[2013] UKUT 0639 (TCC)
Appeal number FTC/57/2012

Carrying on a trade – Edwards v Bairstow [1956] AC 14 – R(Jones) v First-tier Tribunal [2013] UKSC 19 – business involving the exploitation of films with a view to profit – section 609 ITTOIA

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

ECLIPSE FILM PARTNERS (No. 35) LLP **Appellant**

- and -

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

TRIBUNAL: The Honourable Mr Justice Sales

Sitting in public at The Royal Courts of Justice, Rolls Building on 22.11.13 – 27.11.13

Graham Aaronson QC & Jolyon Maugham, instructed by Freshfields Bruckhaus Deringer LLP for the Appellant

Malcolm Gammie QC, Rajesh Pillai & Rebecca Murray, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

© CROWN COPYRIGHT 2013

DECISION

5 *Introduction*

1. This is an appeal from a decision of the First-tier Tribunal (Tax Chamber) (Edward Sadler and John Walters QC - "the FTT"), [2012] UKFTT 270 TC, in which it dismissed an appeal by the Appellant ("Eclipse 35") against a Notice of Completion 10 of Enquiry dated 15 May 2009 ("the closure notice") issued by the Respondents ("HMRC"). Save as otherwise indicated, paragraph references in square brackets in this judgment are to the paragraphs in the FTT's decision.

2. Eclipse 35 is a limited liability partnership. The closure notice referred to 15 Eclipse 35's tax return for the period ended 5 April 2007 and included the determination that Eclipse 35 "carried on neither a trade nor a business and there was no trade or business carried on with a view to profit." It was this determination which Eclipse 35 appeals against. It does so on the ground that it maintains that in the relevant period it carried on a trade with a view to profit.

20

3. The FTT held ([20] and [410]-[413]) that Eclipse 35 did not carry on a trade in the relevant period. It is against this ruling that Eclipse 35 appeals to the Upper Tribunal.

25 4. The FTT also held ([20] and [414]) that the activities of Eclipse 35 in the relevant period amounted to "a business involving the exploitation of films which does not amount to a trade", that is, a "non-trade business" within section 609 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"). The FTT was of the view that Eclipse 35's activities, if they had amounted to trading, were carried on with 30 a view to profit ([21] and [415]). There has been no appeal by either party against these parts of the FTT's decision.

5. As emerged at the hearing before the Upper Tribunal, the logic of the FTT's conclusions at [414] and [415] is that, even taking account of its ruling that Eclipse 35 35 did not carry on a trade, it should have allowed the appeal against the closure notice on the narrow basis that in the relevant period Eclipse 35 carried on a business with a view to profit. Both parties agree that if Eclipse 35's appeal to the Upper Tribunal on the issue of carrying on a trade fails, the Upper Tribunal should nonetheless allow the appeal on the limited ground that HMRC erred in their determination in the closure 40 notice that Eclipse 35 did not carry on a business with a view to profit.

6. In my judgment, that is the proper outcome of this appeal. For reasons which I set out below, I dismiss Eclipse 35's appeal on the trading issue. However, I allow the appeal against the closure notice and the FTT's decision on the narrow ground that in 45 the relevant period Eclipse 35 carried on a business with a view to profit.

7. The reason the appeal to the FTT focused solely on the trading issue lies in the statutory context. It was only if Eclipse 35 carried on a trade that important tax advantages would arise for the members of the Eclipse 35 limited liability partnership.

8. Being a limited liability partnership, Eclipse 35 is a body corporate and as such would ordinarily be subject to tax under the corporate tax regime ([23]-[24]). However, in certain circumstances the tax code provides for there to be "transparency" in relation to a limited liability partnership, so that its activities are treated for tax purposes as having been carried on in partnership by its members ([24]-[27]). In the case of individuals who are members, as is relevant here, section 863 ITTOIA provides for transparency and attribution of the activities of a limited liability partnership to its members for income tax purposes "if a limited liability partnership carries on a trade, profession or business with a view to profit" (section 863(1)).

9. Where transparency operates, the profits of a limited liability partnership, as attributed to its members, form part of the income of its members and are subject to income tax under section 5 ITTOIA ([26]). However, as an aspect of treating such profits as income of the members, various provisions allowing for certain tax reliefs in respect of the members also come into play ([27]-[31]). The present case concerns the availability to the members of Eclipse 35 of tax relief in respect of interest paid on borrowing by them for the purposes of contributing capital to Eclipse 35. The relevant provisions are sections 353 and 362 of the Income and Corporation Taxes Act 1988 ("ICTA 1988").

10. In particular, section 362(1) TA IC1988 provides in relevant part as follows:

> "Subject to sections 363 to 365, interest is eligible for relief under section 353 if it is interest on a loan to an individual to defray money applied –
> …
> (b) in contributing money to a partnership by way of capital or premium, or in advancing money to a partnership, where the money contributed or advanced is used wholly for the purposes of the trade, profession or vocation carried on by the partnership …"

11. It thus emerges that in order for a member to claim tax relief in relation to interest due in respect of borrowings made to contribute to the capital of Eclipse 35, it has to be shown that Eclipse 35 was carrying on a trade and that the borrowed money used to contribute to Eclipse 35 is used wholly for the purposes of that trade ([31]) (there is no suggestion that Eclipse 35 carried on a profession or vocation). The focus in section 362(1)(b) ICTA 1988 on whether Eclipse 35 carried on a trade is narrower than the focus in section 863(1) ITTOIA whether it carried on a trade *or business* with a view to profit.

