if the loss exceeds the income of that year, is applied to the preceding three years starting with the earliest. The loss relief under section 381 is only available if the trade was carried on throughout the relevant year on a commercial basis and in such a way that profits could reasonably be expected to be realised in the period in which the loss occurred or shortly thereafter.

22. Mr Waite also made a claim to carry forward losses to be set off against his income for later years under section 385 ICTA 1988. For the year 2004-05, section 385(1) ICTA 1988 provided as follows:

> "Carry-forward against subsequent profits
>
> (1) Where a person has, in any trade, profession or vocation carried on by him either alone or in partnership, sustained a loss (to be computed as mentioned

in subsections (3) and (4) of section 382) in respect of which relief has not been wholly given either under section 380 or any provision of the Income Tax Acts—

(a) he may make a claim requiring that any part of the loss for which relief has not been so given shall be set off for the purposes of income tax against the income of the trade, profession or vocation for subsequent years of assessment; and

(b) where he makes such a claim, the income from the trade, profession or vocation in any subsequent year of assessment shall be treated as reduced by that part of the loss, or by so much of that part as cannot, on that claim, be relieved against such income of an earlier year of assessment."

23. For the year 2004-05, section 74(1)(a) ICTA 1988 provided that:

"Subject to the provisions of the Tax Acts, in computing the amount of the profits to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of—

(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation;

…"

24. Section 42(1) of the Finance Act 1998 ('FA 1998'), which applied for the 2004-05 tax year, provided for profits and losses to be calculated by reference to generally accepted accounting practice ('GAAP') as follows:

"42 Computation of profits of trade, profession or vocation

(1) For the purposes of Case I or II of Schedule D the profits of a trade, profession or vocation must be computed in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in computing profits for those purposes."

ISSUES

25. Although they put them slightly differently, the parties agreed that the appeals raise questions in relation to three main issues, namely trading (which divides into a number of sub-issues), GAAP and the amount of the losses claimed. The first question in relation to the trading issue, which is whether there was an existing trade which pre-dated the Pendulum Contracts, does not arise in relation to Mr Waite because HMRC accepted that he was trading in relation to his non-Pendulum transactions and the loss thus incurred was a trading loss. HMRC do not accept that Mr Waite was trading in relation to the Pendulum Contracts. The questions are, therefore, as follows.

(1) Were Mr Sherrington and Mr Metcalfe carrying on a trade in derivatives before they entered into the Pendulum Contracts and were the Appellants (including Mr Waite) trading in relation to their Pendulum Contracts?

(2) If the Appellants were trading, was the trade carried on on a commercial basis as required by section 384(1) ICTA 1988?

(3) If they were trading on a commercial basis, were Mr Sherrington and Mr Waite (in relation to his Pendulum Contracts) trading with a view to the realisation of profits in the trade and/or a reasonable expectation of profit as required by section 384(1) and (9) ICTA 1988?

(4) If they were trading on a commercial basis, were the Appellants (including Mr Waite in relation to his Pendulum Contracts) trading in such a way that profits in the trade could reasonably be expected to be realised in 2004-05 or within a reasonable time thereafter as required by section 381(1) ICTA 1988?

(5) If we have found in favour of the Appellants in relation to the trading issues above, were the Pendulum Contracts entered into by the Appellants in the course of a trade?

(6) If the Pendulum Contracts formed part of a trade carried on by the Appellants, were the profits and losses of that trade correctly calculated in accordance with GAAP?

(7) If we have found in favour of the Appellants in relation to all other issues, are the losses claimed by each Appellant excessive and liable to be reduced?

CASE LAW ON TRADING

26. It is perhaps inevitable but still a matter for regret that the many of the terms used in the sections of ICTA 1988 (and the Acts which preceded and succeeded it) are not defined in the legislation. Although words such as "trade" and "commercial" are ordinary English words in everyday use, they have been considered by the tribunals and courts on a number of occasions over many years. We set out below the guidance that we have taken from the leading cases.

Meaning of trade

27. The meaning of "trade" was considered by Sir Nicolas Browne-Wilkinson VC in *Marson (Inspector of Taxes) v Morton* [1986] STC 463 at 470 to 471. He helpfully set out a number of indicators of a trading transaction (the often quoted "badges of trade"), such as whether it was a one-off transaction, whether it is related to the trade, the nature of the subject matter, the way in which the transaction was carried through, the source of finance of the transaction, whether there was an intention to re-sell in the short term or to hold for a lengthy or indefinite period. However, the list is not a comprehensive statement of what constitutes (or by omission does not constitute) trading and Sir Nicolas Browne-Wilkinson recognised that the "badges" do not provide an answer in every case.

28. We gratefully adopt the course suggested by Henderson LJ in *Degorce v HMRC* [2017] EWCA Civ 1427, [2017] STC 2226 ('*Degorce*') at [49], namely that it is sufficient to consider the decisions of the Court of Appeal in *Eclipse Film Partners (No 35) LLP v HMRC* [2015] STC 1429 ('*Eclipse*') and *Samarkand Film Partnership No. 3 & ors v HMRC* [2017] STC 926 ('*Samarkand*'). As Henderson LJ states, those cases contain an authoritative re-statement of the principles which should be followed in deciding whether activities undertaken by a taxpayer constitute a trade for tax purposes.

29. In [51] and [53] of *Degorce*, Henderson LJ stated that the following passages from the judgment of Sir Terence Etherton C in *Eclipse* were of central importance:

> "111. … It is necessary to stand back and look at the whole picture and, having particular regard to what the taxpayer actually did, ask whether it constituted a trade.
>
> 112. The Income Tax Acts have never defined trade or trading further than to provide that (in the words of TA 1988, s 832(1) which was applicable to the relevant tax year) trade includes every trade, manufacture, adventure or concern in the nature of trade. As an ordinary word in the English language 'trade' has or has had a variety of meanings or shades of meaning. Its meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation, depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular

> factual characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles. To that extent the conclusion is one of fact, or, more accurately, it is an inference of fact from the primary facts found by the fact-finding tribunal.
>
> 113. It follows that the conclusion of the tribunal of fact as to whether the activity is or is not a trade can only be successfully challenged as a matter of law if the tribunal made an error of principle or if the only reasonable conclusion on the primary facts found is inconsistent with the tribunal's conclusion. These propositions are well established in the case law …
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> 114. In *Marson v Morton* [1986] STC 463 at 470-471, [1968] 1 WLR 1343 at 1348-1348 Sir Nicolas Browne-Wilkinson V-C set out a list of matters which have been regarded as a badge of trading in reported cases. He emphasised, however, that the list was not a comprehensive statement of all relevant matters nor was any one of them decisive in all cases. He said that the most they can do is to provide common sense guidance to the conclusion which is appropriate; and that in each case it is necessary to stand back and look at the whole picture and, having regard to the words of the statute, ask whether this was an adventure in the nature of trade … The cases by reference to which the list was compiled are not sufficiently analogous to the facts of the present case to make the list of value in these proceedings.
>
> …
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> 117. Finally, on legal principles, it is elementary that the mere fact that a taxpayer enters into a transaction or conducts some other activity with a view to obtaining a tax advantage is not of itself determinative of whether the taxpayer is carrying on a trade: *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] STC 226 at 241, [1992] 1 AC 655 at 677 (Lord Templeman)."

30. Lord Templeman's exact words in *Ensign Tankers* were as follows:

> "… it is elementary that the mere fact that a taxpayer enters into a transaction or conducts some other activity with a view to obtaining a tax advantage is not itself determinative of whether the taxpayer is carrying on a trade."

31. In [115] of *Eclipse*, Sir Terence Etherton C referred, with approval, to the statement of Lord Reid in *Ransom v Higgs* [1974] STC 539 at 545 that the word "trade" is commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services. The full passage from *Ransom v Higgs* is as follows:

> "The Income Tax Acts have never defined trade or trading farther than to provide that trade includes every trade, manufacture, adventure or concern in the nature of trade. As an ordinary word in the English language 'trade' has or has had a variety of meanings or shades of meaning. Leaving aside obsolete or rare usage it is sometimes used to denote any mercantile operation but it is commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services."

32. Lord Morris of Borth-y-Gest in *Ransom v Higgs* at 550 - 551 referred to the following dictum of the Lord President (Clyde) in *IRC v Livingston* (1927) SC 251 at 255-256, 11 TC 538 at 542:

> "I think the test which must be used to determine whether a venture such as we are now considering is, or is not, 'in the nature of trade' is whether the

> operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made."

33. Lord Wilberforce in *Ransom v Higgs* stated at 554:

> "Trade has for centuries been, and still is, part of the national way of life; everyone is supposed to know what 'trade' means; …
>
> 'Trade' cannot be precisely defined, but certain characteristics can be identified which trade normally has. Equally some indicia can be found which prevent a profit from being regarded as the profit of a trade sometimes the question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, of organisation, even of intention, and in such cases it is for the fact finding body to decide on the evidence whether a line is passed. The present is not such a case: it involves the question as one of recognition whether the characteristics of trade are sufficiently present. …
>
> Trade involves, normally, the exchange of goods, or of services, for reward, not of all service, since some qualify as a profession, or employment, or vocation, but there must be something which the trade offers to provide by way of business. Trade, moreover, presupposes a customer (to this too there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral—you must trade with someone. …
>
> Then there are elements or characteristics which prevent a trade being found, even though a profit has been made - the realisation of a capital asset, the isolated transaction (which may yet be a trade). In recent years a transaction, even one of property dealing, which amounts to no more than a planned raid on the revenue (see *FA & A B Ltd v Lupton*) has been held not to be by way of trade a sophistication which I do not reject, but which must be carefully watched for illegitimate extension."

34. In *Samarkand* at [43], Henderson LJ, with whom the rest of the Court concurred, endorsed the analysis in *Eclipse* of the meaning and application of the concept of "trade" in tax legislation. We return to the case of *FA & AB Ltd v Lupton (Inspector of Taxes)* [1972] AC 634 (HL) ('*Lupton'*) at [45] et seq below.

35. The activities under consideration in this case, as in *Thomson*, were highly speculative, involving each Appellant taking a view about movements in shares or, in the case of the Pendulum Contracts, the FTSE 100 over a period of time. Mr Gittins acknowledged that the Pendulum Contracts were speculative in the sense that their outcome was uncertain. The speculative nature of the transactions is relevant to the question of whether an activity is trading. We take the same view as the FTT in *Thomson* that, while many trading transactions involve elements of speculation, risk or uncertainty, activities that are pure speculation, without the application of a profit-making system, may not amount to the carrying on of a trade. As Pennycuick J said in *Emanuel (Lewis) & Son Ltd v White (Inspector of Taxes)* 42 TC 369:

> "The word 'speculation' is not, I think, as a matter of language, an accurate antithesis either to the word 'trade' or to the word 'investment': either a trade or an investment may be speculative. On the other hand, it is certainly true, at any rate in the case of an individual, that he may carry out a whole range of financial activities which do not amount to a trade but which could equally not be described as an investment, even upon a short-term basis. These activities include betting and gambling in the narrow sense. They also include, it seems to me, all sorts of Stock Exchange transactions. For want of a better phrase, I will describe this class of activities as gambling transactions."

36. In *Salt v Chamberlain* [1979] STC 750, Oliver J stated at 760:

> "Where the question is whether an individual engaged in speculative dealings in securities is carrying on a trade, the prima facie presumption would be … that he is not. It is for the fact-finding tribunal to say whether the circumstances proved in evidence or admitted take the case out of the norm."

37. Ms Choudhury submitted that the Appellants did not have an underlying trading strategy and they had not taken steps to hedge their transactions. Her contention was that the Appellants' transactions were pure speculation of a very different kind from trading.

Commercial basis and profitability

38. The second trading issue question is whether, if they were trading, the Appellants carried on their trade on a commercial basis. The third and fourth questions concern whether, assuming they were trading on a commercial basis, the Appellants were trading with a view to the realisation of profits in the trade or the reasonable expectation of profits in the first four years of trading or within a reasonable time thereafter. The commercial basis and profits conditions are separate but closely related and factors which are relevant to one are likely to be relevant to the other (see *Degorce* at [123] and [124]).

39. The leading case on the meaning of 'commercial' is *Wannell v Rothwell* [1996] STC 450, in which Walker J stated at 461:

> "… it was suggested that the best guide is to view 'commercial' as the antithesis of 'uncommercial', and I do find that a useful approach. A trade may be conducted in an uncommercial way either because the terms of trade are uncommercial (for instance, the hobby market-gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable costs of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby art gallery or antique shop where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante."

40. In *Samarkand*, Henderson LJ stated at [90] that it was wrong to regard the profitability and commerciality tests in the legislation as mutually exclusive, and they necessarily overlapped to an extent which would vary from case to case. He agreed with the observations of the Upper Tribunal in the same case at [96] to [97] of its decision, [2015] STC 2135:

> "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."

41. In *Seven Individuals v HMRC* [2017] UKUT 132 (TCC), [2017] STC 874 ('*Seven Individuals*'), one of the issues was whether the LLPs of which the appellants were members were carrying on a trade on a commercial basis and with a view to profit. In response to a submission on behalf of the appellant, Nugee J stated at [46]:

> "The question whether such a trade is being carried on on commercial lines is not to my mind answered simply by pointing to a hope by the trader to make profits. A trade run on commercial lines seems to me to be a trade run in the way that commercially minded people run trades. Commercially-minded people are those with a serious interest in profits, or to put it another way, those with a serious interest in making a commercial success of the trade. If therefore a trade is run in a way in which no one seriously interested in profits (or seriously interested in making a commercial success of the trade) would run it, that trade is not being run on commercial lines."

42. He added at [47]:

> "…the concept of a trade carried on on commercial lines has an objective element to it, and cannot be satisfied by proof merely that the trade is well organised and that the trader had a purely subjective hope or desire to make a profit."

43. At [66], he stated:

> "[The FTT] were well aware that the evidence was that it was possible that any one (or more) of the projects could achieve enormous success or very large profits, and that if it had done so, the trade of the relevant LLP would have been profitable and hence a commercial success. They nevertheless concluded that such success was a rarity and speculative … The only remaining question is whether they supported the conclusion that the trades were not being carried on on a commercial basis … once it is accepted that the correct test is whether the trade is being carried on in a way that commercially-minded people might, I do not see that their conclusion involves any error of law, or was not open to them."

44. We agree with the analysis of the profits conditions by the FTT in *Thomson* at [192] and [193]. The condition in section 381(4) ICTA 1988 that the trade was carried on in such a way that profits in the trade could "reasonably be expected" to be realised in the first four years of the trade or within a reasonable time thereafter is an objective test. Our task is to determine whether each Appellant carried on his trade in such a way that, taking account of all the circumstances, it would be reasonable to expect that he would make a profit in the relevant period. The profits condition in section 384 ICTA 1988 may be satisfied in two ways, each of which requires a different approach. The first is that, under section 384(1), the trade was being carried on with a view to the realisation of profits. That requires the Tribunal to look at the aim or purpose of the person carrying on the activity which is primarily a subjective test (see *Seven Individuals* at [35]). The other way in which the profits condition in section 384 may be satisfied is if the trade is carried on so as to afford a reasonable expectation of profit. If so then section 384(9) deems the trade to be carried on with a view to the realisation of profits thus satisfying section 384(1). Like the condition in section 381(4), whether the trade is carried on so as to afford a reasonable expectation of profit is an objective test.

