[2022] UKFTT 00074 (TC)

TC 08405/V

CORPORATION TAX – claims for losses in two partnership tax returns of an LLP – whether the LLP was carrying on a trade – no, because, properly construed, the LLP's activities amounted to investment and not trading – whether the LLP had a view to profit – no, because the LLP was indifferent as to whether or not it made a profit – whether the accounts of the LLP in its first period of account were prepared in accordance with GAAP – no, because the accounts did not properly record the substance of the relevant transaction – whether, assuming that the LLP was carrying on a trade and the accounts were prepared in accordance with GAAP, the losses shown in those accounts would have been deductible as a trading expense – no, because, even on the assumption that the LLP was trading, the expense in question would not have been wholly and exclusively incurred for trading purposes and would have been capital in nature – whether, on the assumption that the LLP was trading, certain expenses incurred in a later period of account in which a loss arose would have been deductible as trading expenses – certain of those expenses were deductible but others were not because they had not been wholly and exclusively incurred for trading purposes and the fact that they were not deductible meant that no loss would have arisen in the later period of account - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/00414

BETWEEN

ACAMAR PRODUCTIONS LLP **Appellant**

-and-

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

TRIBUNAL: JUDGE TONY BEARE
MR JULIAN STAFFORD

The hearing took place on 12, 13, 14, 17, 18, 19 and 20 January 2022. With the consent of the parties, the form of the hearing was by way of a video hearing on Teams.

A face-to-face hearing was not held because of the COVID 19 pandemic and because the matters at issue were considered appropriate to be dealt with by way of a video hearing.

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

The documents to which we were referred included four documents bundles (together, the "DB") and three authorities bundles. Together, these contained the written evidence, legislation and case law relevant to the hearing.

Mr James Ramsden QC and Mr Sam Brodsky, instructed by RPC, for the Appellant

Ms Elizabeth Wilson QC and Mr Nicholas Macklam, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This decision relates to an appeal against two closure notices, each dated 14 July 2017, amending the partnership tax returns of the Appellant in relation to the tax year ending 5 April 2013 (the "tax year 2012/13") and the tax year ending 5 April 2015 (the "tax year 2014/15"). Each of those partnership tax returns disclosed a trading loss - £3,234,286 in respect of the tax year 2012/2013 and £45 in respect of the tax year 2014/2015. In each case, the trading loss disclosed in the relevant partnership tax return was allocated to the members of the Appellant in accordance with the terms of the document governing the Appellant. Each closure notice amended the relevant partnership tax return in such a way as to reduce the relevant loss to nil.

BACKGROUND

2. The Appellant was incorporated on 6 September 2012 as a limited liability partnership (an "LLP") under the provisions of the Limited Liability Partnerships Act 2000 (the "LLPA"). It was incorporated by Future Films group (the "FF group") for the purpose of raising finance from investors wishing to invest in the film industry and entering into transactions relating to the film the Les Miserables. The latter was to be released by the Universal Studios group (the "Universal group" or the "studio") shortly after the Appellant was formed.

3. On incorporation, the Appellant had two designated members - Future Films Corporate Productions Limited ("FFP") and Prosper Capital Management Limited ("Prosper Management" and, together with FFP, the "Designated Members").

4. Pursuant to Section 1 of the LLPA, an LLP is a body corporate with legal personality which is separate from that of its members.

5. Notwithstanding that that is the position as a matter of general law, Section 863 of the Income Tax (Trading and Other Income) Act 2005 (the "ITTOIA") provides that, if an LLP carries on a trade or business "with a view to profit", then, for income tax purposes, all of the activities of the LLP are treated as carried on in partnership by its members (and not by the LLP as such), anything done by, to or in relation to, the LLP for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to, the members as partners, and the property of the LLP is treated as held by the members as partnership property. Section 1273 of the Corporation Tax Act 2009 (the "CTA 2009") makes an equivalent provision in relation to corporation tax. It follows from this that, as long as an LLP is carrying on a trade or business with a view to profit, it is effectively indistinguishable from a general partnership for income tax and corporation tax purposes in that it is effectively transparent for those purposes.

6. Section 25 of the ITTOIA provides that the profits of a trade must be calculated in accordance with "generally accepted accounting practice" as defined in Section 997 of the Income Tax Act 2007 (the "ITA") ("GAAP"), subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes. Section 26 of the ITTOIA provides that the same rules apply in calculating losses of a trade for income tax purposes as apply in calculating profits of a trade for income tax purposes, subject to any express provision to the contrary. Sections 46 and 47 of the CTA 2009 (and Section 1127 of the Corporation Tax Act 2010 (the "CTA 2010")) contain equivalent provisions for corporation tax purposes.

7. For this purpose, GAAP is defined in Section 997 of the ITA and Section 1127 of the CTA 2010 as meaning, in relation to a company or other entity which does not prepare accounts in accordance with international accounting standards ("IAS accounts"):

(1) generally accepted accounting practice in relation to accounts of UK companies (other than IAS accounts) that are intended to give a true and fair view; and

(2) to have the same meaning in relation to individuals, entities which are not companies and companies other than UK companies.

8. Two of the adjustments required by law in calculating profits for income tax and corporation tax purposes are:

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

(2) Section 34 of the ITTOIA (and Section 54 of the CTA 2009), which provide that, in calculating the profits of a trade, no deduction is allowed for expenses not incurred wholly and exclusively for the purposes of the trade and losses not connected with or arising out of the trade. In each case, the relevant provision goes on to provide that, if an expense is incurred for more than one purpose, the section does not prohibit a deduction for an identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade.

9. As we outline in further detail in describing the transaction which is relevant to this appeal in paragraphs 18 to 22 below, the Appellant raised capital from various sources and entered into contracts in relation to the film. Those, and related, transactions gave rise to significant losses in the Appellant's accounts. If the activities of the Appellant in entering into those transactions amounted to a trade with a view to profit, the accounts of the Appellant complied with GAAP, and the expenditure giving rise to the losses shown in those accounts was revenue (as opposed to capital) in nature and was incurred wholly and exclusively for the purposes of the trade, then the losses shown in the Appellant's accounts fell to be treated as trading losses made by the members of the Appellant.

THE ISSUES

10. The above means that, in order for the trading loss disclosed in each partnership tax return of the Appellant which is the subject of this appeal to be treated as a trading loss of the members of the Appellant:

(1) the Appellant must have been carrying on a trade during the tax year to which that partnership tax return related;

(2) the Appellant's activities during that tax year must have been being conducted with a view to profit;

(3) the accounts for the period of account of the Appellant which formed the basis period for that tax year must have complied with GAAP; and

(4) the expenditure giving rise to the trading loss must have met the conditions to qualify as trading expenses. In particular, they must have had a revenue (as opposed to a capital) nature and they must have been wholly and exclusively incurred for the purposes of the trade.

11. The Respondents submit that the closure notices are correct because:

(1) in the case of the partnership tax return for the tax year 2012/13, the Appellant fails on all four of those grounds; and

(2) in the case of the partnership tax return for the tax year 2014/15, the Appellant fails on the first two and the fourth of those grounds. (Given the quantum of the loss disclosed in the partnership tax return for the tax year 2014/15, the Respondents have not taken issue with the Appellant in relation to whether or not the accounts for the period of account which formed the basis period for that tax year complied with GAAP.)

12. The Appellant disagrees.

13. As a result, the four issues which are in dispute in this appeal are as follows:

(1) did the Appellant's activities during the relevant tax years amount to a trade (the "Trade Issue")?

(2) did the Appellant carry on its activities during the relevant tax years, whether or not they amounted to a trade, "with a view to profit" (the "View to Profit Issue")?

(3) did the Appellant's accounts for its period of account ending 31 October 2012 – the basis period for the tax year 2012/2013 – comply with GAAP (the "GAAP Issue")? and

(4) assuming that there are affirmative answers to each of the first three issues, did the expenditure for which relief is being claimed qualify as deductible trading expenditure (the "Deductibility Issue")?

14. The GAAP Issue is a question of fact whereas the other three issues are mixed questions of fact and law.

15. It is common ground that the burden of proof in relation to each of the issues is on the Appellant. In other words, the Appellant needs to establish that, on the balance of probabilities, its position on each issue is correct and the Respondents were wrong to reduce the losses in respect of each partnership tax return to nil. Having said that, as will become clear from the terms of this decision, the answers to the issues in this case are in our view so clear that the question of which party has the burden of proof is moot.

16. This is a somewhat unusual case. So far as we have been able to determine, there is absolutely no disagreement between the parties as to:

(1) the proper construction of the relevant legislation;

(2) the proper interpretation of the relevant case law; or

(3) the transactions to which the Appellant was party.

17. The areas of disagreement are solely as to:

(1) the conclusions of fact which should properly be drawn from the transactions to which the Appellant was party;

(2) the application of the law to those conclusions of fact; and

(3) whether or not the accounting treatment adopted by the Appellant in respect of its period of account ending 31 October 2012 complied with GAAP.

THE TRANSACTION

18. The transaction involved the following steps:

(1) on 25 September 2012, the Appellant issued an information memorandum (the "IM") to potential investors in the Appellant;

(2) on 27 October 2012, Copex International Credit PCC, a bank unrelated to either the FF group or the Universal group, entered into a loan agreement with a member of the FF group named Journal Productions Limited ("Journal") (the "Copex Loan Agreement") pursuant to which, in return for an arrangement fee of £30,000, Copex granted Journal an interest-free loan facility of up to £3,000,000 for the sole purpose of enabling Journal to make a loan to another member of the FF group, Illuminatrix (ACA) Limited ("Illuminatrix"). The loan made by Copex under the Copex Loan Agreement was required to be repaid on the same day as the funds were drawn down;

(3) on 29 October 2012:

(a) a partnership deed was executed by the Appellant, the Designated Members and Illuminatrix (the "Partnership Deed"). The Partnership Deed provided that the Appellant was to carry on the trade of providing services in respect of one or more projects and Illuminatrix agreed to be (and was accepted as) a member of the Appellant;

(b) the six companies which had agreed to become investors in the Appellant as corporate members (the "corporate members" and each individually a "corporate member") executed a deed of adherence and a power of attorney pursuant to which they became members of the Appellant;

(c) the Appellant entered into a consultancy agreement with another member of the FF group, Future Films Consultancy Limited ("FFC") (the "Consultancy Agreement") pursuant to which the Appellant engaged FFC to provide consultancy services to the Appellant in return for:

(i) an up-front fee equal to 8% of the aggregate capital contributions received by the Appellant; and

(ii) an annual fee thereafter;

(d) the Appellant, FFC and Prosper Capital LLP ("Prosper Capital") entered into a sponsor and operator agreement (the "Sponsor and Operator Agreement") pursuant to which the Appellant engaged Prosper Capital to provide sponsorship and operator services to the Appellant in return for a fee of 0.25% of the total partnership capital plus specified fees and commissions which were payable by Prosper Capital. We propose to say no more in this decision about the Sponsor and Operator Agreement as it has no bearing on the issues with which we are concerned;

(e) a member of the Universal group named Marital Assets LLC ("Marital") entered into a distribution services agreement with another member of the FF group named TFFG Services Limited ("TFFG") (the "Distribution Services Agreement") pursuant to which Marital engaged TFFG to provide services to be mutually agreed in relation to the distribution arrangements for Les Miserables until completion and delivery of the film in return for a fee of £1. We propose to say no more in this decision about the Distribution Services Agreement. This is because:

(i) it was expressed on its face to end on "completion and delivery of the film", and it was common ground at the hearing that the film had been completed and delivered by the day when the agreement was executed;

(ii) it was expressed as an agreement to provide services to be mutually agreed and no evidence was provided to us to show that any such services were so mutually agreed. It was therefore no more than an agreement to agree; and

(iii) neither Mr Stephen Margolis, the sole witness of fact, nor either party's counsel, was able to shed any light on the role which the agreement was intended to play, or did in fact play, in the transaction. We have therefore concluded that it too has no bearing on the issues with which we are concerned;

(f) Journal and Illuminatrix entered into a loan agreement (the "Journal Loan Agreement") pursuant to which Journal agreed to make a loan of £2,781,486 to Illuminatrix for the sole purpose of enabling Illuminatrix to make a capital contribution to the Appellant;

(g) a second company in the Universal group, Corpus Vivos Productions LLC ("Corpus"), and the Appellant entered into a head print and advertising services agreement (the "Head P&A SA") pursuant to which the Appellant agreed to provide print and advertising services ("P&A services") to Corpus in respect of Les Miserables in return for an upfront fee of £15 and future fees which were contingent on the success of the film and dependent on a formula (the "Waterfall");

(h) the Appellant and Journal entered into a sub P&A services agreement (the "Sub P&A SA") pursuant to which Journal agreed to provide P&A services to the Appellant in respect of Les Miserables in return for an upfront fee of £3,005,543; and

(i) Journal and Marital entered into a studio P&A services agreement (the "Studio P&A SA" and, together with the Head P&A SA and the Sub P&A SA, the "P&A SAs" and, individually, a "P&A SA") pursuant to which Marital agreed to provide P&A services to Journal in respect of Les Miserables in return for an upfront fee of £2,957,543, which was to be discharged by the payment by Journal to Marital of £194,057 in cash and the assignment by Journal to Marital of its rights in respect of the loan of £2,781,486 made to Illuminatrix under the Journal Loan Agreement. (In the rest of this decision, we will refer to the £194,057 cash payment to Marital under the Studio P&A SA as the "Studio Benefit");

(4) on 30 October 2012:

(a) Journal made a drawing of £2,781,486 from Copex under the Copex Loan Agreement;

(b) Journal made a loan of £2,781,486 to Illuminatrix under the Journal Loan Agreement;

(c) Illuminatrix contributed £2,781,486 to the Appellant as a capital contribution;

(d) the companies which had agreed to become corporate members contributed £452,800 in aggregate to the Appellant as capital contributions. The aggregate amount of capital contributed to the Appellant was therefore £3,234,286 (£2,781,486 plus £452,800);

(e) the Appellant paid the upfront fee of £3,005,543 to Journal under the Sub P&A SA;

(f) the Appellant paid a fee of £228,743 to FFC under the Consultancy Agreement. (This was not strictly in accordance with the terms of the Consultancy Agreement which, as noted in paragraph 18(3)(c) above, required the Appellant to pay to FFC, as the initial fee under the Consultancy Agreement, an amount equal to 8% of the aggregate capital contributions received by the Appellant. This formula would have produced some £30,000 more than was actually paid but, as nothing turns on this discrepancy for the purposes of this decision, we propose to say no more about it);

(g) Journal repaid the drawing of £2,781,486 from Copex under the Copex Loan Agreement and paid the arrangement fee of £30,000 which was due under that agreement; and

(h) Journal discharged the up-front fee of £2,957,543 which was due to Marital under the Studio P&A SA by paying the Studio Benefit to Marital and assigning to Marital its rights in respect of the loan of £2,781,486 made to Illuminatrix under the Journal Loan Agreement.

19. Thus, by 31 October 2012, which was the final day of the period of account of the Appellant which is the basis period for the tax year 2012/2013:

(1) the Appellant had:

(a) received £3,234,286 by way of capital contributions; and

(b) paid £3,005,543 of that amount to Journal and £228,743 of that amount to FFC;

(2) Journal had:

(a) drawn down a loan 2,781,486 from Copex under the Copex Loan Agreement;

(b) made a loan of £2,781,486 to Illuminatrix under the Journal Loan Agreement;

(c) received £3,005,543 from the Appellant under the Sub P&A SA;

(d) repaid, on the same day that it was drawn down, the loan of £2,781,486 from Copex under the Copex Loan Agreement;

(e) paid an arrangement fee of £30,000 to Copex under the Copex Loan Agreement;

(f) paid £194,057 (ie the Studio Benefit) to Marital; and

(g) assigned to Marital its rights in respect of the loan of £2,781,486 made to Illuminatrix under the Journal Loan Agreement; and

(3) Illuminatrix had:

(a) borrowed £2,781,486 from Journal under the Journal Loan Agreement;

(b) contributed capital of £2,781,486 to the Appellant; and

(c) acceded to the assignment by Journal to Marital of Journal's rights in respect of the loan of £2,781,486 made to Illuminatrix under the Journal Loan Agreement.

20. It is common ground that the steps described above were all conceived and implemented as a single integrated transaction, by which we mean that there was no prospect

that one of the steps comprising the transaction would have been implemented without the others. The transaction documents cross-referred to each other and were intended to take effect at the same time. They were, in effect, a single package.

21. To facilitate the reader's understanding of the transaction described above, we have included, in the Appendix to this decision, a diagram of the structure following the above steps.

22. Further detail in relation to the documents which implemented the transaction is set out in paragraphs 28 to 41 below.

THE EVIDENCE

23. The evidence in this appeal took the form of the written evidence in the DB and witness evidence.

The written evidence

24. The written evidence which we considered included:

(1) certain pre-transaction documents such as the IM, the related presentation to prospective corporate members, the presentation to an investment committee of the FF group (the "Investment Committee") of a submission detailing possible outcomes of the transaction based on prior comparators (the "IC Submission") and the minutes of the ensuing meeting of the Investment Committee;

(2) the documents implementing the transaction; and

(3) certain related post-transaction documents.

Pre-transaction – the IM and the related presentation to corporate members

25. The logical starting point in this regard is the pre-transaction documents.

26. The relevant points arising out of the IM and the related presentation to prospective corporate members are as follows:

(1) the section in the IM headed "V. ARRANGEMENT: KEY DETAILS - Commercial Structure" highlighted to prospective members:

(a) the gearing model which was to be used in the transaction, which meant that, for every 14 of cash invested in the Appellant by a corporate member, an additional 86 would be provided to the Appellant by a member of the FF group (in this case Illuminatrix); and

(b) the fact that the Appellant intended to conduct its business "over a minimum 5-year period";

(2) the section in the IM headed "IX. PROJECT SELECTION" explained that the selection criteria for choosing a film would include "[targeted] returns of c.25% to be earned on provision of services";

(3) the section in the IM headed "XI ACTIVITIES OF THE PARTNERSHIP ONCE A PROJECT IS COMPLETE - Profits and Losses" explained how:

(a) in the initial period of account of the Appellant, the corporate members in aggregate would be entitled to 90% of the profits and losses in the Appellant and the FF group member would be entitled to 10% of those profits and losses but that, in subsequent periods of account of the Appellant:

(i) the profits and losses would be shared in proportion to capital contributions – which is to say, 14% to the corporate members in aggregate and 86% to the FF group member – until the FF group member had received back its capital contribution; and

(ii) thereafter, the profits and losses would be shared as to 50% to the corporate members in aggregate and 50% to the FF group member; and

(b) the Appellant intended to apply any revenues to other projects and did not expect to make distributions to members prior to the winding up of the Appellant;

(4) the section in the IM headed "XII FINANCIAL ILLUSTRATION - Corporate Member Cash Flow and Project Revenues (£s)" contained a table showing how a corporate member investing in the Appellant would fare economically in comparison to its position in the absence of any such investment. The table took no account of any project revenues but simply focused on the tax advantage which the corporate member could anticipate obtaining if it were to invest in the Appellant. It highlighted that, assuming a 25% corporation tax rate, the corporate member could expect to realise additional cash of £85,000 on an investment into the Appellant of £140,000 (because of the gearing provided by the FF group member) assuming that GAAP required the entire cost of providing the services to be written off in the first period of account of the Appellant;

(5) the presentation related to the IM contained similar figures, albeit using a 24% corporation tax rate and this time including a cash receipt by the Appellant in the second year equal to 125% of the anticipated studio benefit and then further cash returns in each of years 3, 4 and 5 equal to 125% of the cash receipts in prior years; and

(6) that presentation also contained projections for how an assumed waterfall for the Appellant based on certain assumptions might operate, based on two recent films, Moulin Rouge and Chicago, as benchmarks although there was a disclaimer to the effect that the outcome shown in those projections were no more likely than any other outcome and did not represent the FF group's opinion of the likely outcome.

Pre-transaction - the Investment Committee and the IC Submission

27. The relevant points arising out of the IC Submission and the minutes of the meeting of the Investment Committee are as follows:

(1) the meeting took place on 24 October 2012, which was just three days before the execution of the first transaction document – namely the Copex Loan Agreement;

(2) the term of the transaction in the IC Submission was described as perpetuity but with an initial cycle of five years. The submission set out four possible scenarios for the film – described as "Downside", "Base Case", Management Case" and "Upside Case" respectively and based on box office returns on budget of 79%, 270%, 358% and 682% respectively. The first two cases showed negative returns to the Appellant of 100% and 47% respectively whereas the latter two cases showed positive returns to the Appellant of 18% and 33% respectively. Each case assumed contingency payments of 20%;

(3) in the section headed "Counsel" in the IC Submission, reference was made to the film's producing an IRR in the Base Case of 31.6% "on the Day 1 Services" (which Mr Margolis explained meant the amount of the Studio Benefit). (Based on a later appendix in the submission, it appears that the reference to the "Base Case" in this section should have been to the "Management Case";)

(4) the terms of the waterfall described in the IC Submission differed slightly from the terms of the Waterfall as eventually agreed. (The terms of the Waterfall as

eventually agreed are set out in paragraph 30(9) below but the two differences were that:

(a) at stage 8 of the Gross Receipts part of the draft waterfall, the Appellant was going to be entitled to receive 18.37% of "Gross Receipts" (as defined) whereas, in the Waterfall as eventually agreed, that figure was 6.02%; and

(b) in the Net Receipts part of the draft waterfall, the Appellant was going to be entitled to receive 1% of the "Net Receipts" (as defined) whereas, in the Waterfall as eventually agreed, that figure was 0.32%;) and

(5) the minutes of the Investment Committee's meeting noted that, with the exception of a slight increase in the production budget since the last transaction by an FF group entity in relation to Les Miserables had been implemented, "there [had] been no change in the status of the Film". The minutes went on to conclude that, on the basis of the box office returns obtained by Moulin Rouge and Chicago, the Appellant "has the potential to recoup net profits in the region of $2.2m (based on the model and assumptions) if it achieves the upside case, but even if does not perform this well the [Appellant] should still realise returns".

The transaction documents

28. We now summarise those terms of the documents which gave effect to the transaction which we consider to be material to our decision.

29. The most significant of the transaction documents so far as this decision is concerned are the P&A SAs.

30. The Head P&A SA provided that, inter alia:

(1) Corpus engaged the Appellant to provide those services which might be mutually agreed by the parties from time to time from the list of services set out in exhibit A to the agreement and/or such other P&A services as might be requested by Corpus from time to time in accordance with the "Approved Marketing Plan". It went on to say that, at the date of the agreement, the services would in any event include those services which were marked with an asterisk in exhibit A (clause 2.1).

The definition of the "Approved Marketing Plan" was set out in clause 4.3. That clause stipulated that:

(a) Corpus, on the request of the Appellant, would submit a marketing plan substantially in the form of exhibit B to the agreement to the Appellant prior to the release of the film in the US and that that would be the "Approved Marketing Plan";

(b) the Appellant would perform the services in accordance with the plan;

(c) any changes to the plan requested by the Appellant would be subject to the prior approval of Corpus; and

(d) if Corpus were to notify the Appellant of changes to the plan, the Appellant would render the services in accordance with the revised plan as long as that did not lead to an increase in the services budget.

Exhibit A contained a long list describing more than fifty categories of possible services and included an asterisk marked against two of those categories – namely, creative advertising and publicity.

