[2010] UKUT 477 (TCC)
Appeal No: FTC/16/2010

Income Tax – whether expenditure constituted allowable deductions under section 74 of the ICTA 1988 – proper construction and application of section 74 – construction of film exploitation documentation.

UPPER TAX TRIBUNAL
(TAX AND CHANCERY CHAMBER)

Icebreaker 1 LLP	**Appellant**
- and –	
The Commissioners for HM Revenue and Customs	**Respondents**

TRIBUNAL: THE HON MR JUSTICE VOS

Sitting in public at the Royal Courts of Justice on 13 and 14 December 2010

Mr Jonathan Peacock Q.C. and Mr James Rivett (instructed by Deloitte LLP) for Icebreaker 1 LLP
Mr. Peter Blair Q.C. and Mr Jonathan Davey (instructed by HMRC) for the Commissioners for HM Revenue and Customs

DECISION

Introduction

1. This is an appeal by Icebreaker 1 LLP ("Icebreaker") from the decision of the First-tier Tribunal (Tax Chamber) (the "FTT") released on 5th January 2010 (the "Decision"), which decided that certain items of expenditure incurred by Icebreaker did not constitute allowable deductions under section 74 of the Income and Corporation Taxes Act 1988 ("ICTA 1988"). References in this decision simply to paragraph numbers are references to paragraphs in the Decision by the FTT comprising Tribunal Judge Howard M. Nowlan and Mr Nicholas Dee.

2. The key questions in Icebreaker's appeal are (1) whether the items of expenditure were of an income rather than a capital nature within the provisions of section 74(1)(f) of ICTA 1988, and (2) if they were revenue expenses, whether they were incurred wholly and exclusively for the purposes of Icebreaker's trade within the provisions of section 74(1)(a) of ICTA 1988.

3. Icebreaker originally criticised the Decision in the following respects:-

i) Icebreaker said that the FTT failed to have regard to the true legal effect of the arrangements between the parties.

ii) Icebreaker alleged that the FTT applied the wrong legal principles to its analysis of whether Icebreaker's payments to Centre Film Sales Limited ("Centre") constituted deductible revenue expenditure.

iii) Icebreaker contended that the Decision was based upon findings of fact:-

a) that no person acting judicially and properly instructed as to the relevant law could have made; and

b) the substance of which were not fairly put to the relevant witnesses.

4. The arguments on both sides have, however, developed significantly during the course of oral argument. Indeed, Mr Jonathan Peacock Q.C., counsel for Icebreaker, submitted 3 additional written submissions in the course of the hearing. Whilst I make no complaint about that process, it has necessitated a rather wider review of the FTT's Decision than might have originally been foreseen from the Grounds of Appeal and Response.

Background

5. In February 2004, Icebreaker was incorporated with two initial corporate members, which were owned and managed by Ms Caroline Hamilton ("Ms Hamilton"). Ms Hamilton was the main witness for Icebreaker at the hearing before the FTT.

6. Also, in February 2004, Icebreaker Management Limited ("IML") published a detailed Information Memorandum for potential investors, referring to the potential tax advantages of the proposed Icebreaker structure. As the FTT found, the proposed transaction changed in a number of significant respects between the Information Memorandum and the transaction itself on 5th April 2004.

7. On 5th April 2004, a series of transactions took place:-

i) 6 individuals (the "Members", one of whom was Ms Hamilton personally) joined the Icebreaker partnership and made capital contributions totalling £1.52 million. 70% of these contributions were funded by loans from Bank of Scotland ("BoS"), and the remaining 30% from the Members' own resources. Icebreaker entered into a fixed and floating charge in favour of BoS over all its assets (including the letter of credit issued by BoS and referred to in sub-paragraph (v) below) to secure repayment of the loans made by BoS to the Members.

ii) The Members entered into a partnership agreement dated 5th April 2004 (the "Partnership Agreement").

iii) Icebreaker entered into the following 4 agreements:-

a) A licence agreement with Screen Partners Asset Management Limited ("SPAM") to licence from SPAM rights relating to 8 film or television projects for a payment of £46,950 (the "SPAM Licence Agreement");

b) A head distribution agreement whereby Icebreaker appointed Centre as its head distributor in relation to the exploitation of film or television projects it had licensed from SPAM (the "HDA").

c) An administration agreement with IML for IML to provide the administrative services detailed in Schedule A to that agreement to Icebreaker (the "IML Administration Agreement"). IML was a company owned and controlled by Ms Hamilton.

d) An advisory agreement with IML for IML to provide advice to Icebreaker (the "IML Advisory Agreement").

iv) Icebreaker paid £1,273,866 to Centre pursuant to an invoice headed "*Re [HDA] dated 5th April, 2004*". Centre instructed BoS to divide that sum, and to pay £1,064,000 into a blocked deposit account at BoS, charged to BoS, and the balance of £209,866 to another Centre account at BoS, which made those funds freely available to Centre. In fact, the two sums were deducted separately from Icebreaker's account at BoS, and, for some unexplained reason, the £209,866 was re-credited to Icebreaker's account before finally going across to Centre on 6th April 2004.

v) BoS issued an irrevocable standby letter of credit in favour of Icebreaker (the "LoC") referring to the "Initial Deposit" as meaning "*an amount equal to the Final Minimum Sum (as defined in the [HDA]) being £1,081,024*". The sum referred to as the Initial Deposit in the LoC was, in fact, the Final Minimum Sum mentioned in the HDA of £1,064,000 (as to which see paragraph 19(v)(a) below) plus BoS's 1.6% interest charge on the Members' loans in the sum of £17,024, totalling £1,081,024. The LoC secured payment of the first 4 (out of 10) Annual Advances and the Final Minimum Sum due from Centre to Icebreaker under the HDA (as to which see paragraph 19(v)(b) below).

vi) Icebreaker paid £120,000 to IML pursuant to an invoice from IML for services under the IML Administration Agreement.

vii) Icebreaker paid £50,000 to IML pursuant to an invoice from IML for services under the IML Advisory Agreement.

8. On 16th August 2004, Icebreaker submitted its tax return for the year ended on 5th April 2004 (the "Tax Return"), computing its accounts on the basis that each of three payments Icebreaker had made on 5th April 2004 was deductible revenue expenditure, and claiming loss relief in respect of a loss of £1,491,816.

9. On 2nd January 2005, the Inland Revenue (the predecessor to the Commissioners for HM Revenue and Customs (the "Commissioners")) commenced an enquiry into the Tax Return for the year ended 5th April 2004 under section 12AC(1) of the Taxes Management Act 1970 (the "TMA 1970").

10. On 2nd May 2007, the Commissioners issued a Closure Notice concluding that Icebreaker's claimed loss in its Tax Return should be reduced from £1,491,816 to £11,900.

11. On 24th May 2007, Icebreaker appealed against the amendment to its Tax Return.

12. The FTT's Decision dated 5th January 2010 concluded that:-

    i) The bulk of the claimed losses in the Tax Return should be disallowed.

    ii) The payment of £1,273,866 to Centre should be split:-

        a) As to £1,064,000, which was disallowable because it was not incurred for Icebreaker's trade, but rather to obtain and secure the right to future payments from Centre (paragraphs 145 and 152).

        b) As to £174,866, which was capital expenditure, deemed to be revenue expenditure by section 40A of the Finance (No 2) Act 1992 (the "FA 1992"), which was allowable but only in periods after 5th April 2004.

        c) As to £35,000, which was disallowable as a prepayment for film distribution purposes, and only deductible in periods after 5th April 2004.

    iii) The two payments to IML totalling £170,000 should be aggregated so that:-

        a) £51,000 was disallowable as having been paid for the acquisition of the Icebreaker structure.

        b) £90,000 was referable to past services and therefore deductible revenue expenditure for the year ended 5th April 2004.

        c) £29,000 was disallowable as a prepayment and only deductible in periods after 5th April 2004.

13. On 5th February 2010, the FTT granted Icebreaker permission to appeal the Decision to the Upper Tribunal.

<u>The relevant provisions of the tax legislation</u>

14. Section 74 of the ICTA 1988 provided (before its repeal) for "*General rules as to deductions not allowable*" as follows:-

> "*Subject to the provisions of the Tax Acts, in computing the amount of the profits or gains to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of—*
>
> *(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation; …*
>
> *(f) any capital withdrawn from, or any sum employed or intended to be employed as capital in, the trade, profession or vocation, but so that this paragraph shall not be treated as disallowing the deduction of any interest; …*"

15. Section 40A of the FA 1992 provided as follows:-

> "*Expenditure incurred on the production or acquisition of a master version of a film is to be regarded for the purposes of the Tax Acts as expenditure of a revenue nature unless an election under section 40D has effect with respect to it* ".

16. Section 42 of the Finance Act 1998 ("FA 1998") provided as follows:-

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

<u>The relevant provisions of the Head Distribution Agreement</u>

17. The detailed provisions of the HDA are important, and have been relied on in considerable detail by both sides. In aid of brevity, however, I shall not set out every one of the terms of the HDA mentioned by the parties. I will, instead, confine myself to the terms on which particular reliance was placed.

18. The preamble to the HDA provided that Icebreaker "*owns, and intends to acquire, certain rights in moving images and wishes to appoint Centre as its head distributor to exploit such rights on its behalf*", and that "*Centre has agreed to act as such head distributor and to pay certain amounts to [Icebreaker]*".