Transactions in the course of a trade

45. The House of Lords decisions in the "dividend stripping" cases of *Lupton* and *Thomson v Gurneville* [1972] AC 661 ('*Gurneville'*) were heard within days of each other and followed on from two earlier conflicting decisions by the House of Lords in *Griffiths v JP Harrison (Watford) Ltd* [1963] AC 1 and *Finsbury Securities Ltd v IRC* [1966] 1 WLR 1402. The

essential elements of these cases were the same. A share dealer bought shares in a company containing distributable profits, stripped out the profit in the company by way of dividend and wrote down the value of the shares. Under the rules at the time, this enabled the dealer to claim a repayment of tax due to the reduction in value of the company notwithstanding that there was no real financial loss. The dividend stripping transactions comprised the elements usually associated with a trading transaction of the type in question. It was held, however, in both *Lupton* and *Gurneville*, that the transactions were not undertaken in the course of the share dealing trade, essentially as they were undertaken wholly or mainly as tax recovery devices rather than for the commercial purpose of dealing in shares. They enabled the taxpayers to recover substantial amounts of tax where there was no actual financial loss.

46. In *Lupton*, Lord Morris stated at 647G:

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

47. Lord Morris also referred to the following extract from Megarry J's judgment at first instance at 648E:

> "… if the greater part of the transaction is explicable only on fiscal grounds, the mere presence of elements of trading will not suffice to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an artificial structure, remote from trading and fashioned so as to secure a tax advantage, the mere presence in that structure of certain elements which by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure."

48. In *Gurneville*, the House of Lords further held that a transaction which had resulted in a commercial profit was nevertheless not part of the taxpayer's share dealing trade because "its very structure and content reveal[ed] it as something different in kind" (per Lord Morris at 672H) and "it was one designed, intended and carried out so far as the respondent company was concerned mainly to provide a basis for claims against the revenue" (per Viscount Dilhorne at 675C).

EVIDENCE AND BURDEN OF PROOF

49. We received evidence in the form of witness statements and oral testimony from the Appellants (Mr Sherrington, who gave evidence by video link from Australia, Mr Metcalfe and Mr Waite) and Mr Gittins who gave evidence about Pendulum, Bayridge and the background to Pendulum Contracts. Guy Wiltcher, a Chartered Tax Adviser and chartered accountant, gave expert evidence for the Appellants as to accounting matters and, in particular, on aspects of UK GAAP. All the Appellants and the witnesses for the Appellants were cross-examined by Ms Choudhury.

50. Two witnesses gave evidence for HMRC: Mark Bradley, an officer of HMRC, and Stephen Harrap, an accountant who gave expert evidence for HMRC on UK GAAP. Mr Gittins, who appeared for the Appellants, cross-examined Mr Bradley and Mr Harrap.

51. In addition, there were bundles of contractual and related documents which were produced by the witnesses and are discussed below.

52. Since these are appeals against closure notices under section 28A TMA 1970 (and not 'discovery assessments' under section 29 TMA 1970), the Appellants bear the burden of proving, on the balance of probabilities, that the closure notices overstated their liability to tax

- see section 50(6) TMA 1970 and *Brady (Inspector of Taxes) v Group Lotus Car Companies plc* [1987] STC 635, per Mustill LJ at 642.

FINDINGS OF FACT

53. On the basis of the witness and other evidence presented to us, we find the material facts to be as set out below.

Montpelier and the marketing of the Pendulum arrangements

54. The Pendulum Contracts were a part of a framework of contracts entered into by the Appellants. The arrangements as a whole were originally devised by Mr Michael Darwyne and later refined and marketed by Montpelier Tax Planning (Isle of Man) Limited, part of the Montpelier group of companies. At the material times, the Montpelier group of companies was headed by Montpelier Group LLC. Mr Gittins was a controlling shareholder of Montpelier Group LLC. Bayridge was an indirect subsidiary of Montpelier Group LLC (and so was a member of the Montpelier group of companies). Unless it is necessary to distinguish between them, we simply refer to all members of the Montpelier group of companies as "Montpelier".

55. The shares in Pendulum were originally owned by a Mr Darwyne but, in September 2005, he sold them to Mr Gittins. The shares in Pendulum are owned personally by Mr Gittins. Mr Gittins accepted that Pendulum and Bayridge are not a part of a group in the Companies Act sense but were closely connected and under common control from September 2005. The FTT in *Thomson* found that, even before September 2005, Pendulum appeared to be more like a group company than an independent company from Bayridge's perspective because Mr Gittins had an understanding that he could buy the Pendulum shares from Mr Darwyne. We agree.

56. The evidence relating to the design and marketing of the Pendulum Contracts presented to us was the same as had been considered by the FTT in *Thomson*. The FTT in *Thomson* described that evidence at [48] – [58] and we gratefully adopt the description which is as follows:

> "48. Montpelier did not devise the contractual framework that underpinned the Pendulum CFDs. That framework was devised by Michael Darwyne (the owner of the Pendulum shares before Mr Gittins acquired them). He had been interested in devising a CFD product that could be 'distance sold' to UK residents who qualified as 'sophisticated investors' for the purposes of the Financial Services and Markets Act 2000 ('FSMA'). To that end, Mr Darwyne drafted the terms of the contracts (the Master Agreement etc.) and sought advice from UK counsel on the applicable regulatory regime under FSMA. He also sought tax advice from UK tax counsel, Mr Shipwright, on the tax consequences for investors. Mr Shipwright's advice included an analysis of the general law, and HMRC practice on what amounted to the carrying on of a trade on a commercial basis with a view to profit. However, that analysis was generic: Mr Shipwright was not purporting to advise as to whether any particular taxpayer met this requirement and he noted that the question was ultimately a question of fact that depended on what a taxpayer actually did.
>
> 49. In July 2004, a scheme that Montpelier had been promoting (the 'charity scheme'), was counteracted by legislation, or proposed legislation. Mr Gittins accepted that this scheme was an 'out-and-out avoidance scheme' whose purpose was to produce an income tax loss that would enable individuals to shelter their tax liabilities. Mr Gittins and others within Montpelier set about devising a replacement scheme that would achieve the same or similar result. We saw emails from Montpelier sent to interested parties (such as independent financial advisers) assuring them that a new scheme was in the pipeline.

50. Initially, Mr Gittins's focus was on developing an avoidance scheme that would involve an interest rate swap. He had some consultations with counsel on such a scheme but could not get it to work.

51. On 8 November 2004 Mr David Conlan sent an email to Mr Gittins and others which Mr Gittins accepted related to the Pendulum CFD arrangements. That email referred to an attachment (with which we were not provided) but which evidently explained the Pendulum arrangements and included the following extract:

> 'The attached, in addition to outlining the relief available, mainly highlights issues and pitfalls. I would expect to 'positive it up' when I have seen Counsel's opinion and WG's trading checklist…
>
> To me, one of the main points is the issue of 'commercial organisation'. And that clients accept that this is planning which needs them to buy in to the idea, not just sign a cheque.
>
> …
>
> Would it help if I were to make an 'Am I trading?' presentation at next meeting….
>
> Also, has anyone looked at minicfds.com in any detail. I have registered. There is a 5 week course on cfd trading and, initially, it is possible to trade a single share, yes, ONE share. The lower limit after training is 100 shares.'

This email indicates that Montpelier intended the Pendulum arrangements to function as a device to deliver a trading loss to a user of the scheme but that, before such a loss could be delivered, the user first needed to commence a trade of dealing in derivatives.

52. On 29 November 2004, Jane Goodall, the Compliance Manager at Montpelier Group Europe Limited, sent an email to a number of sales managers at Montpelier that includes the following paragraphs:

> 'I have been speaking with Pendulum this morning, I am expecting the final draft of the contract any day now.
>
> In an effort to plan, we are trying to gauge the number of trades that clients are likely to make between now and Christmas. To that effect, could you give me an estimate of the quantum of losses that your clients wish to create between the following 2 sets of dates
>
> 1-10 December
>
> 12-24 December.'

This email exchange indicates that Jane Goodall and the sales managers at Montpelier viewed the Pendulum arrangements from the perspective of the tax losses that they could generate for Montpelier customers.

53. Montpelier's view of the arrangements was also set out in a slide presentation and speaking notes that Montpelier prepared for a meeting with a particular firm of independent financial advisers known as Gatekeeper. All of the appellants deny ever having seen this slide presentation before they made their decision to start buying and selling CFDs or to acquire their Pendulum CFDs. We accept that evidence. We have also noted that the slide presentation and speaking notes were dated 10 May 2006 which was after the date on which the appellants entered into their Pendulum CFDs. However, given the background to the development of the Pendulum arrangements, which we have noted, we have concluded that Montpelier's view of the

arrangements would not have changed fundamentally and that the view of the arrangements as set out in the slide show dated 10 May 2006 would have been their view at material times prior to that date as well.

54. The slides explain a transaction that will generate tax losses for individuals. It is explained that there are:

> Two parts to the planning
>
> 1- establishing a self-employed trade
>
> 2- creating a trading loss

55. The slides explain that this can be achieved via a derivative having the following broad terms:

Phase	Year	Index Target Level	Trade Profit
Two	2	8,770	130% of Issue Value
Three	7	11,350	210% of Issue Value
Four	15	24,400	450% of Issue Value
Five	25	63,150	1200% of Issue Value

These figures were, with some small differences, the figures that Mr Thomson specified in the Offer to Trade that he sent Pendulum in March 2006.

56. The speaking notes to this slide explain that the 'first phase of the contract' may be 'based on a movement of FT-SE over a 7-day period' and expanded on this as follows:

> 'If at the end of 7 days the FTSE has moved over a hundred points up or down you will have won the contract and the Seychelles company will pay you the initial margin of £7,000 back plus an additional £7,000 in profit and the contract is terminated. This has happened on several occasions, this is a real contract, and taxes would have to be paid on any profits made.
>
> However, the most likely event is that … the contract will move into phase 2 of the contract and there will be a margin call for the difference.'

57. We accept that Mr Gittins did not prepare the slide show or speaking notes. He characterised the presentation as 'naïve' and suggested in his evidence that it may not even have been referring to the Pendulum arrangements. He noted that the presentation stated that the arrangement it referred to had been 'in the market for 2 years' (whereas Montpelier had been marketing the Pendulum arrangements only since November 2004, some 17 months before the date of the presentation). He also noted that the slides indicated that 'rebates from 1st year already been received' (suggesting that HMRC were already making payments to users of the arrangements), but that this could not have been true of the Pendulum arrangements. However, it is clear to us that, viewed as a whole, the slide show was describing the Pendulum arrangements and we have concluded that, no doubt as a sales pitch, the presentation exaggerated the longevity of the arrangements and the success that Montpelier had had from them.

58. In judicial review proceedings which Mr Gittins initiated in connection with HMRC's decision to execute search warrants at Montpelier's premises, Officer Rawbone, an HMRC officer had described four tax planning products that Montpelier promoted including a 'contract for differences tax plan'. In

> responding to Officer Rawbone's witness statement, Mr Gittins said in his own witness statement:
>
> > 'At all material times Montpelier, which was engaged in the business of tax consultancy and in particular the creation of tax avoidance arrangements including the four specific arrangements referred to by Mr Rawbone [emphasis added] …'
>
> Mr Gittins accepted that, in this statement, he was referring to the Pendulum CFD arrangements. At the hearing, he sought to retreat somewhat from the characterisation of them as 'tax avoidance arrangements' saying only that they had 'tax avoidance potential' (as there would be no 'tax avoidance' if a particular contract came to an end after Phase 1). However, he accepted that what he termed a 'GAAP anomaly' might mean that the arrangements might be regarded as having some tax avoidance potential when viewed from the perspective of individual investors."

57. We saw the slide presentation and speaking notes that Montpelier prepared in 2006 to market the Pendulum scheme to a firm of independent financial advisers. These slides and notes were considered by the FTT in *Thomson* in the passages set out above. The presentation and notes were put to Mr Waite who accepted that they described someone in his situation. Like the FTT in *Thomson* at [53], we have concluded that the slides and notes showed how Montpelier marketed the Pendulum arrangements in 2006 and, we infer, to the Appellants in the previous year. One of the slides described the two stages of the Pendulum arrangements as, first, establishing a self-employed trade and, secondly, creating a trading loss. The notes to one slide said:

> "The individual would have to become a derivative trader and consequently the individual has to have an understanding of the financial markets and the ability to actually become a trader. From this trade, the individual will create a trading loss that can be used to offset tax paid on income earned over the current year plus up to three years previous."

58. The FTT in *Thomson* held that the arrangements constituted a tax avoidance scheme, holding at [58]:

> "We have concluded from the evidence that Montpelier's sales team regarded the Pendulum arrangements as a device to enable individuals to generate tax losses without realising actual economic losses. In order for those arrangements to succeed, Montpelier's sales team considered that users would first need to establish a trade of dealing in derivatives. Since Montpelier held that view of the arrangements, we have concluded that they would have communicated it to their clients, including the appellants, when suggesting the arrangements to them."

59. For the same reasons as the FTT in *Thomson* and on the basis of our findings described below, we also conclude that the Pendulum arrangements were a tax avoidance scheme. Further, the email correspondence between Montpelier and the Welbeck Partnership ('Welbeck'), which introduced Mr Sherrington and Mr Waite to the Pendulum Contracts, made it clear that Welbeck and, in particular one of its partners, Gregor Shaw, would have marketed the Pendulum Contracts in the same way as Montpelier. Accordingly, we find that the Pendulum Contracts were a marketed to the Appellants as a tax avoidance scheme.

60. That finding, by itself, does not determine the issues in these appeals which we have set out at [25] above and we consider other factors below.

Pre-Pendulum transactions

61. The Appellants' case was that they entered into the Pendulum Contracts in the course of existing trades in derivatives. In the case of Mr Waite, HMRC accepted that he was carrying on a trade in derivatives before he entered into any Pendulum Contract. HMRC did not accept that Mr Sherrington or Mr Metcalfe were carrying on a trade at any point. We now consider the pre-Pendulum transactions of Mr Sherrington and Mr Metcalfe.

Mr Sherrington's pre-Pendulum transactions

62. Mr Sherrington qualified as an accountant in Australia although he never practised as an accountant when he lived in the UK but worked in financial services. At the time of the events with which this appeal is concerned, he was employed as an equity analyst at ABN Amro in London for whom he had worked since 1998. When he joined the bank, Mr Sherrington worked initially in the equity derivatives section. In July 2000, Mr Sherrington moved to equity research. He spent about four years as a junior, then became a senior and then, in 2005, became the head of European research for telecoms. The role included advising the ABN Amro 'prop desk' (where the bank traded with its own money) which telecoms stocks to trade. In 2004-05, Mr Sherrington's income from his employment was just over £455,000.