Exhibit B set out the media services and non-media services which were to be included in the Approved Marketing Plan;

(2) exhibit B also set out a list of "Material Elements", of which one was the Approved Marketing Plan. The elements included a number of items which were said to be "to be determined". The agreement provided that Corpus would have sole discretion and approval of the Material Elements and, to the extent that they formed part of the services supplied by the Appellant, required the Appellant to implement any changes to the Material Elements as requested by Corpus (clause 2.4);

(3) Corpus was required to be informed of the progress of the services. The Appellant had the right to sub-contract the services to any person approved by Corpus and the agreement provided that both Journal and Marital were approved sub-contractors for this purpose (clause 2.5);

(4) the services budget was £3,005,543 and it would be allocated in accordance with schedule 1 (clause 3.1). Schedule 1 contained the same list of possible services as were set out in exhibit A and allocated part of the total services budget to each of creative advertising and publicity – the two items marked with an asterisk in exhibit A;

(5) the Appellant was required to provide all funds necessary for the performance of the services up to the amount of the services budget and, to the extent that the services budget was exhausted, Corpus would be entitled to, or to authorise Marital to, perform further and additional services in respect of the film. Corpus was also entitled to, or to authorise Marital to, perform, complete and pay for any P&A services which were not to be performed under the agreement but the Appellant would not have any obligation to Corpus in connection with that (clause 3.2);

(6) Corpus would have reasonable access to the books and records in respect of the services (clause 3.3);

(7) the services would be performed until the earlier of confirmation from Corpus that they had been completed or 31 March 2014 (or such other date as might be nominated by Corpus) (clause 4.1);

(8) Corpus would, on the written request of the Appellant, make available to the Appellant or its designee, such advertising and promotional materials relating to the film as Corpus had in its possession and that, for this purpose, Marital was the Appellant's designee (clause 4.5);

(9) Corpus would pay the Appellant £15, together with the services fee set out in schedule 2 (clause 6.1). Schedule 2 set out the terms of the Waterfall.

In broad terms, the Waterfall was divided into two sections – an allocation of "Gross Receipts" and an allocation of "Net Receipts", in each case, only during the "Term". For this purpose, the "Term" was defined as the period commencing on the first release of the film and ending on 31 October 2017, which meant that it was five years from inception of the structure.

The terms of the Gross Receipts part of the Waterfall stipulated that, prior to any payment to the Appellant in respect of Gross Receipts (at stage 4), there were to be allocated to Corpus:

(a) a distribution fee equal to 30% of the Gross Receipts;

(b) an amount equal to the "Distribution Expenses" (as defined) incurred by Corpus minus an amount equal to the Studio Benefit received by Marital at inception; and

(c) all payments due to third parties in respect of the film including contingent compensation, deferments and participations.

The stage 4 payment which would then become due to the Appellant out of Gross Receipts was a capped amount of £9,703. That was followed by allocations to Corpus, at stages 5 and 6, of amounts equal to the film's production costs.

The first meaningful payment to the Appellant under the Gross Receipts part of the Waterfall arose at stage 7. At that stage, the Appellant would become entitled to 85% of the Gross Receipts, subject to a cap equal to 125% of the Studio Benefit plus 25% of £9,703 (the capped amount payable to the Appellant at stage 4). At stage 8, the Appellant would become entitled to 6.02% of the Gross Receipts, subject to a cap equal to all amounts due under the Journal Loan Agreement including the principal amount of £2,781,486 and interest thereon.

No further payment in respect of Gross Receipts would be made to the Appellant after stage 8.

The terms of the Net Receipts element of the waterfall entitled the Appellant to 0.32% of the "Net Receipts" (as defined).

Paragraph 5 of schedule 2 required Corpus to prepare regular reports on how the Waterfall was operating so far as the Appellant was concerned and paragraph 6 of schedule 2 entitled the Appellant, no more than once annually, to audit the financial records of the studio in order to verify that the Waterfall was being applied correctly;

(10) Corpus would be entitled to retain from any monies otherwise payable to the Appellant under clause 6.1 all losses suffered by Corpus as a result of a default by the Appellant or any permitted sub-contractor (other than Marital) which did not derive directly or indirectly from a default by Corpus or Marital (clause 6.2);

(11) notwithstanding anything to the contrary in the agreement, a breach or default under any of the transaction documents by the Appellant, Journal, any member of the Appellant or any permitted sub-contractor other than Marital would not give rise to a termination right to Corpus or enable Corpus to make a claim against the Appellant to the extent that it was caused by Corpus or Marital (clause 11.2);

(12) all obligations of Corpus under the agreement would automatically terminate upon the termination of the Studio P&A SA or the engagement of Marital under that agreement (clause 11.3);

(13) on termination, each party would be released from all obligations to the other provided that, inter alia, as long as Marital had received the Studio Benefit, the Appellant would be entitled to retain its rights under stages 4 and 7 of the Gross Receipts part of the Waterfall (clause 11.4);

(14) each party would indemnify the other and its affiliates and members for losses caused by reason of a breach of the agreement by that party provided that:

(a) the Appellant would have no obligation to indemnify Corpus and its affiliates or members for any breach by the Appellant caused by Corpus or Marital;

(b) Corpus would have no obligation to indemnify the Appellant or its affiliates or members for any breach by Corpus caused by a permitted sub-contractor other than Marital (clause 12.1(a)); and

(c) Corpus would have no obligation to indemnify the Appellant or its affiliates or members for any tax liability;

(15) the Appellant was precluded from assigning its rights under the agreement other than by way of security to Corpus and Marital but the Appellant was permitted to sub-contract its obligations under the agreement to a permitted sub-contractor (which included Journal and Marital) and Corpus was entitled to assign its rights under the agreement to an affiliate or another member of the Universal group or to its lenders by way of security (clause 13); and

(16) the liability of the Appellant under the agreement would be capped at the amount which it had received by way of the fee for its services (clause 17.5).

31. The Sub P&A SA provided that, inter alia:

(1) the Appellant irrevocably engaged Journal to provide those services which might be required by the Appellant from time to time from the list of services set out in exhibit A to the agreement and/or such other P&A services as might be requested by the Appellant from time to time in order to enable the Appellant to comply with its obligations to Corpus under the Head P&A SA. It went on to say that, at the date of the agreement, the services would in any event include those services which were marked with an asterisk in exhibit A and that the services would in any event not exceed the services budget. In addition, Journal would be responsible for arranging for the services and would co-ordinate with the Appellant and Marital to enable the Appellant to fulfil its obligations to Corpus under the Head P&A SA. The Appellant was precluded from appointing any other contractor to perform the services without the prior approval of Journal (clause 2.1). Exhibit A was in the same form as exhibit A to the Head P&A SA;

(2) Corpus was to have sole control of the “Material Elements” and any change to the technical, financial and business elements and decisions in relation to the services were subject to the Appellant’s confirmation that Corpus was satisfied with them (clause 2.2). The Material Elements, including the Approved Marketing Plan, were then set out in exhibit B, which was the same as exhibit B to the Head P&A SA;

(3) Journal was required to keep the Appellant and Corpus informed of the progress of the services. Journal was permitted to sub-contract the services to any person approved by the Appellant and Marital was an approved sub-contractor for this purpose (clause 2.3);

(4) the services budget was £2,975,543 and it would be allocated in accordance with schedule 1 (clause 3.1). Schedule 1 contained the same list of possible services as were set out in exhibit A and allocated part of the total services budget of £2,975,543 to each of creative advertising and publicity – the two items marked with an asterisk in exhibit A;

(5) to the extent that the services budget was exhausted, Corpus would be entitled to, or to authorise Marital to, perform further and additional services in respect of the film. In addition, Corpus was entitled to, or to authorise Marital to, perform, complete and pay for any P&A services which were not to be performed under the agreement but neither Journal nor the Appellant would have any obligation to the other in connection with that (clause 3.2);

(6) the Appellant would have reasonable access to the books and records in respect of the services (clause 3.3);

(7) the services would be performed until the earlier of the confirmation from the Appellant that they had been completed or 31 March 2014 (or such other date as might be nominated by the Appellant) (clause 3.3);

(8) the Appellant would submit a marketing plan substantially in the form of exhibit B to the agreement to Journal prior to the release of the film in the US and that would be the "Approved Marketing Plan". Then:

(a) Journal would perform the services in accordance with the plan;

(b) any changes to the plan requested by Journal would be subject to the prior approval of the Appellant; and

(c) if the Appellant were to notify Journal of any changes to the plan requested by Corpus, Journal would render the services in accordance with the revised plan as long as that did not lead to an increase in the services budget.

(clause 4.3). As noted in paragraph 31(2) above, exhibit B was in the same form as exhibit B to the Head P&A SA;

(9) the Appellant was required to provide to Journal or its designee, such advertising and promotional materials relating to the film as the Appellant had in its possession and that, for this purpose, Marital was Journal's designee (clause 4.5);

(10) the Appellant would pay Journal the services fee set out in schedule 1 and, to the extent that the services were able to be provided at a lesser cost than the services budget, Journal would be entitled to retain any underage. Schedule 1 set out the services fee of £3,005,543 and included line items for the Marital margin of £28,850.18 and the Journal margin of £30,000;

(11) all obligations of the Appellant would automatically terminate upon the termination of the Studio P&A SA or the engagement of Marital under that agreement (clause 11.3); and

(12) Journal was precluded from assigning its rights under the agreement other than by way of security to Marital, the Appellant or Illuminatrix but Journal was permitted to sub-contract its obligations under the agreement to a permitted sub-contractor (which included Marital) and the Appellant was precluded from assigning its rights under the agreement other than by way of security to Corpus (clause 13).

32. The Studio P&A SA provided that, inter alia:

(1) Journal irrevocably engaged Marital to provide those services which might be required by Journal from time to time from the list of services set out in exhibit A to the agreement and/or such other P&A services as might be requested by Journal from time to time in order to enable Journal to comply with its obligations to the Appellant under the Sub P&A SA. It went on to say that, at the date of the agreement, the services would in any event include those services which were marked with an asterisk in exhibit A and that the services would in any event not exceed the services budget. In addition, Marital would be responsible for arranging for the services and would co-ordinate with Journal and the permitted sub-contractors to enable Journal to fulfil its obligations to the Appellant under the Sub P&A SA. Journal was precluded from appointing any other contractor to perform the services without the prior approval of

Marital (clause 2.1). Exhibit A was in the same form as exhibit A to the two other P&A SAs;

(2) Corpus was to have sole control of the "Material Elements" and any change to the technical, financial and business elements and decisions in relation to the services were subject to Journal's confirmation that Corpus was satisfied with them (clause 2.2). The Material Elements, including the Approved Marketing Plan, were then set out in exhibit B, which was the same as exhibit B to the other two P&A SAs;

(3) Marital was required to keep Journal informed of the progress of the services and Marital was permitted to sub-contract the services to any person approved by Journal provided that:

> (a) that right of approval did not extend to any end-supplier or end-services provider;
>
> (b) Universal Pictures, a division of Universal City Studios, LLC, was an approved sub-contractor for this purpose; and
>
> (c) no permitted sub-contractor would be entitled to sub-contract onward without the prior approval by Corpus of the relevant onward sub-contractor

(clause 2.3);

(4) the services budget was £2,975,543 and it would be allocated in accordance with schedule 1 (clause 3.1). Schedule 1 contained the same list of possible services as were set out in exhibit A and allocated part of the total services budget of £2,975,543 to each of creative advertising and publicity – the two items marked with an asterisk in exhibit A;

(5) Journal would pay Marital the services fee set out in schedule 1 (which was an amount equal to the services budget and included a line item for the Marital margin of £28,850.18) and specified that:

> (a) the services fee was to be discharged by the cash payment by Journal to Marital of the Studio Benefit and the assignment to Marital of Journal's rights under the Journal Loan Agreement;
>
> (b) to the extent that the services budget was exhausted, Corpus would be entitled to, or to authorise Marital to, perform further and additional services in respect of the film; and
>
> (c) Corpus was entitled to, or to authorise Marital to, perform, complete and pay for any P&A services which were not to be performed under the agreement but that neither Marital nor Journal would have any obligation to the other in connection with that

(clause 3.2);

(6) Journal would have reasonable access to the books and records in respect of the services (clause 3.3);

(7) the services would be performed until the earlier of the confirmation from Journal that they had been completed or 31 March 2014 (or such other date as might be nominated by Journal) (clause 4.1);

(8) Journal would submit a marketing plan substantially in the form of exhibit B to the agreement to Journal prior to the release of the film in the US and that would be the "Approved Marketing Plan". Then:

(a) Marital would perform the services in accordance with the plan;

(b) any changes to the plan requested by Marital would be subject to the prior approval of Journal; and

(c) if Journal were to notify Marital of any changes to the plan requested by Corpus, Marital would render the services in accordance with the revised plan as long as that did not lead to an increase in the services budget

(clause 4.3). As noted in paragraph 32(2) above, exhibit B was in the same form as exhibit B to the other P&A SAs;

(9) to the extent that the services were able to be provided at a lesser cost than the services budget, Marital would be entitled to retain any underage (clause 6.1);

(10) the agreement would terminate automatically in the event of Marital's insolvency (clause 11.1);

(11) if Marital failed to perform its obligations under the agreement, then Journal could terminate the agreement (clause 11.2);

(12) the agreement would terminate automatically upon any termination of the Head P&A SA (clause 11.3); and

(13) Marital could terminate the agreement if Journal failed to pay the Studio Benefit to Marital by 31 October 2012 (clause 11.4).

33. The DB contained a number of other relevant transaction documents in addition to the P&A SAs. These included:

(1) the Copex Loan Agreement;

(2) the Journal Loan Agreement;

(3) the Partnership Deed;

(4) the Consultancy Agreement; and

(5) various security documents.

34. The Copex Loan Agreement included conditions precedent to the drawdown (in schedule 2 to the agreement), one of which was that each of Journal, Illuminatrix and the Appellant was required to have signed a letter of instruction to Copex to the effect that the £2,781,486 which it was about to receive into its account with Copex as part of the circular flow of monies on the drawdown date had to be paid on to the account at Copex of the next entity involved in that flow.

35. The Journal Loan Agreement provided that, inter alia:

(1) the loan made under the agreement could be used only to make Illuminatrix's capital contribution to the Appellant (clause 2.3);

(2) the execution of the Partnership Deed, the P&A SAs and the transaction security documents were conditions precedent to drawdown (clause 3.1);

(3) Illuminatrix was required to pay interest on the loan on 31 October 2013 and thereafter on each 31 October until the repayment date but, if, on any interest payment date, Illuminatrix had received insufficient distributions from the Appellant to pay the interest which was then due, the relevant interest would be payable on the repayment date (clause 3.4.4);

(4) Illuminatrix was required to pay all distributions which it received from the Appellant to Journal immediately upon receipt of the distributions (clause 4.2); and

(5) Journal was permitted freely to assign its rights under the agreement (clause 12.4).

36. The Partnership Deed provided that, inter alia:

(1) the purpose of the Appellant was to carry on the trade of providing services in respect of one or more projects involving films (clause 2.2);

(2) the profits and losses were to be allocated to members in the same proportions as those to which we have referred in paragraph 26(3) above (clause 8);

(3) all income and capital proceeds of the Appellant would be used by the Appellant to meet expenses and then retained by the Appellant until the Appellant was wound up (clause 9); and

(4) in each period of account of the Appellant ending on or after 31 October 2017, the Designated Members would review the then current trading position of the Appellant and consider whether or not to propose a resolution to the members to wind up the Appellant (clause 14).

37. The Consultancy Agreement provided that, inter alia:

(1) the Appellant engaged FFC to provide the Appellant with consultancy services and such other services as might be agreed between the parties (clause 2.1);

(2) the Appellant would pay consultancy fees to FFC in an amount equal to 8% of the aggregate capital contributions received by the Appellant in its first period of account (including the capital contribution of Illuminatrix) and an annual fee thereafter (clause 4); and

(3) the consultancy services would be as set out in schedule 1. That schedule set out the range of consultancy services to be provided, including identifying and evaluating suitable projects, carrying out the work needed for the Appellant to be able to enter into a project and perform its services in connection with it, monitoring and managing the provision of services by the Appellant, arranging for the exploitation of the library of film rights or rights in projects and executing, delivering and performing all contracts, and engaging in all activities, necessary to achieve the other services.

38. The security documents included various agreements to secure the obligations of the various FF group entities to Corpus and Marital.

39. The most significant of these was the agreement executed on 28 October 2012, pursuant to which each of the Appellant, Illuminatrix, Journal, Corpus and Marital executed payment directions to the effect that, prior to the repayment of the loan made under the Journal Loan Agreement, a designated share of the Appellant's return under the Waterfall (corresponding to Illuminatrix's share (86%) of the stage 8 payments under the Gross Receipts part of the Waterfall) would be paid by Corpus directly to Marital, in satisfaction of Corpus's obligation to the Appellant under the Waterfall, the Appellant's obligation to make a distribution to Illuminatrix and Illuminatrix's obligation to Marital to repay the loan made under the Journal Loan Agreement.

40. There were a number of other security documents under which, inter alia:

(1) the Appellant charged its rights under the transaction documents to Corpus to secure its obligations to Corpus under the Head P&A SA and the obligations to Corpus of each party to the transaction documents apart from Corpus and Marital;

(2) Journal charged its rights under the transaction documents to Marital to secure its obligations to Marital under the Studio P&A SA and the obligations to Marital of each party to the transaction documents apart from Corpus and Marital;

(3) subject to the prior charge in favour of Corpus, the Appellant charged its rights under the transaction documents to Journal to secure its obligations to Journal under the Sub P&A SA;

(4) Illuminatrix charged its membership interest in the Appellant to Marital to secure its obligations to Marital under the Journal Loan Agreement, Journal's obligations to Marital under the Studio P&A SA and the obligations to Marital of each party to the transaction documents apart from Corpus and Marital; and

(5) subject to the prior charge in favour of Marital, Illuminatrix charged its membership interest in the Appellant to Journal to secure its obligations to Marital under the Journal Loan Agreement.

41. The overall effect of the security package was broadly to ensure that the Universal group was not exposed to the insolvency of any of FF group entities and, in particular, that Corpus could pay Illuminatrix's share of the stage 8 payments under the Gross Receipts part of the Waterfall (if any) directly to Marital even if one or more of the Appellant and Illuminatrix were to be insolvent.

Post-transaction documents

42. In addition to the pre-transaction and transaction documents, the DB contained various post-transaction documents pertaining to the transaction.

43. For instance, it contained:

(1) several updates sent by Mr Lipman to the corporate members in the Appellant during 2013 and 2014, which described the box office returns from the film very positively. The report for July 2013 noted that the film had achieved a 518% return on budget, placing it significantly above the Base Case and the Management Case considered by the Investment Committee and only just below the Upside Case considered by the Investment Committee. It said that receipts were not yet high enough to generate a return under the Waterfall but noted that the figures did not take into account home video sales and other media receipts and that things were still at an early stage. The report for October 2014 was similarly optimistic, noting that the box office returns were still at the same level and that the small payment under Stage 4 of the Gross Receipts part of the Waterfall had been received. It went on to say that FFC anticipated that stage 7 of the Gross Receipts part of the Waterfall would shortly be reached and that the film needed to generate only $8m more in gross receipts before that became due; and

(2) several reports from Corpus to the Appellant setting out how the Waterfall was operating in the light of revenues and expenses to the relevant date. These showed that the expenses and contingent payments arising in connection with the film were considerably greater than had been anticipated by the Investment Committee at the time of its meeting.

44. The DB also contained the accounts of Illuminatrix for its accounting reference period ending 13 September 2013. In the accounts:

(1) Mr Margolis was recorded as the sole director of the company during the relevant period;

(2) the company's investment in the Appellant had been written down to nil; and

(3) the notes to the accounts stated that this was because the directors considered the value of the investment to be nil.

The witness evidence

45. There were two accounting expert witnesses, whose testimony we will set out and discuss in the section of this decision dealing with the GAAP Issue. In this section of the decision, we will confine ourselves to the evidence of Mr Margolis, who was the sole witness of fact at the hearing.

46. The relevant parts of Mr Margolis's testimony were as follows:

(1) he was the director and sole owner of the companies in the FF group and had been involved in the film business for almost 30 years. He had not had primary responsibility for the present transaction. That had rested in the hands of four colleagues – Mr Thomas Gardner, Ms Patricia Jackson, Ms Katrina Stagner and Mr Kwesi Dickson. Mr Gardner's and Ms Jackson's background was in film finance, Ms Stagner's background was in media law and Mr Dickson's background was in film production. Mr Dickson's prior experience meant that he had an understanding about the distribution of films;

(2) from his experience in the industry, Mr Margolis knew that studios were much more interested in the distribution of films than in the production of films. In relation to distribution, the studios liked risk-sharing deals in which, in exchange for initial finance, they would give away some of the potential box office upside through a waterfall. In this regard, studio films were a better bet for a group like the FF group than independent films. This was because the risk to the FF group was lower. However, he recognised that the group's negotiating position with the studios was weaker and therefore that the group's share of returns would not be as high. He was also aware of what he called "studio accounting" – the fact that it was the studio that was in control of reporting on the revenue and expenses in relation to a film for the purposes of operating the waterfall in connection with that film;

(3) he added that the studio would have had "a huge department dealing with the distribution of the movie" (Transcript Day 3 page 78 lines 18 and 19) and that it was likely that Marital would have sub-contracted its obligations under the Studio P&A SA either to that department or to specialist third parties outside, but overseen by, the studio;

(4) the Appellant was the thirteenth in a line of similar partnerships (referred to as "Spotlight" partnerships), two of which had already participated in similar transactions with the studio in relation to Les Miserables. Each of the transactions was effected using template documents developed by the FF group with the assistance of the law firm DLA Piper UK LLP. As he saw it, the transaction involved the provision by the Appellant of P&A services to the Universal group in relation to Les Miserables in return for potential returns through the Waterfall. If the film was successful and generated profits for the Appellant, then it could use those profits to invest in future deals;

(5) Les Miserables had been chosen as the appropriate film as a result of his discussions with Mr Marc Palotay of the studio, with whom he had a long-standing relationship. Les Miserables was a classic story and the film had a stellar cast and director. It could therefore be expected to have a long "tail" – by which Mr Margolis meant that it would continue to generate receipts long into the future and not solely

from the immediate box office revenue, just as had been the case with other successful films such as The Shawshank Redemption and Gone with the Wind;

(6) however, the precise terms of the deal done by the Appellant were negotiated by Mr Gardner and Ms Jackson. In this regard, the decision to enter into the deal and the terms of the Waterfall were the result of a decision of the Investment Committee – of which he was not a member - following the presentation to the Investment Committee of the IC Submission;

(7) once the transaction had been implemented, the Appellant received regular updates from the studio on the receipts and costs associated with the film. A Mr Reece Lipman had been seconded by the FF group to the Appellant to manage the relationship with the studio and it was Mr Lipman who was responsible for overseeing the fulfilment of the P&A services by the Appellant under the Head P&A SA through the sub-contracting arrangements. Mr Lipman was also responsible for receiving the reports on the progress of the Waterfall from Corpus and reporting on the progress of the Waterfall to the corporate members;

(8) as it happened, in this case, the film had not given rise to meaningful returns for the Appellant through the Waterfall. However, this was due not to any shortfall in the box office receipts from the film as compared to those which the Investment Committee had predicted but rather to a large overspend on expenses and participations, which were much greater than the Investment Committee had predicted. Control over how much was spent on marketing and advertising the film was solely in the hands of the studio and the studio could be expected to act in its own interests. There was absolutely no doubt that the studio was "entitled to do what it [wanted] in relation to the distribution and promotion of its picture" (Transcript Day 3 page 87 lines 2 to 5). Moreover, the mere fact that a film was successful did not mean that the spending would be reduced because the push for awards would be likely to involve more marketing expenditure. One therefore had to trust the studio and hope that the eventual returns would justify any increase in spending;

(9) he was unable to explain why, at the same time that Mr Lipman was telling the corporate members that the box office returns from the film were such that payments under the Waterfall could be expected imminently, he had decided to write down Illuminatrix's investment in the Appellant to nil. However, he did say that, following those reports, when the corporate members had not received any distributions from the Appellant, he had received complaints from certain corporate members about that;