19. The main provisions of the HDA can be summarised as follows:-

    i) By clause 2.1, Icebreaker appointed Centre as its sole and exclusive distributor, and provided that Centre should enter into a Service and Exploitation Agreement.

    ii) By clause 2.4, Centre was to provide Icebreaker with copies of invoices for all "*Exploitation Costs*" as defined in Appendix III, and Icebreaker should pay them within 30 days, and that "*[Icebreaker] undertakes to pay an amount of £[   ] in respect of such Exploitation Costs to Centre immediately on signature hereof*". The figure was blank in the HDA, but Icebreaker paid the invoiced sum of £1,273,866.

iii) Appendix III defined "*Exploitation Costs*" as meaning: "*the following items of costs and expenses ... incurred in connection with the exploitation of Moving Images*". 13 items of costs and expenses were listed relating variously to expenses incurred in pre-production, production, post-production and exhibition or exploitation of films or "*Moving Images*". None related to the investment or deposit of monies for any purpose.

iv) By clause 3, Centre was obliged, amongst other things, to distribute and exploit the "*Rights*" (Icebreaker's distribution and exploitation rights in Appendix 1 as updated from time to time) to the best of its skill and ability and to pay receipts into a Collection Account.

v) By clause 4.1, it was agreed that: "*[i]n consideration of the rights and benefits obtained by Centre under [the HDA], Centre hereby undertakes and agrees to pay the Annual Advances and Final Minimum Sum to [Icebreaker] on the dates specified in Appendix II*":

  a) The Final Minimum Sum was £1,064,000 payable at the end of Year 10, guaranteed by the BoS; and

  b) There were 10 Annual Advances of amounts equal to interest at BoS's Base Rate, on £1,064,000, the first four being guaranteed by BoS.

vi) By clause 4.2, Icebreaker had a put option and Centre had a call option to sell/buy the entire business and assets of Icebreaker at the Option Price (being the higher of the Final Minimum Sum and the current market value of the Rights and Materials (for the exploitation of the Moving Images as agreed) assessed by an independent valuation) on the fourth anniversary or subsequent anniversaries of the HDA.

vii) By clause 4.3, Centre undertook to obtain appropriate bank security (which turned out to be the LoC) for its obligations in respect of the first 4 Annual Advances, the Final Minimum Sum, and the Option Price.

viii) By clause 5.1, Centre was to pay Gross Receipts (from exploitation of the Rights) into the Collection Account, and to use reasonable endeavours to procure that Sales and Releasing Agents (granted sub-distribution rights by Centre) pay Gross Receipts into the Collection Account:-

  a) There was then a waterfall for distributions out of the Collection Account in certain proportions specified in Appendix 1.

b) Appendix 1 provided delineated proportions for the film "Alexander the Great from Macedonia" (referred to as "Young Alexander"), but said that the proportions for the other specified titles were to be agreed, subject to certain stated maxima and minima.

c) The proportions for Young Alexander was 250/1040ths to Icebreaker and the balance to Centre until £1,040,000 had been paid, and thereafter 25% to Icebreaker and the balance to Centre.

ix) By clause 5.3, third party participations were to be borne by Centre out of amounts payable to Centre in accordance with clause 5.1.

x) By clauses 5.5 and 5.6, Centre was to provide sales reports to Icebreaker every 3 months, including Exploitation Costs and Additional (exploitation and marketing) Costs, and to keep proper books of account concerning, amongst other things, Exploitation Costs.

xi) By clause 6.1, Icebreaker warranted that it had authority to grant Centre a licence of the Rights.

xii) By clause 9, Icebreaker and Centre had rights of immediate termination, on terms that: Icebreaker recovered its Rights and Materials, Centre lost its right to commissions and shares of Gross Receipts, but not its right to its claim for Additional Costs prior to termination, and without any provision for the return of the £1,273,866 paid by Icebreaker to Centre.

xiii) Clause 14.1 provided that the HDA contained the "*full and complete understanding between the parties relating to the matters set out herein*".

<u>The issues</u>

20. On the second day of the hearing, I gave the parties a list of the issues that I thought needed to be resolved on this appeal. Mr Blair sought to add issue 7 below and Mr Peacock suggested the amalgamation of the original issues 1 and 2. I have accepted both suggestions and would now state the issues to be determined, which are broadly agreed between the parties, as follows:-

i) Whether the FTT was right to conclude that the sum of £1,064,000, paid to Centre as part of the payment of £1,273,866, was not expended wholly and exclusively for the purposes of Icebreaker's trade? In other words, whether the payment was a trading expense within the meaning of section 74(1)(a) of the ICTA 1988?

ii) Whether the payment of £1,064,000 was "*a sum employed or intended to be employed as capital in the trade*" within the meaning of section 74(1)(f) of the ICTA 1988?

iii) Whether the FTT was right to conclude that £174,866 out of the balance of the payment of £1,273,866 to Centre was:-

a) capital expenditure;

b) expended on producing Young Alexander;

c) which was deemed to be revenue expenditure by section 40A of the FA 1992; and

d) allowable only in periods after 5^{th} April 2004?

iv) Whether the FTT was right to conclude that £35,000 out of the balance of the payment of £1,273,866 to Centre was disallowable as a prepayment for film distribution purposes and only deductible in periods after 5^{th} April 2004?

v) Whether the FTT was right to conclude that £51,000 out of the payment of £170,000 to IML was disallowable as having been paid for the acquisition of the Icebreaker structure?

vi) Whether the FTT was right to conclude that £29,000 out of the payment of £170,000 to IML was disallowable as a prepayment and only deductible in periods after 5^{th} April 2004?

vii) Were the transfers from Icebreaker to Centre and IML accounted for in Icebreaker's profit and loss account for the period ended 5^{th} April 2004 in accordance with generally accepted accounting practice as required by section 42(1) of the FA 1998?

21. These issues raise 3 preliminary legal questions, which can usefully be considered first. These questions are:-

i) How should the tribunal approach the application of the proper construction of section 74 of the ICTA 1988 to the facts of the present case?

ii) What is the proper construction of the agreements that the parties have entered into, and in particular the HDA?

iii) In what circumstances would it be appropriate to disregard or re-characterise stages in the transactions undertaken by the parties in this process?

22. I shall deal first, then, with the legal questions I have identified. But before doing so, I shall seek to set out the correct approach to an appeal of this kind.

<u>The correct approach to this appeal</u>

23. This is an appeal brought under section 11 of the Tribunal, Courts and Enforcement Act 2007 (the "2007 Act"), which provides for a "*right of appeal to the Upper Tribunal on any point of law arising from a decision made by the [FTT]*".

24. Section 12 of the 2007 Act provides as follows:-

    i) "*(1) Subsection (2) applies if the Upper Tribunal, in deciding an appeal under section 11, finds that the making of the decision concerned involved the making of an error on a point of law.*

    ii) "*(2) The Upper Tribunal-*

        a) *may (but need not) set aside the decision of the First-tier Tribunal, and*

        b) *if it does, must either-*

            (i) *remit the case to the First-tier Tribunal with directions for its reconsideration*

            (ii) *re-make the decision.*

    iii) "*(4) In acting under subsection (2)(b)(ii), the Upper Tribunal-*

        a) *May make any decision which the First-tier Tribunal could make if the First-tier Tribunal were re-making the decision, and*

        b) *May make such findings of fact as it considers appropriate*".

25. The parties drew my attention to *dicta* in two cases:-

    i) In Edwards v. Bairstow [1956] A.C. 14 at pages 29-30 per Viscount Simonds, and pages 34-36 per Lord Radcliffe, where it was made clear that findings made without evidence can be set aside as errors of law.

    ii) In Bookey v. Edwards [1982] STC 135 at page 139 Walton J said that the Commissioners were entitled to make findings that necessitated their groping "*to some extent in the dark*", and that it could not be said that "*in groping on such insufficient material they have in any way gone wrong in law, that being the only ground on which I could overrule them*".

26. Mr Peacock made detailed submissions as to 16 of the specific findings of the FTT that he submitted were made without evidence, or were incompatible with the evidence, or were based on propositions that were not properly put to the witnesses. I have sought to deal with these submissions where they are relevant to the way in which I have dealt with the various issues. I have not dealt with those of these submissions that are not relevant to the ultimate approach that I have adopted.

Authorities

27. The principles enunciated in W.T. Ramsay Ltd v. Inland Revenue Commissioners [1982] A.C. 300 are now very well-known. The House of Lords held that, even though the separate steps in a transaction were genuine, the court could consider the scheme as a whole and was not limited to a step-by-step examination. In the result, in some cases, the court could disregard some steps in a composite transaction. Lord Wilberforce said this in restating what he described as "*some familiar principles*" at pages 323-4:-

> "*Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance. This is the well-known principle of Inland Revenue Comrs v Duke of Westminster [1936] AC 1, 19 Tax Cas 490. This is a cardinal principle but it must not be overstated or over-extended. While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded; to do so is not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded. For this there is authority in the law relating to income tax and capital gains tax: see Chinn v Collins (Inspector of Taxes) and Inland Revenue Comrs v Plummer.*
>
> *For the commissioners considering a particular case it is wrong, and an unnecessary self-limitation, to regard themselves as precluded by their own finding that documents or transactions are not 'shams' from considering what, as evidenced by the documents themselves or by the manifested intentions of the parties, the relevant transaction is. They are not, under the Duke of Westminster doctrine or any other authority, bound to consider individually each separate step in a composite transaction intended to be carried through as a whole. This is particularly the case where (as in Rawling) it is proved that there was an accepted obligation once a scheme is set in motion, to carry it through its successive steps. It may be so where (as in Ramsay or in Black Nominees Ltd v Nicol (Inspector of Taxes) [1975] STC 372, 50 Tax Cas 229) there is an expectation that it will be so carried through, and no likelihood in practice that it will not. In such cases (which may vary in emphasis) the commissioners should find the facts and then decide as a matter (reviewable) of law whether what is in issue is a composite transaction or a number of independent transactions*".