63. Mr Sherrington's evidence was that he decided to start trading in CFDs in late 2004, which was before he became aware of Pendulum. To do so, he needed the consent of ABN Amro which took weeks to obtain. Each transaction had to be approved by ABN Amro's compliance section. ABN Amro did not permit Mr Sherrington to invest in telecoms stocks which he researched in his role as an analyst. Mr Sherrington stated that, on 30 December 2004, he made an enquiry concerning the Blue Index trading platform but did not proceed with it.

64. On 6 January 2005, Mr Sherrington opened a business current account at Barclays in the name of Sherrington Derivatives Trading. He also opened up a PO Box for the business, created a separate email address using a paid-for Yahoo Mail Plus service, had business cards and letterheads printed, bought a separate mobile phone and bought a filing cabinet and stationery. He also purchased a computer and various trading books.

65. Mr Sherrington had numerous discussions with economists at ABN Amro and other traders about what trades he should make. In particular, he discussed matters with a friend and colleague, Bradley McMaster (who also subsequently entered into Pendulum Contracts and was originally an appellant in this appeal but withdrew his appeal during the hearing). Mr Sherrington made his first bond trade on 10 January 2005 and his last on 20 January. He entered into five transactions buying gilts with a maximum value of £364.87 and a minimum of £99.31. On 20 January, Mr Sherrington emailed Mr McMaster to say that bonds were no longer a good purchase because interest rates and house prices were stable. After ten bond trades in two weeks, Mr Sherrington decided to focus solely on CFD trading because he considered that there was insufficient volatility in the bond markets for him to make a profit. All his gilts were sold by 24 January. Mr Sherrington paid £15 commission to buy the gilts and a further £15 to sell them. In that period, Mr Sherrington lost £156.40 on his bond transactions, of which all but £6.40 was commission.

66. We consider that the relatively small value of each transaction and the amounts of commission on buying and selling them (£20 in total for each trade) combined with the relatively short holding time show that this was not a serious undertaking. Our view is that Mr Sherrington did not seriously intend to make a profit, or was unconcerned about whether he would make a profit, on these transactions.

67. On 20 January 2005, Mr Sherrington opened a trading platform with Hargreaves Lansdown and put an initial deposit into the CFD account.

68. Mr Sherrington produced records of his CFD transactions with Hargreaves Lansdown between 27 January and 5 April 2005 and with E-Trade Financial between 17 March and 5 April. The records show that Mr Sherrington did not conduct any CFD transactions between 10 February and 2 March. Mr Sherrington said this was because he was writing his business plan and doing research including reading books he had bought. We were not shown any business plan. Mr Sherrington maintained in cross-examination that he had had a business plan but that it was lost after he left the UK in 2009 because he had moved house seven times since then and all his emails had been lost when his Yahoo account was deleted after two years of inactivity. A business plan was referred to in some emails which had been sent by him to Mr McMaster which were available. Mr Sherrington was vague about the details of his business plan and trading strategy but pointed out that it was some 14 years earlier.

69. In February and March 2005, Mr Sherrington subscribed to various newsletters and websites, eg Interactive Investor and Zaks TA, that provided advice and tips. From 17 March, Mr Sherrington used E-Trade Financial as his trading platform as the transaction costs were much cheaper than those of Hargreaves Lansdown. He had become unhappy with the CFD service provided by Hargreaves Lansdown and decided to change after meeting E-Trade representatives at the Master Investor Seminar. Hargreaves Lansdown agreed to cut his commission from £25 per trade to £20 (as he was trading so frequently) but could not match E-Trade at £9.95 per trade.

70. Between 26 January and 5 April, Mr Sherrington introduced capital of £11,170 into his two CFD accounts (£8,170 into the Hargreaves Lansdown account and £3,000 into the E Trade account). In the period from 27 January to 5 April, Mr Sherrington entered into 21 CFDs (14 with Hargreaves Lansdown and seven with E-Trade). By the end of the period, he had closed eight of these CFDs (seven with Hargreaves Lansdown and one with E-Trade). Mr Sherrington's net loss from the closed CFDs was £1,088.95 (the largest single loss was £640 and the largest single profit was £230). Mr Sherrington accepted that, for 2004-05, his total CFD profits were £380 and his total CFD losses were just under £3,500.

71. It appears that Mr Sherrington used stop-losses most of the time. Certainly, he placed stop-losses on all seven CFDs he entered into with E-Trade and sometimes he changed the level of stop-loss multiple times in a day. The stop losses removed much of the risk from his positions. We note that this attitude towards risk contrasts with Mr Sherrington's apparent attitude towards the risk of (and actual) loss of far higher amounts in the Pendulum Contracts which could not be mitigated by a stop-loss.

72. Mr Sherrington sought confirmation of the self-employed status of the trading he was undertaking from HMRC and received a confirmation that he was a self-employed trader in derivatives on 22 March 2005.

73. At the time of these transactions and the Pendulum Contracts described below, Mr Sherrington was working full time at ABN Amro. He explained that he normally started work at 6:30am and finished at 11pm from Monday through to Saturday but, as a result of his long hours, he was given leeway to do other things during the day as long as he brought in commission and wrote research. He said that, although most of his day was taken up with his full-time role at ABN Amro, he had three to four hours each day to do his own thing which he did using his personal laptop on his desk. We do not believe that any commercial organisation (and especially one as motivated by profit as an investment bank) would allow an employee to devote a quarter of an, admittedly, long working day to personal matters which had no value to the business.

74. Mr Sherrington said that working gave him access to the advice of other employees of ABN Amro and it is clear that he often met with colleagues to discuss possible trades. Mr

Sherrington accepted that what he was doing was trying to predict which way the price of stocks would move based on information provided by colleagues or from his own research using information from sources such as Zaks TA. While such things were no doubt useful, we do not accept that chatting to colleagues and buying and selling bonds or CFDs during a working day was consistent with Mr Sherrington being a serious trader seriously interested in profit but rather it gave us the impression of someone pursuing a hobby or "dabbling" like Mr Metcalfe (see [83] below). We consider that the small scale of Mr Sherrington's bond transactions and CFDs in terms of their number and value together with the fact that he could only devote a limited amount of time to them during his working day show that he was not trading.

Mr Metcalfe's pre-Pendulum transactions

75. Mr Metcalfe worked in reinsurance broking in the City of London from 1974 until his retirement in January 2016. In 1987, he borrowed money to purchase shares in his employer, Robert Fleming Insurance Brokers. After that, he gradually began to invest in UK and some foreign equities as a "self-directed investor". Mr Metcalfe said that he was very active in investing in UK and international equities for at least ten years before he started to trade in derivatives in December 2004. There was no dispute that Mr Metcalfe's tax returns before 2004-05 showed that he was investing in shares.

76. Mr Metcalfe said that he became aware of "alternative ways of investing" and that being a sole trader offered some tax advantages and so he started trading in December 2004 as a result of conversations with Stuart Richmond, an independent financial adviser who was employed by Cadmans, which was associated with, and later taken over by, Montpelier. Mr Richmond introduced Mr Metcalfe to Ross Sparkes of Montpelier in early 2005, probably in February. Mr Metcalfe was aware that Montpelier were tax advisers and that was how Mr Sparkes had described himself. Mr Metcalfe was not clear whether it was Mr Richmond or Mr Sparkes who explained to him that, as a self-employed trader, he could obtain relief for trading losses by setting them off against his income.

77. He also became aware of the advantages of CFD trading rather than equity trading due to the higher leverage, lower deposits and greater accessibility to trading UK and worldwide stocks and indices. He said that he was prepared to risk his net retained income after tax on financial investments as he had been doing for 17 years prior to his first CFD trade in 2004.

78. Mr Metcalfe was advised by Mr Sparkes that it would be useful for him to register as a sole trader and that this was sufficient for him to obtain the tax relief on losses. He understood that by signing up to a CFD 'trading platform' he was engaging in 'trading'. Mr Metcalfe submitted an application form dated 17 December 2004 to the CFD platform Interactive Investor. His tax return for 2004-05 stated that his trade started on 17 December 2004 which he acknowledged in cross-examination was not accurate because that was simply the date of his application to Interactive Investor.

79. Mr Metcalfe said that he started to trade derivatives because he believed that he could use his expertise in business and finance, achieved over many decades, to create a second source of income. His evidence was that he believed that he could successfully trade in derivatives and make a profit which he said he had on many occasions. Mr Metcalfe said he committed very large amounts of his spare capital to the trading, using his own capital with a view to beating the market and making a profit using his own expertise. He maintained that there was nothing incidental in the trading which was not a hobby but rather a serious financial venture involving substantial risk to capital. Mr Metcalfe transferred £10,000 to his Interactive Investor account on 2 February 2005 and bought his first CFDs later the same day. On the

basis of that payment and transaction, we find that, if Mr Metcalfe was in fact trading, the trade started on 2 February 2005 rather than in December 2004.

80. Mr Metcalfe produced statements for transactions he entered into with Interactive Investor between 2 February and 5 April 2005. In total, he introduced capital of £20,000 which remined intact. There were around 80 trades of buying or selling CFDs, mostly in FTSE 100 and FTSE 250 stock. He entered into five transactions within the space of about 20 minutes on the morning of 9 February and nine transactions on 8 March (he was unsure whether this was the most activity in a single day).

81. Profits and losses on individual transactions were modest. The largest profit shown was £1,125 and the largest loss was £300 (although on 7 April 2005 open positions included unrealised losses of £1,700 and £1,480). Mr Metcalfe summarised his pre-Pendulum results in a letter to Mr Sparkes, dated 12 May 2005, which showed total income from this source was £5,603.25 and combined losses and costs were £3,992.44.

82. Mr Metcalfe said that he did not have a business plan but did have a strategy. This strategy was not written down because it did not need to be. Mr Metcalfe said that his strategy at the time "was to invest cautiously and build up [his] activity cautiously". He stated in re-examination that his "intention was to invest long term".

83. Mr Metcalfe did not hedge or use stop-losses in 2004-05. He considered his activities were commercial because they involved hard cash and because he and his counterparty both intended to make money from the other. He said that the trading was done on a daily basis and the long-term aim of making a profit would be the result of quite a lot of daily activity over a very long period of time. Mr Metcalfe monitored his positions every day but not all the time because it was not necessary and most of his working day was concerned with his employment. When it was put to him, Mr Metcalfe said that he did not regard himself as dabbling (which he described as "fairly half-hearted engagement") in the market but said that "somebody viewing it from the outside might have come to that conclusion". He denied that he had been trying to give the appearance of trading. We do not accept that. The lack of a business plan and the modest scale of his transactions in CFDs and level of profits and losses together with the fact that he could only devote a limited amount of time to them during his working day show that he was akin to the hobby art gallery or antique shop in *Wannell v Rothwell* (see [39] above) and not a trader.

84. Mr Metcalfe said that he had continued to trade since 2004, both profitably and unprofitably, on various commercial CFD trading platforms, City Index and CMC Markets. He lost a tremendous amount of money on CFDs and equities during the financial crisis of 2008. He realised that indices did not collapse to the same extent as individual companies. Since then he had invested in a range of global indices seeking a balance geographically, between short and long and between cash and futures.

85. Mr Metcalfe's evidence was that, as at the date of his witness statement (3 February 2017), he continued to trade profitably in CFDs. He had cash of £742,354 employed in the business as at that time. He said that he now probably spends half an hour a day working on his transactions. His total margin charge was £28,339 with unrealised losses of £229,044 which left free cash of £482,922. He hoped to make a profit for the year of around £400,000. HMRC had not raised any enquiry into Mr Metcalfe's tax returns since 2004-05 (except to request copies of trading statements in one subsequent year). Some returns included claims for loss relief from derivative trading. He accepted that he had not previously made a profit on the scale he made in 2016-17 and that his total losses since 2004-05 probably exceeded his total profits.

Contractual framework of Pendulum arrangements

86. In addition to the Pre-Pendulum transactions described above, each Appellant entered into two or more Pendulum Contracts. We describe below the common features of the contractual framework that underpinned the Pendulum Contracts before considering the facts in relation to each Appellant's transactions in relation to the Pendulum Contracts.

Master Agreements

87. Before entering into a Pendulum Contract, each Appellant entered into a "Master Agreement" with Pendulum. The Master Agreement was not itself a Pendulum Contract but rather template contractual terms that would apply to any such contract documented under it. These template provisions were applied to specific financial and other terms agreed following the service of a CFD Offer to Trade and Acceptance Confirmation Note as described below at [91] and [92]. Any Pendulum Contract entered into under the Master Agreement was expressed to be subject to the law of the Seychelles and the jurisdiction of the courts in the Seychelles.

88. There appear to have been at least five versions (Version 5 to Version 9) of the Master Agreement in use between February and March 2005 although only three of those versions are relevant to this appeal. Mr Sherrington's three Pendulum Contracts were governed by Version 9 of the Master Agreement, as were Mr Waite's fourth and fifth Pendulum Contracts and Mr Metcalfe's second Pendulum Contract. Mr Waite's first three Pendulum Contracts appear to have been governed by Version 5 of the Master Agreement, which was not produced in evidence. Mr Metcalfe's first Pendulum Contract appears to have been governed by Version 8 of the Master Agreement. The description of the relevant contractual provisions in the following paragraphs refers to Version 9 of the Master Agreement (with differences in Version 8 noted where relevant).

89. The Master Agreement specified contractual terms that applied to the Pendulum Contracts documented under it as follows:

(1) Payments were to be made by reference to the performance of the "Designated Index" specified for the purpose which, in the case of all the Appellants' Pendulum Contracts, was the FTSE 100 index. Payments would be calculated by applying percentages either to the "Designated Issue Value" of a Contract or to other figures related to that Designated Issue Value.

(2) There were five "Phases" to each Pendulum Contract.

(3) Phase One commenced on the Start Date proposed by the counterparty (ie one of the Appellants) and accepted by Pendulum. Phase One ended on an End Date agreed in the same manner. The period of time over which Phase One ran was referred to as the "CFD Period".

(4) The counterparty agreed to pay the "Initial Margin" to Pendulum within five days of Pendulum notifying its acceptance. The Initial Margin was a percentage of the Designated Issue Value of that Pendulum Contract with the precise percentage to be determined in the CFD Offer to Trade and Acceptance Confirmation Note described below.

(5) If the Designated Index moved up, or down, by an amount greater than the Designated Swing Movement over Phase One, the contract would come to an end on conclusion of Phase One and Pendulum would be obliged to make a payment of "Trade Profit" to the counterparty. The "Trade Profit" was defined as being twice the Initial Margin.

(6) If a Pendulum Contract did not terminate at the end of Phase One, it would move into Phase Two. If a Contract moved into Phase Two, Pendulum would serve a Notice of Obligation on its counterparty requiring the counterparty to pay Pendulum the "Margin Call Balance" (being the balance of the Designated Issue Value of the Contract less the Initial Margin that had already been paid at the start of Phase One as described at (4) above). The counterparties were contractually obliged to pay the Margin Call Balance to Pendulum within seven days of service of the Notice of Obligation.