(10) he accepted that, at inception, and during the tax years which were the subject of the appeal, the transaction had had a five-year term as set out in the P&A SAs. However, he said that, subsequently, in 2015, he had reached an oral agreement with Mr Palotay to the effect that the studio would continue to make payments under the Waterfall in perpetuity. That agreement had been reached shortly before Mr Palotay had died. The agreement arose as a result of a dispute between the parties caused by the insolvent liquidation of Journal for reasons unconnected with the transaction. Under the terms of the transaction documents, and the documents for similar transactions between other "Spotlight" entities and the studio, that triggered a right for the studio to terminate the deals and so Mr Margolis had sought to renegotiate them. It was in the course of that renegotiation that Mr Palotay had agreed that the Waterfall could be extended in perpetuity. Mr Margolis accepted that this agreement was not recorded in writing despite the fact that the DB contained emails between the two groups following Mr Palotay's death recording the terms of the arrangement which they

had reached as a result of the dispute over Journal's insolvency. However, he said that he had continued to get reports from the studio until as recently as 2019 and that this was an indication that the studio had agreed to the extension;

(11) he added that the present proceedings had caused him to look during the course of giving his evidence at the reports provided to the Appellant by the studio over the term of the transaction and to compare some of the information in those reports with information in the public domain in relation to other films. Having done so, he had realised that the studio must have been over-stating its expenditure and under-stating its income in those reports and that, as he put it himself, "I just don't believe their report and I should be having a conversation with Universal as a result of this…I think almost certainly I'll be giving Universal a call after we've been through these proceedings" (Transcript Day 3 page 16 lines 2 and 3 and page 21 lines 21 and 22);

(12) he confirmed that both the gearing and the accounting write-down in the first period of account of the Appellant were essential to the transaction and that accounting advice in relation to the write-down had been obtained from Mazars but said that he would have hoped that, when negotiating the Waterfall and agreeing terms with the studio, the relevant personnel acting for the Appellant would have been focused more on maximising the profitability of the Appellant than in ensuring that the terms of the Waterfall justified the write-down;

(13) as regards the deliberations of the Investment Committee, he said as follows:

(a) he explained that the reason for the two changes to the terms of what became the Waterfall as between the time of the meeting of the Investment Committee and the execution of the transaction documents was that less money was raised from corporate members than had been anticipated. Thus, the studio was able to negotiate more favourable terms for itself than was initially expected;

(b) he accepted that the terms of the Waterfall were based on the economic reality that the Appellant was providing only the Studio Benefit (and not £3,005,543) to the studio and said that the terms of the Waterfall would have been more favourable to the Appellant if it had been based on a benefit to the studio of £3,005,543;

(c) he was unable to explain why the contingency payments estimated in the submission to the Investment Committee and in the minutes of the Investment Committee had been 20% instead of the 30% figure assumed for the same film in the two earlier transactions entered into by "Spotlight" entities in relation to Les Miserables. At one stage, he said that he could only imagine that, between the date of those earlier transactions and the transaction into which the Appellant had entered, more information had emerged which had suggested that that reduction was appropriate and, at another, he hypothesized that the Investment Committee might have relied on an industry average in reaching the lower figure;

(d) he explained that the Investment Committee would not have been able to obtain a meaningful estimate of the marketing and distribution costs from the studio because the studio would have been wary of being seen to have made binding representations in relation to those costs; and

(e) he said that the reference in the minutes of the Investment Committee to the film's still generating "returns" if it failed to achieve the "Upside Case" simply meant that the film would in that case give rise to cash receipts and not necessarily profit. Those cash amounts could then be used for further transactions, as shown in the presentation to prospective members referred to in paragraph 26 above;

(14) as for the fact that a payment under stage 7 of the Gross Receipts part of the Waterfall would potentially involve a payment by Corpus of an amount equal to 125% of the Studio Benefit, Mr Margolis rejected Ms Wilson's characterisation of the transaction as in that event failing to achieve its purpose for the studio. Ms Wilson had posited that, in that case, instead of being an outright permanent receipt, the Studio Benefit would have become an expensive borrowing for the studio. He said that, as he saw it, the Appellant was providing P&A services to Corpus on a risk-sharing basis and that, if stage 7 of the Gross Receipts part of the Waterfall was reached, the film would have been spectacularly successful so that the studio would not have minded repaying the Studio Benefit at a premium of 25% in that event;

(15) he accepted that he had not seen the Approved Marketing Plan or the letter referred to in paragraph 30(1)(a) above which Corpus was required to send to the Appellant in relation to the creation of the Approved Marketing Plan and that, despite frequent requests by the Respondents for those documents, they had not been provided to the Respondents. He put the absence of those documents down to the fact that:

(a) Mr Lipman was overseeing the services and in regular touch with the studio orally; and

(b) there had been a computer upgrade and an office move for the FF group since the period in question;

(16) similarly, he confirmed that:

(a) he had not seen any of the cost statements or reports mentioned in clause 3.3 of each P&A SA;

(b) he did not think that the Appellant had ever exercised the audit right set out in paragraph 6 of schedule 2 to the Head P&A SA;

(c) he did not know whether the costs which had been included in the reports provided by Corpus during the term of the transaction included a proportion of studio overheads;

(d) Marital was not obliged to use the Studio Benefit in providing the services under the Studio P&A SA; and

(e) the Appellant could not do better under the Head P&A SA by performing the services itself or by finding a sub-contractor other than Journal and Marital to perform the services;

(17) he said that the whole of the stage 4 payment under the Gross Receipts part of the Waterfall which had been received by the Appellant in its period of account ending 31 October 2014 had been used by the Appellant to meet its expenses. Those were:

(a) fees of £5,000 to Shipleys LLP for auditing the accounts of the Appellant and preparing the partnership tax returns; and

(b) fees of £4,528 in respect of the annual service charge due to FFC under the Consultancy Agreement.

(We were shown the invoices in relation to those fees in the DB.) As a result of those fees, none of the receipt in question had been paid to any of the members; and

(18) more generally, he said that the length of time which had passed since the transaction had been implemented had contributed to the absence of documentation.

FINDINGS OF FACT

Introduction

47. Before setting out our conclusions of fact, we should make some general observations about the evidence of Mr Margolis. Although Mr Margolis provided us with some helpful general information on the film industry and the manner in which it operates, we were not persuaded by much of his evidence in relation to the two issues which are key to this decision – namely:

(1) the purpose of the Appellant in entering into the transaction; and

(2) the nature of the transaction.

48. We reached this view for essentially four reasons.

49. The first was that, by his own admission, Mr Margolis was some way removed from the transaction in terms of the detail. Much of his evidence was therefore speculative in nature, based on his general experience of similar deals and not this specific transaction. Mr Margolis himself had not had any meaningful involvement in the transaction so that he could not speak with any authority about the assumptions underlying the recommendation by the Investment Committee that the Appellant should enter into the transaction on the terms which it did or the financial implications of the transaction for the Appellant.

50. In particular, Mr Margolis was unfamiliar with the basis for the assumptions underlying the Waterfall and did not know why the terms of the Waterfall changed in the five days between the Investment Committee's recommendation and the execution of the Head P&A SA. As such, he was forced to guess, based on his general experience of deals such as the present one, what was going through the minds of the people who actually implemented the transaction. For example, when asked whether the desire to obtain the accounting loss in the first period of account of the Appellant had informed the negotiation on the terms of the Waterfall, he was able to say only that he "hoped" that it had not.

51. We really needed to hear evidence from the individuals who were actually involved in implementing the transaction on behalf of the Appellant – one or more of Messrs Gardner, Dickson and Lipman, Ms Jackson or Ms Stagner. In addition, given that each of the issues but, in particular, the Trade Issue, the View to Profit Issue and the GAAP Issue, turned on the economics of the Waterfall and the nature of the transaction, we would ideally have heard evidence from someone from the studio, who might have shed some light on how the studio viewed the transaction. Whilst that evidence would not have been of direct relevance to the question of the Appellant's purpose in entering into the transaction, it would have shed considerable light on the true nature of the transaction and on the likelihood of the Appellant's making a profit from the transaction.

52. Ms Wilson and Mr Macklam invited us to draw an adverse inference from the failure of any of those individuals to attend the hearing. Mr Ramsden objected to that, pointing out that no explanation of why the individuals were not giving evidence had been requested. We do not draw an adverse inference from the failure of the relevant individuals to attend and give evidence at the hearing. There are all sorts of perfectly reasonable explanations as to why they did not. However, in the context of proceedings in which the burden of proof is on the Appellant in relation to each of the issues, we would say that it is, to put it mildly, surprising that sole reliance has been placed on Mr Margolis. We cannot help but contrast the relative paucity of witness evidence in this case with the witness evidence in the similar case of

Eclipse Film Partners (No 35) LLP v The Commissioners for Her Majesty's Revenue and Customs [2015] STC 1429 ("*Eclipse*"), where the taxpayer called four witnesses.

53. The lack of additional witness evidence ties in with the second reason for our reluctance to accept Mr Margolis's evidence in relation to the purpose of the Appellant in entering into the transaction or the nature of the transaction and that is that his evidence was inconsistent with the written evidence before us. It was inconsistent in two respects – that which was there and that which was not there.

54. As regards that which was there, we were provided with the terms of the transaction documents and, in particular, the three P&A SAs. These showed very clearly that all responsibility for the distribution and marketing activities in relation to the film remained within the Universal group because of the manner in which the three documents interacted. The terms of the Waterfall in the Head P&A SA also served to cast doubt on Mr Margolis's proposition that the Appellant entered into the transaction to make a profit. For reasons on which we expand below, we believe that there was no meaningful prospect that the Waterfall would give rise to a profit for the Appellant.

55. As regards that which was not there:

(1) Mr Margolis testified that Mr Lipman had played an ongoing role in liaising with the studio in relation to the provision of the services but there was not a single piece of written evidence in the DB to support that proposition. If that had been the case, we would have expected to see frequent exchanges of emails between Mr Lipman and his contact at the studio to that effect. In the absence of any such written evidence and any oral evidence from Mr Lipman himself, Mr Margolis's testimony on that subject lacks credibility;

(2) Mr Margolis said in his evidence that he had agreed with Mr Palotay shortly before the latter's death an extension to the term over which the Waterfall would continue to operate. Whilst it was of limited relevance to the issues which we were considering – because our decision necessarily relates to the position in the two tax years in question and we are required to identify the purpose of the Appellant in entering into the transaction and the nature of the transaction in those tax years - no written evidence of that agreement was provided to us. That was the case despite the fact that:

(a) the dispute between the parties which had led to the oral agreement was settled by way of exchanges of emails in writing, none of which mentioned the extension of the term; and

(b) there was no commercial reason for the studio to agree to such an extension.

As such, we did not think that Mr Margolis did enough to persuade us that, on the balance of probabilities, that extension occurred; and

(3) Mr Margolis said that he had received complaints from certain corporate members in relation to their failure to receive any distributions of profit from the Appellant. This point was of some significance in the context of whether or not the Appellant was trading with a view to profit and so we would have expected to see some written evidence to that effect but no such written evidence was provided. As such, we are not persuaded that any such complaints were made.

In relation to each of these issues, we are cognisant of the dicta of Arden LJ (as she then was) in *Wetton v Ahmed* [2011] EWCA Civ 610 at paragraph [14], to the effect that "contemporaneous written documentation is of the very greatest importance in assessing credibility…For instance, if the judge is satisfied that certain contemporaneous documentation is likely to have existed were the oral evidence correct, and the party adducing oral evidence is responsible for its non-production, then the documentation may be conspicuous by its absence and the judge may be able to draw inferences by its absence".

In this context, we are not convinced by the reasons given by Mr Margolis – in paragraphs 46(15) and 46(18) above - for the absence of written evidence. We think that, if Mr Lipman had been liaising with the studio in the manner suggested by Mr Margolis, then there would have been some emails indicating that that was the case, even if the emails were just to arrange telephone calls or to summarise conclusions. Those exchanges would not all have taken place orally as Mr Margolis suggested. In addition, we do not find the explanation to the effect that there has been a computer upgrade and an office move since 2012 particularly compelling, given how long this dispute has been running. The Appellant has had every opportunity to locate any written evidence that may have existed. The above issues are of sufficient importance in the context of this appeal that we would have expected more concerted efforts to have been made to track down the relevant evidence (if it existed) notwithstanding the change in computer system and the office move. Finally, as regards the point made in paragraph 46(18) above, although it has taken some time for this appeal to reach the First-tier Tribunal, the enquiry into the tax year 2012/13 was opened in October 2014 and so the Appellant has known since then that the question of whether the Appellant really did supply P&A services to the studio was a source of dispute with the Respondents. The failure to adduce any written evidence in relation to that activity is in our view highly significant.

56. The third reason for our scepticism in relation to Mr Margolis's evidence is that it was in some respects gainsaid by Mr Margolis himself. For example, Mr Margolis maintained throughout his cross-examination that the purpose of the Appellant was to make profits from the transaction and yet we found that difficult to square with the surprise which he expressed at his apparent discovery, mid-way through the hearing, that the studio must have been over-stating its expenditure and under-stating its income in relation to the film in the reports which were provided to the Appellant during the term of the transaction. We considered that Mr Margolis's discovery to that effect only now, in 2022, was inconsistent with the proposition that the Appellant had entered into the transaction with the purpose of making a profit. That is because the obvious question to which it gave rise was why the exercise which Mr Margolis had just carried out during the hearing had not been conducted several years earlier. After all, the Appellant had a right under paragraph 6 of schedule 2 to the Head P&A SA to audit the financial statements provided by Corpus – a right which Mr Margolis admitted the Appellant had not exercised. The only logical conclusion to be drawn from the fact that Mr Margolis was discovering so belatedly that the figures might be inaccurate was that the Appellant was indifferent to the prospect of realising a profit from the making of the film. If the Appellant had really been intent on deriving a profit from the film, then the sort of forensic examination which Mr Margolis had conducted during the hearing would have been made long before.

57. Similarly, Mr Margolis cited, as one of the reasons why the Appellant might expect to make a profit from the transaction, that a successful film like Les Miserables would have a long "tail", by which he meant a stream of revenue running well into the future. And yet he accepted that, at inception, and during the tax years which are relevant to this appeal, the term of the transaction, and the period over which receipts might arise under the Waterfall, was only five years.

58. The final reason for our concerns in relation to the evidence of Mr Margolis was that it lacked commercial credibility. We say this in two distinct respects:

(1) first, the basis on which the P&A services were provided; and

(2) secondly, the economics of the transaction for, on the one hand, the Appellant, the corporate members and the FF group and, on the other hand, the studio.

59. As regards the first of these, there is no commercial reason why the studio would have entrusted any part of the performance of its marketing and distribution activities in relation to the film to the Appellant. Commercial logic suggests that the only reason why the studio would have been prepared to enter into the transaction was to obtain the Studio Benefit. That was de minimis in terms of the overall cost of producing, marketing and distributing the film. Moreover, the studio had a huge marketing and distribution capability of its own. It had no need to seek out the Appellant to assist it in that regard.

60. As regards the second of these, we will explain in further detail below why we think that the economics of the transaction compel the conclusion that the likelihood that any meaningful payments would be made under the Waterfall was remote but, in brief:

(1) as the only economic benefit derived by the studio from entering into the transaction was the Studio Benefit, and the studio had sole control of the calculations in relation to, and hence the application of, the Waterfall, there is no reason to think that the studio would have willingly made payments under the Waterfall which deprived it of that benefit; and

(2) so far as the Appellant, the corporate members and the FF group were concerned, the return derived by the corporate members (as a result of the tax relief) and the FF group (by way of the fee under the Consultancy Agreement) were so substantial as to make the transaction perfectly viable commercially without the need for any profit for the Appellant under the Waterfall.

The findings of fact

61. Having made those general observations in relation to Mr Margolis's evidence, we now set out our findings of fact and the reasons for those findings. In order to facilitate the reading of this decision, this section of the decision does not deal with our conclusions in relation to the GAAP Issue, even though those conclusions are also findings of fact. Those are set out in paragraphs 108 to 115 below.

62. Since the findings of fact are all inter-related, for reasons which will become apparent, there is a degree of overlap in the paragraphs which follow. However, we have attempted to group our findings into four broad categories, as follows:

(1) findings in relation to the flow of funding which occurred at inception;

(2) findings in relation to the services and how they were performed;

(3) findings in relation to the value of the Waterfall and the likelihood of profit in the Appellant; and

(4) finally, findings in relation to the purpose of the Appellant in entering into the transaction.

63. Before setting out our findings, we should reiterate that it is common ground in these proceedings that all of the agreements making up the transaction were conceived and implemented as a single integrated structure (see paragraph 20 above). It is also common ground that the studio at all times retained all rights in the film itself. Both of these

conclusions are, in any event, inescapable from the terms of the various transaction documents.

64. Our findings of fact in relation to the flow of funds which took place at inception are that there was no prospect that the sum of £2,781,486 which was drawn down by Journal under the Copex Loan Agreement:

(1) would be used by Journal for anything other than making the loan to Illuminatrix under the Journal Loan Agreement;

(2) would be used by Illuminatrix for anything other than subscribing for capital in the Appellant;

(3) would be used by the Appellant for anything other than paying Journal under the Sub P&A SA; or

(4) would be used by Journal for anything other than repaying the loan made under the Copex Loan Agreement.

This conclusion is based on the terms of the two loan agreements, including:

(a) the provision in each agreement specifying the required use of the funds;

(b) the condition precedent in the Copex Loan Agreement to the effect that drawdown of the loan under that agreement could be made only if each of Journal, Illuminatrix and the Appellant had signed a letter of instruction to Copex to the effect that the £2,781,486 which it was about to receive had to be paid on to the next entity involved in the circular flow of funds; and

(c) the daylight term of the loan under the Copex Loan Agreement.

This meant that each of the outcomes set out in paragraphs 64(1) to 64(4) above was inevitable.

65. Our findings of fact in relation to the services and how they were performed are as follows:

(1) the Appellant could not earn greater amounts under the Head P&A SA if it chose to perform the services itself than if it chose to sub-contract the services, either to Journal and Marital or to other sub-contractors approved by Corpus. This was apparent from the terms of the Head P&A SA;

(2) Marital was not obliged to use the Studio Benefit in providing the services under the Studio P&A SA. The Studio P&A SA did not require it. Instead it specifically stated that Marital was entitled to retain any underage (see clause 6.1) and Mr Margolis said as much in his evidence;

(3) although the Head P&A SA and the Sub- P&A SA were drafted on the basis that each of Journal and Marital (in the case of the Head P&A SA) and Marital (in the case of the Studio P&A SA) were merely permitted sub-contractors and that other sub-contractors might in fact be appointed, the ostensible freedom for the Appellant or Journal to perform services itself or to select alternative sub-contractors was illusory and had no practical effect. The combined effect of the terms of the three P&A SAs was that there was no practical likelihood that the Appellant would perform the services itself or that any person other than Marital would perform the services. In other words, Marital was more than simply a permitted sub-contractor. It was always intended that the only person responsible for implementing the activities which were involved in the services was going to be Marital;

We draw this conclusion from the fact that:

(a) the appointment of any other sub-contractors required the consent of Corpus;

(b) the entire document chain – including the security package – made sense only if Marital was in fact appointed to provide the services. Putting this another way, this arrangement made no commercial sense to the studio unless Marital could receive the Studio Benefit;

(c) each P&A SA came to an end if the Studio P&A SA was terminated – see clause 11.3 of each P&A SA; and

(d) the Appellant was highly incentivised to ensure that the services were sub-contracted to Marital because it had no liability for any default under the Head P&A SA to the extent that the relevant default was caused by any member of the Universal group and no termination right arose in those circumstances – see clauses 6.2, 11.2 and 12.1(a) of the Head P&A SA. As a result, the Appellant had a significant commercial reason for ensuring that it did not perform the services itself and that all of its obligations to provide the services were performed by Marital;

(4) no Approved Marketing Plan was ever produced – see Mr Margolis's evidence in paragraph 46(15) above and the absence of any written evidence to that effect;

(5) there was no means of distinguishing between, on the one hand, the part of the print and advertising activities in relation to the film which was purportedly carried out by Marital for Journal, by Journal for the Appellant and by the Appellant for Corpus and, on the other hand, the remainder of those activities. There was thus no means of identifying exactly what the former activities entailed.

This is because the three P&A SAs contained no useful information in relation to the nature of the services which were to be supplied. Clause 2.1 of the Head P&A SA provided that the services would be those which might be mutually agreed by the parties from time to time from the list of services set out in exhibit A to the Head P&A SA and/or such other services as might be requested by Corpus in accordance with the "Approved Marketing Plan". It further provided that the services would in any event include those of the services set out in Exhibit A which were marked with an asterisk. Exhibit A then contained a long list of services which were potentially to be provided, and included an asterisk against two of those categories – namely, creative advertising and publicity.

However, no information was set out in the Head P&A SA as to the precise nature of the creative advertising and publicity services so marked and we were not provided with any evidence of discussions which might have taken place between Corpus and the Appellant in that regard. In addition, as noted in paragraph 65(4) above, there was no Approved Marketing Plan, which, based on the drafting of three P&A SAs, was fundamental to the identification of the services to be provided.

Schedule 1 to the Head P&A SA set out a services budget, which allocated part of the aggregate services budget to each of creative advertising and publicity but, without any identification of the precise services to which they related, those were simply meaningless figures. It follows that there was no means of identifying the nature of the precise services which were required to be provided by the Appellant under the Head P&A SA either in the Head P&A SA itself or from extraneous evidence.

Mr Ramsden said that such lack of specificity was attributable to the fact that the reaction of the market to the film would dictate the marketing and distribution strategy to be adopted but we do not see how that is at all relevant. That merely means that one would expect the parties to liaise regularly on the nature of the services to be provided under the agreement and any additional services which might be required and on the terms of the Approved Marketing Plan. That is indeed exactly what clause 2.1 of the Head P&A SA provides. And yet there is absolutely no written evidence that any such discussions took place. The precise nature of the services which were provided under the agreement is impossible to determine;

(6) given that there was no means of identifying exactly what the services entailed – as to which see paragraph 65(5) above – there was no means of identifying when the services had been completed. The services were required to be completed by the earlier of verification by Corpus that the services had been completed and 31 March 2014 (or such other date as Corpus might notify to the Appellant). We have seen no evidence to suggest that Corpus verified that the services had been fully completed or had notified a date other than 31 March 2014 for the completion of the services. That might suggest that the services were completed on 31 March 2014 but we have seen no evidence to that effect or any evidence which might identify what services were provided and when the provision of those services was completed;

(7) the Appellant was not involved in managing the provision of the services to Corpus or liaising with the studio in that regard. No written evidence has been provided to the effect that the Appellant was so involved. Mr Margolis testified that Mr Lipman performed that role but, in the absence of any written evidence to that effect in circumstances where we would expect to see some if that had been the case, or the testimony of Mr Lipman himself, we are not satisfied that it was the case. By Mr Margolis's own admission, marketing and distribution was a significant part of the studio's activities. As Mr Margolis put it, the major studios do not enjoy making films but instead enjoy marketing and distributing them. Mr Margolis explained that, as a result, the studio had a massive department specifically to deal with the marketing and distribution of films. It is inconceivable that the studio would wish to rely on a small UK LLP such as the Appellant to provide it with services in that regard;

(8) even if Marital could properly be seen as having provided services under the Studio P&A SA, the value of the services it provided could not realistically have been anything approaching the specified amount of £2,975,543. Instead, it would have been closer to £194,057. This stems from the fact that Illuminatrix had no means of repaying the loan made to it under the Journal Loan Agreement – as to which, see paragraphs 66(2) and 66(4) below. As a result, the rights to principal and interest under the Journal Loan Agreement which were assigned by Journal to Marital as part of the consideration for the services under the Studio P&A SA had a negligible value and therefore the consideration received by Marital under the Studio P&A SA was just £194,057. We do not accept the proposition that Marital would agree to provide services to Journal with a value of £2,975,543 in return for consideration of £194,057;

(9) the studio retained the unfettered right to dictate how the film was marketed and distributed. We say that for two reasons. First, because it was the result of the rights accorded to Corpus under the Head P&A SA and to Marital under the Studio P&A SA and secondly, because it was a matter of stark commercial reality.