12. In the present case, although the formal question regarding the lawfulness of HMRC's closure notice turns on the tax affairs of Eclipse 35 itself and application of section 863(1) ITTOIA (which explains the form of the closure notice, as set out above), the reality is that the parties were actually primarily interested in the ability

(or otherwise) of the members of Eclipse 35 to claim tax relief in respect of the interest on certain borrowings they made. That issue turns on whether Eclipse was carrying on a trade (see section 362(1)(b) ICTA 1988). Since the same question arose as part of the determination set out in the closure notice and under section 863(1) ITTOIA, the parties used the appeal against the closure notice as the vehicle to test HMRC's determination on the trading issue, with Eclipse 35 in effect representing the interests of its members. Likewise, on the appeal to the Upper Tribunal, the parties' focus has been on the lawfulness of the FTT's decision on the trading issue.

13. Finally, by way of introduction, mention should be made of a potential additional ground for upholding the FTT's decision which HMRC introduced by way of a Respondent's Notice. This was presented in conjunction with an application by HMRC to adduce further evidence which had not been available at the hearing before the FTT, in the form of certain agreements referred to in various contractual documents as "the Prior Agreements" (which were agreements between entities in the Disney group of companies, all governed by the law of California) and evidence from an expert on the law of California, Mr Marks. At the outset of the hearing, in exercise of the Upper Tribunal's case management discretion and applying the principles in *Ladd v Marshall* [1954] 1 WLR 1489, I admitted the Prior Agreements and the main parts of the expert report of Mr Marks in evidence. Mr Marks was cross-examined by Mr Aaronson QC, for Eclipse 35, in the course of the hearing.

14. By their Respondent's Notice, HMRC contend that the effect of the Prior Agreements, which are now available, has been significantly mischaracterised by the FTT (relying on the more limited evidence about them which was available at the time of the FTT hearing) and that, when their true effect is understood, this is material which provides further grounds to conclude that Eclipse 35 had not been carrying on activity which could properly be called trading activity in the relevant period. For reasons which I give below, I conclude that although the FTT could now be seen to have mischaracterised the contractual effect of the Prior Agreements, nonetheless that mischaracterisation does not have a significant impact on the analysis of the question whether Eclipse 35 was trading or not. Accordingly, had HMRC lost in the Upper Tribunal on that issue (contrary to my conclusion that the FTT's decision on that issue should stand), I would not have upheld the FTT's decision on the trading issue on the basis of the new evidence adduced by HMRC.

Factual Background

15. In its lengthy and careful judgment, the FTT reviewed the factual position in great detail. For the purposes of this appeal, it is unnecessary to rehearse the factual background in the same detail. For the full detail, the reader is referred to the FTT's decision itself.

16. The case concerns arrangements in relation to the distribution of two films produced by the Disney group of companies, "Enchanted" and "Underdog". At the outset of the decision, at [7] and [8], the FTT provides a helpful summary of the relevant parties and transactions in issue, as follows:

5

"7. ... Eclipse 35 and its members entered into a complex set of transactions with members of the Disney group of companies in relation to the acquisition, distribution and marketing of film rights and with members of the Barclays group of companies in relation to the financing of the acquisition of such film rights. It is helpful at the outset to identify the principal parties involved and to give a summary of the principal transactions.

The principal parties

Eclipse Film Partners No. 35 LLP ("Eclipse 35")	A UK limited liability partnership and the Appellant in this appeal
The members of Eclipse 35 ("the Members")	The 289 persons (individuals and companies) who were the members (i.e. partners) of Eclipse 35 on 3 April 2007 and who had contributed capital to Eclipse 35, most of which capital they funded by monies borrowed from Eagle
Barclays Bank plc ("Barclays")	The issuer of a letter of credit securing the payment by the Distributor of certain sums due to Eclipse 35 under the film distribution arrangements. Also the funder of Eagle
Eagle Financial and Leasing Services (UK) Limited ("Eagle")	A wholly-owned subsidiary of Barclays, which made loans to the Members and received, as security for such loans, the benefit of the letter of credit issued by Barclays
Walt Disney Pictures ("Disney")	A US corporation and a member of The Walt Disney Company group of companies which on 3 April 2007 as grantor entered into a licensing agreement with Eclipse 35 (as licensee) in relation to two films produced by the Disney group
WDPT Distribution VIII LLC ("the Distributor")	A US corporation and a member of The Walt Disney Company group of companies which on 3 April 2007 as licensee entered into a distribution agreement with Eclipse 35 (as licensor) in relation to the distribution of the two films the subject of the licensing agreement between Disney and Eclipse 35, and which procured the issue by Barclays of the letter of credit to secure its payment obligations to Eclipse 35 under the distribution agreement
WDMSP Limited ("WDMSP Ltd")	A UK company which is a member of The Walt Disney Company group of companies and which

	entered into an agreement with Eclipse 35 for the provision of marketing and advisory services in relation to the two films for which Eclipse 35 held a licence
Future Films Limited (“Future”)	A UK company with a business of arranging financing of films and also the production and distribution of films, which for a consultancy fee promoted Eclipse 35 and provided film advisory and other services to Eclipse 35