(7) Pendulum and its counterparties would agree, in the CFD Offer to Trade and Acceptance Confirmation Note, how long Phase Two was to last. In the Appellants' Pendulum Contracts, Phase Two lasted two years. Payments due to the counterparties under Phase Two would depend on whether the Designated Index was equal to or greater than an agreed and specified "Index Target Level" at the end of Phase Two. If so, the Pendulum Contract ended and the counterparty would be entitled to receive a payment of "Trade Profit" from Pendulum.

(8) For the purposes of Phase One and any subsequent Phases, "Trade Profit" was defined as "… a success payment by Pendulum calculated by reference to Your Initial Margin being in an amount equal to twice that of Your Initial Margin payment …". The definition of Trade Profit in the Master Agreement suggested that it would be the same no matter at which phase the Contracts were successful. This, however, conflicts with the wording of the Acceptance Confirmation Notes issued to the Appellants, which provided that for a win at Phase Two and any of the successive phases the "Trade Profit" would be calculated as a percentage of the Designated Issue Value and not the Initial Margin.

(9) If a Pendulum Contract did not terminate at the end of Phase Two, it would move into Phase Three. A counterparty was not required to make any further payment to Pendulum at the start of Phase Three (or any subsequent phase) because the balance of the Designated Issue Value had been paid at the beginning of Phase Two and no further payment was due from the counterparty. Pendulum and its counterparty would agree the duration of Phase Three and the applicable Index Target Level. In the Appellants' Pendulum Contracts, Phase Three ended seven years after commencement of the contract. At the end of Phase Three, if the Designated Index was at least equal to the specified Index Target Level, the Pendulum Contract would come to an end and Pendulum would be obliged to pay the counterparty the "Trade Profit". If the Pendulum Contract did not terminate at the end of Phase Three, it would move into Phase Four, which in the case of the Appellants would end fifteen years after commencement. If the specified Index Target Level was not met at the end of Phase Four then the Pendulum Contract moved into Phase Five, which would come to an end 25 years after commencement. If, at the end of Phrase Five, the Designated Index did not have a value at least equal to the specified Index Target Level, the Pendulum Contract would come to an end and both parties would be relieved of all rights and obligations thereunder.

(10) The Master Agreement provided that the Appellants could freely assign their rights under their Pendulum Contracts.

(11) Clause 1.6 of the Master Agreement provided that:

> "Pendulum does not direct its communications to or engage in business with citizens or residents or corporate or other entities of the United States of America …"

(12) Appendix 9 to the Master Agreement headed 'United States Persons' provided relevantly:

> "Pendulum Investment Corporation is not licensed to and does not hold itself out as ready to and will not knowingly do business with … any corporation, partnership or other legal entity formed under the laws of the USA ('US Person') … All such persons are expressly prohibited by Pendulum Investment Corporation … from having any contractual dealings with Pendulum Investment Corporation whatsoever".

Pendulum Contracts

90. The Master Agreement left several key contractual terms of the Pendulum Contracts to be agreed between the Appellants and Pendulum. These were agreed and set out in the "CFD Offer to Trade" and "Acceptance Confirmation Note" which were exchanged between the parties.

91. Each Appellant sent Pendulum a CFD Offer to Trade. This document referred to the Master Agreement with the relevant Appellant and provided that the terms of that Master Agreement were incorporated into it by reference. In the CFD Offer to Trade, each Appellant made proposals as to the key financial terms that would apply to the proposed Pendulum Contract. For example, each CFD Offer to Trade contained the Appellant's proposals as to:

(1) the Designated Index (in all cases, this was the FTSE 100);

(2) the Designated Issue Value and the percentage of that Designated Issue Value that would be payable by way of Initial Margin;

(3) the Start Date and the duration of Phase One together with the Designated Swing Movement that, if achieved, would result in the Appellant receiving a Trade Profit payment and the Pendulum Contract terminating at the end of Phase One;

(4) the lengths of Phases Two to Phase Five and the Index Target Levels for each Phase which, if achieved, would result in the Appellant receiving a Trade Profit payment and the termination of the contract; and

(5) the amounts of the Trade Profit, expressed as a percentage of the Designated Issue Value, payable by Pendulum to each Appellant if the Index Target Levels were met at the end of Phase Two (130%), Phase Three (210%), Phase Four (450%) and Phase Five (1200%).

92. Having received a CFD Offer to Trade from the Appellants, Pendulum sent an Acceptance Confirmation Note. The Acceptance Confirmation Note included a statement to the effect that the offer contained in the CFD Offer to Trade had been accepted and set out a list of various key financial terms (including those financial terms on which the Appellant in question had made a proposal in his CFD Offer to Trade).

93. In the case of one Appellant, Mr Waite, there was a minor difference between the swing he offered in his CFD Offer to Trade and Pendulum's acceptance. Mr Waite had written two different figures for the swing and Pendulum's acceptance referred to only one of them. We regard that as a mere slip and nothing turns on it.

94. In *Thomson*, which concerned other Pendulum Contracts under Version 9 and Version 10 of the Master Agreement, the FTT pointed out, at [35] and [36], that there was some disagreement between the parties in that case about the calculation of the amounts payable if the appellants were successful at the end of any Phase because the definition of "Trade Profit" lacked clarity. The same issue arose in these appeals. We agree with the FTT in *Thomson* that nothing much turns on which is the correct interpretation of the definition as it does not determine any of the issues in the appeals. Accordingly, we do not need to resolve this point but, for what it is worth, would have reached the same conclusions as the FTT in *Thomson* had it been necessary to do so. We also agree that the fact that the Appellants were not aware of

and, therefore, took no steps to resolve the lack of clarity in the definition of Trade Profit is relevant when assessing whether there was a commercial basis for the activity and how each Appellant regarded the transactions.

95. Within about five days of receiving the Acceptance Confirmation Note, each Appellant had to pay his Initial Margin to Pendulum. All the Appellants paid their Initial Margin from their own resources.

96. Mr Sherrington and Mr Metcalfe were not successful in Phase One of any of their Pendulum Contracts which, accordingly, moved into Phase Two. Mr Waite was successful at the end of Phase One of his first and fourth Pendulum Contracts which, therefore, came to an end. His second, third and fifth Pendulum Contracts were not, however, successful and moved into Phase Two. Where a contract entered Phase Two, each Appellant had to fund the balance of the Designated Issue Value (i.e. the "Margin Call Balance") that was due.

Loan Agreements

97. Each Appellant accepted that he was offered loans on favourable terms at or before the time when he made his CFD Offers to Trade and that he would not have traded on the same scale or at all without the soft financing.

98. Mr Gittins went to Switzerland to meet a representative of Mandaconsult AG ('Mandaconsult') to discuss financing. Mandaconsult agreed to provide financing in principle and draft Mandaconsult loan agreements were produced. In the event, Mandaconsult never provided any loans to the Appellants or any other Pendulum counterparties.

99. In the case of Mr Waite and Mr Metcalfe, there was confusion about the identity of the company that would provide the financing. It appears that Mr Waite and Mr Metcalfe were offered financing by Mandaconsult and there is no doubt that they signed some agreements with that company although, in fact, the loans were actually made by Bayridge. Mr Sherrington only dealt with Bayridge and he said in evidence that he did not recall the name Mandaconsult. Mr Gittins' evidence was that it was intended that Mandaconsult would offer the loans instead of Bayridge and this led, in some cases, to agreements being executed with Mandaconsult which were later replaced by agreements with Bayridge.

100. Bayridge is incorporated in Delaware and is owned and controlled by Mr Gittins. The terms of the Bayridge loan agreements with the Appellants in this case are materially the same as the terms of the Bayridge loans in *Thomson* (see that decision at [39]). The terms included the following:

(1) Bayridge undertook to lend each Appellant the amount necessary to fund the balance due to Pendulum. That loan could only be used to fund the Margin Call Balance due to Pendulum.

(2) Bayridge did not charge interest on the loans. If an Appellant were to be successful at the end of any of Phase Two to Phase Five of the Pendulum Contract, that Appellant would pay Bayridge a fee equal to an agreed percentage of the profit made on the Contract. Different percentages applied to different Phases.

(3) The loan was repayable to Bayridge at the same time as any fee became due to the company. Accordingly, the loan would be repayable if and when an Appellant achieved success in any of Phase Two to Phase Five. If Phase Two to Phase Four of the Contract ended without the Appellant becoming entitled to a Trade Profit payment, the loan would be rolled over until the end of the next Phase with no amount being repayable to Bayridge.

(4) In the event that the Appellant never becomes entitled to a Trade Profit payment, the loan is repayable 50 years after the loan agreement was signed. Accordingly, if an

Appellant does not achieve success by the end of Phase Five, which ends 25 years after the start of the Pendulum Contract, the loan will continue, on interest-free terms, for a further 25 years. By the time of repayment, the value of the amount originally advanced would have been eroded by 50 years' inflation.

(5) The loan agreements specify that the loan would become immediately repayable on the occurrence of a limited number of "events of default". Those events of default included a breach, by the relevant Appellant, of the terms of the agreement and certain insolvency related events (for example bankruptcy). However, the loan agreements do not specify that the death of a borrower would result in a loan becoming repayable.

101. Having entered into a loan agreement with Bayridge on the above terms, each Appellant assumed that Bayridge would simply pay Pendulum the principal amount of that loan (since the whole purpose of each loan was to enable the Appellants to fund the Margin Call Balance that was due to Pendulum) without any action by the Appellant. Therefore, although each Appellant received the Notices of Obligation referred to at [89(6)] above, informing them that they were obliged to pay the Margin Call Balance to Pendulum, they did not make that payment out of their own funds as they relied on Bayridge to do so. None of the Appellants took any steps to check that this had been done. In fact, no physical payments were made to Pendulum by Bayridge and the Appellants' obligations to pay the Margin Call Balance were satisfied by a system of "book entries" adjusting the intra-company balance between Pendulum and Bayridge.

102. We accept, as did the FTT in *Thomson* at [41], that loan agreements between the Appellants and Bayridge were on the terms summarised at [100] above and that the system of "book entries" was implemented as a means of discharging obligations under the various agreements and contracts.

103. We also reach the same conclusion as the FTT in *Thomson* at [42] which is that, viewed on a standalone basis, the Bayridge loans were on completely uncommercial terms which were highly favourable to the Appellants. The lack of commerciality is clear from a number of features, including the following:

(1) the length of the term (up to 50 years if the borrower was unsuccessful in Phases Two to Five);

(2) the fact that the loan could continue for 25 years after the end of the Pendulum Contract;

(3) the uncertain prospect of a fee if a borrower were to be successful in any of Phases Two to Five;

(4) the absence of any obligation on the borrower to pay Bayridge interest or a premium on redemption after, possibly, 50 years;

(5) the lack of any security for the repayment of the loan and the absence of any obligation on the borrower to keep Bayridge informed of his current contact details;

(6) the fact that the death of a borrower would not cause the loan to become repayable; and

(7) the fact that Pendulum could demand that Bayridge pay the Margin Call Balance recorded as due in the intra-company balance between Pendulum and Bayridge at any time whereas Bayridge had no ability to obtain payment from the borrower in those circumstances.

104. Mr Gittins's evidence in *Thomson*, which was not contradicted before us, was that Bayridge attached little significance to the fact that it would only receive a fee if a borrower achieved success in their Pendulum CFD. This was because Pendulum and Bayridge believed there was little prospect of the borrowers succeeding at Phases Two to Five and Pendulum having to pay out under the Pendulum CFDs.

105. We entirely agree with the conclusions of the FTT in *Thomson*, at [64], that the Bayridge loans were on manifestly uncommercial terms that were disadvantageous to Bayridge and that Bayridge was only prepared to lend money on those terms because it had a separate economic relationship with Pendulum which did benefit from the Pendulum Contracts. We consider, however, that the benefit to Pendulum was illusory in that it would only accrue if Bayridge eventually discharged the amount due in the intra-company balance and, in our view, there was no reasonable prospect of it being able to do so. We also agree with the FTT in *Thomson* that the rationale for the loans was to "ramp up" the amount of the trading loss that users of the Pendulum scheme could claim while at the same time ensuring that loss was not an economic loss.

Pendulum's offers to repurchase

106. When the Appellants were not successful at the end of Phase One and their Pendulum Contracts entered Phase Two, Pendulum made each Appellant an offer to repurchase their Pendulum Contracts. The offers referred to the "market value" of the contract and quoted a repurchase price as at the last day of the relevant tax year. All the offers were a small fraction of the Initial Margin and Margin Call balance paid under the particular Pendulum Contract. None of the Appellants accepted Pendulum's offer.

107. Mr Gittins said in evidence that the offer price was not necessarily the market value, it was Pendulum's view of what it was prepared to pay at that time. It appeared to us that the valuation was highly subjective. Mr Gittins said that that the valuation was not based on the chance of success in any Phase which was not a factor in what Pendulum offered to pay to buy the Contract. We were left without any clear idea of what factors Pendulum did take into account in arriving at an offer beyond vague references to Pendulum's view based on its own book at the time. We agree with the FTT in *Thomson*, at [45], that Pendulum's "repurchase offer" was carefully worded to appear to be a valuation based on a fair market value. That was important because the Appellants used the Pendulum repurchase offers as the basis of their claims for losses. Mr Gittins told us that whether the Appellants used the offer to repurchase amounts in their tax returns was a matter for them. We note, however, that the Appellants' tax returns were prepared by Tony Quinn of Montpelier on Mr Gittins' instructions.

Mr Sherrington's Pendulum transactions

108. In February 2005, Mr Sherrington was introduced to Pendulum by Welbeck. He said that Welbeck had come to his attention already from talking to colleagues in the derivatives section of ABN Amro about trading. Mr Sherrington provided Pendulum with a Sophisticated Investor Certificate and e-mailed this to them when requesting an Information Memorandum on 14 February 2005. Welbeck also introduced Mr Sherrington to Bayridge so that he could obtain loans on generous terms for the purposes of trading with Pendulum. Also, in February 2005, Mr Sherrington sold his car for approximately £37,500 in order to have further funds in addition to his bonus from ABN Amro to fund his transactions.

109. Mr Sherrington described the Pendulum Contract in very favourable terms and as being the best derivative product on the market which, in combination with the soft loan from Bayridge, was a very good deal. He said that it gave him the opportunity to take advantage of a highly leveraged investment which had the ability to provide a much greater profit than he was able to achieve through the other trading platforms. He said that if the FTSE 100 moved

in his favour in the short term (typically seven days), he would double his margin but if that did not happen then the contract continued. He felt that the two year phase represented an opportunity to take advantage of a market rising in the longer term and that there were several opportunities for him to make a profit. Mr Sherrington said he was attracted to the Bayridge loan terms partly because they were long term but, more importantly, because they were interest free with a return to Bayridge based on a percentage of any profit on the Pendulum Contract.

110. Mr Sherrington entered into three Pendulum Contracts between 28 February and 15 March 2005. All three contracts operated by reference to movements on the FTSE 100 index over a 25-year period. Mr Sherrington did not choose the Index Target Levels but they had different swing rates.