Turning first to the two documents, so far as the Head P&A SA was concerned, Corpus:

(a) had sole control over any services to be provided under the agreement (see clause 2.1);

(b) was also entitled to perform, or to ask Marital to perform, any additional services in respect of the film (see clause 3.2);

(c) also had control over the period in which the services were to be performed (see clause 4.1);

(d) had sole discretion and approval of the Material Elements (see clause 2.4) and the form of the Approved Marketing Plan (see clause 4.3); and

(e) was also entitled to ensure that the advertising and promotional materials went straight to Marital and did not need to be shown to the Appellant (see clause 4.5);

So far as the Studio P&A SA is concerned:

(i) clause 2.2 specified that Corpus had sole control over the Material Elements and that any change to the technical, financial and business elements and decisions in relation to the services were subject to Journal's confirmation that Corpus was satisfied with them;

(ii) clause 2.3 specified that:

(A) Marital was not required to obtain the approval of Journal before sub-contracting to any end-suppliers or end-services providers;

(B) a division of Universal Studios LLC was an approved sub-contractor; and

(C) Corpus's approval was a pre-condition of any onward sub-contracting by a permitted sub-contractor;

(iii) clause 3.2 mirrored clause 3.2 in the Head P&A SA by specifying that Corpus could ask Marital to perform additional services in respect of the film;

(iv) clause 4.3 allowed Corpus to make changes to the Approved Management Plan; and

(v) clause 6.1 stipulated that Marital was entitled to any underages.

As for the practical reality, we do not accept the proposition that the studio would divest itself of control of any aspect of the marketing or distribution of the film, particularly when it was merely in return for the relatively derisory sum of £194,057. The amount in question was a drop in the ocean when one considers the aggregate marketing and distribution spend on the film in aggregate. (According to a report produced by Corpus to the Appellant on 13 September 2016, the aggregate marketing and distribution spend on the film as at 30 June 2016 was some \$300m – comprising distribution fees of \$119m and distribution expenses of \$181m.) The situation in this case is not unlike that pertaining in the case of *Eclipse*, where the First-tier Tribunal held that the involvement of the partnership made no difference to the manner in which the Disney group marketed and distributed the relevant films and that the partnership played no meaningful role in that process – see *Eclipse* at paragraphs [65] and [66];

(10) the reason why Corpus was prepared to enter its obligations under the Head P&A to make contingent payments under the Waterfall was because Marital had received the Studio Benefit. It had nothing to do with the services purportedly provided to Corpus

by the Appellant under the Head P&A SA. Those services were of no moment. This is shown by the fact that:

(a) even if the Head P&A SA came to an end, so that the services were no longer required to be provided, as long as the Studio Benefit had been provided to Marital, Corpus remained obliged to make any payment required under stages 4 and 7 of the Gross Receipts part of the Waterfall - see clause 11.4 of the Head P&A SA; and

(b) if Journal did not pay the Studio Benefit to Marital by 31 October 2012, then Marital could terminate the Studio P&A SA and that would automatically terminate the Head P&A SA and the Sub P&A SA (see clause 11.4 in the Studio P&A SA and clause 11.3 in each of the other two P&A SAs).

We recognise that, on the termination of the Head P&A SA, the Appellant forfeited the right to receive certain contingent payments which it might otherwise have received under the Waterfall – any payment under stage 8 of the Gross Receipts part of the Waterfall and any payment under the Net Receipts part of the Waterfall. However, in the light of the compelling evidence to the contrary in this case, we believe that the explanation for that loss is not that Corpus was according any value to the services supplied by the Appellant under the Head P&A SA – as we indicate in paragraph 66(1) below, we think that the prospect of any meaningful payments under the Waterfall was in any event remote - but rather that any payments under those parts of the Waterfall would have exceeded the return of the Studio Benefit together with interest and there was no need for the studio to run the risk of having to pay those amounts, however small that risk was, once the transaction had ended. The loss of those rights on an early termination does not detract from the general point that, from the commercial perspective, the value of the transaction to the studio lay in the receipt by the studio of the Studio Benefit and it was that, rather than any services which the studio was receiving from the Appellant, for which the studio was prepared to enter into its obligations under the Waterfall. In his evidence, Mr Margolis accepted that the Studio Benefit was the reason why the studio was prepared to enter into the transaction at all. It was not to derive from the Appellant services for which it had no need because it had the print and advertising capacity in-house already; and

(11) the consequence of the facts described in paragraphs 65(1) to 65(10) above is that the execution of the three P&A SAs made absolutely no difference to the manner in which the studio conducted its print and advertising campaigns in relation to the film. Instead, the studio retained absolute control at all times over all of the activities involved in the film's marketing and distribution and, in particular, the print and advertising campaigns in relation to the film.

66. Our findings of fact in relation to the value of the Waterfall and the likelihood of profit in the Appellant are as follows:

(1) although there was a theoretical possibility that Corpus might be required to make a significant payment to the Appellant under the Waterfall, that possibility was, to put it at its most favourable, highly remote. There was no practical likelihood that the Waterfall would generate any revenue for the Appellant apart from the negligible amount of £9,703 at stage 4 of the Gross Receipts part of the Waterfall, which it did. This is because:

(a) first, as we have already intimated, the purpose of the studio in entering into the transaction was to obtain the Studio Benefit as a fee for its participation in the transaction. That purpose would have been thwarted to the extent that Corpus was required to make any meaningful payments under the Waterfall. In the latter case, as Ms Wilson pointed out in her cross-examination of Mr Margolis, the transaction would not have produced a permanent benefit for the studio in an amount equal to the Studio Benefit but would instead have produced the equivalent of a loan of that amount. Moreover, the loan which it would have resembled would have been very expensive. Even if the payments under the Gross Receipts part of the Waterfall were only to have reached stage 7, and before any consideration of stage 8 of that part of the Waterfall or the Net Receipts part of the Waterfall, the studio would have been required both to repay the Studio Benefit and to pay "interest" of 25% on the Studio Benefit. That would have made no sense from the studio's perspective. It would have been better off entering into a conventional borrowing if that was going to be a plausible outcome. Mr Margolis's response to that proposition was to say that, if that stage were to have been reached, the studio would have made so much profit from the film that it would be happy to pay some of it to the Appellant. However, in our view, that rather misses the fundamental point that no matter how well the film did, the studio would still rather have retained all of the profit from the film than have had to pay some of it away;

(b) secondly, the studio was in an excellent position to ensure that it did not have to make any meaningful payments under the Waterfall because it was in total control of the revenue and expense calculations. It is important to note that payments under both the Gross Receipts part of the Waterfall and the Net Receipts part of the Waterfall were dependent on the expenses incurred by the studio. As long as it was able to ensure that the expenses were sufficiently fulsome, no significant payments would fall to be made. Mr Margolis reiterated several times during his evidence that the performance of the film in terms of box office revenue had been spectacular by any standard. A return of 518% represented an amount which was well above the Management Case and only just short of the Upside Case considered by the Investment Committee. And yet, despite that excellent performance in terms of revenue, the Waterfall generated no meaningful payments because the expenses and contingency payments were so much higher than had been predicted;

(c) thirdly, when one turns to the drafting of the Waterfall in schedule 2 to the Head P&A SA, it is notable that, whereas there was a lengthy and detailed definition of the term "Gross Receipts":

> (i) there was no definition of the terms "contingent compensation", "deferments" and "participations" – which fell to be deducted at stage 3 of the Gross Receipts part of the Waterfall – or "production costs" – which fell to be deducted at stages 5 and 6 of the Gross Receipts part of the Waterfall; and
>
> (ii) the definition of the term "Distribution Expenses" - which fell to be deducted at stage 3 of the Gross Receipts element of the Waterfall – was extremely wide. Leaving aside the fact that the definition was inclusive and not exhaustive, it encompassed all costs, charges and expenses incurred by Corpus and its sub-distributors "in connection with the distribution, exhibition, advertising, exploitation and turning to account of the Picture, or in the exercise of any of [Corpus's] other rights in the Picture, of whatever kind or nature". In addition, the definition expressly provided that no volume discounts or rebates, discounts for early payment or commissions

which happened to be enjoyed by Corpus or a sub-distributor would be taken into account in quantifying the relevant expenses. The definition was so wide that Mr Margolis admitted at the hearing that he did not know whether the expenses which had been deducted in applying the Waterfall included a portion of the studio's overheads. In the circumstances, there was more than enough leeway in the drafting of the schedule to ensure that the studio would be able to avoid making a meaningful payment under the Waterfall; and

(d) finally, there was very little incentive on the part of the Appellant to push for meaningful receipts under the Waterfall for the reasons to which we turn in paragraph 67 below in setting out our conclusions of fact in relation to the Appellant's purpose;

(2) similarly, there was no practical likelihood that Illuminatrix would be able to discharge the loan which had been made to it by Journal under the Journal Loan Agreement and the rights to which were assigned to Marital as part of the consideration which was payable under the Studio P&A SA. This is because Illuminatrix was a special purpose vehicle whose sole source of revenue was its investment in the Appellant, the asset which it was compelled to acquire by the terms of the Journal Loan Agreement;

(3) the consequence of the facts described in paragraphs 66(1) and 66(2) above is that:

(a) as we have already noted in paragraph 65(8), the value of the consideration which was received by Marital under the Studio P&A SA was not the £2,975,543 which it purported to be (as set out in clause 3.2.1 of, and schedule 1 to, the Studio P&A SA) but instead only £194,057, which was the cash amount of the Studio Benefit paid by Journal to Marital under clause 3.2.1(a) of the Studio P&A SA; and

(b) from the perspective of Marital as a single entity, the terms of the Studio P&A SA made no commercial sense whatsoever. In effect, those terms stipulated that Marital would provide services to Journal with a value of £2,975,543 in return for consideration of only £194,057;

(4) those facts also mean that the transaction made no commercial sense from the perspective of Illuminatrix as a single entity. This is because:

(a) it entailed Illuminatrix's borrowing £2,975,543 on a full recourse basis from Journal under the Journal Loan Agreement on terms that it was required to use the proceeds of the loan to invest in the Appellant and Illuminatrix should have realised that there was no practical likelihood that it was going to be able to meet its obligations under that loan, given the terms of the Waterfall. (Before taking into account any tax liabilities which it might incur in respect of its entitlement to the Appellant's profits– as to which, see paragraph 66(4)(b) below – Illuminatrix would have been unable to discharge its obligations under the Journal Loan Agreement in full out of its share of the profits of the Appellant even after the payment to the Appellant of the full amount under stage 8 of the Gross Receipts part of the Waterfall. This is because:

(i) 10% of the initial fee under the Consultancy Agreement was borne by Illuminatrix;

(ii) Illuminatrix was entitled to receive only 86% of the profits in the Appellant; and

(iii) the stage 7 payments under the Gross Receipts part of the Waterfall were capped by reference to the Studio Benefit plus £9,703 (and the 25% premium on those two amounts) and the stage 8 payments under the Gross Receipts part of the Waterfall were capped by reference to the principal amount under the Journal Loan Agreement plus the interest and other amounts accruing thereon.

As such, even before taking into account its tax liabilities, Illuminatrix was entirely dependent on the Appellant's deriving a return under the Net Receipts part of the Waterfall just to meet its obligations under the Journal Loan Agreement; and

(b) when one then takes into account the potential tax liabilities faced by Illuminatrix, the transaction made even less sense for Illuminatrix from the commercial viewpoint. The terms of the profit-sharing arrangements in relation to the Appellant meant that, even if its share of the profits of the Appellant would otherwise have been sufficient to enable it to meet its obligations under the Journal Loan Agreement, Illuminatrix would have had a significant and disproportionate tax liability in respect of those profits with no wherewithal to meet that liability. This is because, although it would have obtained only 10% of the loss which is claimed to have arisen in the first period of account of the Appellant, it would have been allocated 86% (subsequently declining to 50%) of the profits arising in the Appellant in subsequent periods of account of the Appellant. It would therefore have had insufficient prior losses to shelter the profit so arising. That potential tax liability meant that, even in the unlikely event that receipts under the Waterfall were sufficient for Illuminatrix to discharge its obligations under the Journal Loan Agreement out of its share of the profits of the Appellant, Illuminatrix would have had insufficient assets both to discharge those obligations and to meet its tax liabilities. Moreover, given the terms of the payment direction of 28 October 2012, pursuant which Illuminatrix's share of the stage 8 receipts was to be paid directly by Corpus to Marital, Illuminatrix's tax liability would have ranked behind the debt owed to Marital in Illuminatrix's insolvency. In the circumstances, it is perplexing, to say the least, that Illuminatrix stood to lose all of its economic rights in the Appellant in the event of its insolvency (see clause 12 of the Partnership Deed); and

(5) for completeness, we would add that, even if we are wrong in concluding that the likelihood of there being a significant payment to the Appellant under the Waterfall was remote and Corpus had been required to make a payment under stage 7 of the Gross Receipts part of the Waterfall, that would still have been insufficient to give rise to a profit in the Appellant. This is because of the mismatch between the amount of the benefit received by the studio in connection with the transaction (the Studio Benefit) and the amount of the expenses incurred by the Appellant in connection with the transaction (the £3,005,543 paid by the Appellant to Journal and the fees paid by the Appellant to FFC under the Consultancy Agreement, including the initial fee of £228,743). Mr Margolis testified that the terms of the Waterfall reflected the former amount – which is to say the fact that the transaction produced a benefit for the studio of only £194,057 - and not the latter amount – which is to say the fact that the transaction cost the Appellant a little over £3,234,286. That oral evidence is supported by the reference in the IM to the selection criterion of a targeted return of

approximately 25% “to be earned on provision of services” (see paragraph 26(2) above) and the table in the presentation related to the IM which showed a return equal to 25% of the studio benefit (see paragraph 26(5) above). It follows from this that the studio would have regarded a stage 7 outcome under the Gross Receipts part of the Waterfall - which would have produced for the Appellant the sum of £194,057 together with a 25% return on that amount - as being an expensive outcome for the studio and consequently an excellent outcome for the Appellant. It would have had that in mind in setting the terms of the Waterfall. And yet that outcome would still have left the Appellant with a considerable loss because of its initial expense in connection with the transaction of £3,005,543.

67. Our findings of fact in relation to the purpose of the Appellant in entering into the transaction are as follows:

(1) the purpose of the Appellant in entering into the transaction is to be determined by reference to the purpose of the FF group, as the controlling mind of the Appellant. We believe that this was common ground but, even if it hadn’t been, it is perfectly apparent from the evidence presented to us. For example:

(a) it was the FF group which was responsible for incorporating the Appellant and approaching investors to become corporate members;

(b) it was the FF group which was responsible for devising the form of the transaction, for liaising with the studio in relation to the choice of film and for engaging lawyers to produce template documents; and

(c) in keeping with this, the Partnership Deed provided that the Investment Committee was to control the process of selecting the project in accordance with the recommendations of FFC (see clause 4.3 of the Partnership Deed). The Investment Committee was comprised of employees within the FF group and FFC was a member of the FF group.

In short, the FF group was the controlling mind of the Appellant and it is by reference to the purpose of the FF group that the purpose of the Appellant is to be identified;

(2) looking at the purpose of the FF group in order to determine the purpose of the Appellant, the sole purpose of the Appellant in entering into the transaction, and indeed the sole purpose for the Appellant’s establishment, was to enable the corporate members to secure a tax deduction for their respective shares of the £3,005,443 which was paid by the Appellant to Journal at inception under the Sub P&A SA. That much is clear from:

(a) the terms of the IM which was provided to prospective corporate members, and, in particular, the table in the IM – see paragraphs 26(1) to 26(4) above;

(b) the fact that the corporate members were awarded a disproportionate share of the profits and losses in the first period of account of the Appellant under the terms of the Partnership Deed (90%, instead of the 14% which their capital contributions logically suggested and to which they, in fact, reverted following the first period of account), coupled with the accounting write-down of the amount paid under the Sub P&A SA in full in respect of that period; and

(c) the extent of the return derived by the corporate members from that fiscal advantage, relative to the prospects of any profit which they might have expected to receive through the Appellant, which was minimal, for the reasons outlined in paragraph 66 above;

(3) implicit in that finding of fact is a further finding of fact, which is that the FF group, as the controlling mind of the Appellant, was simply indifferent as to whether or not the Appellant made any profit. In making that statement, we are not saying that the investors who were corporate members would not have welcomed a distribution of profit from the Appellant were one to have been made. No doubt, those investors would have preferred to receive profit from the Appellant than not to have received such profit. We are reminded of the analogy adopted by the Upper Tribunal in *Ingenious Games LLP v The Commissioners for Her Majesty's Revenue and Customs* [2017] SFTD 1158 ("*Ingenious UT*"), at paragraph [379], of the amateur runner who enters the London Marathon, where victory would doubtless be most welcome but for most would not be an aim. It was ultimately a matter of no moment to both those investors and the Appellant as to whether or not such profit arose because the transaction achieved its objectives without the profit. That is to say that, assuming that the tax planning worked as it was designed to do, the investors were able to secure a sufficient return to make their participation in the Appellant worthwhile, through the tax relief which they expected to get at inception. That tax relief, when compared to the amount they had invested, was substantial and represented a significant profit. It made the transaction worthwhile for the investors in and of itself. Any further receipts obtained through the structure, if they arose, would simply have been a bonus – a "nice to have" and not in any way a purpose. Moreover, for the reason set out in paragraph 66(4)(b) above, there was a positive reason why the FF group, the controlling mind of the Appellant, would not have wanted any such profit to arise;

(4) so far as the FF group (as the controlling mind of the Appellant) was concerned, the transaction had served its purpose as long as it delivered its day one tax loss to the corporate members. In that event, each corporate member would have obtained a significant return over the short term from its investment in the Appellant and the FF group would have derived a sizeable fee under the Consultancy Agreement. Everyone would be content with the outcome of the transaction apart from the Respondents. Conversely, if the Waterfall were to have produced significant returns for the Appellant, then, as we have outlined in paragraph 66(4)(b) above, Illuminatrix would have been in a difficult position economically. In that case, it would have been facing a significant tax bill as a result of its 86% (eventually declining to 50%) share of the Appellant's profits in the periods of account of the Appellant following the first one, with potentially no means to meet that tax liability. It follows that, whilst receipts under the Waterfall might have been a welcome additional benefit for the corporate members were they to arise, they were by no means essential for the corporate members and would in fact have been a potential problem for Illuminatrix (and, hence, the FF group);

(5) the reasoning described above is, in our view, apparent in the way that the FF group approached the transaction throughout. For example:

(a) the deliberations of the Investment Committee were deficient in a number of respects:

(i) first, so far as predicting the expenses and contingency payments associated with the film, Mr Margolis was unable to explain why the estimate made by the Investment Committee for contingency payments was 20% when the contingency payment estimates made by the FF group for the two previous Spotlight entities which were involved with the same film was 30%. This is particularly perplexing in that the minutes of the Investment Committee's meeting noted that, since the previous two Spotlight transactions in relation to Les Miserables, apart from the slight increase in the production budget, "there [had] been no change in the status of the Film". As it transpired, the actual contingency payments did amount to 30%;

(ii) secondly, the primary focus of the Investment Committee appears to have been on the revenue side of the equation – the return on box office – with relatively little attention paid to the role that the expenses and contingency payments could play in the application of the Waterfall. That much is apparent from the fact that, as it transpired, the actual return on box office was extremely good – 518%, which was well above the Management Case – and yet no meaningful return to the Appellant under the Waterfall was forthcoming because the actual expenses and contingency payments were so much higher than predicted;

(iii) thirdly, the Investment Committee appeared to be under the impression that the Appellant's rights under the Waterfall would exist in perpetuity – see paragraph 27(2) above – whereas the terms of the transaction documents and Mr Margolis's testimony made it clear that, at inception, the Waterfall was to operate for only five years. In the context of Mr Margolis's assertion that the value in a successful film lay in its "tail" (see paragraph 46(5) above), this error seems to us to be remarkable.

In this regard, we should say that whether or not the Appellant's purpose in the tax years in question was to make a profit depends on the purposes of the Appellant in the relevant tax years. If there was no purpose to make a profit at that time, the position cannot have been "cured" by a subsequent change in purpose.

Consequently, even if the Appellant had been able to establish that Mr Margolis subsequently negotiated with Mr Palotay an extension to the period over which the Waterfall would continue to operate – which we have already said in paragraph 55(2) above that we doubt – that extension would have been of no moment in this context. In order for that to be of any relevance in this appeal, the Appellant would need to show that that extension was in accordance with the parties' intentions during the tax years in question. We have seen no evidence to that effect. Indeed, Mr Margolis's testimony in relation to the extension was that that was not the case. It is perfectly clear from the transaction documents and Mr Margolis's evidence that, during the tax years in question, the parties had agreed that the transaction would have a five-year time frame with no possibility of payments under the Waterfall thereafter. As such, no reliance can be placed on the "tail" when it comes to identifying whether or not the Appellant's purpose was to make a profit. We have to consider whether the purpose of the Appellant was to make a profit assuming that the Waterfall ceased to operate from 31 October 2017; and

(iv) finally, in its deliberations, the Investment Committee appears to have focused more on whether or not the Appellant might derive receipts under the Waterfall, as opposed to whether or not those receipts might give rise to a profit. For instance, the IC Submission referred to the IRR on the Studio Benefit, and the Studio Benefit was only a fraction of the aggregate amount paid by the Appellant to Journal in connection with the transaction. The

IRR on the Studio Benefit would have needed to be astronomical if it were to represent a profit for the Appellant. Similarly, the minutes of the Investment Committee in approving the recommendation merely referred to the Appellant's deriving "returns" from the transaction in all cases apart from the Upside Case. As Mr Margolis explained in giving his evidence, the "returns" referred to were simply some measure of cash receipts. They were not profits; and

(b) a similar lack of interest in profit was displayed by the Appellant during the course of the transaction. In that context, as we have already noted in paragraph 56 above, we were struck by the fact that Mr Margolis appeared to identify issues with the accounts provided by the studio only upon perusing those accounts in the middle of giving his evidence at the hearing. The surprise which he expressed at the discovery of possible accounting errors by the studio spoke volumes in terms of the profit motive of the Appellant during the term of the transaction because it begged the question of why the possible errors had not been identified at that time. If the Appellant had genuinely been interested in making a profit, it would surely have been examining the figures in some detail when those figures were produced and identified any possible lacunae many years ago; and

(6) finally in this context, we should say something briefly about the accounting in the transaction. We deal with this in greater detail later on in this decision but, for present purposes, it suffices to observe that the accounts of the Appellant for its first period of account – the period of account ending on 31 October 2012, a few days after the inception of the transaction – accorded a nil value to the asset comprising the Head P&A SA and the Sub P&A SA, based on the conclusion of the Appellant's management that the two contracts were likely to lead to a loss. (A similar approach was adopted in Illuminatrix's accounts in relation to the asset representing its investment in the Appellant, for the same reason).

We think that there is considerable tension in this appeal between the proposition that the Appellant entered into the transaction for the purpose of making a profit and the fact that, only a few days later, the Appellant concluded that the transaction was likely to lead to a loss. We do not dissent from Mr Ramsden's submission at the hearing that it is possible for a person to enter into a transaction with the purpose of making a profit whilst recognising that the transaction might well give rise to a loss or might even be likely to give rise to a loss. However, in that event, we would expect to see some analysis of the relative probabilities, and the relative quantum, of profit and loss leading to the conclusion that the potential upside makes running the risk of the potential downside worthwhile. If a person decides to enter into a transaction which is likely to lead to a significant loss, then some cogent evidence is required to demonstrate that that is consistent with the proposition that, in taking that step, the relevant person has the serious purpose of making a profit – see, in this respect, *Ingenious UT* at paragraph [382]. We have seen no such evidence in the present case.