28. In MacNiven v. Inland Revenue Commissioners [2003] 1 A.C. 311, the House of Lords revisited Ramsay. Lord Hoffmann made the following rationalisation at paragraphs 39-42:-

> "*[39] My Lords, I venture to suggest that some of the difficulty which may have been felt in reconciling the Ramsay case with the Duke of Westminster's case arises out of an ambiguity in Lord Tomlin's statement that the courts cannot ignore "the legal position" and have regard to "the substance of the matter". If "the legal position" is that the tax is imposed by reference to a legally defined concept, such as stamp duty payable on a document which constitutes a conveyance on sale, the court cannot tax a transaction which uses no such document on the ground that it achieves the same economic effect. On the other hand, if the legal position is that tax is imposed by reference to a commercial concept, then to have regard to the business "substance" of the matter is not to ignore the legal position but to give effect to it.*
>
> *The real world*
>
> *[40] The speeches in the Ramsay case [1982] AC 300 ... and subsequent cases contain numerous references to the "real" nature of the transaction and to what happens in "the real world". These expressions are illuminating in their context, but you have to be careful about the sense in which they are being used. Otherwise you land in all kinds of unnecessary philosophical difficulties about the nature of reality and, in particular, about how a transaction can be said not to be a "sham" and yet be "disregarded" for the purpose of deciding what happened in "the real world". The point to hold onto is that something may be real for one purpose but not for another. When people speak of something being a "real" something, they mean that it falls within some concept which they have in mind, by contrast with something else which might have been thought to do so, but does not. When an economist says that real incomes have fallen, he is not intending to contrast real incomes with imaginary incomes. The contrast is specifically between incomes which have been adjusted for inflation and those which have not. In order to know what he means by "real", one must first identify the concept (inflation adjustment) by reference to which he is using the word.*
>
> *[41] Thus in saying that the transactions in the Ramsay case were not sham transactions, one is accepting the juristic categorisation of the transactions as individual and discrete and saying that each of them involved no pretence. They were intended to do precisely what they purported to do. They had a legal reality. But in saying that they did not constitute a "real" disposal giving rise to a "real" loss, one is rejecting the juristic categorisation as not being necessarily determinative for the purposes of the statutory concepts of "disposal" and "loss" as properly interpreted. The contrast here is with a commercial meaning of these concepts. And in saying that the income tax legislation was intended to operate "in the real world",*

one is again referring to the commercial context which should influence the construction of the concepts used by Parliament".

29. In Barclays Mercantile Business Finance Ltd v. Mawson [2005] 1 A.C. 684, the House of Lords accepted the taxpayer's claim for a writing-down allowance under section 24(1) of the Capital Allowances Act 1990. In that case a pipeline, which was not expected to earn taxable profits soon enough to take advantage of capital allowances, was the subject of a sale and leaseback to the taxpayer. The result was that the taxpayer could claim capital allowances on its £91 million investment and pass the benefit of them on to the Irish statutory gas supplier, within the taxpayer's own group, that had originally owned the pipeline. In the course of argument, an issue arose as to whether the real issue in Mawson was whether elements of the transaction were to be disregarded as having no commercial purpose on the principles enunciated in Ramsay and MacNiven, or whether the real issue was whether the payment of £91 million was made for the purposes of BMBF's trade. Lord Nicholls, who gave the only speech to which all members of the committee had contributed, recorded this at paragraph 6 as follows: "*[BMBF] carries on the trade of leasing and has acquired the asset wholly and exclusively by way of provision for the purposes of that trade*", and at paragraph 41 that: "*Mr Boobyer, a director of BMBF, gave unchallenged evidence that from its point of view the purchase and leaseback was part of its ordinary trade of finance leasing*". But, somewhat confusingly, Mr David Goy QC, counsel for the Inspector of Taxes, undoubtedly argued that BMBF did not incur the capital expenditure wholly and exclusively for the purposes of its trade within the requirements of section 24(1). Ultimately, however, Mr Peacock did not argue that Mawson governed this case, in the sense that it was not open to this Tribunal to hold that Ramsay principles should be applicable to this case. For that reason, therefore, it seems to me that the speech of Lord Nicholls is of the greatest assistance in directing this Tribunal to the correct approach to adopt, whatever precise issues were actually decided by their Lordships.

30. Lord Nicholls held as follows:-

> "*[32] The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd [2001] UKHL 6 at [8], [2001] 1 All ER 865 at [8], [2003] 1 AC 311: 'The paramount question always is one of interpretation of the*

particular statutory provision and its application to the facts of the case.'

[33] The simplicity of this question, however difficult it might be to answer on the facts of a particular case, shows that the Ramsay case did not introduce a new doctrine operating within the special field of revenue statutes. On the contrary, as Lord Steyn observed in McGuckian's case [1997] 3 All ER 817 at 824, [1997] 1 WLR 991 at 999 it rescued tax law from being 'some island of literal interpretation' and brought it within generally applicable principles.

[34] Unfortunately, the novelty for tax lawyers of this exposure to ordinary principles of statutory construction produced a tendency to regard Ramsay as establishing a new jurisprudence governed by special rules of its own. This tendency has been encouraged by two features characteristic of tax law, although by no means exclusively so. The first is that tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said, 'in the real world'. The second is that a good deal of intellectual effort is devoted to structuring transactions in a form which will have the same or nearly the same economic effect as a taxable transaction but which it is hoped will fall outside the terms of the taxing statute. It is characteristic of these composite transactions that they will include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge.

[35] There have been a number of cases, such as IRC v Burmah Oil Co Ltd [1982] STC 30, Furniss (Inspector of Taxes) v Dawson [1984] 1 All ER 530, [1984] AC 474 and Carreras Group Ltd v Stamp Comr [2004] UKPC 16, [2004] STC 1377 in which it has been decided that elements which have been inserted into a transaction without any business or commercial purpose did not, as the case might be, prevent the composite transaction from falling within a charge to tax or bring it within an exemption from tax. Thus in the Burmah case, a series of circular payments which left the taxpayer company in exactly the same financial position as before was not regarded as giving rise to a 'loss' within the meaning of the legislation. In Furniss, the transfer of shares to a subsidiary as part of a planned scheme immediately to transfer them to an outside purchaser was regarded as a taxable disposition to the outside purchaser rather than an exempt transfer to a group company. In the Carreras case the transfer of shares in exchange for a debenture with a view to its redemption a fortnight later was not regarded as an exempt transfer in exchange for the debenture but rather as an exchange for money. In each case the court looked at the overall effect of the composite transactions by which the taxpayer company in Burmah suffered no loss, the shares in Furniss passed into the hands of the outside purchaser and the vendors in

Carreras *received cash. On the true construction of the relevant provisions of the statute, the elements inserted into the transactions without any commercial purpose were treated as having no significance.*

[36] Cases such as these gave rise to a view that, in the application of any taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far. It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, to decide whether the transaction in question does so. As Ribeiro PJ said in Collector of Stamp Revenue v Arrowtown Assets Ltd (2004) 6 ITLR 454 at 468: '[T]he driving principle in the Ramsay line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.'

[37] The need to avoid sweeping generalisations about disregarding transactions undertaken for the purpose of tax avoidance was shown by MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd [2001] 1 All ER 865, [2003] 1 AC 311 in which the question was whether a payment of interest by a debtor who had borrowed the money for that purpose from the creditor himself and which had been made solely to reduce liability to tax, was a 'payment' of interest within the meaning of the statute which entitled him to a deduction or repayment of tax. The House decided that the purpose of requiring the interest to have been 'paid' was to produce symmetry by giving a right of deduction in respect of any payment which gave rise to a liability to tax in the hands of the recipient (or would have given rise to such a liability if the recipient had been a taxable entity). As the payment was accepted to have had this effect, it answered the statutory description notwithstanding the circular nature of the payment and its tax avoidance purpose.

[38] MacNiven shows the need to focus carefully upon the particular statutory provision and to identify its requirements before one can decide whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute. In the speech of Lord Hoffmann in MacNiven it was said that if a statute laid down requirements by reference to some commercial concept such as gain or loss, it would usually follow that elements inserted into a composite transaction without any commercial purpose could be disregarded, whereas if the requirements of the statute were purely by reference to its legal nature (in MacNiven, the discharge of a debt) then an act having that legal effect would suffice, whatever its commercial purpose may have been. This is not an unreasonable

generalisation, indeed perhaps something of a truism, but we do not think that it was intended to provide a substitute for a close analysis of what the statute means. It certainly does not justify the assumption that an answer can be obtained by classifying all concepts a priori as either 'commercial' or 'legal'. That would be the very negation of purposive construction: see the *__Arrowtown__* *case (2004) 6 ITLR 454 at 468–469, 470 (paras 37 and 39) per Ribeiro PJ and the perceptive judgment of the Special Commissioners (Theodore Wallace and Julian Ghosh) in* *__Campbell v IRC__* *[2004] STC (SCD) 396.*

[39] The present case, like *__MacNiven__*, *illustrates the need for a close analysis of what, on a purposive construction, the statute actually requires. The object of granting the allowance is, as we have said, to provide a tax equivalent to the normal accounting deduction from profits for the depreciation of machinery and plant used for the purposes of a trade. Consistently with this purpose, s 24(1) requires that a trader should have incurred capital expenditure on the provision of machinery or plant for the purposes of his trade. When the trade is finance leasing, this means that the capital expenditure should have been incurred to acquire the machinery or plant for the purpose of leasing it in the course of the trade. In such a case, it is the lessor as owner who suffers the depreciation in the value of the plant and is therefore entitled to an allowance against the profits of his trade.*

[40] These statutory requirements, as it seems to us, are in the case of a finance lease concerned entirely with the acts and purposes of the lessor. The Act says nothing about what the lessee should do with the purchase price, how he should find the money to pay the rent or how he should use the plant. As Carnwath LJ said in the Court of Appeal ([2003] STC 66 at [54]): '[T]here is nothing in the statute to suggest that "up-front finance" for the lessee is an essential feature of the right to allowances. The test is based on the purpose of the lessor's expenditure, not the benefit of the finance to the lessee.'