111. Mr Sherrington made his first offer to trade to Pendulum on 28 February 2005. He sent an email to Gregor Shaw, a partner at Welbeck, at 7:15pm on 28 February saying that he had decided to go ahead with the Pendulum transaction. Gregor Shaw's signature, as witness to Mr Sherrington's signature, is dated 28 February 2005 but Mr Sherrington was unable to explain how this had happened given the timing of his email to Mr Shaw. Mr Sherrington said he believed that he had chosen the swing figures but he could not be certain. He said he negotiated a 5% margin rather than the 6% that Pendulum wanted. The offer was accepted by Pendulum on 2 March. Mr Sherrington's evidence was that his basis for the trade was his own work experience, speaking to various market commentators and looking at technical analysis specific to the FTSE 100. Pendulum did not send confirmation of receipt of the Initial Margin within three working days as required in the Master Agreement. Mr Sherrington thought that he would have chased it up by phone with Welbeck. He did not receive a receipt until 6 April 2005.

112. Mr Sherrington also entered into two other Pendulum Contracts on 11 March and 14 March 2005. In relation to the second Pendulum Contract, the CFD Offer to Trade misstated the End Date for Phase One and was corrected in the Acceptance Confirmation Note, which stated that Pendulum had confirmed this with Mr Sherrington but he acknowledged that he had no recollection of this happening. He accepted that the second 'Confirmation of Receipt of the Initial Margin' was sent late and said that Pendulum were "slack in their paperwork". The 'Confirmation of Receipt of the Initial Margin' for the third Pendulum Contract was also sent late.

113. Mr Sherrington said that he had not heard of Bayridge before it was mentioned to him by Welbeck and he did not conduct any research into Bayridge. He was not aware that Bayridge was a Delaware LLC. Mr Sherrington could not recall whether he was required to complete any form of loan application and did not know whether Bayridge checked his creditworthiness. He accepted that Bayridge provided 95 per cent of the capital but would get at most 75 per cent of the profit. He was not aware of any other commercial lenders offering loans on similar terms. Mr Sherrington stated: "I signed my forms, gave them back to Welbeck and what happened to them after that I don't know anything about". It is clear that Welbeck organised everything for him and he relied on Welbeck to guide him through the documentation although he was aware that Welbeck were not lawyers. As mentioned above at [94], there was some disagreement about the amount that would be payable if Mr Sherrington was successful at any of Phases Two to Five. Mr Sherrington insisted he would receive the Issue Value in addition to the Trade Profit. In his evidence, Mr Gittins said that was plainly wrong.

114. Mr Sherrington stated that his family, lawyers and business associates were well aware of the position in respect of repaying the Bayridge loans. He had taken no steps, separate from

his involvement in the appeal, to keep Bayridge informed of his whereabouts and contact information and, indeed, he now lived in Australia.

115. Mr Sherrington was unsuccessful at the end of Phase One in all his Pendulum Contracts and received Notices of Obligation to pay the Margin Call Balance, which was £285,000 for each contract. The amounts due were settled by Bayridge according to the terms of the respective loan agreements. In order to satisfy his obligation to pay the Margin Call Balances to Pendulum, Mr Sherrington entered into three loan agreements with Bayridge signed by him and by Mr Gittins, on behalf of Bayridge.

116. Mr Sherrington said that he had received notices of confirmation of satisfaction of obligations in respect of the Margin Call Balance for each contract and he was happy to accept them as confirmation that Bayridge had satisfied his obligations.

117. Mr Sherrington's Pendulum Contracts did not reach the Index Target Levels at the end of Phase Two, at the end of two years, or Phase Three after seven years and the 15 and 25 year target points have yet to be reached.

118. Mr Sherrington also entered into Pendulum Contracts in the 2005-06 tax year as well as CFDs. We accept that he undertook over 188 transactions and that in two of the Pendulum Contracts in that year he made a profit at the end of Phase One. Those transactions and the losses claimed in respect of them are not the subject of this or any other appeal as HMRC have not opened an enquiry into his 2005-06 tax return.

119. It seemed to us that Mr Sherrington had a very relaxed attitude towards the risks to which he might be exposed by entering into the transactions. He did not carry out any research or due diligence on Pendulum himself but simply relied on what Welbeck told him. Mr Sherrington did not remember whether he was aware that Pendulum was not regulated in the UK or in the Seychelles but he said that this would not have concerned him had he known. We have difficulty in accepting that a person who had worked for so long in financial services, which is highly regulated, would be unconcerned to learn that he was investing substantial amounts of money in and hoping to make substantial profits from an entity that was not regulated anywhere. He did not see the relevance of Pendulum having paid up capital and reserves of only €1,000 in relation to the possibility that Pendulum could owe him as much as £11,700,000 (on his understanding of profit if all three 2004-05 contracts won at Phase Five).

120. In the hearing, considerable time was spent exploring whether Mr Sherrington's view of the growth prospects of the FTSE 100 was realistic and whether that meant that success at the end of the later Phases was achievable. We found Mr Sherrington's evidence to be confused. Having stated that he relied on the growth trend of the FTSE100, he then sought to rely on the Dow index. HMRC produced figures which showed that Mr Sherrington's calculations were wrong. Mr Sherrington had taken the growth of the Dow over 26 years (between 1979 and 2005) and calculated what the annual growth rate would have been had it grown by this amount over 25 years. In any event, we do not consider that it makes sense to use figures relating to the Dow to predict the growth of the FTSE100. Indeed, Mr Gittins accepted there was no direct correlation between the FTSE100 and the Dow. We find that Mr Sherrington's predictions for growth were based on incorrect data and we accept HMRC's evidence that, had the correct figures been used, the predictions would have shown that Mr Sherrington would not have been anywhere near achieving the specified Index Target Level in the Pendulum Contracts at the end of Phase Five.

121. Mr Sherrington stated in evidence that he had not read the documentation "in super detail" but had read what he "thought were the important parts". He said that he relied on Welbeck to provide "guidance in understanding the contract". Mr Sherrington also appeared confused about the nature of the Pendulum Contract. He stated that only Phase One of the

contract was a CFD and the other four phases were binary contracts but later appeared uncertain whether Phase One was a CFD saying that he was "not smart enough to actually know what the definition regulatory [sic] is for a CFD".

122. More fundamentally, Mr Sherrington did not appear to have confirmed how much would be payable by Pendulum in the event that he succeeded at any of Phases Two to Five. He was content to rely on what he was told by Welbeck, who were not lawyers, rather than reading the contract and, if necessary, obtaining advice.

123. Mr Sherrington displayed a similar lack of concern about Bayridge but that may be explained by the fact that the loans are unsecured and the loan agreements contain no obligation on Mr Sherrington to keep Bayridge informed of his whereabouts. In interview with HMRC and in giving evidence, Mr Sherrington said that the Bayridge loans were clearly on soft terms but he had assumed that was because Pendulum was keen to attract counterparty traders and used the soft leverage as a marketing tool. In making this assumption, Mr Sherrington seemed to ignore the fact that Pendulum and Bayridge were separate companies and that he had no knowledge of any arrangements between them or even if there were any such arrangements.

124. Mr Sherrington said that he had made provision for ultimate repayment and his solicitor and family are well aware of the debt and he had never discussed the writing off of the loans nor had it ever been suggested to him. The exact nature of the provision for repayment was not made clear but seemed to consist of no more than having informed his family and associates of the obligation.

125. Mr Sherrington stated that the soft loan was an important consideration in his overall assessment of the Pendulum risk but it was not the dominant factor. His evidence was that the dominant factor was his view that he could make a profit.

Mr Waite's Pendulum transactions

126. Mr Waite had worked in both trading and broking at major international banks and brokerage houses in derivatives since for about 25 years. He has worked in London, New York and Zurich. At the time covered by this appeal, Mr Waite was employed as a corporate bond and derivatives trader/broker in high yield corporate bonds, credit default swaps and various other instruments at MIS Brokers Limited. He had worked in that capacity since 1996.

127. Prior to his CFD transactions, Mr Waite entered into various spread betting transactions, mostly in small currencies. At some point, he became concerned that the people operating the spread betting were manipulating the price. In 2004, Mr Waite incurred losses of £177,500 on spread betting. He described this as a disaster. He knew that profits from spread betting were not taxable and that any losses were not tax deductible. His evidence was that, at that point, he decided that all his future trades would be CFDs because, while any profits would be taxable, any losses could be set against tax paid by him or due from him. Mr Waite said that he was happy to pay tax if he made profits but liked the fact that, if he made any losses then the financial impact would be lessened by the fact that they could reduce his tax liabilities.

128. Mr Waite had been a client of Montpelier since April 2004 and he said that he had "done lots of things" with Stuart Richmond since 2000. He accepted that he had been involved in AlphaBeta which he believed to be another tax planning product. His evidence was that he told Stuart Richmond that he was thinking about transacting in CFDs. Mr Waite was not sure if Stuart Richmond had brought up the possibility of claiming tax relief on losses.

129. In late 2004, Mr Waite decided to begin trading on his own account, with the full knowledge of his employer. He opened a business current account at Barclays in the name of Paul Waite Trading Derivatives Trading on 6 January 2005. He had opened a trading platform with IG Markets CFDs with transactions effective between the time period November 2004 to

December 2004. Mr Waite began trading CFDs with IG Markets in whatever took his fancy. He had access at this time to Bloomberg services which provided information and analysis as well as news updates and real time trading information. Mr Waite said that he also followed the markets extensively on CNBC in the evenings after the London close and read various print and online publications.

130. Mr Waite's witness statement says that he was introduced to Pendulum and Bayridge by Welbeck in February 2005 but he told us that the Pendulum Contracts were mentioned to him by Stuart Richmond, who did not work for Welbeck then or at any point. In fact, we were shown a letter from Mr Richmond to Mr Waite and one from Mr Waite to Montpelier, both dated 3 February 2005, which appeared to refer to Pendulum Contracts without using that name. We were also shown a letter, dated 8 February 2005, from Mr Waite to Pendulum and a sophisticated investor certificate signed by him of the same date. On 14 February 2005, Mr Waite emailed a completed Sophisticated Investor Certificate to Pendulum and requested an Information Memorandum about the Pendulum Contracts. On being asked about his memory of these documents, Mr Waite said that Stuart Richmond dealt with lots of different things for him and would often bring him things to sign and he would just sign them. We conclude that Mr Waite was told about the Pendulum Contracts and introduced to Pendulum and Bayridge by Mr Richmond in February 2005.

131. Mr Waite accepted that he did not carry out any research or due diligence into Pendulum and said that he assumed that Stuart Richmond would have done that. Mr Waite did not recall if he knew that Pendulum was not regulated in the UK, Seychelles or anywhere else. He told us that he would probably not have been concerned because he thought that, in 2004 and 2005, there were a lot of people who were not regulated.

132. Mr Waite said that, in his discussions before he traded with Pendulum, he had been assured that a soft loan would be available. We find that those discussions must have been with Mr Richmond. Mr Waite understood that Bayridge had undertaken to provide loans on generous terms to investors entering into Pendulum Contracts. He said that, if he had not had that agreement, it is probable that he would have traded with Pendulum for lesser sums or perhaps not traded at all.

133. Mr Waite sought advice from Montpelier (then MTM (Tax Consultants) Limited) about the effect of trading on his own account and the tax consequences of making profits or losses from trading. He was aware of the different tax treatments of the spread betting that he had been carrying on before and trading in derivatives. Mr Waite's evidence was that he was acutely aware, after many years of trading, that trading in derivatives was extremely risky.

134. Mr Waite said that the combination of the soft loan from Bayridge and the Pendulum Contract gave him the opportunity to take advantage of highly leveraged investment which had the ability to provide a much greater profit than he was able to achieve on his own through the other trading platforms. He was attracted by the ability to be long and short of the market at the same time and by the fact that if the first phase went against him, he still had the possibility to succeed on future phases. He said that, at that time, he had a long term bullish view of the FTSE 100.

135. In the first period of trading, Mr Waite entered into five Pendulum Contracts on 17 February, 2 March, 10 March, 16 March and 22 March 2005. Mr Waite received acceptance confirmations for each contract. In relation to the first contract, the Acceptance Confirmation Note was sent after the contract had started and his Initial Margin Payment was made late (which gave Pendulum the right to cancel the contract although they did not do so). Mr Waite was successful at the end of the first phase of the February Pendulum Contract and became entitled to a Trade Profit of twice the Initial Margin which was paid by a funds transfer from

Pendulum in Apri1 2005. Mr Waite invested his Trade Profit in two more Pendulum Contracts. Mr Waite was not successful at the end of the first phases of the next two contracts and he received Notices of Obligation requiring him to pay the Margin Call Balances to Pendulum. He was successful again at the end of the Phase One of his fourth Pendulum Contract and received a Trade Profit which he used to enter into the fifth Pendulum Contract in which he was once more unsuccessful at the end of the first phase. In each of the five Pendulum Contracts. Mr Waite paid an Initial Margin of £14,000 but the Margin Call Balances varied, being £336,000 in the first three contracts and £686,000 in the last two. The difference is explained by the fact that Mr Waite agreed a more favourable percentage in the fourth and fifth contracts so that the same Initial Margin, ie £14,000, supported a higher Designated Issue Value than in the first three contracts. The Margin Call Balances were each settled by Bayfield Investments LLC under the terms of the relevant loan agreements.

136. Mr Waite could not remember the details of his Pendulum Contract transactions such as who had chosen the Phase One swing figures or the Index Target Levels for the other Phases. The length of Phase One was seven days in the first two contracts but only five days in the remaining three. Mr Waite did not think that he would have noticed whether the phase was five days or seven days because he told us that this probably was not the most important thing going on in his life at the time. He was equally vague about the fact that payments of the Initial Margins in relation to his first, second and third Pendulum Contracts appeared to have been made late and could not recall if he was chased for payment. Mr Waite told us that, in those days, he had so much money coming in and going out that he did not look at bank statements for months on end so would not have seen if money had gone out or come in and did not know exactly how much money he had in the bank. He freely admitted that he did not know what was going on at that time. Mr Waite told us that he would not have picked up that a number was not right (as in the case of the Margin Call Balance figure for his fourth Pendulum Contract) because he just signed documents with one hand while doing a trade with someone else on the desk with the other.

137. Mr Waite maintained that, in entering into the Pendulum Contracts, he believed that his short term view of the market was right as against Pendulum's view, which it was in relation to the successful first contract of 17 February 2005 and fourth contract of 16 March 2005. His evidence was that the Bayridge loans on soft terms were very attractive to him and he regarded the Pendulum Contracts as entirely commercial. He said that he entered the transactions to make money.

138. The first three Pendulum Contracts were governed by version 5 of the Master Agreement. Mr Waite could not recall whether he had received a copy of version 5 and would not have looked at which version he was signing. When asked whether he had signed a copy of any version of the Master Agreement, Mr Waite could not remember. He said that, at this time, he would probably not ask to see every single thing that he signed and he might have missed things. He thought that he had read the Master Agreement but he could not remember how he perceived it and when or where he had read it.