If, at the time when it entered into the transaction, the Appellant was sufficiently uncertain about the prospects of receiving anything under the Waterfall to justify its writing down its rights under the Head P&A SA and the Sub P&A SA to nil, then one would expect to see, in the analysis of the transaction which took place before implementation, some consideration of how the probability and quantum of profit relative to the probability and quantum of loss were sufficient to justify the decision to enter into the transaction. There was nothing of the sort in either the IC Submission or the minutes of the Investment Committee. There was a range of possible outcomes but no attempt to analyse whether the amount of potential profit, and the likelihood that it would arise, justified the risk which was about to be taken.

The truth of the matter, as we see it, is that the Appellant was facing something of a dilemma when it came to the tax efficacy of the transaction for the corporate members. On the one hand, it was necessary to establish that the Appellant was carrying on a trade with a view to profit but, on the other hand, it was necessary for the accounts of the Appellant in respect of its first period of account to show a nil value for the Appellant's rights under the Head P&A SA and the Sub P&A SA. The evidence suggests to us that the way in which the Appellant sought to resolve that dilemma was to pay lip service to the notion that it was entering into the transaction in order to make a profit – by producing a detailed analysis of the possible outcomes of the Waterfall but without making any meaningful attempt to reach a judgment on whether the likelihood and amount of the possible profit that it might make justified the risk that it was taking – while at the same time telling its accountants that the degree of uncertainty in relation to the transaction was sufficiently high that the rights under the Head P&A SA and the Sub P&A SA were likely to lead to a loss. Mr Margolis denied that the desire to recognise the accounting loss played any part in the Appellant's approach to negotiating the terms of the Waterfall and we accept that the Appellant may well not deliberately have negotiated poor terms for itself in order to generate the loss but we do think that the imperative to recognise the accounting loss may well have played a part in the Appellant's indifference to the realisation of a profit from the transaction.

DISCUSSION

Introduction

68. We now turn to each of the issues involved in this appeal. In the case of each of the issues in question apart from the GAAP Issue, we first set out our understanding of the case law which is relevant to the issue before setting out our conclusion in relation to the issue and the reasons for that conclusion based on the agreed facts and our findings of fact. In the case of the GAAP Issue, we first set out the views of the two accounting experts – Ms Fiona Hotston Moore (of FRP Advisory) for the Appellant and Ms Jayne Hemingway (of the Respondents) for the Respondents – before setting out our conclusion in relation to the issue and the reasons for that conclusion based on the agreed facts and our findings of fact.

The Trade Issue

The case law

69. The case law in relation to the question of whether or not a person has carried on a trade is voluminous but the following principles emerge from it:

(1) "trade" is a concept of common law. It has for centuries been part of the national way of life and everyone is supposed to know what it is. So Parliament has wisely abstained from defining it – see *Ransom v Higgs* [1974] 1 WLR ("*Ransom*") at 1610E;

(2) whether or not a particular activity is capable of constituting a trade is a matter of law but whether or not the particular activity in question constitutes a trade is a question of fact. It is an inference of fact from the primary facts found by the First-tier Tribunal and depends on an evaluation of all the facts relating to the activity against the background of the applicable legal principles – see *Eclipse* at paragraph [112];

(3) in considering whether a person carried on a trade, it is essential to discover and examine what exactly it was that the person did. It is necessary to stand back and look at the whole picture and, having regard to what the taxpayer actually did, ask whether it constituted a trade. It requires an unblinkered approach to the analysis of the facts and

a realistic approach to the transaction – see *Ransom* at 1601 and 1606, *WT Ramsay Limited v Inland Revenue Commissioners* [1981] STC 174 ("*Ramsay*"), *Eclipse* at paragraphs [109] to [111] and *Samarkand Film Partnership No 3 & others v The Commissioners for Her Majesty's Revenue and Customs* [2017] EWCA Civ 77 ("*Samarkand CA*") at paragraph [59];

(4) consistent with that approach, one must not look at the separate steps comprising a single integrated transaction in isolation but instead look at them as a whole – see *Samarkand Film Partnership No 3 & others v The Commissioners for Her Majesty's Revenue and Customs* [2011] UKFTT 610 (TC) ("*Samarkand FTT*") at paragraphs [217] to [220];

(5) case law has shown that certain tests – which have come to be known as "badges of trade" – can be useful in determining whether or not a particular activity amounts to a trade. However, those tests do not amount to a comprehensive statement of all relevant matters and no one test is decisive in any particular case. The most they can do is to provide common sense guidance to the conclusion which is appropriate and, in each case, it is necessary to stand back and look at the whole picture in order to determine whether the activity amounted to a trade. Moreover, the badges of trade are not always helpful in answering this question – see *Marson v Morton* [1986] STC 463 ("*Marson*") at 470 and 471 and *Eclipse* at paragraph [114];

(6) trade normally involves the exchange of goods or services for reward and a person normally cannot be trading unless there is someone with whom it is trading. However, in a complex transaction, it is not necessarily helpful to try to identify whether the relevant counterparty can properly be characterised as a "customer" – see *Ransom* at 1611, *Eclipse* at paragraphs [115] and [116] and *Degorce v The Commissioners for Her Majesty's Revenue and Customs* [2017] EWCA Civ 1427 ("*Degorce CA*") at paragraph [57];

(7) the mere fact that a person enters into a transaction with a view to obtaining a tax advantage is not of itself determinative of whether that person is carrying on a trade – see *Ensign Tankers (Leasing) Limited v Stokes* [1992] 1 AC 655 at 677D and *Eclipse* at paragraph [117]; and

(8) in a case where multiple contracts are executed as part of a single transaction, it is not correct to say that all of the contracts should together be regarded as comprising a single composite agreement. However, it does mean that, in determining the legal and rights and obligations of the parties pursuant to the contractual arrangements, consideration should be given to the package of agreements as a whole. It is not appropriate to adopt blinkers and look at each agreement comprising the arrangement in isolation – see *Ingenious UT* at paragraph [110].

Conclusion

70. Applying the principles described in paragraph 69 above to:

(1) the agreed facts;

(2) our conclusions of fact in paragraphs 64 to 67 above; and

(3) the contractual rights and obligations to which we have referred in reaching those conclusions of fact,

and following the injunction inherent in those principles to adopt an unblinkered, realistic approach to the facts in determining what it was that the Appellant did, we find it impossible to see the activities of the Appellant in this case as amounting in any meaningful way to a supply of P&A services by the Appellant (in reliance on the activities of Marital) in return for rights under the Waterfall. Instead, looked at as a whole, the activities of the Appellant appear to us to have involved the acquisition by the Appellant of rights under the Waterfall in consideration for the payment (through Journal) to Marital of the Studio Benefit.

71. This conclusion follows inexorably from:

(1) the circular funding at inception involving Copex, Journal, Illuminatrix and the Appellant; and

(2) the fact that the three P&A SAs were part of a single composite transaction both legally and commercially and must therefore be considered together.

As regards the first of these points, the Appellant did not in any meaningful sense receive a capital contribution of £2,781,486 from Illuminatrix and then choose to apply that capital contribution in making its payment to Journal. Instead, the relevant monies were already bound to be paid to Journal (and then onward by Journal to Copex) before they were ever received by the Appellant.

As regards the second of these points, the situation in this case is identical to the purchase and leaseback which the First-tier Tribunal in *Samarkand FTT* identified as being part of a single composite transaction both legally and commercially. Once one does that, it can be seen that, in reality, the Appellant was not supplying services in return for rights under the Waterfall but instead simply making a payment (through Journal) to the studio of the Studio Benefit in order to acquire rights under the Waterfall. Putting this another way, as was the case in *Ingenious Games LLP v The Commissioners for Her Majesty's Revenue and Customs* [2017] SFTD 1158 ("*Ingenious FTT*"), the Appellant was merely "inserted into a process which was already going on" within the Universal group – in this case the distribution and marketing of the film (see *Ingenious FTT* at paragraph [1212]). It had no meaningful role to play in that process. The activity of the Appellant was more "the acquisition of a [financial asset] dressed in a complex contractual framework than the conduct of trade" (see *Ingenious FTT* at paragraph [1233]).

72. We should stress that the conclusion we have reached:

(1) does not mean that we are saying that, as a matter of contractual construction, the Appellant's obligation to provide the services under the Head P&A SA, the Appellant's right to receive the capital contribution from Iluminatrix or the Appellant's obligation to make the onward payment of that amount to Journal can be disregarded. All that we are saying is that the contractual rights and obligations relating to those matters need to be considered in conjunction with all of the other contractual rights and obligations under the transaction documents and then those contractual rights and obligations need to be looked at realistically and as a whole in determining whether, collectively, they mean that the activities of the Appellant amounted to a trade;

(2) does not mean that we are saying that the transactions documents should be construed as a single composite agreement. All that we are saying is that the transaction documents need to be construed together in order to determine their legal effect. As the Upper Tribunal noted in *Ingenious UT* at paragraph [110], "where there is in truth one transaction, the tribunal is entitled to read the contracts together for the purpose of determining their legal effect. That is not the same as saying that where there is a series of contracts to implement a transaction there is a single composite agreement";

(3) does not mean that we are saying that the transaction documents were shams. The Respondents did not argue that they were and we make no finding to that effect. As was noted by the Court of Appeal in *Eclipse* at paragraphs [140] and [141], the word "sham" has a technical and well-known meaning. It was defined by Diplock LJ in *Snook v*

London and West Riding Investments Limited [1967 1 All ER 518 ("*Snook*") as "acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create" (see *Snook* at 528). In the present case, we are not saying that there is a difference between the legal rights and obligations which the parties intended to create and the legal rights and obligations to which the transaction documents gave rise. Instead, we are saying that the reality of the transaction, when it is viewed in the round by reference to its commercial substance and unblinkered, is that it amounted to an investment activity for the Appellant and not a trade; and

(4) does not mean that we are saying that the transaction can simply be recharacterized in accordance with its commercial substance. Instead, it is based on our analysis of the legal rights and obligations to which the transaction documents gave rise. To paraphrase the Court of Appeal in *Samarkand CA* at paragraph [61], the conclusion we have reached is based on the inference of fact that we have drawn from the totality of the primary facts which we have found and is not "a crude conclusion based on an impermissible transformation of the taxpayers' activities into an economic equivalent".

73. In *Eclipse*, the Court of Appeal contrasted the right of the partnership to obtain fixed receipts – which it said had the character of an investment – and the right of the partnership to obtain contingent receipts – where it agreed with the conclusion of the First-tier Tribunal in that case that the prospect of receiving the relevant amounts was so remote as to make wholly unrealistic a conclusion that the entitlement to the contingent receipts gave the transaction a trading character.

74. It seems to us that the likelihood of payments' being received under the Waterfall in this case was equally remote but, in any event, even if that were not the case, the mere fact that that the payments were contingent and therefore involved an element of speculation would not mean that the transaction would amount to trading. It would still have the character of an investment when viewed as a whole. This is because, for the reasons which we have already explained, on an unblinkered view of the facts, the transaction did not involve a supply of services by the Appellant at all. Instead, the Appellant simply made a payment of £194,057 (through the agency of Journal) to the studio in return for the right to receive speculative amounts from the studio under the Waterfall. In our view that activity was an investment activity and not a trade. It involved the acquisition of rights which might generate income over time – in this case, five years. In our view, the situation in the present case is analogous to that described in *Degorce v The Commissioners for Her Majesty's Revenue and Customs* [2016] STC 542 (*Degorce UT*") at paragraph [98], where the Upper Tribunal distinguished between, on the one hand, the speculative nature of the overall exercise – in that whether, and to what extent, the taxpayer would receive income from the exploitation of the rights was unknown - and the entire lack of speculation involved in the transactions which had been implemented on a pre-determined basis. The lack of speculation inherent in the transactions is inconsistent with the proposition that this was a trade. All the Appellant had to do in this case was "to pay and sit back and wait" (see *Ingenious FTT* at paragraph [239]). The mere fact that the investment in this case proved to be a poor one does not change the position on this point.

75. In the light of the conclusion we have reached, we do not need to address the impact which the fiscal motive underlying the transaction might have had on the question of whether or not the Appellant was carrying on a trade. As the Upper Tribunal noted in *Ingenious UT* at paragraph [267], "there is no need to consider fiscal motivation if an activity is clearly an investment and not a trading transaction". A fiscal motive is relevant where the nature of the activities

carried on is otherwise equivocal. Where, as in this case, it is plain that the Appellant was not carrying on a trade, it is unnecessary to consider the impact of the fiscal motive on the question of whether or not the Appellant was carrying on a trade.

76. This means that the nine propositions of law set out by Millet J in *Ensign Tankers (Leasing) Limited v Stokes* [1989] STC 705 ("*Ensign HC")* - in relation to the question of identifying when the presence of a fiscal motive will prevent an activity from amounting to a trade - are of limited relevance to this case. The activity of the Appellant in this case was an investment activity. It did not amount to a trade even before taking into account the fiscal aspect of the transaction. However, the propositions of Millet J are of interest in this case in two respects, as follows:

(1) first, they make it clear that an activity can bear the hallmarks of a trade and yet, on a detailed objective assessment, taking into account all of the relevant circumstances, still not constitute a trade. Thus, in this case, even if the Head P&A SA had the hallmarks of a provision of services, the reality of the situation, taking into account all the relevant circumstances, was that the Appellant was simply purchasing rights under the Waterfall; and

(2) secondly, they make it plain that, where the sole purpose of an activity is to derive a fiscal advantage, then the activity cannot constitute a trade. Thus, in this case, even if it hadn't been apparent that the activity of the Appellant was one of investment and not trade, the fact that the sole purpose of the Appellant was to produce a fiscal advantage for the corporate members meant that the activity of the Appellant lacked the commercial purpose necessary to amount to a trade. The relevant transaction in this case was so fundamentally affected by fiscal considerations that it "[was] in truth a mere device to secure a fiscal advantage, albeit one given the trappings normally associated with trading transactions". In other words, it was analogous to the situation described in *Degorce UT*, where the Upper Tribunal referred to the conclusion of the First-tier Tribunal in that case as being based on the view that the fiscal objectives had so affected the shape and character of the relevant transaction as to deprive it of the quality of commerciality which was essential to the existence of a trade (see *Degorce UT* at paragraph [104]). (The fiscal purpose of the Appellant is also pertinent to the View to Profit Issue and the Deductibility Issue and we therefore address it once again in considering those issues below.)

77. Similarly, we do not need to base our conclusion solely on the absence of a profit motive within the Appellant. An important feature of a trade is a profit-making purpose and, for the reasons set out in paragraph 67 above, we consider that that was entirely absent in this case. However, even if it had been present, we consider that the features of the transaction implemented by the Appellant make it perfectly apparent that its activity did not amount to a trade.

78. In the circumstances, we do not find it helpful to consider the transaction in this case by reference to the badges of trade. As we have already noted in setting out the principles applicable to this issue, it is not appropriate slavishly to apply the badges of trade in all cases where trading is in dispute. The Court of Appeal did not find it helpful to do so in *Eclipse* because the cases by reference to which the badges were compiled were considered to be insufficiently analogous to the facts in that case – see paragraph [114] in *Eclipse*. We consider the same to be true here. Having said that, we agree with Mr Macklam's submission to the effect that, once the transaction is viewed realistically, the badges of trade point firmly in the direction of an investment activity in this case. For instance:

(1) there was simply a single payment by the Appellant in return for rights to potential future payments;

(2) this was a one-off transaction with no repetition;

(3) the Appellant was entirely equity-capitalised. Although there was a substantial amount of debt involved in the transaction as a whole, this was located within Illuminatrix at a level above the Appellant. So far as the Appellant was concerned, there was no borrowing and it derived all of its funds by way of capital contributions. (We should add that, contrary to the approach adopted by both parties in their submissions, we consider that a high level of gearing is an indicium of trade whereas equity capitalisation is an indicium of an investment activity. Gearing was said in *Marson* to be an indicator of trading because it would normally require resale in the short term – see *Marson* at 1348F and *Degorce UT* at paragraph [47(5)];)

(4) the transaction bore no relationship to any trade which the Appellant was already carrying on;

(5) the transaction was documented using template documents and there was no evidence of negotiation on the terms of the documents;

(6) there was no involvement by the Appellant in the distribution and marketing activities and thus no provision of services; and

(7) there was no intention to deal in the rights under the Waterfall. Instead, those rights, if they gave rise to anything, would have produced income for the Appellant. The activities of the Appellant were entirely passive in nature.

79. At the hearing, Mr Ramsden submitted that, contrary to the conclusion which we have drawn above, what the Appellant actually did in this case was to provide services to Corpus under the Head P&A SA through its sub-contractors, Journal and Marital. Mr Ramsden supported this submission in four distinct ways as follows:

(1) first, he pointed out that an entity can act through the agency of a third party just as easily as it does through its employees. Authority for this proposition may be found in the decision of Millet J in *Ensign HC*, *Floor v Davis* [1978] Ch 295 at 313 and the recent First-tier Tribunal decision of Judge Popplewell in *CHF PIP! Plc v The Commissioners for Her Majesty's Customs and Excise* [2021] UKFTT 383 (TC);

(2) secondly, he focused on specific aspects and clauses of the transaction documents and said that those were not unusual in any way. For example, he said that:

(a) the fact that a number of transactions were entered into on the same day was not unusual – the same occurred in the event of a company sale or merger, for example;

(b) similarly, the fact that a sub-contractor was pre-approved was not unusual – it was not uncommon for a client to specify a preferred sub-contractor when it knew that its counterparty was proposing to sub-contract the services which the counterparty was undertaking to provide;

(c) it was perfectly normal for a contracting party to accept that a default caused by a person related to it should not entitle it to damages or a right to terminate the contract or a right of indemnity. Thus, clauses 6.2, 11.2 and 12.1(a) of the Head P&A SA were perfectly standard contractual provisions; and

(d) the fact that the Appellant had no liability under the Head P&A SA for damages beyond the amounts which it received by way of the fee for its services under that agreement was not unusual. It was common practice for a service provider to include a cap on its liability to the extent of its fees;

(3) thirdly, he said that each step in the transaction made commercial sense in and of itself. There was nothing off-market about any of the individual agreements making up the whole transaction; and

(4) finally, he said that:

(a) the Court of Appeal in *Ingenious CA* had said that it was important to apply the badges of trade in cases such as this one – see *Ingenious CA* at paragraph [100]; and

(b) the badges of trade in this case pointed in favour of there being a trade. For instance:

(i) there was an intention to make a profit;

(ii) there was a connection with an existing trade because, whilst the corporate members were new to the industry, the Appellant was able to take advantage of the significant experience gained through over 20 years in the film and television industry of the FF group;

(iii) the organisation of the activity pointed in the direction of trading because the provision of P&A services to the film and television industry would typically be organised in the same manner, with a profit share according to a waterfall arrangement; and

(iv) the appointment of FFC as a consultant to advise the Appellant on the choice of film, the significant industry expertise of the members of the Investment Committee, the selection criteria adopted in choosing the film and the subsequent reporting regime to corporate members all pointed to a level of due diligence, oversight and organisation which one would expect to see in a trading organisation.

80. Whilst Mr Ramsden made these points with considerable polish, we consider that there is no merit whatsoever in any of these submissions.

81. As regards the first of them, we have no difficulties in accepting the general proposition that an entity can act though the agency of a third party as well as its employees. We agree that, in certain circumstances, the activities of a sub-contractor can properly be regarded as the activities of the contractor. However, that will not be so in all cases. It depends on the legal rights and obligations of the parties viewed as a whole. In our view, Mr Ramsden's submission is contrary to the injunction made clear by the case law cited above, to the effect that the documents comprising a single composite transaction should be viewed in the round, and not approached with blinkers. It is perfectly possible to envisage circumstances where a person might enter into an obligation to provide services to A and then agree with B by way of sub-contract that B will provide those services to A on its behalf.

82. However, in our opinion, when viewed as a whole, those circumstances are some way removed from the present ones. In this case, the legal rights and obligations created by the contractual framework were such that the Appellant had no meaningful role in the provision of services under the Head P&A SA at all. We have found that the reality of the situation was that the studio could get on with marketing and distributing the film without involving the Appellant. Indeed, as we have noted above, it is not even clear which activities of Marital in that regard can properly be identified as having amounted to the performance of its obligations under the Studio P&A SA and, hence, the performance of the Appellant's obligations under the Head P&A SA. In those circumstances, it is not appropriate to attribute to the Appellant the activities carried on by Marital in relation to the marketing and

distribution of the film. The position here is instead analogous to that described in *Ingenious FTT* (at paragraphs [1224] et seq.) and *Ingenious UT* (at paragraphs [264] and [265]), where the mirroring of the rights and obligations in the contract/sub-contract structure meant that the LLP was regarded as having no meaningful production role at all. (This point was not addressed in *Ingenious Games LLP v The Commissioners for Her Majesty's Revenue and Customs* [2021] STC 1791 ("*Ingenious CA*") because there was no right of appeal in relation to the issue to which it was relevant – see *Ingenious CA* at paragraphs [109] to [111]).

83. Mr Ramsden's second point leads to a similar response. We would not demur from the proposition that there are individual clauses in the agreements which might appear in other contracts and for which there is a reasonable explanation commercially. However, this approach again involves considering individual clauses in isolation and not standing back and looking at the legal rights and obligations as a whole. For example, it is true that it is not unknown for a customer to specify to its contractor that it has certain preferred sub-contractors. However, when that is coupled with provisions which make the appointment of that sub-contractor inevitable – such as the provisions which exculpated the Appellant from liability in the event of any loss caused by Marital and the provision which specified that the Head P&A SA would come to an end if the Studio P&A SA terminated - then that means that the relevant clause cannot reasonably be seen as an expression of sub-contractor preference but rather as an obligation to appoint the relevant sub-contractor. To describe the clause as being no more than an expression of sub-contractor preference is to view the clause in isolation and without regard to the circumstances as a whole.

84. Moreover, there are other clauses in the contracts which cannot be readily explained as according with normal commercial arrangements in relation to the provision of services by the Appellant to Corpus. We have already mentioned the clause which meant that the termination of the Studio P&A SA would lead to an automatic termination of the Head P&A SA but two other examples are:

(1) clause 11.4 in the Studio P&A SA, which allowed Marital to terminate that agreement if it did not receive the Studio Benefit by 31 October 2012; and

(2) clause 11.4 in the Head P&A SA, which specified that, even though the Appellant ceased to be obliged to provide services on a termination of that agreement, as long as it had procured the receipt by Marital of the Studio Benefit, its rights under stages 4 and 7 of the Gross Receipts part of the Waterfall would remain.

The first of those clauses is unusual in that the Studio Benefit was only a small fraction of the overall aggregate consideration which was expressed to be payable to Marital under the Studio P&A SA. If the loan to Illuminatrix, the rights to which were assigned to Marital by Journal as consideration under the Studio P&A SA, really had a value approximating to the face value of £2,781,486 which was attributed to it by the terms of the Studio P&A SA, why would the non-payment of £194,057 (a relatively small amount in the scheme of things) trigger the termination of the entire agreement within days of inception without any recompense to Journal? It is not a normal commercial arrangement for the non-payment of such a small portion of the aggregate consideration to trigger a termination right without recompense to the payer for the consideration it has actually already provided.

Similarly, the only explanation for the preservation of the rights to payment under stages 4 and 7 of the Gross Receipts part of the Waterfall upon a termination of the Head P&A SA following the payment by Journal of the Studio Benefit to Marital is that those rights were attributable to the payment of the Studio Benefit.

The above clauses therefore point directly away from the conclusion that this transaction involved a provision of services by the Appellant to Corpus.

85. We consider that Mr Ramsden's third point was equally misconceived. In our view, there are two glaring examples of agreements in this transaction which made no commercial sense whatsoever. The first of those was the Journal Loan Agreement and the second of those was the Studio P&A SA. In both cases, the relevant agreement made commercial sense for the parties to it only if the value of the rights under the Waterfall at inception could be seen to approach (even if not exactly to equate) to the £2,781,486 which was the amount advanced by Journal to Illuminatrix.