A summary of the transactions

8. The following will suffice as an introductory summary of the transactions involving Eclipse 35 and the Members which are relevant for the purposes of
5 this appeal:

(1) Eclipse 35 is a limited liability partnership incorporated on 3 October 2006. Its partnership deed was entered into on 13 March 2007, and states that Eclipse 35 will carry on the business of the production, distribution, financing and exploitation of films, including the licensing
10 and exploitation of film rights acquired from Disney.

(2) On 3 April 2007 Eclipse 35 had 289 Members (and two Designated Members). All or most of the Members are individuals liable to UK income tax, and for whom, if the relevant conditions are met, tax relief will be available for interest paid on borrowed monies applied by them by
15 way of contribution to the partnership capital of Eclipse 35.

(3) On 3 April 2007 Eclipse 35 obtained a licence from Disney, for a period of twenty years, of specified rights to exploit and distribute two films produced by Disney and entitled respectively “Enchanted” and “Underdog” (together, “the Films”) (“the Licensing Agreement”). As
20 consideration for such licence Eclipse 35 paid a licence fee (in aggregate, for the Films, of approximately £503 million) and also a variable royalty. The licence fee was divided into twenty annual instalments, and on 3 April 2007 Eclipse 35 paid Disney the aggregate amount as an advance against its obligations to pay the annual instalments. [It is relevant to add
25 here that the Rights granted under the Licensing Agreement were stated to be “subject to the Prior Agreements”].

(4) Also on 3 April 2007 Eclipse 35 entered into an agreement with the Distributor by way of sub-licence of the exploitation and distribution rights in the Films for a term of twenty years (“the Distribution
30 Agreement”). The Distributor is required to exploit the Films and ensure their distribution. As consideration the Distributor is obliged to pay Eclipse 35 specified sums annually over twenty years (referred to as Annual Ordinary Distributions, and totalling approximately £1,022 million), variable distributions (the variable royalty which Eclipse 35 is

due to pay to Disney under the Licensing Agreement matches these variable distributions), and "contingent receipts", being amounts payable under a complex formulation if gross receipts from the exploitation of the Films exceed a certain threshold after payment of prior charges ("Contingent Receipts"). [Again. it is relevant to add here that the rights granted under the Distribution Agreement were also stated to be "subject to the Prior Agreements"].

(5) As security for its obligations to pay the Annual Ordinary Distributions to Eclipse 35, the Distributor provided a letter of credit issued by Barclays, payments under the letter of credit directly corresponding to the Annual Ordinary Distribution payments ("the Letter of Credit"). Issuance of the Letter of Credit relieved the Distributor from its payment obligations to Eclipse 35 (so that, in effect, Eclipse 35 substituted Barclays risk for Distributor risk). The Distributor deposited the sum of approximately £497 million with Barclays and charged that sum to Barclays to secure the issue of the Letter of Credit and to fund Barclays in respect of its obligations under the Letter of Credit.

(6) Eclipse 35 was financed by its Members, who on 3 April 2007 contributed capital to the partnership in an aggregate amount of £840 million (thereby providing Eclipse 35 with the capital to pay the licence advance to Disney and to make the other payments which Eclipse 35 undertook on that day). Each Member chose to finance his capital contributions in part from his own resources but substantially (as to approximately 94 per cent) by undertaking borrowings for that purpose, borrowing under a twenty year facility made available to him by Eagle. In aggregate the Members borrowed approximately £790 million from Eagle and contributed the balance of capital (approximately £50 million) from their own resources.

(7) The terms of the Eagle facility provided for a fixed rate of interest, and required the borrowing Member to pre-pay the interest accruing over the first ten years of the borrowing (a payment in aggregate of approximately £293 million, which the Members paid on 3 April 2007). The borrowing by Members from Eagle was secured by a charge given by Eclipse 35 over the Letter of Credit.

(8) On 3 April 2007, following the contribution by Members of their capital, and pursuant to a provision to that effect in the partnership agreement, Eclipse 35 made a payment (expressed to be by way of loan on account of anticipated profits) to the Members of an aggregate amount of approximately £293 million (enabling Members to make the prepayment of interest to Eagle).

(9) The payments made between the parties on 3 April 2007, and the payments due over the twenty year term of the transactions, were in accordance with cash flow statements produced from financial models devised by Future and used in the promotion of the Eclipse 35 partnership to potential investors.

(10) On 9 February 2007 Eclipse 35 entered into an agreement with WDMSP Ltd ("the Marketing Services Agreement") whereby WDMSP Ltd agreed, for a fixed fee plus a share of any Contingent Receipts from the Films, to act as Eclipse 35's agent in developing marketing and release plans for the Films and to provide to Eclipse 35 services relating to the supervision of the Distributor in its implementation of such plans. Under the Distribution Agreement the Distributor agreed to implement the marketing and release plans prepared by WDMSP Ltd.