[41] So far as the lessor is concerned, all the requirements of s 24(1) were satisfied. Mr Boobyer, a director of BMBF, gave unchallenged evidence that from its point of view the purchase and lease back was part of its ordinary trade of finance leasing. Indeed, if one examines the acts and purposes of BMBF, it would be very difficult to come to any other conclusion. The finding of the special commissioners that the transaction "had no commercial reality" depends entirely upon an examination of what happened to the purchase price after BMBF paid it to BGE. But these matters do not affect the reality of the expenditure by BMBF and its acquisition of the pipeline for the purposes of its finance leasing trade.

[42] If the lessee chooses to make arrangements, even as a preordained part of the transaction for the sale and lease back,

> *which result in the bulk of the purchase price being irrevocably committed to paying the rent, that is no concern of the lessor. From his point of view, the transaction is exactly the same. No one disputes that BMBF had acquired ownership of the pipeline or that it generated income for BMBF in the course of its trade in the form of rent chargeable to corporation tax. In return it paid £91m. The circularity of payments which so impressed Park J and the special commissioners arose because BMBF, in the ordinary course of its business, borrowed the money to buy the pipeline from Barclays Bank and Barclays happened to be the bank which provided the cash collateralised guarantee to BMBF for the payment of the rent. But these were happenstances. None of these transactions, whether circular or not, were necessary elements in creating the entitlement to the capital allowances*".

31. Henderson J and the Court of Appeal in Tower MCashback LLP1 v Revenue and Customs Commissioners [2008] STC 3366 and [2010] STC 809 considered and applied Mawson in circumstances that were not dissimilar from the transaction in this case. In essence, the taxpayers claimed first year allowances under section 45 of the Capital Allowances Act 2001 in respect of a payment of £27.5 million for software licences. The Commissioners argued that the taxpayer had not incurred expenditure in buying the software licences because the members of the LLPs had borrowed 75% of the funds against security provided by the vendor of the software on uncommercial terms. Henderson J allowed an appeal from the Special Commissioner (the same Judge Nowlan as in this case) by applying the principles in Mawson and MacNiven saying at paragraph 72 that "*What happened to the purchase price of £27.501m after it had been paid by LLP2 to MCashback is immaterial, because s11 of CAA 2001 'requires one to look only at what the taxpayer did' (BMBF in the Court of Appeal per Peter Gibson LJ ...)*". In paragraph 77, Henderson J said this: "*In my judgment there are several difficulties with this analysis [the Special Commissioner's analysis], of which the most important is that the market value of the software is completely irrelevant to the Expenditure Issue, once the contention that the purchase price was paid for something other than the software has been eliminated*" (emphasis added).

32. Moses LJ in the Court of Appeal in MCashback described the question on this issue as follows in paragraphs 58-9:-

> "*[58] Henderson J thought (at [72]) there was no real doubt about the answer to this issue. He concluded that LLP 2 had incurred expenditure of £27.5m on the software for the purposes of its trade (see [81], [82] and [86]). In reaching that conclusion he drew (at [84]) from the decision of the Court of Appeal ([2002] EWCA Civ 1853, [2003] STC 66, 76 TC 446) and from the opinion of the Appellate Committee of the House of Lords in Barclays Mercantile Business Finance Ltd v Mawson [2004] UKHL 51, [2005] STC 1, [2005] 1 AC 684 ('BMBF'), the proposition that the borrowing arrangements were irrelevant, 'so long as the purchaser actually*

incurs expenditure on acquiring the plant for the purposes of his trade.'

[59] This appeal is focussed on whether BMBF stands for that proposition in circumstances where the terms on which the investor members borrowed £22.5m and thereby enabled LLP 2 to pay the full price for the software were plainly not commercial. In BMBF both the Court of Appeal and the House of Lords accepted the commerciality of the terms on which BMBF borrowed the price it paid for the pipeline it purchased. Does the commerciality of that loan in contrast to the terms on which the investor members borrowed 75% of the consideration in the instant appeal, make, as the Revenue contends, all the difference?" (emphasis added).

33. It is worth noting at this point that the Commissioners' contention in this case is not the same as it was in MCashback. What is said here is that the payment of £1,273,866 was not paid for the rights to distributions from the Collection Account and other benefits under the HDA (i.e. for the purpose of the film distribution trade), but rather that it was paid as to £1,064,000 for the right to receive the Annual Advances and the Final Minimum Sum (i.e. as a capital expenditure and not for the purpose of the film distribution trade). If there had been an equivalent position in MCashback, Henderson J at paragraph 77 and Moses LJ at paragraph 58 make clear that that case would have been decided differently. It is also worth noting that I understand that MCashback is shortly to be considered by the Supreme Court.

34. The Court of Appeal recently revisited the Mawson decision in John Astall, Graham Edwards v. HM Revenue and Customs [2009] EWCA Civ 101, where Arden LJ (with whom Keene and Sullivan LJJ agreed) said this at paragraphs 44-45:-

"*[44] Is a purposive interpretation of the relevant provisions possible in this case? In my judgment, there is nothing to indicate that the usual principles of statutory interpretation do not apply and accordingly the real question is how to apply those principles to the circumstances of this case. In my judgment, applying a purposive interpretation involves two distinct steps: first, identifying the purpose of the relevant provision. In doing this, the court should assume that the provision had some purpose and Parliament did not legislate without a purpose. But the purpose must be discernible from the statute: the court must not infer one without a proper foundation for doing so. The second stage is to consider whether the transaction against the actual facts which occurred fulfils the statutory conditions. This does not, as I see it, entitle the court to treat any transaction as having some nature which in law it did not have but it does entitle the court to assess it by reference to reality and not simply to its form.*

[45] I have described the processes involving two distinct steps. I have not overlooked that in Mawson Lord Nicholls held that the court did not need to force its thinking into two separate

compartments (see 32 of his speech set out in para 27 of this judgment). In my judgment, the process is likely to be an iterative one. While one probably starts with determining the purpose of the relevant provision, it may well be necessary to refine that purpose as and when the facts are more closely defined. This may be what Lord Hoffmann had in mind when he spoke in Carreras *(see para 23 of this judgment) of the need to find facts "in the* process *of construction".*"

First legal question: How should the Tribunal approach the application of the proper construction of section 74 of the ICTA 1988 to the facts of the present case?

35. From these authorities and those they review, it seems to me that the following process can be extracted, which is relevant to the exercise upon which the FTT was engaged:-

i) The Tribunal should adopt a purposive construction in considering the meaning of the statutory provision in question and so as to determine the nature of the transaction(s) to which it was intended to apply.

ii) The Tribunal must also determine whether the statute applies to the facts as found, viewing those facts realistically in an unblinkered way.

iii) In undertaking this exercise:-

a) The Tribunal should have regard to whether the statute in question is concerned with commercial concepts, like gains or losses, in which case elements of a transaction without any commercial purpose can often be disregarded, or legal concepts such as payment of debts, in which case an act satisfying the requirement will normally be effective to satisfy the statute whatever its commercial purpose.

b) Where the purpose of a transaction needs to be considered, it is necessary to consider the terms of the statute to ascertain from whose point of view that purpose is to be understood. If, for example, the statute directs attention to the purpose of the lessor, then the purpose of the counterparty lessee will be nothing to the point.

36. In applying this latter principle in this case, I will need to consider the competing submissions of the parties:-

i) Mr Peacock submits that section 74(1)(a) and (f) of ICTA 1988 is directing attention to the purpose of the trader and taxpayer in relation to its own trade and not to the purpose of any third party to whom the disbursements may be made, so that the FTT was wrong to have regard to the actual use made, and intended to be made, of the disbursements by Centre and IML .

ii) Mr Blair Q.C., counsel for the Commissioners, makes two submissions:-

a) First, that on the proper construction of the HDA, there was no provision that explained the character of the payment of £1,064,000, since only payment for "Exploitation Costs" was covered by clause 2.4 of the HDA. For that reason, the FTT was entirely justified in finding as a matter of construction that the payment had been made to secure the Annual Advances and the Final Minimum Sum rather than for any trade purpose.

b) Secondly, even if that were wrong, that the question raised by section 74(1)(a) is whether the money was disbursed for the purposes of the taxpayer's trade, something that was accepted in Mawson. That is a commercial question, like whether a profit was made, rather than a strictly legal one, like whether or not a debt was paid. Accordingly, the FTT was justified in answering it by reference to the commercial realities, namely that the payment of £1,064,000 had been made, not for the purposes of its trade in film distribution, but for the purpose of securing the Annual Advances and the Final Minimum Sum.