139. Mr Waite signed six loan agreements in relation to his five Pendulum Contracts. Mr Waite's recollection of the loan agreements was extremely vague even taking account of the passage of time. He was not sure who the loans were with but thought that he would have known who the lender was at the time. He could not remember how many loan agreements he had signed in 2005 or whether he had signed loan agreements with Mandaconsult or Bayridge although he said that he had heard of both companies. He could not recall if he had signed loan agreements in relation to the two Pendulum Contracts on which he had been successful at the end of the first phase. Nor did he know why he appeared to have signed a loan agreement with Bayridge and then signed one covering the same Margin Call Balance with Mandaconsult. He

said that Stuart Richmond would have understood it and explained it to him at the time. Mr Waite said that he was sure that he was happy to do it at the time.

140. As with Pendulum, Mr Waite did no due diligence into Bayridge before he entered into the loan agreements. He told us that this was because he was being given a soft loan and so did not think that he needed to do any due diligence and also because he assumed Stuart Richmond would have done some.

141. Mr Waite never sought confirmation that the Margin Call Balances had been paid by Bayridge to Pendulum. He could not remember if he was aware that the loan would terminate if not drawn down within four weeks. He said that, while he was entering into the Pendulum Contracts, he was also running a bond desk in London which was turning over an enormous amount of money and generating something like US$50 million a year in brokerage.

142. He thought that he probably did not ask Pendulum for a receipt to show that the Margin Call Balance had been paid and could not recall whether he had received the 'Confirmation of Satisfaction of Obligations in Respect of Margin Call Balance'. He accepted that he had no evidence of whether the loan was drawn down.

143. Mr Waite was aware that he would be obliged to repay the loans and pay fees to Bayridge if he were successful at the end of any phases of the Pendulum Contracts after Phase One.

144. Like the other Appellants, Mr Waite thought that, if he won at the end of Phase Two of any of the Pendulum Contracts, he would receive his Issue Value plus 130 per cent of his Issue Value and would pay Bayridge the amount of the loan plus 30 per cent of the 130 per cent of the Issue Value.

145. Mr Waite told us that he did not consider it odd that the Pendulum Contract was for 25 years but the loan term was 50 years. He said he was happy to have a 50-year loan. Nor did he find it odd that the loan was interest-free for the entire period. He thought that the loans were provided to induce people to enter into the Pendulum Contracts. He compared it to a four or five year interest free loan to sell sofas or cars. Mr Waite did not accept that the loan was uncommercial.

146. In his witness statement, Mr Waite said that his loans from Bayridge remained due and payable. He said that he had made financial provision for payment of the loans when they become due, when he would be aged 88. Mr Waite told us that he was not concerned about this at the time because he was making so much money and was expecting to make a lot more. He had ringfenced some assets to meet the Bayridge loans but told us that circumstances had changed which led to the assets becoming "unringfenced". He told us that his aunt was the executor of his will and she was aware of the existence of the Bayridge loans. Mr Waite said that had never held any discussions concerning the loans being written off and there was no understanding to do so.

147. Mr Waite initially stated that he believed that he had provided Bayridge with updated contact details (he now lived in Switzerland) but said he did not remember exactly when he had done so, if he had, but thought he might have told Stuart Richmond.

148. Mr Waite did not recall receiving the offers from Pendulum to purchase his Contracts, nor was he aware that the figures were used to value the Pendulum Contracts for his tax return. He said that if he had received the information, he would probably not have looked at the valuations in any detail or at all. Mr Waite could not explain how the valuations were calculated. He said that he was not concerned about the loss he had incurred because he believed that there was a large amount of profit to be made as well.

149. Mr Waite did not have a business plan and his strategy for the Pendulum Contracts seemed vague. He spoke about looking at historical prices of equity markets but offered no detail. He made general assertions that he felt, at the time, that the market could rise in a big way and might have done if the 2008 financial crisis had not occurred.

150. Mr Waite maintained that the losses claimed had arisen in respect of the movement of the contract and were losses arising in a trade carried on by him with a view to making a profit. Mr Waite said that tax avoidance was never in his mind and his sole focus was on making profit. In particular he did not discuss with Welbeck or anybody from Pendulum or Montpelier the creation of a tax loss. We do not accept Mr Waite's evidence on this point. We discuss why a person would prefer to lose at Phase One of a Pendulum Contract in [171] below. We also conclude, at [178] and [179], that the Pendulum arrangements were marketed as a means to reduce a person's liability to income tax by generating a trading loss. It is clear that Mr Waite was keenly aware of the need to make a profit on a deal in his regular day job and in his other personal trading. We cannot accept that Mr Waite would not have realised that he was much better off losing at the end of Phase One of a Pendulum Contract than winning. We speculate that perhaps, as an inveterate trader, Mr Waite could not help himself from specifying a Designated Swing Movement that gave him a reasonable chance of winning in Phase One and receiving a Trade Profit payment. However, we consider that Mr Waite's real objective was not to win overall which would mean that he would not obtain the substantial reduction in his tax liability that was the intended consequence of losing at Phase One. This was shown by the fact that, after each success, Mr Waite entered into another Pendulum Contract and went on to lose at the end of Phase One.

Mr Metcalfe's Pendulum transactions

151. Mr Metcalfe had had some meetings about Pendulum at some point in late 2004 or early 2005 (Mr Metcalfe's evidence about the timing varied). The initial meeting or meetings were with Mr Richmond but it is clear that Mr Metcalfe also met Mr Gittins at an early stage. Mr Metcalfe told us that:

> "In 2004, when this structure was being contemplated, I asked the question [of Mr Gittins] as to whether any sums that I owed, first of all to Pendulum, would be a specific commercial and enforceable debt, and I asked if the loan facility would result in an enforceable debt."

152. In his evidence in chief, he described Pendulum offering a method of gaining exposure to the FTSE, promising "a return of sorts" and being relatively low risk due to its structure. In cross-examination, however, Mr Metcalfe said that he viewed the Pendulum Contract as a low-risk transaction because of the soft financing and that he would never have entered into it if there had not been "some kind of mitigation of risk". By that, we understood Mr Metcalfe to be referring to the loans offered to meet the Margin Call Balance if the contract was not successful at the end of Phase One. Notwithstanding the importance that Mr Metcalfe attached to the soft financing, as will be seen, his attitude towards the availability of and obligation to provide such finance was decidedly casual. For example, he had not carried out any research or due diligence in relation to Pendulum. He admitted that he was not aware that Pendulum was not regulated in the Seychelles or the UK or anywhere else and said that, had he been aware, he would have asked for an explanation. His understanding of the Master Agreement was based on what he was told by Mr Sparkes and he admitted that he had not asked Pendulum or Montpelier to clarify any points on the documentation. Nor did Mr Metcalfe carry out any assessment of whether Pendulum would have been able to pay if he were to win in later Phases. Mr Metcalfe said that he trusted Montpelier and Mr Sparkes.

153. Mr Metcalfe must have received a satisfactory answer to his questions and reassurance about the debt position because he entered into two Pendulum Contracts: the first on 3 March

2005 and the second on 11 March. The contracts had face values of £150,000 and £200,000 respectively.

154. The first Pendulum Contract appears to have been governed by Version 8 of the Master Agreement and the second by Version 9. Mr Metcalfe produced a copy of Version 8 of the Master Agreement signed by him but not by Pendulum. He did not produce a copy of a Version 9 Master Agreement. Mr Metcalfe could not recall ever having received a copy of Version 9 and did not know whether he had ever received a copy of either version of the Master Agreement signed on behalf of Pendulum. In relation to the Master Agreements, Mr Metcalfe said that he simply signed the documents that were put in front of him and that it was "highly unlikely that [he] would have trawled through all of the small print definitions at the time" but that he "would have scanned through the headings to see how things were defined". This was also Mr Metcalfe's approach in relation to the Offer to Trade form which he simply signed when it was presented to him already completed. He did not appear to have considered putting forward his own figures for each of the phases. He told us that he understood that he was simply responding to an offer from Pendulum to contract on the basis proposed by them. That was not right as Mr Gittins confirmed in his evidence.

155. In Phase One of his first Pendulum Contract, Mr Metcalfe specified a range of swing movement both up of 120 points and down of 100 points from the level of the closing price of the FTSE 100 on the day before he entered into his contract. The first contract stated that the starting level was 4922.8. Mr Bradley had consulted the FTSE 100 historical prices through Google Finance which showed that the actual closing price for the FTSE 100 on 2 March 2005 (the day before the start date of the contract) was in fact 4992.8. There was clearly a typing error in the Pendulum Contract. Mr Metcalfe said that he thought there was a document with the correct level but he could not locate it in the bundles. Overnight, he looked in his files at home and could not find it and concluded that he must have been mistaken.

156. At the end of Phase One of Mr Metcalfe's first Pendulum Contract, the FTSE 100 had not moved outside of the range specified by him and the contract moved into the Phase Two which lasted seven years. At this point, Mr Metcalfe became obliged to pay the Margin Call Balance which, in this case, was £141,000. Mr Metcalfe's evidence was that he entered into a loan agreement, which we discuss below, to satisfy his obligation to pay the Margin Call Balance to Pendulum.

157. The second phase of the contract lasted two years. If the FTSE 100 had reached or exceeded 7,020 points at the end of Phase Two, Mr Metcalfe was entitled to be paid a trade profit. In the event, the FTSE 100 did not reach or exceed its target level and the contract moved into Phase Three.

158. Two days after he was unsuccessful at the end of Phase One of his first contract, Mr Metcalfe entered into a second Pendulum Contract. As in the case of his first Pendulum Contract, Pendulum chose all the variables in the second contract. Mr Metcalfe said in evidence that he had decided how much he was going to invest with Pendulum and the decision to split that figure was made before he entered into the first transaction but he did not agree that he was planning to enter into the second Pendulum Contract regardless. However, Mr Gittins said in his evidence that Mr Metcalfe was told that he ought to split his £21,000 of capital into two Contracts, which is what happened as the initial margin of the first Pendulum Contract was £9,000 while the initial margin for the second was £12,000. At the end of Phase One of his second Pendulum Contract, the FTSE 100 had not moved outside of the specified range and Mr Metcalfe was required to pay the Margin Call Balance which was £188,000. The second Pendulum Contract also failed to reach the FTSE 100 target at the end of Phase Two after two years.

159. Both of Mr Metcalfe's Pendulum Contracts also failed to meet the specified levels at the end of Phase Three after seven years. The 15 and 25 year anniversary dates have yet to be reached in relation to the contracts in question. Mr Metcalfe seemed sanguine about his chances of success. When asked whether he had assessed his prospects of success in the later Phases, Mr Metcalfe did not provide any detail about any such evaluation. He said that he had understood that there was a "possibility of profit" in Phase Two and that the later Phases "looked to be really far out and quite difficult to gauge". In Mr Metcalfe's opinion, nobody could predict where the FTSE would be in one month's time. Mr Metcalfe said that he did not take independent advice but relied on his own assessment of the possibility. It is clear to us (and we so find) that Mr Metcalfe did not undertake any proper assessment of the chances of success or evaluation of risk in relation to his two Pendulum Contracts.

160. As we have already said, Mr Metcalfe's first Pendulum Contract appears to have been governed by Version 8 of the Master Agreement and the second by Version 9. It is strange therefore that the Acceptance Confirmation Note, Receipt for the Initial Margin and the Notice of Obligation to Pay Margin Call Balance were all Version 10 documents. Version 10 only had effect from 8 June 2005, which is three months later than the dates on the Acceptance Confirmation Notes which suggests that the Acceptance Confirmation Notes may have been produced at a later date and no valid contract was entered into in the 2004-05 tax year in question. Mr Metcalfe maintained that he would not have received them as late as June 2005. We do not consider that to be credible. In our view, it is more likely that the contractual documentation relied on by Mr Metcalfe was not provided to him before 8 June 2005 at the earliest. That suggests to us that Mr Metcalfe was not overly concerned that Pendulum had failed to perform its obligations under the Master Agreement by the times specified. We consider that the only reasonable explanation is that the contractual terms were not regarded by him as important.

161. In relation to the assessment of risk, Mr Metcalfe said that, as a businessman, he was more than capable of assessing risks. However, he seemed to regard the availability of the interest-free loans meant that the transactions were low risk. That was clearly incorrect. The 50 year term of the loans combined with the absence of interest reduced the cost to Mr Metcalfe as, in real terms, he would repay much less than he borrowed, but it did not reduce the risks associated with the transactions. Those risks included the possibility that the lender, whether Mandaconsult or Bayridge (and, as we will see, there was some confusion about that), would not meet the Margin Call Balance if Mr Metcalfe were unsuccessful at the end of Phase One of the Pendulum Contract and, if he were successful at the end of any subsequent Phase, whether Pendulum would have sufficient assets to pay him the Trade Profit (and, if not, leaving Mr Metcalfe with the obligation to repay his loan without any funding from Pendulum). Mr Metcalfe would, of course, be right in his assessment if there was no real prospect of him (or his heirs) ever having to repay the loan.

162. As we have already seen at [152], Mr Metcalfe did not carry out any due diligence in relation to Pendulum and knew almost nothing about it. From his attitude towards Pendulum, we infer that he was unconcerned about whether Pendulum would be able to pay any Trade Profit if he were to be successful in any Phase. Similarly, Mr Metcalfe's assessment that the financing made the transaction low risk and his relaxed attitude towards his obligations together with the slipshod approach of those lending him the money in documenting those obligations show, in our view, that it was never seriously contemplated by Mr Metcalfe or his lender (whether Mandaconsult or Bayridge) that the loans would be repaid.

163. As we have already said, Mr Metcalfe was unsuccessful at the end of Phase One in both of his Pendulum Contracts and became liable to pay the Margin Call Balance due in each case. That obligation was met by utilising the soft financing arrangements that appeared to be

important to Mr Metcalfe as a way of reducing his exposure to risk. There was, however, considerable confusion about the identity of the lender of the Margin Call Balance amounts.

164. In his witness statement, Mr Metcalfe said that he executed loan agreements with Mandaconsult at the time of his Pendulum Contracts. He said that he was indifferent as to the identity of the lender. He must also have been indifferent to whether Mandaconsult was legally obliged to advance the loan as he never saw a counter-signed loan agreement executed by Mandaconsult. Mr Metcalfe said that he was not concerned as he relied on the verbal assurance of Montpelier that there was such an agreement in place and that the Margin Call Balances would be satisfied by a loan on the favourable terms, ie 50 years and interest-free. We do not find Mr Metcalfe's evidence about his lack of concern to be credible. The availability and terms of the finance were clearly important to Mr Metcalfe because he said that he might not have traded at all, or only at a reduced level, if the soft financing had not been part of the package. The significance of this is that it subsequently emerged that Mr Metcalfe did not have any loan agreements with Mandaconsult or Bayridge.