(11) On 3 October 2006 Eclipse 35 entered into a consultancy agreement with Future, whereby Future was appointed to provide to Eclipse 35 a number of services relating to the selection, acquisition and exploitation of films and film rights and the management of such matters on behalf of Eclipse 35. For these services Eclipse 35 agreed to pay Future a fee based on a percentage of the partnership capital raised by Eclipse 35 and of the net proceeds from the exploitation of any film rights licensed by Eclipse 35. Pursuant to this agreement Eclipse 35 paid Future a fee of approximately £44 million on 3 April 2007."

17. It is helpful to distil the essential elements of the transactions, as follows. On a single day, 3 April 2007:

(a) Eclipse 35 entered into the Licensing Agreement with Disney under which it was granted specified rights to exploit the Films for a period of 20 years;

(b) As consideration for those rights, Eclipse 35 agreed to pay a licence fee to Disney of about £503 million and a variable royalty. The licence fee was divided into 20 annual investments, but Eclipse 35 immediately paid Disney £503 million as an "Advance" against those annual instalments;

(c) Simultaneously, Eclipse 35 entered into the Distribution Agreement with the Distributor. Under the Distribution Agreement, Eclipse 35 granted the Distributor the same specified rights to exploit the Films for the same period of 20 years. The Distributor was another Disney group entity, and under the terms of the Distribution Agreement its place could be taken by other Disney companies. In the event, Disney's usual distribution vehicles, various Buena Vista companies, conducted the distribution of the Films.

(d) In consideration for the rights granted to it under the Distribution Agreement, the Distributor agreed to pay Eclipse 35:

(i) specified sums annually over 20 years, referred to as Annual Ordinary Distributions ("AODs"). Over the entirety of the period, the total AODs to be paid would amount to about £1,022 million;

(ii) variable distributions (which precisely matched the variable royalty which Eclipse 35 had agreed to pay Disney under the Licensing Agreement); and

(iii) "Contingent Receipts", calculated according to a complicated formula set out in the agreement, representing a special profit share element if the Films did particularly well in generating income.

(e) On the same day, the Distributor deposited £497 million with Barclays, which issued a Letter of Credit in favour of Eclipse 35 as security for the Distributor's obligations to pay the AODs to Eclipse 35. Payments under the Letter of Credit directly corresponded to the AODs and issuance of the Letter of Credit relieved the Distributor of any further payment obligations to Eclipse 35. The effect of this was that the credit risk to Eclipse 35 of non-payment of the AODs by the Distributor was substituted by the credit risk of Barclays.

18. Also on 3 April 2007, the Members entered into or arranged for the making of a series of financial transactions, as follows:

(a) Barclays funded its subsidiary Eagle by lending it £790 million;

(b) Eagle lent the Members £790 million;

(c) The Members contributed the £790 million plus £50 million from their own cash resources to Eclipse 35;

(d) Payments were made by Eclipse 35 as follows:

(i) Eclipse 35 paid £44 million to Future as its fee due under a Partnership Consultancy Agreement between them;

(ii) £293 million was returned by Eclipse 35 to Members as loans against future income profits due under the Partnership Agreement under which Eclipse 35 was established;

(iii) Eclipse 35 paid £503 million to Disney (see para. [17(b)] above);

(e) Members used the £293 million returned to them by Eclipse 35 to prepay 10 years' interest on the Eagle loan. It was particularly in relation to this payment of interest that the Members hoped to be able to claim tax relief under section 362(1)(b) ICTA 1988;

(f) Eagle used the £293 million to prepay 10 years' interest on the loan from Barclays; and

(g) Barclays credited the £293 million received from Eagle to the Distributor's account with Barclays, expressed to be on account of the interest accruing on the deposit that the Distributor had made with Barclays to secure the Letter of Credit ([150]). The sums which Barclays treated as being on

deposit for the Distributor, with interest on them, covered Barclays' liability under the Letter of Credit to pay the AODs of £1,022 million over the 20 year life of the Distribution Agreement (para. [17(d) and (e)] above).

19. On the same day, the following security arrangements in favour of Eagle were put in place:

(a) Eclipse 35 assigned the benefit of the Letter of Credit to Eagle;

(b) Eclipse 35 assigned the Eclipse 35 loan account to Eagle;

(c) Members of Eclipse 35 assigned their Eclipse 35 partnership shares to Eagle;

(d) Rights in respect of the AODs were assigned to Eagle ([157], [199]); and

(e) Eclipse 35 assigned the right to a Termination Amount under the Licensing Agreement to Eagle.

20. All these licensing, banking and security transactions and arrangements were implemented on 3 April 2007, which was designated "Financial Close", and funds moved accordingly. The net effect was that the Members introduced £50 million of their own money; Future was paid £44 million as a consultancy fee; Disney was paid £6 million as Studio Benefit; but otherwise the money originated in and remained in the Barclays group ([186]).