37. The FTT's view on the legal questions that I have identified can be divined from the way it approached what it saw as the central issue in the case, namely what Icebreaker paid for when it paid £1,273,866 to Centre (paragraphs 111ff):-

i) The FTT was much moved by what it saw as the glaringly obvious tax motive for the payment of the £1,064,000 (paragraph 136), to the exclusion of the commercial aspects (acknowledged in paragraph 129).

ii) In paragraphs 141-163, the FTT decided that the payment of the £1,064,000 was not made for trading purposes, but was paid to obtain and secure the rights to what the FTT called the "certain payments", namely the Annual Advances and the Final Minimum Sum payable under the HDA.

iii) In paragraph 157, the FTT said this about the effect of Mawson: "*We fail to understand the contention on behalf of the Appellant to the effect that the passages in the House of Lords decision in BMBF v. Mawson [2005] 1 AC 684 to the effect that the payments in that case were made in the course of BMBF's trade, have the slightest bearing on the facts of this case. The decision in the Mawson case was that, once it was concluded that it was a common feature of the transactions undertaken by finance lessors that they periodically leased assets but were funded in one way or another by "lessee-deposits", such funding did not mean that the transactions were outside the course of the trade of the lessor. The decision does not appear to us to mean that on every occasion where a taxpayer asserts that a particular payment is tax deductible as a trading expense, that it is so deductible or that this issue is to be conclusively proved by the wording chosen by the parties by reference* *to which the payment is made. Nothing in our view in the Mawson case casts any doubt on the fairly elementary proposition that for a payment to qualify for relief as a trading deduction it must be made by the payer as an income expense for the purposes of the trade conducted by the payer*".

iv) Three ways were available to reach the decision that the £1,064,000 was not deductible, of which the FTT preferred the first, but did not rule out the other two:-

a) The payment was not an expense of Icebreaker's film distribution trade, because it had nothing to do with that trade, being used for the purposes of securing the receipts from Centre.

b) The documentation mislabelled the payment as in respect of exploitation costs, which it was not, since it was always intended to be used as to £1,064,000 for securing the receipts from Centre.

c) The transaction was a sham, since the documentation was dressed up to achieve a tax benefit in a number of specific ways, some of which bordered on being false and deceptive.

38. In my judgment, it is possible to adopt a purposive construction for section 74 of the ICTA 1988. Its simple object is to allow a deduction from taxable profits for revenue expenses incurred by the taxpayer for the purposes of its trade. This may sound like a statement of the obvious, but it is, nonetheless, I think, clearly the purpose of the section. Though I have not set out each of the sub-sections of section 74(1), they are all directed to a consideration of what is expended in the taxpayer's trade, profession or vocation, even though those words are not always mentioned. Section 74(1)(a) in particular, specifically makes clear that only monies "*wholly and exclusively laid out or expended for the purposes of the trade ...*" are to be deductible. There is no indication in these words that the ultimate use of the monies by the recipient is to be relevant to a determination of the purpose for which they were expended. The focus is all on the taxpayer's own business. In other words, the statute directs attention to a single end of the telescope. The same applies, in my judgment to section 74(1)(f), which provides that "*any capital withdrawn from, or any sum employed or intended to be employed as capital in the trade ...*" is not to be deductible. The focus once again is on the taxpayer's trade, not on the use made of the money by the recipient.

39. This construction does not, of course, answer the question posed by Ribeiro PJ in <u>Collector of Stamp Revenue v. Arrowtown Assets Ltd</u> to be answered in an unblinkered way namely: "*whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically*". That is a question of the application of the law to the facts, to which I shall come in due course. As it seems to me, however, the starting point in this case is the purposive construction of section 74, which points the Tribunal towards a consideration of the use that was made of the disbursement

in question in relation to the taxpayer's trade, and does not require a consideration of how the money was ultimately dealt with by the recipient. That said, the rules I have attempted to extract from <u>Mawson</u> are not prescriptive, and it would be unrealistic and blinkered to consider the transactions in question without understanding their provenance and what they were intended to achieve. Thus far, therefore, I have broadly accepted Mr Peacock's submissions. It should not be forgotten, however, that the FTT accepted them as well (see paragraph 154 set out below).

40. In reality, however, the answer to this legal question does not take the matter very much further, since both sides accept that, once one has understood the purpose of the statute, and the correct approach to the analysis of the transaction in question, the next most important task is the construction of the documents creating the transaction itself. Only after that exercise has been concluded, can one consider whether this is a case in which the Tribunal would be justified in disregarding certain stages of that transaction on the principles in <u>Ramsay</u>, <u>MacNiven</u>, and <u>Mawson</u>.

<u>Second legal question: What is the proper construction of the agreements that the parties have entered into, and in particular the HDA?</u>

41. Underlying the FTT's core finding that the payment of £1,064,000 was not an expense of Icebreaker's film distribution trade was its construction of the HDA. This construction is made clear in numerous paragraphs of the judgment, but not very clearly alluded to in its conclusions at paragraphs 158 to 163. In paragraphs 89-91, 112, 119, 140, 144 148, 150-1, and 154, however, the FTT explained repeatedly the basis for its decision. Perhaps paragraphs 148 and 154 explain the point most clearly:-

> "*148. Addressing the Appellant's contention that the £1,273,866 was all paid for services, we repeat the point made in paragraph 90 above. There was not a simple obligation to pay a fee of a given amount for services. All that Icebreaker 1 was meant to be invoiced for under the HDA was for Exploitation Costs as defined in Appendix III, meaning Exploitation Costs paid or incurred by Centre. In that regard, we seriously question whether the £1,273,866 was strictly due at all under the HDA on 5 April 2004. …*
>
> *154. Counsel for the Appellant also encouraged us to approach this current issue by considering not what Centre did with the payment that it received but by considering the consideration given in return for the payment. We accept that this is right. If Icebreaker 1 had paid the whole amount of £1,273,866 to Centre for services, and Centre had of its own volition applied £1,064,000 in paying down existing bank debt, or indeed in any manner that it chose, those applications of the money would have had no bearing on the tax deductible nature of Icebreaker 1's payments. The only reason why the application of the £1,064,000 is significant in this case is that the banking arrangements made it clear that the placing of the blocked deposit, directly provided out of the £1,064,000 received*

> *from Icebreaker 1, was the very way in which it was envisaged by all parties that Centre would provide and secure the making of the "certain payments", in return for the £1,064,000 received. Thus it is realistic to match the relevant receipt with the very rights that its application produced, and had to produce, and to treat the £1,064,000 as the consideration for those rights. That linkage pays more regard to the irresistible reality than the Appellant's counsel's suggestion, based on Clause 4.1 that the "certain payments" were given in return for the general rights and benefits acquired by Centre*".

42. As Mr Blair concedes, the position would be completely different if clause 2.4 of the HDA had provided that Icebreaker should pay Centre a fee of £1,273,866. But the HDA did not so provide. It provided in clause 2.4 that Centre was to provide Icebreaker with copies of invoices for all "*Exploitation Costs*" as defined in Appendix III, and Icebreaker should pay them within 30 days, and that "*[Icebreaker] undertakes to pay an amount of £[ ] in respect of such Exploitation Costs to Centre immediately on signature hereof*". As I have already recorded, the figure was blank in the HDA, but Icebreaker paid the invoiced sum of £1,273,866.

43. The first question, therefore, is whether the FTT was right to construe the HDA as if the figure in clause 2.4 were blank. In my judgment, the FTT was wrong on this point. There was clear extrinsic evidence from Ms Hamilton, which the FTT did not doubt, that the omission of the agreed figure of £1,273,866 from clause 2.4 was an oversight. Moreover, the figure is specified as being included in clause 2.4 by Appendix II to a Project Proposal sent to Members on 4th April 2004. As Lord Hoffmann said, by way of his first principle of construction in <u>Investors' Compensation Scheme v. West Bromwich Building Society</u> [1998] 1 W.L.R. 816 at page 912: "*Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract*". The parties undoubtedly knew and intended that clause 2.4 was to contain the figure of £1,273,866. It would be unrealistic and inappropriate to construe the HDA as if the parties intended to leave the figure blank when they plainly did not. There is, in my judgment, no need for a rectification claim to remedy this kind of error. The HDA can and should simply be construed as the parties intended it to read.

44. The next question is probably the most important in the appeal, namely whether, as Mr Peacock submits, the HDA is to be construed as meaning that the sum of £1,273,866 was paid for Exploitation Costs and no part of that sum can therefore be taken to have been paid in consideration of the Annual Advances and the Final Minimum Sum. This question requires an analysis of the whole of the HDA. Mr Peacock has drawn attention to a number of clauses that he says support his submission, in particular clauses 2.1, 3, 4.1, 5.5, 5.6 and 9.3. In essence he says that the payment must be taken to have been made in respect of Exploitation Costs as defined, and that the adequacy of the consideration is irrelevant. The parties agreed that Icebreaker should

pay £1,273,866 in respect of the package of Exploitation Costs provided for in the HDA, and that is what it must be taken to have been paid for. No part of the payment can be split out, sub-divided or attributed to the receipts due under clause 4.1.

45. Mr Peacock put the submission slightly differently in his second supplemental skeleton on construction which contained this opening paragraph:-

> "*The proper construction of the HDA is, the Appellant contends, that:*
>
> a. *the Partnership paid to Centre £1.273m in return for Centre's services;*
>
> b. *the Partnership granted to Centre the right to receive 30% of Gross Receipts as a sales commission in relation to its distribution activities;*
>
> c. *the Partnership granted to Centre (i) the right to receive approximately 75% of remaining Gross Receipts (ie a total of 82.5%) (ii) a licence over rights acquired by the Partnership under the Screen Partners Licence Agreement and other rights that might be acquired by the Partnership from time to time (see Clause 3.4 of the Head Distribution Agreement) and (iii) the right to a call option over the entire business and assets of the Partnership (see Clause 4.2 of the Head Distribution Agreement) in return for the Clause 4 Payments;*
>
> d. *no part of the £1.273m was paid by the Partnership for the Clause 4 Payments*".

46. Conversely, Mr Blair argued that the requirement that the sum of £1,273,866 be paid "*in respect of such Exploitation Costs*" meant that any sums paid under clause 2.4 that were used for another purpose could not be regarded as having been paid under this clause. Plainly, the term is defined so as to exclude any payment for what might loosely be called a "non-film" purpose.