86. We have already set out our conclusion that the value of the rights under the Waterfall at inception was negligible and the reasons why we have reached that conclusion. On that basis, it made no sense on a single company basis for either Journal or Illuminatrix to agree to enter into the Journal Loan Agreement. It made no sense for Illuminatrix to borrow that sum of money when it would have very little prospect of ever being able to repay it and thus no sense for Journal to lend that sum of money to Illuminatrix on terms that Illuminatrix was required to use the money to invest in the Appellant.

87. Similarly, it made no sense for Marital to agree to provide services to the value of £2,975,543 when it was receiving no more than the Studio Benefit.

88. Mr Ramsden made a valiant attempt to justify these agreements by saying that it was perfectly possible for different persons to reach different views on the value of rights to contingent payments and that therefore it was perfectly possible that Journal, Illuminatrix and Marital might all have been according considerable value to the rights under the Waterfall notwithstanding the fact that the Appellant was taking the view that the rights had a negligible value. Whilst we agree with the general point that that there may be circumstances where different persons might reach different views on the value of rights to contingent payments, this is not one of those circumstances. For the reasons which we have already given, it is in our view impossible for Journal, Illuminatrix and Marital to have concluded at the inception of the transaction that the value of the rights under the Waterfall was sufficient to justify their respective involvement in the agreements in question. Moreover, we have already noted that, very shortly after the transaction was implemented, Illuminatrix wrote down its investment in the Appellant to nil in its accounts, which demonstrates that Illuminatrix, like the Appellant, was according a negligible value to the rights.

89. In the case of Marital, a second argument made by Mr Ramsden on this subject was that a service provider does not provide its services at cost but always builds in a mark-up on cost when agreeing to provide its services. Thus, said Mr Ramsden, even if Marital accorded no value to the rights under the Waterfall (in the same way as the Appellant) there was nothing off-market in Marital's agreeing to provide services to the value of £2,975,543 for the consideration which it did because the cost to Marital of providing those services would have been lower than that value. Again, we consider that Mr Ramsden was taking a general point with which we both agreed and then extrapolating from that point to try to justify an untenable position in the particular circumstances of this case. Whilst we agree that Marital might well have agreed to supply services with a value which exceeded the cost to Marital of providing those services, on this analysis Marital was receiving no more than the Studio Benefit for providing those services. It is inconceivable to us that the cost to Marital of providing services worth £2,975,543 could have been equal to or less than £194,057. The gap between the two amounts is simply too great. (For completeness, we should record that we were provided with no explanation for the statement, in schedule 1 to each of the Sub P&A SA and the Studio P&A SA, that the "Marital margin" was £28,850.18. Quite what relationship that figure bore to the Studio Benefit or the stated services budget of £2,975,543 or the cost to Marital of notionally supplying services under the Studio P&A SA as postulated by Mr Ramsden is wholly unclear.)

90. As regards Mr Ramsden's final point, we do not agree that the Court of Appeal in *Ingenious CA* said that it was important to apply the badges of trade to a case such as the one that it was there considering. All that it said was that, contrary to the decision of the Upper Tribunal, the First-tier Tribunal had not made an error of law in applying the badges of trade in that case. With respect to Mr Ramsden, that is not the same as saying that it was important to apply the badges of trade in a case such as the one which the Court of Appeal was there considering or, by extension, this case.

91. The position in relation to the significance of the badges of trade is as we have described it in paragraph 69(5) above – which is to say that the badges of trade can be helpful in certain cases but not all and should not be slavishly applied. In the context of this particular case, we note that, at the end of paragraph [114] in *Eclipse*, the Court of Appeal observed that "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". We think that the same can equally be said of the present proceedings.

92. More importantly, we do not agree that the badges of trade, were they to be applied, point in the direction of trade at all. In our opinion, the badges of trade point heavily in the direction of investment, as we have outlined in paragraph 78 above. In particular:

(1) there was no intention to make a profit, as we have already concluded in paragraph 67 above;

(2) there was no connection to an existing trade because the Appellant was a special purpose entity with no other activity. In this regard, we think that the existence of experience in the film industry in other entities within the FF group or the personnel who were on the Investment Committee is neither here nor there because the fact remains that the Appellant itself had no existing trade at the time when it entered into the transaction; and

(3) there is nothing in the organisation of the transaction to suggest that the activity of the Appellant amounted to a trade. The appointment of FFC as consultant to the Appellant, the consideration of the Investment Committee and the subsequent reports given to the corporate members of the Appellant are just as consistent with an investment activity as they are to a trading activity. Moreover, the fact that the body tasked with recommending the Appellant's involvement in the transaction was called the Investment Committee is in our view indicative of what the Appellant was doing – it was investing in the film by paying an amount to acquire rights in the Waterfall. In a similar vein, we think that it is telling that, at various points in his evidence, Mr Margolis referred to the activity of the Appellant as an "investment" in the film. Indeed, the same language was occasionally used by Mr Ramsden in making his submissions – see paragraph [72] of the Appellant's skeleton argument. We think that the use of that language was entirely appropriate – it involved a recognition of the reality that the transaction did not involve the trade of providing services in relation to the film at all but instead involved an investment in the film.

93. On that basis, the only badge of trade which might be said to support the Appellant's submission is based on its contention to the effect that it is common for entities carrying on a trade of providing P&A services to take, as a fees for their services, a position in a waterfall instead of pre-agreed fixed fees. We have been given limited evidence to support that proposition but, even if it is true, that on its own could not outweigh the impact of the result of applying the other badges of trade.

94. For the reasons set out in paragraphs 70 to 93 above, we have concluded that the Appellant was not carrying a trade in the two tax years which are relevant to this decision.

That conclusion on its own is sufficient to dispose of this appeal in favour of the Respondents. However, because we had the benefit of the parties' submissions in relation to the other three issues, we now go on to address those issues as well.

The View to Profit Issue

The case law

95. The Court of Appeal in *Ingenious CA* set out the following principles in relation to the question of whether or not there is a view to profit:

(1) whether or not there is a view to profit is a wholly subjective test. It must be the actual subjective purpose or intention of the relevant person to make a profit - *Ingenious CA* at paragraph [119];

(2) there is no need for the purpose to derive profit to be the predominant purpose. It is merely necessary that the derivation of profit should be one of the purposes, viewed subjectively – *Ingenious CA* at paragraph [121], endorsing the Upper Tribunal decision to this effect in *Ingenious UT* at paragraph [333];

(3) the question of whether a trade is being carried on with a view to profit cannot be answered in isolation, divorced from the business in question. The context of the phrase directs attention, at least to some extent, to the way in which the trade is conducted - *Ingenious CA* at paragraph [121], endorsing the Upper Tribunal decision to this effect in *Ingenious UT* at paragraph [333];

(4) an indifference as to whether or not a profit is realised is not sufficient to meet this test - *Ingenious CA* at paragraph [121], endorsing the Upper Tribunal decision to this effect in *Ingenious UT* at paragraph [333];

(5) whilst there is no objective element to the relevant test, the likelihood of profit and the timescale over which it might be achieved will often be relevant in testing whether there is a genuine subjective view to profit - *Ingenious CA* at paragraph [122], endorsing the Upper Tribunal decision to this effect in *Ingenious UT* at paragraph [345];

(6) different individuals are willing to take on differing levels of risk and the extent of risk taken may depend not only on the risk appetite of the individual but on the degree to which the individuals making the decision are answerable for any failure, or incentivised by success - *Ingenious CA* at paragraph [121], endorsing the Upper Tribunal decision to this effect in *Ingenious UT* at paragraph [333];

(7) the word "profit" has an objective meaning. For example, the mere fact that an entity may consider gross revenue to be profit does not mean that the entity will have a view to profit by establishing that its purpose was to derive gross revenue – *Ingenious CA* at paragraph [123];

(8) the word "profit" means an excess of income over expenses, over a possibly indefinite period. This means that whether or not the accounts for a single year in accordance with GAAP may or may not show a profit is of little significance – *Ingenious CA* at paragraph [123];

(9) there is no maximum period over which the profit needs to arise although, the longer the period, the more searching the enquiry into the real subjective purpose of the person will be - *Ingenious CA* at paragraph [123]; and

(10) it is important to distinguish between motivation and intention. Motivation is that which stimulates a person to act, while intention is a person's objective or purpose in

acting. Thus, a tax motivation will not of itself mean that there is no view to profit. The question is whether the person can establish an intention to make a profit regardless of whether or not he was motivated by tax considerations – *Ingenious CA* at paragraph [125] endorsing views expressed by the Supreme Court of Canada in *Backman v R* [2001] 1 SCR 367 at paragraph [22].

Conclusion

96. Applying the principles described in paragraph 95 above to the agreed facts and our conclusions of fact in paragraphs 64 to 67 above, there can be only one answer on the View to Profit Issue and that is that the Appellant had no view to profit in the tax years in question. The facts in this case are such that:

(1) there was no practical likelihood that the Appellant would have been able to make a profit from its participation in the transaction;

(2) the Appellant was indifferent as to whether or not any profit arose because the transaction had served its purpose regardless of any such profit - as a result of the tax relief for the corporate members and the fees for FFC under the Consultancy Agreement; and

(3) as we have already seen, there was a reason why the receipt of profit might actually have been positively unhelpful for Illuminatrix, one of the members of the Appellant and an affiliate of FFC, the controlling mind of the Appellant.

97. At the hearing, Mr Ramsden submitted that, contrary to the conclusion set out above, the Appellant did have a view to profit in entering into the transaction. He made the following points in support of his proposition:

(1) the mere fact that there was a collateral fiscal advantage to a transaction or that a transaction was fiscally-motivated did not mean that the entity entering into the transaction did not have the subjective purpose of making a profit. Indeed, it might be the case that the fiscal motivation underlying the transaction led the transaction to be structured in such a way as to facilitate the obtaining of a profit;

(2) in any event, the important question was not the motive of the investors who became corporate members for investing in the Appellant but rather the purpose of the Appellant in entering into the transaction - see paragraph 95(10) above;

(3) normally, if business people enter into a commercial transaction which may give rise to profit, it is natural to conclude that this will form part of their subjective intentions in doing so (see *Ingenious CA* at paragraph [163]);

(4) the tax advantage for the investors who became corporate members would arise only if the Appellant had a genuine subjective view to profit and therefore that must have been the case or the transaction would not have been implemented (see *Ingenious CA* at paragraph [165]);

(5) it was common for businesses to make losses in the initial years. That was particularly the case in the film industry, which was necessarily speculative in nature. Thus, the existence of a loss in the initial period of account of the Appellant did not mean, in and of itself, that there was no intention on the part of the Appellant to make a profit over the long term. The principles set out above made it clear that there was no need for there to be a purpose of deriving profit in any particular period of account – see paragraphs 95(8) and 95(9) above. The relevant test could be satisfied by the purpose of making a profit over a longer period;

(6) in that regard, it was pertinent that the Appellant had invested in a film which was highly successful and could be expected to have a long "tail";

(7) the predictions made by the Appellant as to the success of the film had been vindicated in that the gross revenue had been in line with expectations. The reason for the lack of payments under the Waterfall had been the unexpectedly high level of the distribution expenses and the contingency payments, neither of which could reasonably have been foreseen;

(8) it was quite wrong to approach this issue with the benefit of hindsight when the relevant film had not given rise to receipts under the Waterfall. Instead, it was necessary to consider the subjective intention of the Appellant at the time of the transaction;

(9) the mere fact that the accounts of the Appellant in respect of its first period of account anticipated that the transaction might give rise to a loss did not mean that there was no intention to make a profit. A person might aim to make a profit but anticipate that that aim might not come to fruition because of the risks involved;

(10) similar structures marketed by the FF group and using similar waterfalls had given rise to profits and therefore there was no reason to suppose that the same should not occur in this case; and

(11) Mr Margolis had testified that certain investors who became corporate members had contacted him to complain about the lack of returns to the Appellant in this case. This showed that there was an intention to make a profit.

98. Despite the eloquence of Mr Ramsden, we are not persuaded by any of the submissions set out in paragraph 97 above, essentially for the reasons which we have already articulated in our conclusions of fact in paragraph 67 above and paragraph 96 above (when setting out our conclusion in relation to this issue).

99. It suffices to say that:

(1) we agree with Mr Ramsden that the relevant question is what was the subjective purpose of the Appellant in entering into the transaction and not what was the motive of the investors in choosing to become corporate members. However, we consider that the fact that, even if the Appellant made no profit whatsoever, the corporate members stood to obtain a significant tax-related return by entering into the transaction and that FFC obtained its fees under the Consultancy Agreement by virtue of the transaction are factors which we should take into account in trying to determine the subjective purpose of the Appellant in entering into the transaction;

(2) as will be apparent from the preceding paragraphs of this decision, so far as the Appellant is concerned, we do not regard this transaction as having been a commercial transaction which might give rise to a profit for the Appellant. So far as the Appellant was concerned, the transaction was not commercial and the possibility of a profit was remote;

(3) we do not think that it follows that, just because the existence of the fiscal advantage depended on the Appellant's having a view to profit, that must have been the case. Whether or not there was a view to profit depends on whether the evidence shows that such a purpose actually existed and not on whether the existence of that purpose was essential in order to obtain the fiscal advantage;

(4) we accept the general proposition that a person might have the intention of making a profit over the long term while accepting that, in the initial phase of

operations, losses will or might arise. However, this was not such a case. In this case, there was no meaningful prospect that a profit would ever arise. In reaching that conclusion, we have ignored the possibility that the "tail" might ultimately have generated a profit for the Appellant because it is clear that the transaction had only a five-year term;

(5) we are not relying on hindsight to reach the conclusion that there was never any prospect that the film would generate a profit for the Appellant under the Waterfall. We think that that much should have been apparent to the Appellant from the information which it had at inception and we believe that the evidence points firmly in the direction that it was so apparent to the Appellant;

(6) the fact that the film performed so well and in fact generated revenues which were between the two best of the possible cases which were considered by the Investment Committee at inception is a factor which we find to be supportive of our conclusion and not inconsistent with it. This is because it demonstrates that insufficient attention was paid by the Investment Committee to the expenses and contingency payments which might fall to be made and it was those which meant that no meaningful payments were in fact made under the Waterfall;

(7) we have already explained in paragraph 67(6) above our view that it is not sufficient in this context simply to assert that an anticipation of loss does not negate an intention to make a profit. Of course there may be situations where the likelihood and quantum of profit when compared to the likelihood and quantum of loss mean that a person with a view to profit and an appetite for commercial risk might well enter into the relevant transaction with a view to profit despite the likelihood of loss. However, in order to demonstrate that there is a profit purpose in circumstances where there is a likelihood of loss, cogent evidence is required of why the likelihood of profit and the amount of potential profit, when compared to the likelihood of loss and the amount of potential loss, is such that the transaction is worth implementing. We are not saying that this is simply a matter of mathematics. In other words, we are not saying that there needs to be a minimum percentage probability of profit in order to show that there is a view to profit. The test is qualitative and is more nuanced than that. For example, a low probability of profit might suffice if the amount of the potential profit is significant. But what is being tested is "whether there is a real and serious intention to make a profit" (see *Ingenious UT* at paragraph [340]) and an analysis along the above lines would have been evidence of that. Instead, we have seen no evidence that that process occurred in this case;

(8) we have also been provided with no evidence that other similar structures with waterfalls on similar terms have generated profits for the entity in question. Moreover, even if we had been, that evidence would have been somewhat tangential to the question which we have to decide because we are considering only the purposes of the Appellant in relation to this transaction and not the purposes of, or the results of transactions implemented by, any other entities. In our view, for the reasons which we have already rehearsed, the evidence that there was no view to profit for the Appellant is compelling;

(9) we have already expressed some scepticism in relation to Mr Margolis's evidence to the effect that he had received complaints from certain corporate members about the lack of returns to them through the Appellant. However, even if such complaints had been made, we would not find the existence of those complaints particularly persuasive in this context, essentially for three reasons:

(a) first, the fact that a corporate member may have been happier to receive a return than not to receive a return is understandable, as we have previously noted (see paragraph 67(3) above). It says nothing about whether that corporate member's purpose in entering into the transaction was to derive any return beyond the tax relief;

(b) secondly, the optimistic tone of Mr Lipman's reports to the members – see paragraph 43(1) above - may well have encouraged a belief amongst the corporate members that a return under the Waterfall was imminent and, once that expectation was created, the failure of that expectation to come to fruition could well have led to complaints in circumstances where there was no expectation of profit or view to profit at the time when the corporate member entered into the transaction; and

(c) finally, it is worth observing that the purpose of any corporate member in subscribing for its capital in the Appellant is ultimately irrelevant. The salient question here relates to the purpose of the Appellant – controlled as it was by members of the FF group – and not the purpose of any particular corporate member.

100. For the reasons set out in paragraphs 96 to 99 above, we have concluded that the Appellant did not have a view to profit in the two tax years which are relevant to this decision. Our conclusions in relation to the Trade Issue and the View to Profit Issue mean that our views in relation to the GAAP Issue are of limited consequence but we will now proceed to address that issue. As noted in paragraph 11(2) above, the GAAP Issue is relevant only in relation to the partnership tax return for the tax year 2012/13.

The GAAP Issue

The views of the experts

101. We heard oral expert evidence in relation to the Appellant's accounts in respect of its period of account ending 31 October 2012 from Ms Hotston Moore on behalf of the Appellant and Ms Hemingway on behalf of the Respondents. Prior to the hearing, each expert had produced her own report on those accounts and then, helpfully, the two experts had produced a joint statement setting out the areas of agreement and disagreement between them.

102. Although there were a few minor matters in relation to which the experts disagreed, there was really only one fundamental area of disagreement and this related to each expert's view on the commercial substance of the transactions into which the Appellant had entered in the relevant period of account.

103. Before setting out the differing views of the experts on that issue, we should say that the experts were agreed that:

(1) the accounts of the Appellant were required to be produced in accordance with GAAP;

(2) the key concepts of GAAP in this context were "true and fair view", "materiality", "substance of transactions", the "accruals basis" and "prudence";

(3) in relation to a transaction or a series or group of transactions, it was possible for there to be more than one view in relation to the accounting treatment which was "true and fair";

(4) FRS 5, which related to the substance of transactions, applied in its entirety in determining whether a particular accounting treatment was in accordance with GAAP;

(5) paragraph 14 of FRS 5 required that "a group or series of transactions that achieves or is designed to achieve an overall commercial effect should be viewed as a whole";

(6) in determining how a transaction or a series or group of transactions should be shown in the accounts, the use of hindsight was inappropriate;

(7) the asset arising out of the Head P&A SA and the Sub P&A SA for the Appellant should have been written down to its realisable value in the accounts although:

(a) the experts differed on the quantum of that asset prior to any such write-down, with Ms Hotston Moore setting the quantum of that asset at £3,005,543 (the amount paid by the Appellant under the Sub P&A SA) and Ms Hemingway setting the quantum of that asset at £194,057 (the cash amount paid to Marital under the Studio P&A SA); and

(b) the experts differed on the amount of the realisable value, with Ms Hotson Moore relying on the view of management to the effect that the realisable value was nil and Ms Hemingway declining to express a view on the value; and

(8) they had insufficient information from management to determine whether a prepayment asset should have been recognised in respect of the initial fee paid under the Consultancy Agreement although they agreed that, if one should have been recognised, then only that part of the fee which related to services which had been rendered under the agreement by the end of the period of account should have been shown as an expense. However, the experts differed on whether a prepayment asset should have been recognised. Ms Hotston Moore inclined to the view that:

(a) although "it was possible, or even probable" that one should have been recognised, the absence of sufficient information meant that one should not have been recognised because the precise monetary value could not be measured with sufficient reliability;

(b) as a result, the entire fee should have been recognised in the accounts as an expense; and

(c) therefore, the fee had been correctly shown as an expense in its entirety in the accounts.

In contrast, Ms Hemingway concluded that the fee should have been recognised as a prepayment asset and that it should have been recognised as an expense in the accounts only to the extent that the services under the Consultancy Agreement had been supplied by the end of the period of account. As such, the maximum amount of the fee which could have been recorded in the accounts in respect of the relevant period of account would have been the whole fee but further information would be needed from management before it was possible to quantify quite how much of that figure could be recorded as an expense.

104. Turning then to the areas in which the experts did not agree, Ms Hotston Moore's expert opinion was that the accounts of the Appellant in respect of the relevant period of account were compliant with GAAP. In particular:

(1) the substance of the transactions into which the Appellant had entered was that:

(a) it had received capital contributions of £3,234,286. (In her initial report, Ms Hotston Moore recorded all of this amount as coming from the corporate members and excluded Illuminatrix as a contributor of capital. In the joint report, Ms Hotston Moore acknowledged that this was an error on her part but said that it had no impact on her opinion because the aggregate amount of capital which had been contributed to the Appellant remained unchanged even after the list of contributors was corrected);

(b) it had then entered into the Head P&A SA (which imposed on it an obligation to provide services) and the Sub P&A SA (which enabled it to fulfil the requirements of the Head P&A SA) and paid £3,005,543 to Journal under the latter agreement; and

(c) it had also entered into the Consultancy Agreement which enabled it to receive certain services from FFC and had paid £228,743 as an initial fee to FFC under that agreement;

(2) since the value of the services which the Appellant was required to provide under the Head P&A SA was £3,005,543 and the Appellant's management both:

(a) predicted that the terms of the Waterfall under that agreement was likely to lead to a loss; and

(b) could not produce an estimate of the likely income under the terms of the Waterfall,

it was appropriate to record a loss of £3,005,543 in respect of that contract under paragraphs 10 and 11 of SSAP 9 (long term contracts);

(3) there was nothing unusual or uncommercial in the P&A SAs. In particular, a head-contract and sub-contract structure was not uncommon and it was not unusual for a customer entering into a head-contract to specify certain identified persons who would be permitted to act as sub-contractors. It was also not unusual for there to be a series of contracts signed and exchanged on the same day which were nevertheless independent; and

(4) the legal rights and obligations arising under contracts were of great significance when applying FRS 5. They were not determinative in and of themselves but were a material factor in considering the commercial substance of the transactions to which they gave rise.