21. In terms of the future income which Eclipse 35 might expect to receive from the transactions:

(i) the AODs of £1,022 million to be paid under the Distribution Agreement over 20 years were pre-arranged sums calculated by reference to the notional interest payable by Barclays in respect of the sums deposited with it ([197]-[198] – "… the Members were assured that, in cash terms, and assuming no default, all payments of interest and repayments of capital would be made to Eagle, and the profile of AOD payments over the twenty year term was fixed to give this result" - and [401]);

(ii) the variable distributions due to Eclipse 35 under the Distribution Agreement matched and cancelled out the variable royalty due from Eclipse 35 to Disney under the Licensing Agreement;

(iii) this left only the Contingent Receipts as income which depended on the commercial success or otherwise of the Films upon distribution.

23. In addition to these transactions, on 9 February 2007 Eclipse entered into the Marketing Services Agreement with WDMSP Ltd, under which WDMSP Ltd purportedly agreed to act as Eclipse 35's agent in developing marketing and release

plans for the Films and to provide to Eclipse 35 services relating to the supervision of the Distributor in its implementation of those plans ([321]-[358]). The marketing and release plans were to be drawn up by Screen Capital International Corporation ("SCI") and Mr Stuart Salter, as consultants for Eclipse 35, together with individuals identified as "Designees", who were employees of Buena Vista companies in the Disney group. Mr David Molner is the managing director of SCI.

24. There was an issue before the FTT whether WDMSP Ltd really was an agent of Eclipse 35 under the Marketing Services Agreement, having regard to all the terms of that agreement. HMRC submitted that it was not ([333]-[334]), and the FTT upheld that submission ([343]-[344]).

25. There was also an issue before the FTT as to the extent of the contribution made by Eclipse 35 via SCI and Mr Salter to the initial marketing and release plans and the subsequent implementation of those plans. HMRC argued that, in substance, the whole of the marketing and distribution activity was carried out by the Disney group, by the Distributor, using the Buena Vista companies in accordance with normal Disney group practice ([331]-[340]). The FTT accepted the thrust of this submission ([345]-[358]).

26. The FTT examined the questions (see [254]) (a) whether Eclipse 35 acquired any rights from Disney having regard to the effect of the Licensing Agreement and the Distribution Agreement and, if so, whether those rights had value and whether Eclipse was engaged in the distribution of those rights; (b) whether Eclipse 35 was engaged in the directing and supervision of the marketing and release of the Films; and (c) what impact the borrowing, deposit and security arrangements had on the question whether Eclipse 35 was carrying on a trade.

27. As to (a) (the value of the rights acquired), HMRC argued that a proper construction of the Licensing Agreement and the Distribution Agreement showed that Eclipse 35 was not entitled to receive any rights (or any meaningful rights), and that such rights as it acquired from Disney were immediately returned to the Disney group; and further, that the nature and value of such rights were significantly depreciated by the Prior Agreements, subject to which they were granted ([256]). HMRC's case was that, in return for the Studio Benefit, Disney agreed to provide Eclipse 35 (and through it, the Members) with the package of contractual rights set out in the various agreements, plus a right to receive Contingent Receipts, "but on terms which ensured it kept full control of the rights in the Films, which it proceeded to exploit just as it would have done absent any involvement of Eclipse 35" ([256]). The arguments before the FTT principally focused ([257]) on the terms of the Licensing Agreement and the Distribution Agreement ([258]-[263]); the effect of the Prior Agreements ([264]-[273]); the value and valuation of the Rights ([274]-[281]); and the significance of the Contingent Receipts ([282]-[288]).

28. The FTT found that Eclipse 35 acquired genuine and valuable rights under the Licensing Agreement and that the Licence Fees "broadly represented that value when seen in the overall context of a commercially negotiated transaction" ([289]-[292]). It

concluded "on balance" that, on the evidence available to the FTT about the Prior Agreements (i.e. the evidence of Mr Molner, which changed in the course of the hearing - the Prior Agreements themselves were not available to the FTT), "the Prior Agreements, and the grant of the licence of the Rights in the Licensing Agreement subject to the Prior Agreements, did not render the licensed Rights valueless, or materially depreciate their value" ([293]-[300]). It noted that a more valid point was that Eclipse 35 was prepared to take a licence of the Rights subject to the Prior Agreements without obtaining much comfort from Disney as to their significance for the Rights granted, which indicated a degree of indifference on the part of Eclipse 35 ([301]). The FTT found that the Distribution Agreement was also a valid and genuine agreement which, like the Licensing Agreement, should be given effect according to its own terms ([302]-[307]). Overall, the rights acquired by Eclipse 35 had significant value, and such value was taken into account by it in determining the consideration which it gave for the Rights ([315]-[320]).