47. In my judgment, Mr Peacock's argument that the sum of £1,273,866 was paid only in respect of Centre's film services and Exploitation Costs, and not for any other benefit that Icebreaker was entitled to under the HDA is a strained and artificial construction. He relied primarily on clause 4.1, about which his second supplemental skeleton said this:-

> "*The HDA provides in terms that the consideration the Partnership is providing to Centre for the "certain payments", per clause 4.1 [F/10/149], is "the rights and benefits obtained by Centre under this Agreement". This is, the Appellant contends, a clear agreement between the Partnership and Centre that those "rights and benefits" (as to which, see below) are for the "certain payments" and that, by necessary implication, the £1.273m (or any part of it) was <u>not</u> consideration for the "certain payments".*

48. I do not accept this submission. As it seems to me, clause 4.1 makes it clear that the payment of the Annual Advances and the Final Minimum Sum are paid "*[i]n consideration of the rights and benefits obtained by Centre under [the HDA]*". I do not see why one of the rights and benefits obtained by Centre under the HDA is not the payment to which it is entitled under clause 2.4. Moreover, the fact that clause 2.4 states that the payment is "*in respect of Exploitation Costs*" seems to me to be over-ridden by the obvious provision of clause 4.1, namely that the cash payments to be made by Centre (that are provided in addition to the income streams to be provided by the film distribution activities) are made by Centre in consideration of all the rights and benefits that Centre obtains, including the right to receive the £1,273,866. Of course, the rights and benefits that Centre obtains include also those that Mr Peacock identifies in paragraph 1(b) and 1(c) of the passage from his second supplemental skeleton that I have set out above. But it does not follow, as he goes on to submit that "*no part of the £1.273m was paid by [Icebreaker] for the Clause 4 payments*". Clause 4.1 says the reverse.

49. The drafting is obviously imperfect in that the payment of £1,273,866 is said in clause 2.4 to be in respect of Exploitation Costs when clause 4.1 implies that it is for more than just that. But clause 2.4 does not say that the payment is "only" in respect of Exploitation Costs.

50. Once this is established, it seems to me that none of the arguments advanced by Icebreaker as to the other provisions of the HDA take the matter much further:-

i) The preambles simply refer to Centre's appointment as head distributor and its agreement to make the payments in Appendix II.

ii) The agreement that Centre will make sales reports and keep proper books and accounts of the Exploitation Costs is simply a provision supporting the Exploitation Costs requirements. It tells you nothing about the consideration for the payments that are to be made.

iii) The termination provisions in clause 9 do not support Icebreaker's construction. The fact that the HDA does not provide for the £1,273,866 to be returned to Icebreaker on termination is neutral, because in fact, Icebreaker has the security of the LoC, as envisaged by clause 4.3 of the HDA. In the result, Icebreaker exercised that security when it terminated the HDA, as it must always have been expected to do, so that the Members could repay the loans in the same amount that BoS had made to the Members in the first place.

51. It is at this point that the exercise of construction of the HDA ends, and the process of the analysis of the entire transaction begins. The proper construction of the HDA leaves a question mark over the reason for the payment of parts of the sum of £1,273,866. No breakdown is indicated by the HDA itself, and there is the inherent difference between clauses 2.4 and 4.1 that I have drawn attention to. The FTT filled that gap by looking at the surrounding agreements, banking transactions, and the material factual

findings that I have referred to. The question is whether that was a legitimate process within the principles which I have tried to set out.

52. In reaching the above conclusions, I have not ignored Mr Peacock's three alternative submissions on construction made in reply to the effect that, if the payment in clause 2.4 was not held to be a payment purely for services, there were three possible constructions that he contended for:-

i) That Icebreaker agreed to pay Centre for what Centre had already incurred. This submission was based upon the contention that the FTT decided at paragraph 113 that considerable work had been done prior to the HDA in making deals and preparing for the filming of Young Alexander, although they said wrongly at paragraph 121 that they had no evidence as to how much by way of costs had been incurred by Centre, even though there was some evidence of invoices provided to the Commissioners by Icebreaker's accountants, Cheesmans, showing Centre had incurred obligations of £1,050,000 by 5th April 2004 in paying various third parties in relation to exploitation of Young Alexander.

ii) That Icebreaker agreed to pay Centre for what Centre would incur in the future by way of Exploitation Costs.

iii) That Icebreaker appointed Centre as its head distributor and paid Centre a fee for its services.

53. The third alternative submission is the same as Mr Peacock's main case, and I do not need to deal with it again. But the first two alternative submissions do not, in my view, take the matter any further. Whether clause 2.4 indicates that the payment is in respect of pre-contract or post-contract Exploitation Costs or both does not answer the inconsistency with clause 4.1 to which I have drawn attention. On any basis, as I have indicated above, clause 4.1 must prevail.

<u>Third legal question: In what circumstances would it be appropriate to disregard or re-characterise the stages in the transactions undertaken by the parties in this process?</u>

54. I have already decided that the focus of section 74(1)(a) and (f) is on the taxpayer's trade, and requires a consideration of the use that was made of the disbursement in question in relation to the taxpayer's trade, and does not require a consideration of how the money was ultimately dealt with by the recipient, but that the principles I have extracted from <u>Mawson</u> are not prescriptive.

55. The question that now arises is whether the <u>Ramsay</u> principles could possibly apply to the circumstances of this case. In this regard, Mr Peacock eventually accepted that they could, even though he did not accept that they should. He submitted that the questions of whether the sums of £1,273,688 or £1,064,000 or the other sums in issue were actually expended or disbursed are questions of law. That I accept. He also, I think, eventually accepted that the question of whether these sums were disbursed or expended wholly and exclusively for

the purposes of Icebreaker's trade was a commercial question, and therefore in Lord Hoffmann's second category. That I accept also, as did Mr Blair.

56. Thus, the Tribunal should have regard to the nature of these questions, and should take into account that if the disbursement was made, that disbursement will normally be effective to satisfy the statute whatever its commercial purpose, but that the Tribunal can have regard to the commercial realities in deciding whether the disbursement was made wholly and exclusively for the purposes of Icebreaker's trade.

57. Ultimately, Mr Peacock QC accepted that this did not mean that Ramsay principles could never be applicable in a case of this kind, because it would, at least in theory, be possible for the Tribunal to consider that the expressed purpose of the transaction was so artificial and commercially unreal as to merit being disregarded by the application of the principles in the cases I have sought to summarise. The question of whether these principles should be applied will, however, only arise after the HDA has been construed, and the transaction has been analysed, if it still appears that, unless those principles were applied, the entire payment was indeed disbursed for the purposes of the taxpayer's trade. Ramsay is, therefore, something of a fall-back position for the Commissioners in this case.

The FTT's main findings of fact

58. The FTT's central finding of fact concerned Ms Hamilton's knowledge that £1,064,000 of Icebreaker's initial payment was to be paid into a blocked account at BoS to secure the payments that Centre was to make to Icebreaker under clause 4 of the HDA, and thus the return of the 70% loans that BoS had made to Members to finance their investments in Icebreaker. The FTT said this at paragraphs 104-106, 110 and 127:-

> "*104. ... The critical point is whether we accept the proposition that so far as Icebreaker 1 was concerned, it was paying one sum essentially into one bank account of the recipient, and that it was only as a result of a subsequent different instruction given by Centre, as regards which Icebreaker 1 was ignorant and indifferent, that the £1,064,000 element was paid into the blocked account.*
>
> *105. Without hesitation we conclude that we do not accept this gloss on the facts and the payment mechanics.*
>
> *106. It is first inconceivable that Bank of Scotland was simply waiting to be told how Centre wanted the money dealt with. Bank of Scotland were offering a nil risk deal under which it was clear that a blocked deposit would be placed by Centre, and we consider it inconceivable that the Bank of Scotland's loans would have been advanced, had it not been absolutely agreed that the £1,064,000 element, exactly matching the Bank of Scotland's loans, would come straight back to Bank of Scotland. Whilst thus the evidence given suggested that it was Kent Walwin [the director of Centre] who gave instructions to the bank, we conclude without hesitation that*

that instruction was one that had to be given under the arrangements with Bank of Scotland and both Caroline Hamilton and Kent Walwin knew this. This was clear following the evidence given about the mid-February meeting attended by Caroline Hamilton, Tim Jeynes and Kent Walwin and the Bank of Scotland representatives. It was also absolutely obvious in the light of the Bank of Scotland's internal paper, and the credit clearance given on the basis that the transaction was nil risk, and that the margin was minimised by one bank dealing with all the transactions.

110. We feel that we should specifically address the issue of whether we concluded that Caroline Hamilton's evidence was wholly trust-worthy. We believe that she knew perfectly well that Centre had to place the blocked deposit with Bank of Scotland. We believe that she felt entitled to say that she did not know this because the technical arrangements between Icebreaker 1 and Centre made it theoretically possible that the funds could have been placed with a different bank or (assuming other resources and ability to secure AA- bank guarantees without placing a collateral deposit) Centre could technically have delivered the AA- guarantees in other ways. She knew that that was not going to happen, but theoretically it could have done, and that is why she felt able to say that she did not know with absolute certainty that the blocked deposit would be placed, and indeed had to be placed, with Bank of Scotland. Whilst we believe that this is what she felt, we do conclude that it made that part of her testimony wholly unrealistic.
…

127. ... The fiddling with different banking instructions on 5 April was play-acting, this being obvious, and confirmed by the unrealistic way in which Centre issued a wrong indication of the account to which the funds under its total invoice were intended to be credited, knowing that this is not what it intended, and that the instruction would have to be changed. That can only be explained by the reality that Centre was trying to assist Icebreaker 1 in its attempt to conceal the fact that it knew that the £1,064,000 element simply had to go straight into the blocked Bank of Scotland deposit account".

59. It is accepted by Mr Peacock that Ms Hamilton's knowledge was Icebreaker's knowledge at the time that these transactions were entered into.