105. Ms Hotston Moore supplemented those views with her oral testimony at the hearing, which was as follows:

(1) she confirmed that, as stated in her report, she had been instructed to prepare her report on the basis that the Appellant was carrying on a trade, on a commercial basis, with a view to making a profit and that she had analysed the transactions into which the Appellant had entered as involving the provision of P&A services to Corpus. She said that, in considering whether the accounts were GAAP-compliant, she had assumed that she was looking at a trade and not an investment activity;

(2) in reaching her opinion, she had been provided with – and had considered - the documents listed in appendix 3 to her report. These included the three P&A SAs, the Partnership Deed, the Consultancy Agreement, the Copex Loan Agreement, the Journal Loan Agreement, the payment directions to which the Appellant was a party and various other security documents;

(3) she could not recall asking for any other documents;

(4) she initially said that, although:

(a) paragraph 11 in FRS 5 said that "the term 'transaction' includes both a single transaction or arrangement and also a group or series of transactions that achieves or is designed to achieve an overall commercial effect"; and

(b) paragraph 14 of FRS 5 said that "a group or series of transactions that achieves or is designed to achieve an overall commercial effect should be viewed as a whole",

this did not require transactions in a series or group of transactions to which the reporting entity was not itself a party to be taken into account. This was because paragraph 14 referred to "the substance of transactions into which [the reporting entity] has entered" and paragraphs 16 to 19 were focused on the assets or liabilities of "the reporting entity";

(5) however, she subsequently conceded that transactions in a series or group of transactions to which the reporting entity was not itself party could be relevant in determining the substance for the reporting entity of the transactions into which the reporting entity had entered and that therefore this was something which needed to be considered in relation to the reporting entity;

(6) she accepted that paragraphs 51 and 52 of FRS 5 stipulated that the commercial effect of a transaction for the reporting entity should be considered in the light of the commercial logic of the transaction for each of the parties. In particular:

(a) if a transaction appeared to lack commercial logic for any one or more party or parties, then this might indicate that not all related parts of the transaction had been identified or indicate that the commercial effect of some element of the transaction had been incorrectly assessed; and

(b) it followed that, in assessing the commercial effect of a transaction, it was important to consider the position of all the parties to it, including their apparent expectations and motives for agreeing to various terms;

(7) she accepted that paragraph 46 of FRS 5 stated that, for more complex transactions, "it will not be sufficient merely to record the transaction's legal form, as to do so may not adequately express the commercial effect of the arrangements" and that paragraph 47(b) of FRS 5 stated that transactions requiring particularly careful analysis in this context would often include features such as "the linking of a transaction with others in such a way that the commercial effect can be understood only by considering the series as a whole";

(8) she said that she might have reached a different view of the commercial substance of the transactions for the Appellant if she had been told that all of the transaction documents with which she had been presented were to be executed together as a single package. However, that would not necessarily be the case;

(9) she also said that she might have reached a different view of the commercial substance of the transactions for the Appellant if she had known that Marital was more than simply a permitted sub-contractor and was, in fact, bound to be appointed. However, she had concluded that this was not the case, despite knowing that the Head P&A SA would terminate automatically if the Studio P&A SA came to an end;

(10) Ms Hotston Moore provided inconsistent responses to the question of whether, had she had known that the consideration passing to Marital to perform the services under the Studio P&A SA was only £194,057, that would have changed her view on the

commercial substance of the transaction for the Appellant. She said as follows at various stages in her testimony:

(a) at one stage, she said that, if Marital had in fact received consideration of only £194,057 under the Studio P&A SA, it did not necessarily follow that that was the value of the services which Marital was providing under that agreement. The key issue was not the amount of the consideration which passed to Marital but rather the value of the services provided by Marital. The quantum of the consideration passing to Marital was not significant because:

(i) it was not uncommon for a sub-contractor in a contract chain to make a significant profit and so the fact that Journal might have made a significant profit from the combination of the Sub P&A SA and the Studio P&A SA was unremarkable; and

(ii) the question of how Marital financed its obligations under the Studio P&A SA was not relevant to her assessment of the commercial obligations of the Appellant.

In providing this response, she said that the main point so far as she was concerned was whether the value of the services which were provided by Marital to Journal, by Journal to the Appellant and by the Appellant to Corpus was the figure set out as the services budget in the relevant P&A SA;

(b) at another point in her evidence, she said that, if she had known that the only consideration that Marital was receiving under the Studio P&A SA was £194,057, that might have caused her to question how Marital was going to provide services to Journal to the value of £2,975,543 and therefore whether the value of the services which the Appellant was required to provide really was £3,005,543;

(c) a third response she gave was that she had been told by management to assume that the value of the services supplied up the chain by each of Marital, Journal and the Appellant was as specified as the service budget in the relevant P&A SA; and

(d) finally, at another point in her testimony, she said that she had considered the value of the loan under the Journal Loan Agreement when it was assigned to Marital and had concluded that the value of the loan was equal to its face value, with the result that the consideration received by Marital under the Studio P&A SA was in fact as specified in the agreement;

(11) she did not think that the fact that the loan drawn down under the Copex Loan Agreement was outstanding for less than a day and that the monies drawn down under that agreement moved in a circle affected her view of the transaction as involving the receipt by the Appellant of aggregate capital contributions of £3,234,286 and an obligation on the part of the Appellant to pay £3,005,543 to Journal under the Sub P&A SA; and

(12) she said that, if Ms Hemingway's view of the commercial substance of the transaction was correct and her view of that commercial substance was not, then she would agree with the accounting conclusions drawn by Ms Hemingway. As such, the maximum amount of the expense which could be recorded in the accounts in respect of the Head P&A SA and the Sub P&A SA in the relevant period of account would be £194,057 (the amount paid to Marital).

106. Ms Hemingway's expert opinion was that the accounts of the Appellant in respect of the relevant period of account were not compliant with GAAP. In particular:

(1) when the transaction documents were viewed as a whole, it was apparent that the Appellant never had rights or access to future benefits in respect of the £2,781,486 which was contributed to it by Illuminatrix by way of capital and then immediately paid by the Appellant to Journal under the Sub P&A SA because the use of those funds was pre-determined. The previously-executed irrevocable payment instructions meant that the monies never left the control of Copex;

(2) similarly, when the transaction documents were viewed as a whole, the Appellant never had an obligation to transfer economic benefits of £3,005,543 as a result of the P&A SAs because all three documents were inter-linked and only £194,057 of that amount was ever paid to Marital;

(3) in her view, the overall commercial effect of the three P&A SAs was that the studio provided the P&A services to itself and the Appellant transferred £194,057 to Marital and received rights under the Waterfall (excluding the rights to part of the payment at stage 8 of the Gross Receipts part of the Waterfall - because those were subject to the payment direction which meant that they would be paid directly by Corpus to Marital if they ever arose);

(4) in addition to its payment to Marital, the Appellant had an obligation to transfer economic benefits in respect of the £30,000 fee to Copex and in respect of the £228,743 which was paid to FFC;

(5) thus, the accounts should have excluded the capital contribution made by Illuminatrix and shown that the Appellant had acquired an asset which cost £194,057 and if, at the time when the accounts were approved, the value of the asset was less than £194,057, then the asset should have been written down to that value. The maximum expense which could therefore have been recognised in respect of the asset was therefore £194,057 and further information was required from management in order to answer that question;

(6) in addition, the Appellant should have recognised as an expense:

(a) the whole of the fee of £30,000 which had been paid to Copex (because the service to which the fee related had been fully performed within the relevant period of account); and

(b) such part of the fee paid to FFC as related to services which had been performed by FFC in the relevant period of account. Further information was required from management in order to determine the extent to which the relevant services had been provided; and

(7) it followed that the maximum expense that could have been recognised in the accounts was £452,800 - £194,057 as a result of the P&A SAs, £30,000 as a result of the fee paid to Copex and £228,743 as a result of the fee paid to FFC. Quite how much of the £194,057 and £228,743 should have been shown as an expense in the accounts would depend on the valuation and further information referred to in paragraphs 106(5) and 106(6)(b) above.

107. Ms Hemingway's supplemented those views with her oral testimony at the hearing, which was as follows:

(1) when deciding whether or not to take account of a series or group of transactions, in determining commercial substance, it wouldn't matter whether each person

participating in the transactions was under common control. Nevertheless, if two parties to the series or group of transactions were under common control, that would be a factor to be taken into account in determining the commercial substance of the transactions;

(2) commercial substance was to be identified by reference to the commercial effect of the transactions. Thus, once the legal rights and obligations to which the transactions gave rise had been identified, it was necessary to recognise the commercial effect of those legal rights and obligations, even if that commercial effect differed from the form of the documents giving rise to the legal rights and obligations;

(3) paragraph 54 of FRS 5 defined an asset for these purposes by reference to control over access to future benefits. In this case, the Appellant never had control over the monies which were contributed to it by Illuminatrix for the purpose of acquiring P&A services as it (and Journal) were bound by obligations which ensured that the monies were applied in repaying Copex;

(4) a chain of sub-contracts would not necessarily change the commercial substance of the transaction for the entity which had entered into the initial contract. It would all depend on the rights and obligations to which the relevant contracts gave rise. In this case, the Appellant was never going to have to provide the services under the Head P&A SA itself. Instead, those services would just be supplied by one Universal group company to another. In addition, the only circumstances in which Marital would ever receive the £2,781,486 which was the principal amount outstanding under the loan which had been assigned to Marital pursuant to the Studio P&A SA would be if the Waterfall were to generate receipts of that amount for the Appellant. (In that case, those receipts would be paid directly by Corpus to Marital in satisfaction of the obligation of Corpus to pay the relevant amounts to the Appellant, the Appellant's obligation to distribute the relevant amounts to Illuminatrix and Illuminatrix's obligation to pay to Marital the outstanding amounts under the Journal Loan Agreement.) The upshot was that, as a matter of commercial substance, the Appellant would never have to incur the cost of the £2,781,486;

(5) the Studio P&A SA lacked commercial logic so far as Marital was concerned because it was undertaking an obligation to perform services worth £2,975,543 in return for consideration of £194,057. That was an indication that treating each P&A SA as containing an obligation to perform services for the value specified as the services budget in the relevant agreement did not accord with commercial substance and required further consideration as to what the commercial substance actually was;

(6) the initial fee under the Consultancy Agreement could be shown as an expense in the accounts only to the extent that the services had been performed by the end of the relevant period of account. The balance would just be shown as a prepayment asset in the balance sheet. Thus, the quantum of the expense in the profit and loss account depended on the extent to which the relevant services had been performed; and

(7) the position in relation to the Head P&A SA and the Sub P&A SA was different because the key question was not the extent to which the services under those agreements had been performed but rather the extent to which the prepayment asset should be written off in the accounts as irrecoverable. She and Ms Hotston Moore were in agreement on that. It was just that:

(a) Ms Hotston Moore considered that the relevant asset was £2,781,486 greater than she did; and

(b) Ms Hotston Moore was saying that the relevant asset should be written down to nil based on the views of management as to recoverability under the Waterfall whereas she was expressing no view on recoverability. She was merely saying that the maximum amount of the write-down was £194,057.

Conclusion

108. In our view, Ms Hemingway's view of the commercial substance of the transaction is correct and Ms Hotston Moore's is not. This is not a case where Ms Hotston Moore's view on the commercial substance of the transaction is tenable such that Ms Hotston Moore's view that the accounts of the Appellant in respect of its first period of account were nevertheless GAAP-compliant can be accepted. (For completeness in relation to Ms Hemingway's view of the commercial substance of the transaction, we should note something of an oddity in the way in which the terms of the Waterfall interacted with the allocation of profits to the members of the Appellant under the Partnership Deed. It seems to us that, in terms of the economics of the deal, the payments under stage 7 of the Gross Receipts part of the Waterfall were referable to the corporate members, in that they were capped by reference to a the Studio Benefit (which had been funded out of the corporate members' contributions of capital to the Appellant) plus a premium, whilst the payments under stage 8 of the Gross Receipts part of the Waterfall were referable to Illuminatrix, in that they were capped at the amount of the loan made to Illuminatrix plus interest on that loan. Since the terms of the Partnership Deed contained no such distinction, Illuminatrix was in fact entitled to 86% of the stage 7 payments and the corporate members were in fact entitled to 14% of the stage 8 payments (which is why only 86% of the stage 8 payments were subject to the payment direction of 28 October 2012 pursuant to which they were paid directly by Corpus to Marital). However, in our view nothing turns on this in terms of Ms Hemingway's analysis of the substance of the transaction. She was right to say that the Appellant would never have to bear the cost of discharging the loan made by Journal to Illuminatrix (and, hence, £2,781,486 of the fee paid to Journal under the Sub P&A SA) because any payments to Marital under that loan would always be funded by Corpus under the Waterfall.)

109. So far as Ms Hotston Moore's view on the commercial substance of the transaction for the Appellant is concerned, the reasons for our conclusion to the effect that it is wrong and that the accounts of the Appellant in respect of the relevant period of account were not compliant with GAAP are essentially the same as Ms Hemingway's and are as follows:

(1) the essential problem with Ms Hotston Moore's approach as we see it is that it gives too much importance to the legal form of the transaction and pays insufficient attention to the commercial substance of the transaction. In the words of the First-tier Tribunal in *Ingenious FTT*, we believe that Ms Hotston Moore was "blinded by the story the draftsman of the relevant agreements wished to tell" (see *Ingenious FTT* at paragraph [940]). As we have noted above, paragraph 46 of FRS 5 requires accounts to depart from legal form where that form does not adequately express the commercial effect of the arrangements. This is such a case. Any attempt accurately to capture the commercial substance of the transaction in the accounts of the Appellant needed to take into account all of the linked transactions comprising the transaction as required by paragraph 47(b) of FRS 5. In this regard, we are cognisant of paragraph 3.14 of FRS 5 which states unequivocally that "[a] group or series of transactions that achieves an overall commercial effect will often need to be viewed as a whole in order to be accounted for in accordance with its substance";

(2) it is possible that Ms Hotston Moore was thrown off-course in this endeavour because she was instructed by the Appellant to assume that the Appellant was carrying on a trade of providing P&A services pursuant to the Head P&A SA and that this

caused her to pay insufficient regard to the terms of the transaction documents as a whole;

(3) however, the inconsistent answers which she gave at the hearing in relation to:

(a) the relevance to the reporting entity of those transactions in a group or series of transactions to which the reporting entity was not itself party; and

(b) the significance to the commercial substance of the transaction for the Appellant of the value of the consideration which was received by Marital under the Studio P&A SA,

suggests to us that she did not fully understand the transaction at a most fundamental level;

(4) it was apparent from her answers at the hearing that, despite having access to the relevant transaction documents, she had not paid sufficient attention to a number of unusual features in those documents and, in particular:

(a) the circularity of the funding at the inception of the transaction and the knock-on implications which that circularity had on the commercial reality of the transaction;

(b) the fact that, at the same time as management was telling her that the rights to income under the Waterfall had a low value (in order to justify the loss in the accounts of the Appellant for the first period of account of the Appellant), the loan under the Journal Loan Agreement which formed the lion's share of the consideration passing to Marital under the Studio P&A SA, and whose value was entirely dependent on the value of the Waterfall, was being attributed a value equal to its face value in terms of the stated consideration and the services budget in the Studio P&A SA; and

(c) the unusual contractual provisions in the P&A SAs which meant that Marital was more than merely a permitted sub-contractor of whom Corpus approved but was in fact irrevocably bound to carry out all the services involved in the transaction;

(5) in this regard, even though it might appear to have been of minor import because the aggregate amount of capital contributed was correct and she merely failed to include Illuminatrix as a named member, we think that the error which Ms Hotston Moore made in her report in relation to the names of the members who had made capital contributions to the Appellant – as described in paragraph 104(1)(a) above - is extremely telling. The reason for saying this is that, in our view, it is critical to the understanding of the commercial substance of the transaction to appreciate the impact on the transaction of the circle of funds which occurred at inception. As we have said in paragraph 109(4) above, it was that circle which led to the mismatch between the value of the consideration given by the Appellant under the Sub P&A SA and the value of the consideration given by Journal under the Studio P&A SA and which therefore suggested that the Appellant might not be providing services to the value of the services budget stated in the Head P&A SA. Illuminatrix was an integral part of that circle because its role was to be the obligor under the loan which was assigned by Journal to Marital and to be the member of the Appellant which contributed the proceeds of that loan to the Appellant. It is therefore hard to see how Illuminatrix could have been omitted from the list of members in Ms Hotston Moore's report if Ms Hotston Moore had properly understood the commercial substance of the arrangement; and

(6) for similar reasons, it is telling that Ms Hotston Moore's expert report made no mention of the Copex Loan Agreement, the Journal Loan Agreement or the Studio P&A SA apart from recording that she had been provided with those documents. We consider that it is impossible to reach an accurate conclusion on the commercial substance of the transaction for the Appellant without taking the terms of those agreements into account.

110. It follows from the above that we agree with Ms Hemingway that the maximum expense that could have been recognised in the accounts in this case was £452,800 - £194,057 as a result of the P&A SAs, taken together, £30,000 as a result of the fee paid to Copex and £228,743 as a result of the fee paid to FFC.

111. So far as concerns the amount which should have been recognised as an expense as a result of the P&A SAs, given our finding of fact in relation to the likelihood of there being meaningful payments under the Waterfall, we think that the value of nil placed on that asset by management was entirely appropriate. We therefore believe that GAAP-compliant accounts would have given rise to an expense of £194,057 in respect of that item.

112. Similarly, as the service provided by Copex was completed by the end of the period of account, we agree with both experts that the entire fee should have been shown as an expense in the accounts.

113. The position in relation to the initial fee under the Consultancy Agreement is more difficult to assess, given that neither party devoted much time to it in their respective examinations of the experts at the hearing and no clear view emerges from the two expert reports, when taken together with the joint report. The experts concluded that the absence of management information meant that it was unclear:

(1) whether a prepayment asset should have been recognised; and

(2) if it should have been, how much of the initial fee should have been shown as an expense in the accounts for the period of account in question.

114. The conclusion we have reached, based on that, is that we would need more information from management in order to determine whether it was appropriate:

(1) to show the whole of the initial fee as an expense in the accounts; or

(2) instead to show a prepayment asset in the accounts and then treat only such proportion of the initial fee as was attributable to services performed by FFC before the end of the period of account as an expense in the accounts.

115. For the reasons set out in paragraphs 108 to 114 above, we have concluded that:

(1) the accounts of the Appellant in respect of its period of account ending 31 October 2012 were not GAAP-compliant; and

(2) GAAP-compliant accounts would have recorded an expense of something between £224,057 (£194,057 plus £30,000) and £452,800, depending on the information provided by management in relation to the extent to which the services under the Consultancy Agreement had been performed by the end of the period of account.

The Deductibility Issue

Introduction

116. Finally, we turn to the last issue which we have been asked to address. We do so on the assumption that:

(1) the conclusions of law we have reached in relation to the first two issues are incorrect but that the facts on which we based those conclusions remain the same – which is to say that they are the facts which are either agreed between the parties or as we have found; and

(2) contrary to the conclusion of fact which we have reached in relation to the GAAP Issue, the accounts in relation to the first period of account of the Appellant, showing a loss in respect of the £3,005,543 paid by the Appellant to Journal under the Sub P&A SA as an expense, were compliant with GAAP. We have a point to make about this assumption in paragraphs 119 and 120 below.

117. The three questions which we need to address in the light of the above assumptions are:

(1) in relation to the loss shown in the partnership tax return for the tax year 2012/13, was the expenditure referred to in paragraph 116(2) above which gave rise to the loss in the accounts of the Appellant ending 31 October 2012 wholly and exclusively incurred for the purposes of the Appellant's assumed trade of providing P&A services?

(2) in relation to the loss shown in the partnership tax return for the tax year 2014/15, was the expenditure referred to in paragraph 46(17) above which gave rise to the loss in the accounts of the Appellant ending 31 October 2014 – the fees to Shipleys LLP and the additional annual fees to FFC under the Consultancy Agreement - wholly and exclusively incurred for the purposes of the Appellant's assumed trade of providing P&A services? and

(3) did the expenditure referred to in paragraph 116(2) above have a revenue, as opposed to a capital, nature? (The Respondents do not seek to challenge the deductibility of the expenditure referred to in paragraph 117(2) above on the grounds that it was capital in nature.)

118. We address each of these questions in turn in the following paragraphs.

119. Before doing so, there is one preliminary point that we need to make in relation to the assumption set out in paragraph 116(2) above. At the hearing, the Respondents conceded that, on the assumption that the accounts of the Appellant in respect of its first period of account showing a loss of £3,005,543 were GAAP-compliant, it was not open to them to submit, as a stand-alone argument, that relief should be denied for £2,781,486 of that aggregate amount on the basis that the Appellant had not borne the economic burden of that part of the aggregate amount. They made that concession on the basis of the decision of the Court of Appeal in *NCL Investments Limited v The Commissioners for Her Majesty's Revenue and Customs* [2020] 1 WLR 4452 ("*NCL*"). In that case, the Court of Appeal held that an item appearing in GAAP-compliant account as an expense should be regarded as an "expense" for the purposes of Sections 46 and 48 of the CTA 2009 and therefore as being "incurred" for the purposes of Section 54 of the CTA 2009 regardless of whether the relevant item was actually an expense or was actually incurred.

120. The situation in this case is not unlike the situation in *Ingenious UT*, where the Upper Tribunal held that Section 54 of the CTA 2009 required that an expense had actually to be incurred before it could be deducted for corporation tax purposes. The Court of Appeal in *NCL* declined to adopt the same conclusion, noting (inter alia) that the conclusion in *Ingenious UT* was obiter because the Upper Tribunal had already held that the taxpayers were not either trading or trading with a view to profit and that the taxpayers' accounts were not GAAP-compliant. It would therefore seem that the Respondents' concession in this case is entirely appropriate, unless the Court of Appeal's decision in *NCL* on this point is reversed by the Supreme Court. Having said that, it is perhaps difficult to imagine circumstances in

which GAAP-compliant accounts would show, as a receipt and an expense, amounts received and paid in the course of a pre-determined circular flow of funds such as the one in this case. Instead, GAAP-compliant accounts would be likely to disregard the receipt and expense. That is the conclusion which was reached in *Ingenious UT* and is also the conclusion we have reached in this case. So the issue may be somewhat academic.

Wholly and exclusively – the case law

121. The Upper Tribunal in *Ingenious UT* (at paragraph [461]) approved of the manner in which the First-tier Tribunal had expressed the relevant principles in this area in *Ingenious FTT* at paragraph [839]. These are as follows:

(1) "for the purposes of the trade" means for the purposes of enabling a person to carry on the trade and earn profits in it;

(2) a dual purpose, where not saved by Section 34(2) of the ITTOIA (or Section 54(2) of the CTA 2009, as the case may be) is not exclusively a trading purpose. As a result, an expense incurred both for the purposes of the trade and for another purpose is not deductible;

(3) the purpose referred to is that of the taxpayer, subjectively determined;

(4) the purpose of the taxpayer must be distinguished from the effect of the expense. Thus, a private benefit which is merely a consequence or an incidental effect does not give rise to a dual purpose – see *Vodafone Cellular v Shaw* [1997] STC 734 ("*Vodafone*") at 742 to 745; and

(5) although the purpose is to be subjectively determined, this does not limit the investigation to the taxpayer's conscious motives. A pinch of salt is necessary – some consequences are so inevitably and inextricably involved in a payment that, unless merely incidental, they must be taken to be a purpose for which the payment is made.

122. The Upper Tribunal in *Ingenious UT* at paragraphs [462] and [463] added the following two additional principles, which it said derived from the Upper Tribunal decision in *Scotts Atlantic Management Limited (in liquidation) v The Commissioners for Her Majesty's Revenue and Customs* [2015] STC 1321:

(1) first, although the focus of the test is on the object of the expenditure rather than the means of incurring it, it does not follow that the means by which the expenditure is incurred cannot be one of the circumstances to be taken into account in determining its purpose; and

(2) secondly, a trader may have a choice of the way in which it achieves an end which is exclusively for the benefit of the trade and that choice may be influenced or dictated by the tax consequences. Making such a choice does not necessarily involve a duality of purpose as regards the expense. In each case, the question is whether the payment is made exclusively for the purposes of the trade and that is a question of fact for the First-tier Tribunal.

Wholly and exclusively – conclusion

The tax year 2012/13

123. It is helpful to approach the answer to the question posed in paragraph 117(1) above by distinguishing between the four distinct elements of the Appellant's expenditure in the period of account ending 31 October 2012. These were:

(1) £2,781,486 of the £3,005,543 that was paid to Journal as the fee under the Sub P&A SA, which was the amount used by Journal to repay Copex under the Copex Loan Agreement and funded by the capital contribution to the Appellant by Illuminatrix;

(2) £30,000 of the same fee, which was the amount used by Journal to pay the arrangement fee due to Copex under the Copex Loan Agreement;

(3) the balance of that same fee (£194,057), which was the amount used by Journal to make the cash payment of the Studio Benefit to Marital under the Studio P&A SA; and

(4) the initial fee paid to FFC under the Consultancy Agreement of £228,743.

124. Even on the assumption that the activities of the Appellant amounted to a trade, the purpose of the first two elements described above was not to benefit that trade but instead to inflate the claim for tax relief by the corporate members. So far as we can see, this was not even a case of a mixed trading and other purpose.