29. In relation to Contingent Receipts payable under the Distribution Agreement, Eclipse 35 argued that its entitlement to such payments was further evidence of the reality and value of the Rights it obtained by the Licensing Agreement. HMRC, on the other hand, argued that the entitlement to Contingent Receipts was not necessarily dependent upon the Rights, and in any event was an expectation so speculative and remote as to be of little, if any, value ([308]). The FTT found that the entitlement to Contingent Receipts represented a genuine benefit flowing from holding the Rights ([309]). However, it found that "The prospect of earning Contingent Receipts, although a possibility, is too remote to qualify as a basis or justification for entering upon a trading venture on any commercial level, which Mr Molner readily acknowledged" ([310]-[312]); it also said that "at the time the transaction was entered into a payment of Contingent Receipts, although speculative, was reasonably anticipated to be possible in the course of the twenty year term of the licence" ([320]). An important reason why a payment of Contingent Receipts was so speculative was that the two Films were, as it was described, "cross-collateralised", so that it was their combined performance which was relevant to the calculation of the super-profits which were to be the basis of any Contingent Receipts; and it was anticipated that "Underdog" might well perform less well than "Enchanted": [95]-[102].

30. As to (b) (involvement of Eclipse 35 in the marketing arrangements) ([321]-[358]), the FTT noted that an initial Marketing and Release Plan relating to all the media in which the Films were to be marketed was devised before release, which SCI and Mr Salter then used as a point of reference to monitor the Distributor's performance ([326]) and also noted the dispute between the parties about whether WDMSP Ltd was truly an agent for Eclipse 35 under the Marketing Services Agreement (see para. [24] above). The FTT held that WDMSP Ltd was not, on proper construction of the Marketing Services Agreement, an agent of Eclipse 35 ([343]-[344]); but it did not consider that this was, in itself, fatal to Eclipse 35's overall case, since Eclipse 35 could still seek to argue that it was in substance engaged in providing the marketing services in question, in that it had arranged for them to be undertaken for its own benefit ([345]). However, the FTT found that, looking at the substance of the matter, the Designees, as employees of Buena Vista companies, simply performed

their usual duties as such when preparing marketing and release plans and there was no additional element of marketing service provided by Eclipse 35, Mr Salter, SCI or WDMSP Ltd ([346]-[358]). At [358], the FTT concluded as follows:

> "Whilst we can conclude that, through WDMSP Ltd, Eclipse 35 monitored the activities of the Distributor with regard to the marketing and release of the Films, and was kept fully aware of the activities in that regard which the Distributor undertook and of the financial performance of the Films, we are unable to conclude that Eclipse 35 had a part, or at least a meaningful part, in directing and supervising the marketing and release of the Films by the Distributor."

31. As to (c) (borrowing, deposit and security arrangements), the FTT concluded that the inter-connected nature of the arrangements and the fact that they had as part of their objective the obtaining of tax relief by Members on the interest paid did not mean that the arrangements should be considered as a composite whole, nor that the arrangements did not have the commercial purpose or effect on their face which they purport to have ([359]-[367]).

The FTT's Legal Analysis and Conclusions

32. At [370]-[373] the FTT set out four propositions which were common ground between the parties, as follows:

> "370. First, that the task of the Tribunal is to form a view on whether what Eclipse 35 actually did amounted to a trade or adventure or concern in the nature of trade. This emerges from various authorities, for example per Lord Morris of Borth-y-Gest in *Ransom v Higgs* 50 TC 1 at 84 – "it seems to me to be essential to discover and to examine what exactly it was that the person did".
>
> 371. Secondly, that our examination of what Eclipse 35 actually did must view the matter in the context of transactions taken as a whole, or, as Lord Templeman put it in *Ensign Tankers (Leasing) Ltd. v Stokes* [1992] STC 226 at 235/6, we must ascertain the fiscal consequences corresponding to the legal consequences of the scheme documents read and construed as a whole. We would only add that all the evidence of what Eclipse 35 actually did, which includes but is not limited to the licensing, distribution and marketing services documents, is clearly relevant.
>
> 372. Thirdly, that a tax avoidance motive (or scheme) incorporated within what is otherwise a trading transaction does not "de-nature" the transaction so that it is for that reason no longer a trading transaction (see, for example, per Lord Jauncey of Tullichettle in *Ensign Tankers* (*ibid* at 247) where he said that he did not consider that *FA and AB Ltd v Lupton* [[1972] AC 634] had that result).

> 373. Fourthly, that a financial model was produced which reflected the cash flows which were the product of what the parties had agreed in the documents entered into and that those cash flows were an important part of the transactions as a whole, giving a tax advantage to the Members of Eclipse 35 in the earlier years, and reversing over time."

33. The FTT then reviewed the rival submissions of the parties on the law and relevant authorities, including in particular *Ensign Tankers* at both first instance before Millett J ([1989] STC 705; [1989] 1 WLR 1222) and in the House of Lords ([1992] STC 226); *FA & AB Ltd v Lupton* [1972] AC 634, HL; *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1, HL; and *New Angel Court Ltd v Adam* [2004] STC 779, CA ([374]-[394]).

34. In the course of this discussion, the FTT referred to a submission of Mr Gammie QC for HMRC by reference to section 609 ITTOIA. Section 609(1) provides:

> "**609 Charge to tax on films and sound recordings businesses**
>
> (1) Income tax is charged on income from a business involving the exploitation of films or sound recordings where the activities carried on do not amount to a trade. Such a business is referred to in this Chapter as a "non-trade business". …"

Mr Gammie's submission was that this provision showed that Parliament contemplated the possibility that income from the exploitation of films could be income from a "non-trade" business ([390]). This was said in order to encourage the FTT to find that Eclipse 35 was not carrying on a trade, but rather a different type of activity which would be classified as a non-trade business in the sense in which that phrase was used in section 609.