60. Mr Peacock made a number of technical submissions aimed at demonstrating that these findings were incompatible with the evidence. I have reviewed the transcripts of Ms Hamilton's evidence and her witness statements, and I am entirely satisfied that these findings were open to the FTT. The FTT made its reasoning clear and it was entitled to disbelieve Ms Hamilton when she said that she was not sure that the £1,064,000 was destined for the blocked deposit account. Mr Peacock's reasoning in relation to finding 6 in his Note on Disputed Findings of Fact is an argumentative attempt to explain why a reasonable tribunal might have reached the opposite conclusion. But that is

not the test that I have to apply. Findings of fact can only be challenged, as the original Grounds of Appeal fairly acknowledged, if they are such that "*no person acting judicially and properly instructed as to the relevant law could have come to*". Such an attack on these findings does not, in my judgment get to first base. I did not hear the oral evidence, and my own view of the evidence may be less important than that of the FTT for that reason, but I am bound to say from reading the transcripts that I have little doubt that I would have reached almost exactly the same conclusions as the FTT on these points. It would be remarkable if Ms Hamilton and Mr Walwin, operating in the same offices, could have entered into a pre-ordained series of some 24 agreements on the same day without each having a clear understanding of the commercial realities of the transaction. Those central commercial realities included the facts that BoS was lending the £1,064,000 to the Members to invest in Icebreaker, which would pay it to Centre, which would place it on a blocked deposit account to secure the Annual Advances and the Final Minimum Sum.

<u>1st issue: Whether the FTT was right to conclude that the sum of £1.064 million, paid to Centre as part of the payment of £1.273 million, was not expended wholly and exclusively for the purposes of Icebreaker's trade? In other words, whether the payment was a trading expense within the meaning of section 74(1)(a) of the ICTA 1988?</u>

61. This is the main issue as to the application of the law to the facts. And I have already set out the main findings of fact made by the FTT in relation to it.

62. As a matter of construction, the HDA does not specify what the £1,273,866 was paid for, because of the uncertainty created by clause 4.1. The transaction as a whole, was however, correctly analysed by the FTT, in my judgment, as demonstrating that the sum £1,064,000 that came from BoS to the Members into Icebreaker, and then on to Centre, was paid for the purpose of securing the Annual Advances and the Final Minimum Sum. That is not a matter of looking at what Centre did with the money, but of looking at what Icebreaker paid the money for. I do not think there can be any realistic challenge to the FTT's finding that Ms Hamilton, as the directing mind and will of Icebreaker, intended that £1,064,000 out of the payment of £1,273,866 was to be used for the purposes I have mentioned. Icebreaker, through Ms Hamilton, never expected or intended that the sum of £1,064,000 would be used for any film distribution trading purpose. Instead, Icebreaker intended and expected that the sum would be used for the purpose of securing the Annual Advances and the Final Minimum Sum.

63. There was much debate in argument about whether or not the FTT was justified in splitting the payment of £1,273,866 into the sums of £1,064,000 and £209,866. That debate seemed to me a rather sterile one. Of course, the FTT could split the payment if it was called upon to analyse the reality of the transaction, having decided that the HDA itself did not clearly define precisely the purpose of the payment of £1,273,866. Splits are regularly made in identifying what sums are paid wholly and exclusively for the purposes of the taxpayer's trade and what sums are not. For example, in <u>Ensign Tankers (Leasing) Limited v. Stokes</u> [1992] 1 A.C. 655, the House of Lords decided that only a part ($3.25 million) of an expenditure of $14 million payment had

in fact been expended towards the production and exploitation of a film. Mr Blair also gave what to me seemed a compelling example of a trader who uses his car partly for trade and partly privately splitting his total petrol expense when claiming a deductible expense within section 74 (1)(a).

64. In these circumstances, it seems to me that analysing the transaction as a whole, and looking at the matter exclusively from Icebreaker's end of the telescope, the payment of the £1,064,000, as part of the global payment of £1,273,866, was not made wholly and exclusively for the purposes of Icebreaker's trade. Indeed, that part of the payment was not made for the film distribution trade at all. It was made so that Icebreaker could be assured that it, and therefore, its Members, would recover the loans that its members had borrowed from BoS, and which had been used to finance precisely that sum by way of investment into Icebreaker. BoS would not have regarded the transaction as such a low risk one (a fact much relied upon by the FTT) if that had not been the case. Moreover, the payment of £1,064,000 was never intended to be used for any film production or distribution purpose. Whatever Centre might have expended on preparing to film Young Alexander or making distribution deals for that or other films prior to the HDA is nothing to this point. The sum of £1,064,000 was expended and disbursed for the sole purpose of investment and security, and not for Icebreaker's film trade properly so regarded.

2nd issue: Whether the payment of £1,064,000 was "*a sum employed or intended to be employed as capital in the trade*" within the meaning of section 74(1)(f) of the ICTA 1988?

65. This issue can be dealt with briefly in the light of my conclusion on issue 1. When Mr Peacock opened his appeal, I suggested to him that the sum of £1,064,000 must have been intended by Icebreaker to be "*employed as capital in the trade*", since it was deposited in the blocked account to secure the payment of the Annual Advances and the Final Minimum Sum. His response was to say that, even if the sum was "*intended to be employed as capital*", it was not so employed in Icebreaker's trade, but only in Centre's trade, and so fell outside section 74(1)(f). Mr Blair did not much question this proposition, and it seems to me to be correct. Icebreaker never intended to employ the sum of £1,064,000 as capital in its own trade, even if it intended Centre to employ it as capital in its trade.

66. I am persuaded that section 74(1)(f) is looking only at the trade, profession or vocation of the taxpayer, and it is necessary for the purposes of section 74(1)(f), as for section 74(1)(a), to consider the question from the point of view of the taxpayer (see the *dictum* of Lord Morton in Morgan v. Tate & Lyle Limited [1955] A.C. 21 at page 39 in relation to the predecessor of section 74(1)(a)). The FTT did not rely on section 74(1)(f) as a ground for holding that the payment of £1,064,000 was not a deductible expense, and I think they were right not to have done so.

3rd issue: Whether the FTT was right to conclude that £174,866 out of the balance of the payment of £1.273 million to Centre was (a) capital expenditure; (b) expended on producing Young Alexander; (c) which was deemed to be revenue expenditure by section 40A of the FA 1992; and (d) allowable only in periods after 5th April 2004?

67. The FTT's reasoning on this issue is primarily at paragraphs 121, and 166-184, and at paragraphs 193-194 as to the accountancy evidence on the point. In the broadest outline, the FTT:-

i) Looked at how Centre had used the balance of £209,866 after the sum of £1,064,000 had gone into the blocked account, and concluded that only £35,000 had been used on film distribution, whilst the balance of £174,866 had been spent on production of the film Young Alexander. The FTT accepted that neither the evidence nor the documentation produced a clear or reliable answer.

ii) Concluded that the £174,866 spent on film production was used to enhance the value of Icebreaker's 10-year licence in respect of Young Alexander, and was, therefore capital expenditure.

iii) Accepted that section 40A of the FA 1992 might apply to make the expenditure incurred on the production of the film an expenditure of a revenue nature, but since no income was received from the film in the accounting period ended on 5th April 2004, it concluded that no revenue deduction was available for that period.

68. Applying the principles that I have sought to summarise above, this seems to me to be the wrong approach. The question is what, on the true construction of the HDA or the transaction as a whole, the expense or disbursement was paid for from Icebreaker's point of view. It is not relevant to look at what Centre did with the money, as the FTT itself accepted at paragraph 154 in a different context.

69. I have already held that looking at the transaction from Icebreaker's point of view, the sum of £1,064,000 was paid the for the purpose of securing the Annual Advances and the Final Minimum Sum. That is because of the express provisions of clause 4.1, which says that the Annual Advances and the Final Minimum Sum are being paid in consideration of the rights and benefits obtained by Centre (which must include the payment under clause 2.4). Clause 4.1 does not, however, provide expressly that any other services rendered by Centre are being provided in consideration of the rights and benefits obtained by Centre under the HDA, though that may be an obvious implication. As it seems to me, however, Icebreaker's intentions and understandings as to the balance of the payment of £1,273,866 were obvious. There is no reason to suppose that it was not paid as clause 2.4 indicates for Exploitation Costs including pre-production, production, post-production and exploitation costs. As Ms Hamilton described it in evidence: "*to pay Centre to run around and organise things and try to get projects off the ground and then also to go out and sell those products once they were ready to be sold*". Centre had already done some of that as even the FTT acknowledged, when it held that the balance of £35,000 paid to Picture Print may have been spent on

distribution, and that Kent Walwin travelled widely before 5th April 2004 to arrange the filming of Young Alexander. Moreover, Ms Hamilton's witness statement had made it clear that work had been done on other projects, and though the FTT suggested that it had never been given any information as to the costs that Centre incurred pre 5th April 2004, a letter from Cheesmans dated 11th November 2005 was in fact put before it indicating that some £700,000 might have been spent in that regard.

70. Against this background, it is necessary to consider whether it was a legitimate exercise for the FTT to seek to break down the sum of £209,866 to ascertain:-

i) what part was spent on production so as to enhance a capital asset, and what part may have been legitimate distribution or other revenue expenses; and

ii) what part was a pre-payment expense for future years.