165. Mr Metcalfe first became aware of Bayridge when Montpelier prepared a list of documents to send to HMRC in October 2006. Montpelier told Mr Metcalfe that the Mandaconsult loans had been transferred to Bayridge. Mr Metcalfe did not sign any loan agreement with Bayridge or any document agreeing to the assignment of his agreements with Mandaconsult (if there ever were any such agreements) nor did he ever see any documents setting out how Bayridge had taken over the loans. Mr Metcalfe displayed a surprising insouciance in relation to the lack of documentation and said that the debt was his and he intended to honour it. In his evidence, Mr Gittins agreed that neither he nor Mr Metcalfe had signed any Bayridge loan agreements. The obvious problem created by the lack of properly executed agreements is that Bayridge might find it impossible to enforce repayment of the loans at the end of the term, which could be as long as 50 years, without signed agreements. Mr Gittins, who gave oral evidence after Mr Metcalfe, said that as Mr Metcalfe had confirmed, on oath, that he had a liability to Bayridge then "from Bayridge's rather selfish point of view" they would perfect a written agreement with him and enforcement would be in the normal way. Whether or not such a course of action is adopted, we consider that Mr Gittins evidence clearly shows that, in the case of Mr Metcalfe at least, there were no genuine loan arrangements in place with Bayridge.

166. The first Mandaconsult loan agreement was signed by Mr Metcalfe on 10 March 2005. This was the day after the conclusion of Phase One of Mr Metcalfe's first Pendulum Contract. It was for an amount of £141,000 which was amount of the Margin Call Balance due under the contract. Mr Metcalfe signed the second Mandaconsult loan agreement on 21 March 2005. That was four days after the conclusion of Phase One of his second Pendulum Contract. It was for an amount of £188,000 which was the Margin Call Balance under that contract.

167. The Bayridge loan agreements were for the same amounts as the Mandaconsult agreements. Neither Bayridge loan agreement was signed by Mr Metcalfe. The first Bayridge loan agreement was shown as being dated 3 March 2005 which was seven days before the equivalent Mandaconsult agreement. The second Bayridge loan agreement was dated 11 March 2005: ten days before the equivalent Mandaconsult agreement. The dates of the Bayridge loan agreements were the dates on which the related Pendulum Contracts commenced but clearly Mr Metcalfe would have no idea whether he would be required to settle the margin call balance. Mr Gittins suggested that all loan agreements were prepared and signed by him, on behalf of Bayridge, on the day that a person entered into a Pendulum contract so that the agreements were ready should they be needed at the end of Phase One. If they were not needed, Mr Gittins said the loan agreements would be torn up. No satisfactory explanation was given by any witness for the discrepancy in dates. If the Bayridge agreements had already been

produced and signed then it made no sense for Mr Metcalfe to be required to sign agreements with Mandaconsult a week or more later.

168. Mr Metcalfe's evidence was that he had have never had any discussion with Bayridge concerning writing off part or all of the loans and there was no understanding to do so. He said that he had advised his heirs and successors of the need to make full financial provision for repayment of the loans but had not made any provision in his will. Mr Metcalfe's apparent acceptance of the obligation to repay a loan made by an entity with whom he had no agreement seemed to us to be at odds with his admission that he had not kept Bayridge updated with his contact details. In cross-examination, he said that he had asked Montpelier to confirm that they would enforce the debt and was told that they would and it "was then up to me to decide whether I could live for 50 years". We consider that this last answer shows that Mr Metcalfe did not expect the debt to survive him but that is not what he said when the point was put directly to him.

169. Overall, we found Mr Metcalfe's attitude to the loans to be confused and, for us, confusing. Mr Metcalfe appeared to be completely unconcerned about whether he had a contractual right to the loans even though the soft financing was important to his decision to enter into the Pendulum Contracts at all or at the level he did. We find that Mr Metcalfe did not enter into any legally binding loan agreements with Mandaconsult or Bayridge: Mandaconsult did not sign any loan agreement with Mr Metcalfe and he did not sign any loan agreement with Bayridge. Having learned that there was no contract with the actual lender, Bayridge, Mr Metcalfe seemed happy to accept this state of affairs without any legal documentation to record his obligations or those of the lender. We consider that Mr Metcalfe's lack of concern about due diligence and proper documentation at the outset and willingness to take on obligations to Bayridge, without any contractual documentation, can only be explained by the fact, which we find, that he did not regard the loans as creating real world rights and obligations. In our view, the absence of any genuine loan arrangements casts doubt on the commercial reality of Mr Metcalfe's Pendulum Contracts.

Economics of the Pendulum arrangements as a whole

170. Mr Bradley produced a schedule analysing all the Pendulum Contracts known to HMRC. HMRC had identified 253 contracts which were the same or similar to those entered into by the Appellants. In relation to those contracts, Pendulum received £3,049,849 by way of Initial Margins. The Initial Margin was a percentage of the overall value of each Pendulum Contract. The actual percentage varied between 2% and 14%, with most between 4% and 10%; both 2% Initial Margins were paid by Mr Waite in his fourth and fifth contracts. Only 29 of the 253 contracts were successful at Phase One. In this appeal, only Mr Waite won (twice) at the end of Phase One and none of the Appellants won at the end of Phase Two. In relation to the successful contracts, Pendulum would have had to pay a Trade Profit of twice the Initial Margin. We accept that Mr Bradley's schedule is broadly correct and shows that only 11.5% of Pendulum Contracts achieved success at Phase One. For the successful 29 contracts, the total Trade Profit was £434,500, leaving Pendulum with £2.62m in net Initial Margin receipts. In relation to the Pendulum Contracts that were not successful at Phase One, Pendulum was owed a total of £36,017,867 in Margin Call Balances. Pendulum's offers to re-purchase the Appellants' Pendulum Contracts show that Pendulum assessed the chances of those contracts achieving the relevant Index Target Level as negligible.

171. Mr Bradley explained why a person might prefer to lose at the end of Phase One and continue into Phase Two and subsequent Phases rather than win. The different economic benefits that flowed from success and failure at Phase One of a Pendulum Contract can be seen by examining the figures from Mr Sherrington's three contracts (which all had an Issue Value of £300,000). In each case, Mr Sherrington paid a 5% Initial Margin of £15,000. Mr

Sherrington was unsuccessful at Phase One in all three contracts but had he won at Phase One, he would have received twice the Initial Margin, ie £30,000, as Trade Profit. Mr Sherrington would thus have made a profit of £15,000 on which, as a higher rate taxpayer, he would have paid tax at 40% leaving a net gain of £9,000 on each contract that was successful at Phase One. In fact, Mr Sherrington always lost at Phase One and was left with three contracts, each with an Issue Value of £300,000, which were valued by Pendulum at £3,501, £4,000 and £4,199 respectively. That gave Mr Sherrington a total loss of £888,300 which he used to claim relief from tax in the current and previous years giving him a right to a repayment of £355,320. As he had paid three Initial Margins amounting to £45,000, Mr Sherrington's net position, having lost at Phase One, was a gain of £310,320. Against that, Mr Sherrington had a liability to repay Bayridge the three loans of £285,000, ie £855,000 in total, after 50 years which we consider below.

172. Mr Bradley's evidence was that all the people who made a 'Trade Profit' at Phase One went on to re-invest their proceeds into further contracts, which then went on to lose at Phase One. Mr Bradley explained that, in reality, the individuals had far more to gain from losing at Phase One than from winning because of the economics of the Pendulum Contract. Mr Bradley's view was that, given the benefits of losing, no one would have wanted to win at Phase One which is why, if they did, the participants in the Pendulum Contracts, including the Appellants, went on to enter into new contracts and lose at Phase One of those contracts. Mr Bradley's view was that the participants entered into the Pendulum Contracts solely in order to generate a loss. We accept Mr Bradley's analysis and conclusions. We find that the true objective of the Appellants in entering into the Pendulum contracts was not to make a profit at the end of any Phase but to lose at the end of Phase One so as to create a loss in respect of which they did not bear the full economic cost but which reduced their liability to tax.

Liability to repay Bayridge loans

173. On 12 January 2005, Ryan Morgan, the sales and marketing director of Montpelier, sent an email to Mr Gittins in which he said:

> "I am getting a few questions around the loan after 50 years. I know that in reality it won't be called."

174. Mr Gittins said in cross-examination that Mr Morgan's words could not be right or that he must have meant that the loan would not be called for no reason. Mr Gittins also said that Mr Morgan was a salesperson. We do not consider that the fact that Mr Morgan was trying to sell the Pendulum arrangements to Montpelier's clients makes his description of the effect of part of those arrangements unreliable. On the contrary, it seems to us that it is good evidence of what those clients were told and, therefore, the basis on which they entered into the arrangements with Pendulum and Bayridge. That is especially true in this case, given the Appellants' lack of due diligence and reliance on what they were told by their respective advisers. It was put to Mr Gittins that, in his reply to Mr Morgan, he had said that it was "crucial to the deal that they *are seen to* pay the full price' (emphasis supplied) as opposed to 'they pay'. He accepted there was a difference and explained that it was because Montpelier wanted evidence. We do not accept that explanation. We consider that the true meaning of Mr Gittins' words is the more natural reading, namely that the clients would never actually pay the full price of entering into the Pendulum Contracts but would only be seen to do so.

175. Without the trading loss, there could not be any tax relief but if the loss were a genuine economic loss (ie if the counterparty had had to pay the Margin Call Balance) then, as Mr Bradley has shown, a person who entered into a Pendulum Contract and lost at Phase One would be much worse off at the end of the contract than if they had not participated. Only if the loss that arose when the Pendulum Contracts entered Phase Two was not a genuine

economic loss would the tax relief produce a saving in excess of the amount expended. The speaking notes to the last slide of the presentation prepared by Montpelier in 2006 referred to at [56] – [57] above included the following:

> "White board ----
>
> Now at this point in time you still have a long-term derivative contract and loan in your name. There are a number of exit strategies, the most likely one being that you sell the contract back to the Seychelles company – by doing this you are forfeiting any chance of future profits and therefore no tax to pay. The interest free loan will still be assigned to you and this will be repayable in 50 year [sic] time.
>
> This is a full recourse loan, and it must be as otherwise it would not be seen as a true liability. However it is uncertain what will happen to both the Seychelles company and the Swiss company in the future. There is a very"

The note ends abruptly on the word "very". In our view, it is likely that the missing words, if they were ever written down, or words supplied by the speaker would, given the reference to the uncertain future of Pendulum and Mandaconsult (later replaced by Bayridge), state something like "There is a very [good chance that neither would be around in 50 years to enforce the payment of amounts under the contracts][1].

176. The effectiveness of the Pendulum arrangements and the Appellants' case depend on the loans, albeit on favourable terms, from Bayridge (or Mandaconsult) being a genuine economic loss. The Appellants contend that they have a genuine obligation to repay the loan to Bayridge in due course (either when they succeed in a subsequent Phase of the Pendulum Contract or after 50 years). We do not accept that and conclude that, on a realistic view of the facts, the Appellants would never be required to repay the 'loans' to Bayridge. It seems clear that, contrary to what Mr Gittins said in evidence, the complete absence of documentation meant that Mr Metcalfe was under no obligation to Bayridge and any assumption of liability or payment by Mr Metcalfe would be purely voluntary and would wipe out the benefit of the tax relief that he had obtained. In relation to Mr Sherrington and Mr Waite, there were agreements but we consider that the reality is no different to Mr Metcalfe's position and that is shown by the way the Pendulum arrangements were marketed and the understanding of those, like Mr Morgan, who marketed them.

177. We conclude that the way the arrangements were marketed and economics of the scheme showed that the Appellants did not and never would have any liability to repay the purported loans.

Conclusion on the Pendulum arrangements

178. We agree with Mr Bradley that, given the benefits of losing, no one would have wanted to win at Phase One. The financial benefit, in the form of the ability to claim a loss relievable against tax, to each Appellant of losing at Phase One was significantly greater than the benefit that would (or, in Mr Waite's case, did) accrue in the event they were successful at Phase One. We consider that the fact that losing at Phase One provided a much greater return to the participants than winning explains why everyone who succeeded at Phase One went on to re-invest their proceeds into further Pendulum Contracts, which then went on to lose at Phase One. We also consider that the economics of the Pendulum Contracts shows that the true

[1] Indeed, it appeared from correspondence received from HMRC and Montpelier while this decision was in preparation that Bayridge was dissolved on 1 June 2014 and its assets transferred to Bayridge (Isle of Man) Limited which, it was said by Montpelier, still exists and holds the loans.

purpose of the Pendulum Contracts was not to provide a realistic prospect of making a profit but to enable the participants to realise a loss which could be set against tax.

179. Our view of the purpose of the Pendulum arrangements was reinforced by the fact that Mr Metcalfe's file at Montpelier was labelled 'income loss' which neither Mr Metcalfe nor Mr Gittins could explain. We consider that, in the light of all the evidence, the explanation is clear: the sole purpose of the Pendulum arrangements was to produce a loss that would reduce the user's income for tax purposes. The Appellants all maintained that they had entered into the Pendulum Contracts with a view to making a profit and, while they were aware that losses could be offset against profits, they were not seeking to create losses in order to reduce their tax liability. We do not accept the Appellants' assertions that the avoidance of tax was not their primary motive in entering into the Pendulum Contracts. On the basis of the economics of the Pendulum arrangements and the way the scheme was marketed, we find that the Appellants entered into their Pendulum Contracts solely or mainly in order to generate a loss.

TRADING ISSUE

180. As stated at [25] above, the trading issue can be broken down into five questions. The first four questions relate to whether the Appellants were trading on a commercial basis with a view to or a reasonable expectation of profits. If the Appellants were not so trading then they will not be able to obtain relief for the losses that they have claimed. As the questions about trading, commerciality and profitability overlap to a considerable extent, it is logical and convenient to consider them together before reaching any conclusion on whether the Appellants, or some of them, were trading in the required sense and manner. If the Appellants were trading, the final question in relation to the trading issue is whether the Appellants entered into the Pendulum Contracts in the course of a trade.

181. On the basis of our findings of fact set out above, we have concluded that, for broadly similar reasons, none of the Appellants was carrying on a trade at any point except possibly, as HMRC accept, Mr Waite in relation to his non-Pendulum transactions. We have already indicated in our findings of fact those matters which we did not accept or caused us to doubt that the Appellants were trading and so we only summarise those matters below.

182. In relation to the pre-Pendulum transactions entered into by Mr Sherrington and Mr Metcalfe, we consider that they were intended to give the appearance of trading, while risking a minimum amount of capital, solely in order to enable the Appellants to make a later claim for trading losses allegedly incurred in relation to the Pendulum Contracts. This is shown by the way that Montpelier marketed the Pendulum arrangements as part of a two stage process of, first, establishing a self-employed trade and, secondly, creating a trading loss (see [56] - [59] above). The sole or primary purpose of the first part, establishing a trade, was to allow the participants to proceed to the second stage. There was no economic or commercial purpose to the initial transactions other than to allow participants to enter into Pendulum Contracts with the objective of creating losses. Further, not only were the amounts of the individual trades small but little time was spent by Mr Sherrington and Mr Metcalfe, who were both in full time employment, on the pre-Pendulum trading. Mr Metcalfe tellingly acknowledged that a third-party observer might have regarded what he was doing as "dabbling" (see [83]).