125. The first element described above was the amount of the loan made by Copex which went round in a circle at inception and was not paid on by Journal to Marital under the Studio P&A SA. There is no conceivable explanation for that element of the Appellant's expenditure apart from the fact that it served to inflate the accounting loss and thus provide a meaningful return to the corporate members. Since that was not for the purposes of the Appellant's trade, it clearly fails the present test. The fact that the tax benefit arose at the level of the corporate members and not within the Appellant does not change the answer on this point. As the Upper Tribunal said in *Ingenious UT* at paragraph [472], "the fact that any tax benefit was at the investor level does not preclude a finding of tax purpose in respect of the LLP (a separate legal entity) as determined by its controlling minds, who, as found by the FTT, clearly had the tax benefits well in mind at the time the transactions were undertaken."

126. The same conclusion follows inexorably in relation to the second element described above. This was the amount paid by the Appellant to Journal so that Journal could discharge the fee required by Copex for facilitating the circle of funding which led to the inflated claims to relief.

127. The third element of the expenditure is a little more difficult to analyse in this context. Before doing so, we should note that, as a clearly identifiable element of the aggregate fee of £3,005,543 paid by the Appellant to Journal, it is not automatically infected by the tax purpose which attached to the first two elements simply by virtue of being part of the same fee. The saving in Section 34(2) of the ITTOIA (or Section 54(2) of the CTA 2009, as the case may be) for identifiable parts of expenses incurred for more than one purpose is capable of applying. So the question which we need to determine is whether the element of the fee paid by the Appellant to Journal which Journal then paid on to Marital was incurred wholly and exclusively for the purposes of the Appellant's assumed trade.

128. This element of the Appellant's expenditure led to the receipt by the Appellant of its rights under the Waterfall. We have previously concluded that that activity involved the acquisition of an investment and was not a trading transaction. However, on the basis of the assumption which we are required to make for the purposes of considering this issue, we have to assume that the activity of purchasing those rights was a trading activity. As such, if the purpose of the Appellant in incurring this element of the fee was wholly and exclusively for the purpose of purchasing the rights, then this element of the fee satisfies the test in Section 34 of the ITTOIA (and Section 54 of the CTA 2009). In contrast, if this element of the fee was incurred, at least in part, for the purpose of facilitating the fiscal advantage which the corporate members expected to enjoy as a result of the transaction, then it does not satisfy the test in those provisions.

129. If the value of the rights under the Waterfall had been meaningful, and the purpose of the Appellant in purchasing those rights had been to make a profit from them, we would have been inclined to say that the former was the case and that the tax benefit anticipated by the corporate members from the transaction was merely an incidental effect of the expenditure. However, as we have previously indicated, we can discern no meaningful value in the rights. More significantly in this context, where the relevant test is based on subjective purpose (albeit tempered by the proverbial pinch of salt mentioned in paragraph 121(5) above), we can discern no meaningful interest in the controlling minds of the Appellant in deriving a profit from the Waterfall. We think that the purpose of the Appellant in incurring this expenditure was simply to pay a fee to the studio for its participation in this transaction in order to provide the fiscal benefits to the corporate members. In other words, the Studio Benefit was no more than a necessary cost associated with the creation of a structure which would deliver fiscal benefits to the corporate members. It follows that, in our view, this element of the Appellant's expenses is infected with the same fiscal (ie non-trade) purpose as the first two elements.

130. Turning to the final element described in paragraph 123 above, the analysis is not very different from that pertaining to the third element of the expenses. In other words, the fee paid to FFC was not wholly for the purpose of acquiring services which were designed to maximise the revenue derived by the Appellant but was instead for the purpose of acquiring services which would facilitate the receipt of tax benefits by the corporate members. In other words, the role played by FFC in the transaction, and the reason why it was remunerated by the Appellant out of the monies contributed to the Appellant by the corporate members, was to provide advice on, and to assist the Appellant in implementing, the structure which would deliver those tax benefits to the corporate members. That purpose was not a trading purpose for the Appellant.

131. In our view, therefore, even on the assumption that, contrary to our conclusions in relation to the Trade Issue and the View to Profit Issue, the Appellant was carrying on a trade with a view to profit, none of the expenditure which it incurred was wholly and exclusively for the purposes of that trade.

132. Mr Ramsden submitted that the above conclusion was incorrect because all of the expenditure incurred by the Appellant was wholly and exclusively for the purposes of deriving profit from the provision of the P&A services. On his analysis:

(1) the Appellant only ever had a single purpose and that was to derive a profit from providing P&A services;

(2) the tax benefit derived by the corporate members was merely an incidental benefit arising from, and not a purpose of, the expenditure. It was an effect of the expenditure and not the purpose of the expenditure;

(3) the mere fact that the Appellant had chosen a more tax-efficient way of achieving its commercial purpose did not mean that therefore it had a duality of purpose. Here, the sole purpose of the Appellant was to benefit its trade and the fact that it had chosen to pursue that purpose tax-efficiently did not alter that purpose; and

(4) it was important not to elide the purpose of the corporate members in investing in the Appellant and the purpose of the Appellant in entering into the transaction. Only the latter was relevant in relation to this question and it permitted of only one answer, which was that the Appellant had incurred the expenditure for the purposes of its trade.

133. For the reasons which we have already given, we do not agree with the above characterisation of the Appellant's purpose. Even if it might be said that some part of the

Appellant's purpose was to derive a profit for itself from its activities – a conclusion which we doubt, given the findings of fact set out in paragraphs 64 to 67 above – there can be little doubt that a significant purpose of the Appellant in incurring each element of expenditure was to generate a fiscal benefit for the corporate members. As such, we consider that none of the expenditure was incurred wholly and exclusively for the purposes of the assumed trade of the Appellant.

The tax year 2014/15

134. As for the question posed in paragraph 117(2) above, we think that, on the assumption that the activities of the Appellant did amount to a trade with a view to profit, the £5,000 of fees paid to Shipleys LLP for preparing the accounts and tax computations of the Appellant would fall to be treated as having been incurred wholly and exclusively for the purposes of the assumed trade, in accordance with general practice. However, the fees paid to FFC under the Consultancy Agreement would not be so treated, for the same reason as we have set out in paragraph 130 above in relation to the initial fee under the Consultancy Agreement. As such, the fees paid to FFC would not have been deductible even if the Appellant had been carrying on a trade. The absence of relief for that element of the expenditure means that the income of the Appellant in the relevant period of account would have exceeded the deductible expenditure incurred by the Appellant in that period of account, with the result that, even on the assumption that the Appellant was carrying on a trade, no loss would have arisen in the relevant tax year.

Capital – the case law

135. There is a considerable body of case law which relates to the distinction between capital and revenue expenditure. The case law is not straightforward. Lord Edmund-Davies in *Tucker v Granada Motorway Services* [1979] 1 WLR 683 ("*Tucker*") observed that the case law had "created a morass of uncertainties, or, as Templeman J put it [1977]1 WLR 1411, 1412 -1413:

"an intellectual minefield in which the principles are elusive…analogies are treacherous…precedents appear to be vague signposts pointing in different directions…and the direction finder is said to be 'judicial common sense'…"

To which he added the depressing postscript that, "the practice of judicial common sense is difficult in revenue cases.""

136. Given those uncertainties and the fact that:

(1) this decision is already lengthy; and

(2) our conclusions in relation to each of the questions we have addressed so far have been in favour of the Respondents,

we propose to deal with this question relatively briefly.

137. The First-tier Tribunal in the second of the two First-tier Tribunal decisions in relation to Ingenious Games LLP and others, *Ingenious Games LLP and others v The Commissioners for Her Majesty's Revenue and Customs* [2017] UKFTT 429 (TC) ("*Ingenious FTT 2*"), set out the following principles in relation to this issue:

(1) <u>no single test</u> - there is no single "brightline" test which can be applied to identify capital expenditure from revenue expenditure. "[No] single rule or touchstone has been devised for distinguishing between capital and revenue payments" – see Lord Fraser in *Tucker* at 694;

(2) <u>fixed capital as opposed to circulating capital</u> - one test is based on a distinction between "fixed capital" and "circulating capital", with only the latter's being treated as

revenue in nature and therefore deductible for tax purposes. However, it is often hard to identify which of those categories a particular item of expenditure falls within. Tiley & Collinson's UK Tax Guide (34th edition) provides a useful summary of the distinction which is that "fixed capital is [that] retained in the shape of assets which either produce income without further action…or are made use of to produce income…[whereas] circulating capital is that which the [business] intends should be used by being temporarily parted with and circulated in the [business] to return with, it is hoped, profit". The distinction does not turn on the nature of the asset in fact or law but rather on the relationship of the asset to the precise nature of the trade. For example, land could be fixed capital for a manufacturing business but circulating capital for a property developer. So, in each case, the answer depends on what the expenditure is calculated to effect from a practical and business viewpoint;

(3) enduring benefit - another test is based on whether the expenditure has given rise to an asset which is of enduring benefit to the trade. "[When] an expenditure is made, not only once and for all but with a view to bringing into existence an asset or advantage for the enduring benefit of a trade…there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital" - see Viscount Cave in *British Insulated and Helsby Cables v Atherton* [1926] AC 205 at 213 and 214. Whilst this test is valuable, it does not identify how long a benefit or advantage needs to be in order to be "enduring". The answer in each case depends on examining the benefit or advantage in the light of the nature of the trade in question from the practical and business viewpoint. Accordingly, no rule can be laid down as to a minimum period of endurance for a capital asset or a maximum period of endurance for a revenue asset – see Lord Wilberforce in *Regent Oil v Strick* [1966] AC 295 ("*Strick*"). Depending on the nature and durability of the trade, a five-year contract might well be revenue in nature – see Lord Upjohn in *Strick* at 345 and Lord Pearce in *BP Australia Ltd v Commonwealth of Australia Taxation Commissioner* [1965] 3 All ER 209 ("*BP Australia*") at 273 and 274;

(4) one-off payment as opposed to recurrent payments - a third test focuses on whether expenditure is a one-off or recurrent. Expenditure falls to be treated as revenue in nature if it has the quality of recurrence, by which is meant that "its purpose brings it within the very wide class of things which in the aggregate form the constant demand which must be answered out of the returns of the trade or its circulating capital and that actual recurrence of the specific thing need not take place or be expected as likely" – see Lord Pearce in *BP Australia* at 216 quoting with approval Dixon J in *Sun Newspapers, Ltd v Federal Commissioner of Taxation* [1938] 61 CLR 337. A one-off payment under a contract can still be revenue in nature if it is clear that similar payments will have to be made again under similar contracts in the future – see Lord Pearce in *BP Australia* at 273 and 274. In this context, it is relevant to consider if the trade is "durable" so that similar contracts are likely to arise in the future;

(5) contract regulating the trader's activities as opposed to an ordinary commercial contract - a fourth test looks at whether the relevant contract pursuant to which the expenditure is incurred can be said to be one of the ordinary commercial contracts made in the course of carrying on the trade (revenue) or instead a contract which regulates the trader's activities (capital) – see *Van den Berghs Limited v Clark* [1935] AC 431. In other words, one needs to consider the manner in which the benefit arising from the contract is to be used;

(6) accounting treatment - in some cases, the accounting treatment can provide a guide to the nature of the expenditure. Expenditure written off in the year of payment

would tend to be revenue in nature whereas expenditure giving rise to an asset on the balance sheet would tend to be capital in nature – see *BP Australia* at 271; and

(7) profit made "with" the asset as opposed to profit made "upon" the asset - one way of identifying the category into which expenditure falls is to consider whether the profit made in relation to the asset to which it gives rise is a profit made "upon" the asset (revenue) or "with" the asset (capital) – see *Commissioner of Taxes v Nchanga Consolidated Copper Mines* [1964] 1 All ER 208.

Capital - conclusion

138. We have concluded that, after taking into account the nature of the Appellant, the assumed trade and the expenditure in question, the expenditure incurred by the Appellant in its first period of account was capital in nature. The facts which we need to take into account in addressing this question are as follows:

(1) the payments made by the Appellant were:

(a) a fee of £3,005,543 under the Sub P&A SA in return for which the Appellant received the rights to receive payments under the Waterfall over a five-year period; and

(b) an initial fee of £228,743 under the Consultancy Agreement in return for providing advice on, and assisting the Appellant to implement, the transaction pursuant to which the rights to those payments were acquired;

(2) the Appellant had no intention of disposing of its rights under the Waterfall for a profit or turning those rights to account in any way other than simply receiving the payments to which those rights gave rise;

(3) whilst the Appellant intended to reinvest, into other deals, any payments which it might happen to derive from the rights under the Waterfall, pending the winding-up of the Appellant, the precise nature of those other deals was never clarified. There was certainly no clearly-expressed intention on the part of the Appellant that we could discern to enter into transactions in the future on a similar basis to the transaction itself – by which we mean that we were provided with no evidence to the effect that the Appellant intended to enter into transactions in the future in which it would pay a significant lump sum in return for rights under a waterfall and hence no evidence that the transaction was simply the first of many similar transactions;

(4) it was anticipated that the Appellant would have a life-span of five years and then be wound up, distributing any assets it might then have to its members. This is apparent from the fact that the terms of the Partnership Deed required the members to consider winding up the Appellant in each period of account ending on or after 31 October 2017; and

(5) the initial fee paid under the Consultancy Agreement was an integral part of the cost incurred by the Appellant in order to acquire its rights under the Waterfall.

139. Turning first to the fee paid by the Appellant under the Sub P&A SA, we do not consider that this had a revenue nature. Applying each of the tests set out in paragraph 137 above in turn:

(1) the rights under the Waterfall were fixed capital in that they were intended to produce income without further action on the part of the Appellant;

(2) the fee gave rise to an asset of enduring benefit to the assumed trade because the rights to which it gave rise were to last for the anticipated life of the Appellant. These

were not circumstances such as those in BP Australia where the trade was "durable" and the Sub P&A SA could fairly be seen as the first of several similar transactions running into the indefinite future;

(3) the fee was a one-off payment. Again, the lack of "durability" in the trade meant that it could not be seen as the first of a series of recurrent payments. It lacked the quality of recurrence which was noted as a requirement of a revenue payment by Lord Pearce in BP Australia;

(4) given the coincident term of, on the one hand, the Waterfall and, on the other hand, the Appellant, the Head P&A SA and the Sub P&A SA are more appropriately seen as having been contracts regulating the Appellant's activities, as opposed to ordinary commercial contracts forming part of the bread and butter of an ongoing trade;

(5) the accounting treatment of the transaction was consistent with the conclusion that the rights under the Waterfall had a capital nature because – leaving aside the fact that the asset was written down immediately because of the nil value accorded to the rights – the accounts required that the payment give rise to an asset in the balance sheet of the Appellant; and

(6) this was a case where any profit made by the Appellant from the rights under the Waterfall would properly be said to be "with" the rights and not "upon" the rights. In other words, the rights were the means by which the profit would have been made and the profit would not be on the rights themselves.

140. In short, the fee under the Sub P&A SA was a one-off lump sum which gave rise to an asset which was intended to last for the whole of the life of the Appellant and was of enduring benefit to the Appellant. There was no quality of recurrence and no sense in which the fee could properly be regarded as part of the circulating capital of the Appellant.

141. A similar conclusion arises in the case of the initial fee under the Consultancy Agreement. In the parlance of the chargeable gains legislation, the fee was an incidental cost of acquiring the capital asset comprising the rights under the Waterfall. It was effectively part of the cost of that acquisition for the Appellant. Although there were subsequent ongoing annual fees under the Consultancy Agreement in addition to the initial fee, we do not see the existence of those payments as being sufficient to endow the initial fee with a revenue nature. In the first place, the quantum of those subsequent annual fees was de minimis in comparison to the initial fee. To all practical intents and purposes, the initial fee was a one-off lump sum which was qualitatively different from the subsequent annual fees and was an integral part of the costs incurred by the Appellant in acquiring the rights under the Waterfall. In addition, even if it could properly be seen as just one of a series of recurrent fees, recurrency is just one of the six tests we have described in paragraph 137 above. It would still fail the other five tests. Accordingly, we think that the initial fee under the Consultancy Agreement was also capital in nature.

142. Mr Ramsden sought to rely on the decision of Lush J in *Hancock v General Reversionary and Investment Company, Limited* 7 TC 358 ("*Hancock*") to support his submission that the payments in this case had a revenue nature. However, the circumstances in *Hancock* were very different from those in this case. In *Hancock*, the taxpayer company paid a sum to secure an annuity for one of its former employees to replace the pension which it had previously been paying him. In concluding that that sum had a revenue nature, Lush J stated that the payment was "ordinary business expenditure…the pension in another form…actuarially equivalent in value and…identical in character". Accordingly, the fact that it was paid in the form of a lump sum instead of a recurring series of annual payments made no difference to its revenue character. The payments in the present case are distinguishable from

the payment in *Hancock* in that they weren't "ordinary business expenditure" at all. Instead, they gave rise to an asset which was of enduring benefit to the Appellant. They were accordingly part of the fixed capital of the trade and not part of its circulating capital.

143. The other cases on which Mr Ramsden relied are of a similar ilk to *Hancock* in that, in each case, there was a one-off payment which was held to be of a revenue nature because it facilitated the day-to-day operations of the existing trade and did not generate any enduring capital asset or benefit.

144. In *Inland Revenue Commissioners v Carron Company* 45 TC 18, the payments in question were made to remove restrictions in the taxpayer company's existing charter which limited its borrowing power and prevented it from hiring management of the appropriate calibre. In giving his judgement, Lord Reid observed that all payments made by a company are made for the purpose of obtaining an advantage. By way of example, sums spent on durable repairs often yielded an enduring advantage. The fact that a payment gave rise to an advantage was not the issue. What mattered was the nature of the advantage which was sought by the payment. Since the payments in that case did not result in a new asset or new fields of activities but simply facilitated the company's existing trade, they left the fixed capital of the company untouched. Lord Guest concurred, saying that the advantages brought about by the payments facilitated the day-to-day operations of the business and were therefore income advantages and not capital advantages. They removed the grit from the existing machinery rather than creating new machinery. The position was no different from the payment made in *Anglo-Persian Oil Company Limited v Dale* 16 TC 253 to get rid of a disadvantageous agency contract. The payment in that case was held to have a revenue nature because it did not procure any enduring capital benefit for the taxpayer company.

145. The same was true of the payment in *Vodafone*. The contract which was terminated by virtue of the payment in that case was held to have the characteristics of circulating capital rather than fixed capital. Accordingly, there was no enduring benefit for the taxpayer company as a result of its making the payment. Instead, the company simply obtained a reduction in its ongoing annual expenditure.

146. In *Lawson v Johnson Matthey plc* [1992] STC 466, the payment in question did not relate to an onerous contract but was instead an injection of capital made into a failing subsidiary for the purpose of preserving the taxpayer company's trade. The House of Lords held that the capital contribution had not been made to get rid of an onerous capital asset but rather to remove a threat to the existing trade of the company. It had no enduring effect on the capital of the company and it therefore had a revenue nature.

147. Each of these cases is readily distinguishable from the present case in that:

(1) it did not concern the acquisition of an asset but rather the removal of an onerous liability; and

(2) more significantly, the advantage obtained by virtue of the relevant payment in each case was a revenue advantage – which is to say that, unlike the fees in this case, the relevant payment facilitated the operation of the ordinary course of business of the paying company and hence affected just its circulating capital. It did not effect any change to the fixed capital of the paying company's business.

148. The cases therefore do not support the submission that the fees in this case were revenue in nature.

149. For the reasons set out in paragraphs 123 to 134 and 138 to 148 above, we have concluded that, even on the basis of the assumptions set out in paragraph 116 above:

(1) none of the expenditure incurred in the period of account ending 31 October 2012 was deductible;

(2) with the exception of the fees paid to Shipleys LLP of £5,000, none of the expenditure incurred in the period of account ending 31 October 2014 was deductible; and

(3) given that the income of the Appellant in the period of account ending 31 October 2014 exceeded the deductible expenditure of the Appellant in that period of account, no trading loss arose in either period of account.

CONCLUSION

150. On the basis of the preceding paragraphs of this decision, we:

(1) find for the Respondents in relation to each of the four issues described in paragraph 13 above;

(2) dismiss the appeal; and

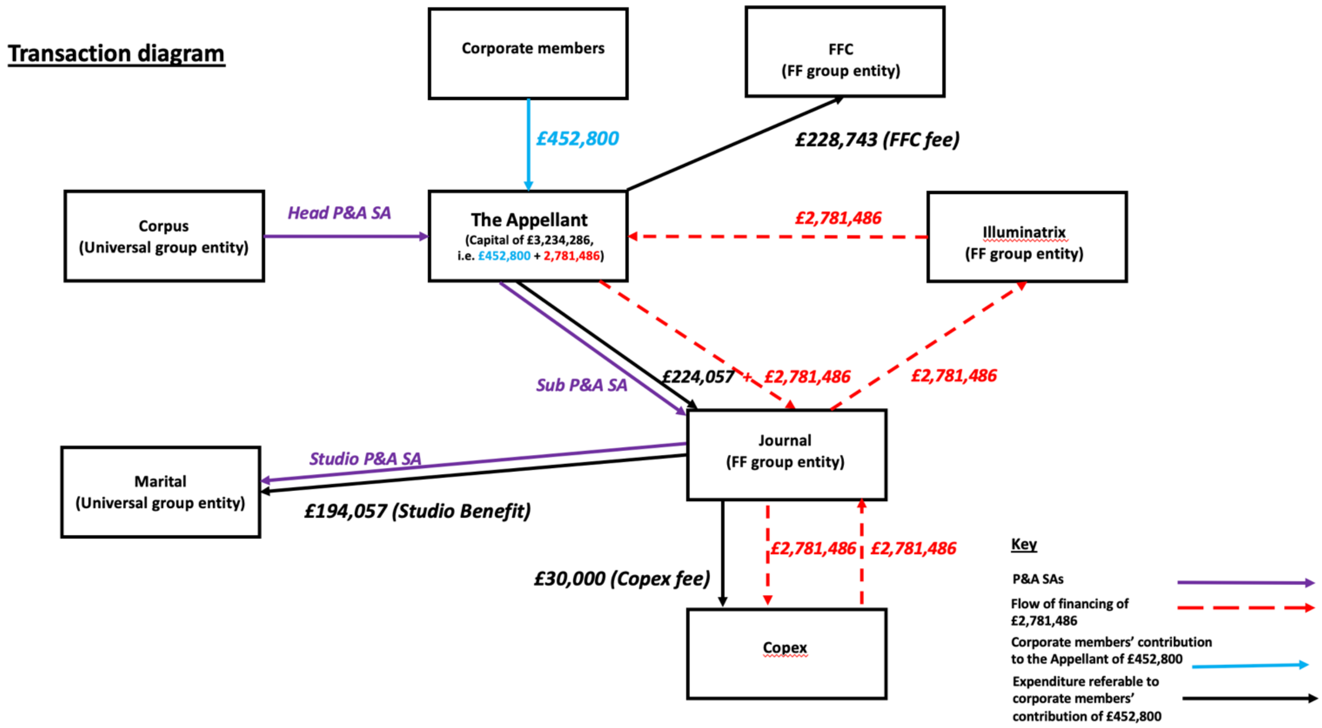
(3) uphold the two closure notices in question.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

151. 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.

TONY BEARE
TRIBUNAL JUDGE
Release date: 17 FEBRUARY 2022

APPENDIX



Transaction diagram
Corporate members
FFC
(FF group entity)
£452,800
£228,743 (FFC fee)
Corpus
(Universal group entity)
Head P&A SA
The Appellant
(Capital of £3,234,286,
i.e. £452,800 + 2,781,486)
£2,781,486
Illuminatrix
(FF group entity)
Sub P&A SA
£224,057 + £2,781,486
£2,781,486
Marital
(Universal group entity)
Studio P&A SA
Journal
(FF group entity)
£194,057 (Studio Benefit)
£2,781,486
£2,781,486
£30,000 (Copex fee)
Copex
Key
P&A SAs
Flow of financing of £2,781,486
Corporate members' contribution to the Appellant of £452,800
Expenditure referable to corporate members' contribution of £452,800