71. Since I have reached the clear view that the FTT approached the matter from the wrong angle as a matter of law, by looking at what Centre spent rather than what Icebreaker expended, it seems to me that I must approach the matter afresh. Whilst it is true that part of the Exploitation Costs for which Icebreaker was paying under clause 2.4 was intended to be for production of Young Alexander and perhaps other projects, once one leaves aside the £1,064,000, the balance was undoubtedly made by Icebreaker for its film distribution business. Ms Hamilton's evidence to that effect could not seriously be challenged. The payment was, again leaving aside the £1,064,000 element and the disparity between clause 2.4 and 4.1, a fee for Centre's services. It was a fee paid in the year of account. It was not appropriate to look to see whether the consideration for the payment was adequate. It was only if the expense was truly a pre-payment that it could be challenged as deductible expenditure.

72. In my judgment, the fact that Centre may, as a matter of cash-flow have used some or all of the £209,866 on production costs for Young Alexander was not something that Icebreaker can be taken to have known or expected, let alone intended. The £209,866 was a global payment made for the package of Exploitation Costs. The implication from clause 2.4 is that the up-front payment was for past Exploitation Costs, since provision is made in that clause for Icebreaker to discharge future Exploitation Costs.

73. Thus, in my judgment, the FTT was not justified in enquiring into where the £209,866 went. It was, in my judgment, on the face of the HDA a legitimate revenue expense, incurred wholly and exclusively for the purposes of Icebreaker's film distribution trade.

<u>4th issue: Whether the FTT was right to conclude that £35,000 out of the balance of the payment of £1.273 million to Centre was disallowable as a prepayment for film distribution purposes and only deductible in periods after 5th April 2004?</u>

74. It follows from what I have said above that the FTT was not justified in finding that the £35,000 element of the £209,866 balance was a prepayment of

revenue expenses for distribution services. It was part of the fee that Icebreaker paid, and as such was deductible under section 74(1)(a).

5th issue: Whether the FTT was right to conclude that £51,000 out of the payment of £170,000 to IML was disallowable as having been paid for the acquisition of the Icebreaker structure?

75. In paragraphs 196-209, the FTT engages in the exercise of breaking down the payments of £120,000 and £50,000 respectively made to IML under the Administration Agreement and the Advisory Agreement. The FTT aggregated these payments to make £170,000 which was paid as one sum to IML on 5th April 2004. The FTT's reasoning can be summarised as follows:-

i) The Information Memorandum and the two agreements said that the payments were for future services, whilst Ms Hamilton said in evidence they were for past services. This caused a confusion, which made it difficult to give confident answers.

ii) One possible explanation for the reluctance to concede in the drafting that the fees were for past services was that some element of the fees was for delivery of the Icebreaker structure. That was why the FTT imagined that the Commissioners disallowed 30% of the fees amounting to £51,000.

iii) The denial that set up costs were included in the fees was on the basis that the 2 agreements did not provide for them, and they would be disallowed as a capital payment in the hands of IML, not Icebreaker.

iv) But it was realistic to say that some element of the £170,000 should be disallowed as set up costs. There was no reliable basis for doing so, but the FTT adopted the figure the Commissioners' initially adopted.

v) This approach was supported by the facts that:-

a) Ms Hamilton was much more involved than Mr Walwin in setting up the structure, the costs of which must have been considerable; and

b) The fee of £170,000 was said by Ms Hamilton to be a fairly standard one at 13% of the aggregate of £1,273,866 and the SPAM fee of £46,950, but the proper comparison was between £170,000 and £256,816 (taking out the £1,604,000), which indicated that Icebreaker was paying for something more than administration and advice.

vi) The FTT acknowledged that nothing hinged on whether the fees were good value or not.

vii) The fact that the subscriptions reduced from £5 million to £1.5 million between the Information Memorandum in February 2004 and the subscription on 5th April 2004 justified a conclusion that a greater percentage of the fees related to past services.

viii) Though there was no other evidence to support the chosen figure, £90,000 of the £170,000 was attributable to past services, and the balance of £29,000 was a pre-payment.

76. Mr Peacock submits that, in this reasoning, the FTT failed to have regard to the provisions of the Administration Agreement and the Advisory Agreement, but had regard instead to an analysis of what, in the absence of evidence, it supposed that the aggregate fee must have been paid for.

77. It seems to me that this submission is soundly based. Schedule A to the Administration Agreement sets out 14 heads services in respect of which the fee of £120,000 and future payments of £3,040 per annum were paid. The services listed included:-

i) Accounting services;

ii) Preparing project business plans for each proposed acquisition;

iii) Servicing Members' meetings;

iv) Liaising with authorities and submitting returns;

v) Obtaining legal services;

vi) Admitting new Members and communicating with Members;

vii) Opening and maintaining bank accounts and making payments;

viii) Reporting on assets.

78. It is plain that some of these services are to be carried out after the date of the Administration Agreement (e.g. opening bank accounts and making future payments and admitting new Members), whilst others have obviously been carried out in the past (e.g. preparing project business plans for the existing projects), and others would be partly already undertaken and partly to be undertaken in the future (e.g. obtaining legal advice).

79. In my judgment, however, if the parties have entered into an agreement, which is not challenged as being a sham or otherwise vitiated, the Tribunal cannot look behind it to see whether the taxpayer has paid too much (as the FTT correctly acknowledged). Some assistance can be obtained from the approach of the Special Commissioners in Micro Fusion 2004-1 LLP v. Revenue and Customs Commissioners [2008] STC (STD) 952, where they said at paragraph 223: "*In the absence of any evidence to suggest that the level of the Film Consultancy Fee was not arrived at on a commercial basis, having regard to the services to be provided under the January 2005 FCA, we do not consider that this fee can be characterised as payment by Micro Fusion for the structuring costs*".

80. The position is much the same here. There was no evidence of any kind before the FTT that the payment under the Administration Agreement was for the Icebreaker structure, nor that the services set out in schedule A to the Administration Agreement were not genuinely those that had been and would be provided, for which Icebreaker was paying an arm's length fee both at the time of the agreements and annually thereafter. No case was advanced that the division of the up-front and annual payments was a pretence, or had been deliberately front-loaded to evade tax.

81. The Advisory Agreement was, however, in a different form. It provided by paragraph 1 that IML "*will provide [Icebreaker] with advisory services relating to the acquisition, licensing and exploitation of rights in moving images*" and that "*[w]e will advise you on all of the areas of business set out in the LLP Agreement of today's date, including the negotiation and entry into agreements with sub-contractors and other third parties for the exploitation of rights in moving images*". Clause 3 says that the term shall be until 5th April 2014 (i.e. 10 years), and the fee is "*one stage payment ... in the sum of £50,000 on the date hereof in consideration for the provision of the services set out in paragraph 1 above*".

82. As it seems to me, the Advisory Agreement is expressed to be entirely in respect of future advice. As such, whilst it is a revenue expense, it is one in respect of services to be rendered in the following 10 years, and cannot be deductible in the year of account in which payment was made ending 5th April 2004.

83. My conclusion, therefore, is that the FTT was wrong in law to look behind the Administration Agreement and the Advisory Agreement and find, without evidence, that £51,000 was paid for the Icebreaker structure and was disallowable as a capital expense. It should have simply construed the two agreements as I have sought to do above, and reached the conclusions that the £120,000 payable under the Administration Agreement was a disbursement made wholly and exclusively for the purposes of Icebreaker's trade in the year of account, but that the £50,000 paid under the Advisory Agreement was a revenue expense made by way of pre-payment for the following 10 years, and was therefore disallowable.

<u>6th issue: Whether the FTT was right to conclude that £29,000 out of the payment of £170,000 to IML was disallowable as a prepayment and only deductible in periods after 5th April 2004?</u>

84. For reasons I have already explained the exercise on which the FTT embarked was an inappropriate one. There was anyway no evidence on which it could properly have concluded that the sum of £29,000 was a disallowable pre-payment. The result is not, however, that much different in the way that I have determined the matter.

7th issue: Were the transfers from Icebreaker to Centre and IML accounted for in Icebreaker's profit and loss account for the period ended 5th April 2004 in accordance with generally accepted accounting practice as required by section 42(1) of the FA 1998?

85. This issue was raised by the Commissioners as a fall-back position, in case it lost on issues 1 and 2. Since it has succeeded on issue 1, the accountancy evidence on this point is no longer relevant. The point that was made was that section 42(1) of the FA 1998 requires taxpayers' accounts to be drawn in accordance with GAAP, and that the return that Icebreaker was bound to obtain by way of the Annual Advances and the Final Minimum Sum should have been accounted for as an asset worth £1,064,000, thus reducing the claimed loss by that sum. The issue revolved around the proper method of accounting for put and call options under FRS 5. It was, however, agreed between the parties that if I came to the conclusion that the accountancy evidence on this point was determinative, I should call for further more detailed argument. In the result, I have not so concluded, and that further argument can, therefore, be dispensed with.

Conclusions

86. In the above circumstances, I have reached the conclusion that the appeal from the Decision must be allowed in part. The expenditure of £1,064,000 should be disallowed, but for rather different reasons from those adopted by the FTT. In the circumstances, I shall set aside the FTT's Decision and re-make the decision as follows:-

i) Dis-allowing the deduction of the sum of £1,064,000 as not being a disbursement or expense wholly and exclusively expended for the purposes of Icebreaker's trade within the meaning of section 74(1)(a).

ii) Allowing the entirety of the deduction of £209,866 under section 74(1)(a) as a disbursement or expense wholly and exclusively expended for the purposes of Icebreaker's trade.

iii) Allowing the deduction of £120,000 paid under the Administration Agreement also under section 74(1)(a) as a disbursement or expense wholly and exclusively expended for the purposes of Icebreaker's trade.

iv) Dis-allowing the deduction of £50,000 paid under the Advisory Agreement as a pre-payment of allowable expenses to be incurred in future tax years.

87. I will hear counsel on the consequences of the decisions that I have indicated, to be fixed in the usual way within one month of this decision.

THE HON MR JUSTICE VOS

RELEASE DATE: Wednesday 26th January 2011