35. In this section of its decision, the FTT referred to the marketing activities which Eclipse 35 claimed it carried out through WDMSP Ltd, in relation to which the FTT summarised the thrust of each side's case at [391] as follows:

> "We have already referred in some detail above to the submissions of the parties as to the effect and significance of the marketing services arrangements: it is sufficient to note here that the tenor of Mr Gammie's arguments [for HMRC] was that the peripheral type of activity undertaken by WDMSP Ltd in carrying out those arrangements did not lend any credence to the idea that Eclipse 35 was trading. Mr Peacock's response [Mr Peacock QC appeared for Eclipse 35 at the hearing before the FTT], in summary, was that through those arrangements Eclipse 35 had a real interest in, and a real ability to influence, the exploitation of the Films, so that the exploitation of the Rights by the grant of the sub-licence to the Distributor was thereby a matter in which Eclipse 35 had an active involvement."

36. The FTT also referred to the dispute between the parties regarding the significance for the trading issue of the Contingent Receipts, which "represented the only income stream which Eclipse 35 might receive which reflected the success of the Films", and Mr Gammie QC's contention for HMRC that the entitlement to Contingent Receipts did not have any significant real value or content ([392]).

37. In the final section of its decision ([395]-[417]), the FTT set out its reasoned conclusions on the issue of whether Eclipse 35 was carrying on a trade, arriving at the determination that it was not. Paragraphs [395]-[414] are central to the arguments on this appeal, and should be set out in full, as follows:

> "395. We consider, in agreement with Mr Peacock, that the manner in and extent to which the Members of Eclipse 35 financed themselves to contribute the necessary capital to Eclipse 35 is extraneous to whatever it was that Eclipse 35 did. Also, we have concluded that the banking and security arrangements entered into by Barclays and Eagle involving the Members, Disney and the Distributor are similarly extraneous to what Eclipse 35 did. We have rejected (see paragraph 364 above) the Commissioners' contention that Eclipse 35 is to be treated as not having acquired the Rights or sub-licensed them at all, or that the Rights had no significant value.
>
> 396. What Eclipse 35 did was to enter into the Partnership Consultancy Agreement with Future (on 3 October 2006), the Marketing Services Agreement with WDMSP Ltd (on 9 February 2007) and, most importantly, the Licensing Agreement with Disney and the Distribution Agreement with the Distributor (both on 3 April 2007). These transactions had legal effect according to their terms.
>
> 397. In ascertaining whether Eclipse 35 was carrying on a trade, we examine these transactions. The relevance of the Members' financing arrangements and the banking and security arrangements entered into by Barclays and Eagle is that they are part of the context in which Eclipse 35 entered into the transactions identified. As we take a realistic view of the facts of this case, these facts, which (as we have said) are extraneous to "what exactly it was that Eclipse 35 did", may, as part of the context, indicate why the transactions referred to in paragraph 396 above were entered into by Eclipse 35. We will have to decide whether these extraneous facts affected the commerciality of what Eclipse 35 did with the consequence that "the shape and character of the transaction is no longer that of a trading transaction" (see: per Millett J in *Ensign Tankers* [1989] STC at 763). We return to this point below (at paragraph 412).
>
> 398. A purposive construction of the concept of "trade" as that word is used in the Corporation Tax Acts must take account of the definition in section 832(1) ICTA 1988 – that it "includes every trade, manufacture, adventure or concern in the nature of trade". We note that Lord Templeman in *Ensign Tankers* stated that the transaction which Victory Partnership entered into in that case (which he accepted was a trading transaction) "was not a sham and

could have resulted in either a profit or a loss" ([1992] STC at 243). We also note that Lord Reid in *Iswera* used the expression "an *adventure* which has all the characteristics of trading" (our emphasis) to describe an activity which comes within the category of "trade" for relevant purposes ([1965] 1 WLR at 668). We consider that an element of speculation is a characteristic of the concept of trade – if a taxpayer is trading, what he does must, normally at any rate, be speculative in the sense that he takes a risk that the transaction(s) may not be as profitable as expected (or may indeed give rise to a loss).

399. In *Ransom v Higgs*, Lord Wilberforce said (in the context of identifying a trade) that "there must be something which the trade offers to provide by way of business" and that, as a norm, "trade ... presupposes a customer" (50 TC at 88). He also said that "everyone is supposed to know what 'trade' means" and that the best the Court can do is to apply the general characteristics of trade to a novel set of facts in order to see how near to, or far from, the norm the facts are (*ibid.*).

400. Eclipse 35's case is that the sub-licence to the Distributor of the rights acquired from Disney in consideration of specified periodic payments over twenty years which ensured over that period profits for Eclipse 35, together with the possibility of receiving Contingent Receipts, had the profit-making character necessary for it to be recognised as a trading transaction. Of course Mr Peacock also prayed in aid the marketing services arrangements which Eclipse 35 entered into with WDMSP Ltd, but we have concluded (at paragraph 358 above) that these did not, as a matter of fact, endow the activities of Eclipse 35 with the character of trading. In argument, however, Mr Peacock was clear that the acquisition and sub-licence of the Rights, looked at alone, was sufficient to support, even compel, the conclusion that Eclipse 35 was trading.