183. In relation to the Pendulum Contracts, the Appellants all showed a remarkable lack of concern about matters that, if they were genuinely trading, we would expect them to want to establish. None of the Appellants carried out any, or any proper, due diligence into the entities with which they thought they were contracting. All of them seemed to be content to rely on their financial advisers, who were not lawyers, for advice on the interpretation and effect of agreements. They also assumed, without obtaining specific confirmation, that the advisers had carried out sufficient due diligence. No Appellant was concerned to establish for himself

whether Pendulum would be able to honour its obligation to pay amounts due under the Pendulum Contracts at the end of any Phases. Mr Metcalfe was unaware that Pendulum was an unregulated Seychelles company but said he would have asked questions had he known. Mr Sherrington and Mr Waite were not sure if they were aware of the status of Pendulum but said they would not have been concerned if they had known it was unregulated.

184. The Appellants did not seem to regard the terms of the Pendulum Contracts and whether they or Pendulum complied with them as important. For example, no concerns were expressed by Mr Sherrington when Pendulum were "slack in their paperwork". Mr Waite simply signed the documents that were presented to him. He did not seem to think it strange that, contrary to the contract, Pendulum provided the Acceptance Confirmation Note in relation to the first contract after the contract had started and accepted his Initial Margin Payment late yet nevertheless agreed to pay a Trade Profit when he was successful at the end of Phase One. Mr Metcalfe admitted that he also simply signed the documents that were put in front of him and never read them in detail but only scanned the headings. None of the Appellants had appreciated what the correct amount of the Trade Profit payable at the end of Phase Two or any later Phases would be because, it was clear, they had not read the relevant provision properly.

185. Further, although the availability of soft financing was of fundamental importance, the Appellants showed a remarkable indifference to details such as whether the lender had the means to meet its obligation to pay the Margin Call Balances and whether, when the obligation arose, it had done so. In the case of Mr Metcalfe, there was no binding loan agreement in place at all. The indifference of the Appellants to the details and, in Mr Metcalfe's case, absence of the loan agreements together with the evidence about how Montpelier marketed the arrangement (see [173] to [175] above) leads us to conclude that Appellants never expected that they would actually be required to repay the purported loans.

186. If the Appellants' activities were capable of being characterised as trading, we consider that the Appellants were nevertheless 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 381(4) and 384(1) ICTA. Many of the same factors that caused us to decide that the Appellants were not trading would, even if we are wrong in that view, support the conclusion that the trades were not carried on on a commercial basis. We do not need to repeat the points in detail but it is enough to refer to the casual attitude to due diligence, contractual documentation and risk described above which, in our view, show that the activities were not carried on on a commercial basis. Most significant of all in relation to the question of whether the Appellants were trading on a commercial basis with a view to or a reasonable expectation of profits is our conclusion that that the Appellants entered into their Pendulum Contracts solely or mainly in order to generate a loss. Although Mr Waite (and a minority of other participants in Pendulum Contracts) were successful at the end of Phase One, we do not consider that indicated a serious intention to realise profits. We find that the fact that Mr Waite and others who were successful in Phase One entered into new Pendulum Contracts and that, as Mr Bradley demonstrated, the Appellants were economically much better off losing at the end of Phase One than winning shows that the Appellants' real purpose was to generate losses in the purported trade rather than profits.

187. As we have found that the Appellants were not carrying on a trade (with the exception of Mr Waite whose non-Pendulum trading is not at issue) or, if they were, it was not on a commercial basis and did not meet the profits condition, the question of whether they entered into the Pendulum Contracts in the course of a trade does not arise. Had we been required to decide that question, however, we would have found that the Pendulum Contracts were not entered into in the course of any trade. If we assume that the trade was one of dealing in CFDs,

and no other was suggested, then it seems to us to be clear that the Appellants' CFD transactions were very different in terms of scale, timing, risk, and duration to the Pendulum Contracts. For that and all the reasons that led us to conclude that the Pendulum Contracts themselves were not trading transactions (and did not meet the profits condition), we would hold that the Pendulum Contracts were not part of any trade

GAAP ISSUE

188. Given our decision in relation to the trading issue, the question of whether the losses claimed by the Appellants had been calculated in accordance with GAAP does not arise. We will therefore only summarise the evidence that we heard on this issue and then briefly explain our conclusion.

189. At the relevant time, section 42(1) FA 1998 provided that trading profits and losses must be calculated by reference to GAAP. HMRC's position is that, even if the Appellants were carrying on a trade, they have not proved that the profits of the trades were computed in accordance with GAAP in the UK. The Appellants contended that they accounted for the profits and losses in accordance with UK GAAP at the time.

190. As we have already stated, the parties each relied on the evidence of an expert witness in relation to this issue. Mr Wiltcher gave evidence for the Appellants and Mr Harrap gave evidence for HMRC. They were also put forward as expert witnesses in *Thomson* and the FTT in that case made critical comments in relation to both of them saying, among other things, that both experts' opinions left questions unanswered and neither fully satisfied the tribunal. Although Mr Harrap and, to a lesser extent, Mr Wiltcher both tried to address some of the concerns expressed by the FTT in *Thomson*, we found ourselves similarly dissatisfied with the evidence on this issue. We endorse wholeheartedly the comments of the FTT in *Thomson* at [269] about the need for expert evidence to be sufficiently detailed and in proper form. We also share the view, expressed in [275] of *Thomson*, that we would have derived much more assistance from the views of a single expert.

191. In our view, although the Civil Procedure Rules ('CPR') do not apply to the FTT, and un-necessary formality in proceedings must be avoided, parties should nevertheless have in mind and seek to comply with CPR 35 and CPR Practice Direction 35. As the FTT observed in *Megantic Services Ltd v HMRC* [2013] UKFTT 492 (TC) at [39]:

> "It is … likely to assist the tribunal if an expert giving evidence complies with CPR 35 and states that he has done so … But a failure to do so will not, unless the tribunal considers that such evidence will only be acceptable in particular circumstances if full compliance is demonstrated, necessarily result in the evidence being excluded; such failure will instead raise questions of weight."

192. We would add that we also respectfully agree with the observations of the Upper Tribunal (Administrative Appeals Chamber) in *The Royal Borough of Kensington and Chelsea v CD* [2015] UKUT 396 (AAC) at [35] – [37]:

> "33. As in all cases, the parties and tribunal must bear in mind the provisions of the overriding objective of rule 2 of the Tribunal Procedure (First-tier Tribunal) (Health, Education and Social Care Chamber) Rules 2008 ("the First-tier Tribunal Rules") – that dealing with a case fairly and justly includes dealing with the case in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties.
>
> 34. Further, whilst I am, of course, mindful of the fact that the Civil Procedure Rules 1998 do not apply to First-tier Special Educational Needs and Disability Tribunals, and that un-necessary formality in those

> tribunal proceedings must be avoided, nevertheless, in my judgment Part 35 of the Civil Procedure Rules provides a useful backdrop in relation to case management decisions concerning expert evidence in such tribunals, and I draw upon it.
>
> 35. With that introduction, the starting point must be that expert evidence should be restricted to that which is reasonably required to resolve the appeal. If a party intends to seek to rely upon expert evidence, then pursuant to the duty under rule 2(4) of the First-tier Tribunal Rules, this should be communicated to the other party as soon as possible. If (as is likely in most cases) the issue falls within a substantially established area of knowledge, where it is not necessary for the tribunal to sample a range of opinion, it may well be that the evidence should be provided by a written report of a single expert jointly instructed by the parties.
>
> 36. … a tribunal judge may wish to decide whether and, if so, how to exercise his or her discretion to give directions as to expert evidence. In doing so, he or she will be mindful of: (i) rule 15(1)(c) of the First-tier Tribunal Rules, which provides that, without restriction on its general case management powers, "the tribunal may give directions as to … whether the parties are permitted or required to provide expert evidence, and if so whether the parties must jointly appoint a single expert to provide such evidence," and (ii) the observations which I have made at paragraphs 33 - 35 above. It may well be that the parties would have to make out a strong case either for relying on expert evidence from an expert who had not been jointly instructed, or for requiring oral evidence of an expert at the hearing of the appeal.
>
> 37. Further, in giving any case management directions relating to expert evidence it would be helpful to all involved if the tribunal judge were to identify precisely the issues which the experts are to address."

193. The *Kensington and Chelsea v CD* case concerned an appeal from the FTT (Health, Education and Social Chamber) but the rules referred to bear the same numbers in the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 and, in our view, the Upper Tribunal's comments apply with equal force to proceedings in the Tax Chamber of the FTT.

194. Before us, Mr Wiltcher agreed that the high level summary of his evidence by the FTT in *Thomson* at [270] was, as his evidence was the same, also an accurate summary of his evidence in these appeals. Paragraph 270 of *Thomson* was as follows:

> "270. Our understanding of Mr Wiltcher's opinion, at a high level, is as follows:
>
> (1) The appropriate accounting standard to follow was the Financial Reporting Standards for Small Entities ("FRSSE"). That is a cut-down version of UK GAAP that is relevant to the accounts of smaller entities.
>
> (2) Applying FRSSE, Mr Thomson realised a loss on his Pendulum CFD equal to the difference between the cost of that CFD (£325,000) and its fair value at the end of the 2005-06 tax year of just £6,500 . A similar principle applied to Mr Mungavin and Mr Worsfold.
>
> (3) Finance costs on the Bayridge Loan would not have affected the calculation of any appellant's profit or loss for the period.
>
> (4) Even though the Bayridge Loan was on terms favourable to the appellants, that loan had no effect on the appellants' profit or loss for the period. That was because paragraph 12.3 of FRSSE requires borrowings (such as the Bayridge Loan) to be initially stated in the balance sheet at the fair value of the consideration received. The consideration that the

appellants received when they took out their Bayridge Loan was the discharge of their obligation to Pendulum to pay the Margin Call Balance. There was no requirement in FRSSE to ascertain the fair value of the appellants' liability under the Bayridge Loan. Therefore, Mr Thomson's accounts should have initially recognised his Bayridge Loan as a liability of £308,750 (the amount of his Margin Call Balance) and, since finance costs were immaterial, that amount would never fall to be adjusted with the result that the Bayridge Loan did not affect Mr Thomson's profit and loss computed under UK GAAP for the 2005-06 tax year. A similar principle applied to the other appellants.

(5) FRS5, on which Mr Harrap placed great emphasis, was relevant and applied. However, it did not alter the fundamental requirement in paragraph 12.3 of FRSSE that the Bayridge Loan be stated as a liability equal in amount to the consideration that the appellants received. Therefore, FRS5 did not apply in the manner for which Mr Harrap argued."

195. Mr Harrap's evidence can be summarised as follows. He regarded both the loan transaction and the Pendulum Contract as part of a single arrangement, or transaction. He said that his understanding was the Appellants received an expectation or hope that they would make a profit on the transaction which was the asset they carried in their balance sheet. On Day 1, the Appellants acquired that expectation or hope and, in return, they paid the Initial Margin and assumed liability for a long-dated loan from Bayridge. He did not regard the Pendulum Contract and loan agreement as two separate transactions. Even if they had been, they were effectively rolled into one by FRS5 paragraph 11 and paragraph 40.

196. Mr Harrap's analysis was based on the assumption, based on information he had been provided with, that there was not a real prospect of success in phases 2 - 5. He had concluded that the Appellants were unlikely to ever repay the loans before 50 years were up. We asked Mr Harrap whether if, having reviewed all the evidence, we concluded that there was a real prospect of success at any phase that would change the accounting treatment in his view? He said that, if there was a real prospect of success, the debt would be discounted over a very different time frame which would give a different result.

197. In relation to the GAAP issue, we make no claim to have any particular experience or knowledge of the accounting practice that was generally accepted as correct in the UK in relation to the transactions such as those under consideration in these appeals at the relevant time. That is, presumably, why it was thought that expert evidence would be helpful. However, we find ourselves in the difficult position of having to choose between two conflicting expert opinions which do nothing to help us resolve the point at issue. That is clearly unsatisfactory. The role of the FTT (Tax Chamber) is to determine the material facts, in so far as they are not agreed, and decide questions of law. Assuming that the Appellants carried on a trade, whether the profits and losses of the trade were correctly calculated in accordance with GAAP is a question of fact not law. In relation to issues of fact, the Appellants bear the burden of proof and the standard of proof is the balance of probabilities. As we cannot decide which of Mr Wiltcher and Mr Harrap is more likely to be correct in their opinion of what is the correct accounting treatment, we hold that the Appellants have failed to discharge the burden of proving that they calculated their losses in accordance with GAAP.

EXCESSIVE LOSSES ISSUE

198. As with the GAAP issue, the question of whether the losses claimed by the Appellants were excessive and fall to be reduced does not need to be decided given our conclusions on the other issues in the appeals. In fact, very little time was spent on this issue at the hearing. In case it becomes necessary to deal with this issue, we summarise the parties' positions and our conclusions below.

199. HMRC's case was set out in their skeleton. HMRC contended that the Initial Margins paid by each Appellant to Pendulum were, in reality, a mechanism to provide Montpelier with fees. As such, the Initial Margins were not expenditure incurred wholly and exclusively for the purposes of each Appellant's trade and were not deductible. HMRC relied on an email dated 17 September 2004 from Gregor Shaw of Welbeck to a person who was not one of the Appellants. The email referred to an income tax planning scheme and referred to a 6% upfront fee with no VAT. Mr Gittins said that email was not referring to the Pendulum arrangements. In the absence of any other evidence to support HMRC's assertion that Mr Shaw's email referred to the Pendulum Contracts, we accept Mr Gittins' evidence that the email referred to a different scheme. The Appellants all claimed that the Initial Margins were paid under the Pendulum Contracts. As there was no evidence to contradict that evidence, we accept that the Appellants paid the Initial Margins to Pendulum under the Pendulum Contracts and those payments cannot be regarded as fees paid to Montpelier by the Appellants.

200. In relation to the Margin Call Balances, HMRC submitted that where the Appellants entered into loan agreements with Bayridge (and we have found that Mr Metcalfe did not), such a liability did not involve an Appellant incurring expenditure in any relevant sense and, in the alternative, that any 'loan' purportedly made by Bayridge was never intended to be repayable. As, in reality, none of the Appellants had any liability to repay the alleged loan, they never incurred any expenditure in respect of their Margin Call Balances.

201. The Appellants' skeleton did not deal with this issue and no submissions were made on the point by Mr Gittins at the hearing. Mr Wiltcher's evidence was that, as the profits and losses were calculated in accordance with GAAP, the losses were not excessive in accounting terms. The Appellants' case in relation to the excessive losses issue relied entirely on the evidence of Mr Wiltcher but that did not address the issue of whether any expenditure was actually incurred. We have already found, at [177], that that the Appellants did not and never would have any liability to repay the purported loans and so it follows that they did not incur the expenditure. Had we found that the loans were expenditure incurred by the Appellants, we would have held, for the reasons set out at [172] above, that it was not expenditure incurred for the purposes of any trade but solely or mainly in order to generate a loss and reduce the Appellants' liability to income tax. Accordingly, the expenditure was not deductible.

202. For those reasons and had it been necessary to do so, we would have found that, to the extent described above, the Appellants have not shown, on the balance of probabilities, that the losses claimed were not excessive.

Decision

203. For the reasons set out above, the Appellants' appeals are dismissed.

Right to apply for permission to appeal

204. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JUDGE GREG SINFIELD
CHAMBER PRESIDENT

RELEASE DATE: 9 MARCH 2020