401. There is no doubt that the sub-licence has produced and can be expected to continue to produce profits for Eclipse 35 (see for example the audited financial statements for the periods ended 5 April 2008, 2009 and 2010 referred to at paragraphs 193 to 195 above). Disregarding for the moment the question of Contingent Receipts, the profit over a twenty year period, year by year, is determined at the outset, and is determined without any reference to the success or otherwise of the exploitation of the Rights sub-licensed. In these circumstances we cannot realistically regard the profit as the speculative profit of a trading venture consisting of the exploitation of film rights. We accept that Eclipse 35 has taken the commercial risk that Barclays may not meet its liabilities under the Letter of Credit so that payments directly corresponding to the AODs might not be received (although it should be noted that the substitution of Barclays was a credit-enhancement arrangement designed to minimise the risk that Eclipse 35 would not receive the AODs). But the risk of Barclays not meeting its liabilities under the Letter of Credit (certainly as viewed as at 3 April 2007 but also as viewed at all times thereafter) is too remote to cause the pre-determined profit to be speculative in any relevant sense. In addition, and importantly, that risk is not associated

with the acquisition and exploitation of the rights in the Films (the trade Eclipse 35 claims to be carrying on); it is associated with the solvency of Barclays, which is a factor as far removed from what Eclipse 35 actually did as the Members' financing arrangements.

5 402. The Contingent Receipts are the only element of the income streams which Eclipse 35 has bargained for which is affected by the performance of the Films in consequence of their exploitation. Although obviously the prospect of Eclipse 35 actually receiving any Contingent Receipts, while being possible, was highly speculative – and made more speculative by the fact that 10 the Films were "cross-collateralised" as described above – it was in our judgment (as we have stated at paragraph 314 above) so remote as to make wholly unrealistic a conclusion that the entitlement to Contingent Receipts under the sub-licence of the rights in the Films gave the sub-licence the character of a trading transaction. Mr Molner's evidence (paragraph 312 15 above) was that no-one would be advised to invest in film rights by reference only to the prospect of what might be delivered by a participation such as the Contingent Receipts in this case. The truth of that is seen in the financial illustrations which were given to potential investors when the arrangements were marketed, since those illustrations disregarded the prospect of Contingent 20 Receipts in presenting an internal rate of return which was considered by Future to render the investment attractive even if an investor did not wish to borrow part of the capital intended to be contributed (see paragraph 112 above). The prospect of Eclipse 35 receiving anything from Contingent Receipts was clearly at all times considered by everyone involved as a 25 "bonus" rather than as a profit to be reasonably expected from entering into the acquisition and sub-licence transactions.

403. For these reasons we conclude that the transactions entered into by Eclipse 35 did not have the speculative aspect which we would expect to see in trading transactions.

30 404. We now turn to consider what the transactions offered to provide by way of business, and if there was any discernible customer (*cf* Lord Wilberforce's comments in *Ransom v Higgs* referred to at paragraph 399 above).

405. The acquisition by licence and the sub-licence of the Rights were not 35 sham transactions and we have concluded (see paragraphs 289 and 320 above) that they had effect according to their terms and that the Rights were real and meaningful. The fact remains, however, that the Licensing Agreement and the Distribution Agreement are co-terminous and were intended to be (and were) entered into concurrently. They were also interdependent, in the sense that 40 Eclipse 35 could enter into the Licensing Agreement only if it entered into the Distribution Agreement: it could acquire a licence of the Rights only if it sub-licensed them on the specified terms to the Distributor (and it also denied itself the right to do anything else whatsoever, without Disney consent).

406. Also relevant to the question of what the transactions offered to provide by way of business is the provision that Eclipse 35 would never receive actual physical delivery of the physical manifestation or representation of the Films. By clause 8 of the Licensing Agreement, Disney contracted to provide physical delivery of the Films to Eclipse 35 by delivery of the relevant prints and negatives to a specified laboratory to be held to the account of the Distributor. Also, the provisions for termination of both agreements effectively dove-tail so that it is unrealistic to assume that either agreement could have any effective life beyond the life of the other. In addition, Eclipse 35's acceptance that the Distributor may act in the best interests of the Disney group which may not be in the best interests of Eclipse 35 is relevant to this question.

407. As we have already concluded in relation to the marketing services arrangements, the capability of strategic and day-to-day planning for the marketing and release of the Films was within the Disney group.

408. In these circumstances it is difficult to see what services Eclipse 35 realistically offered to provide to the Disney group by way of business. Eclipse 35 did sub-license the Rights to the Distributor, but it had acquired the self-same Rights a moment previously from Disney, and had acquired them on terms whereby they would be so sub-licensed. Eclipse 35's case is (and has to be) that the Distributor was its customer, but we consider it is unrealistic to conclude that this was so on any meaningful basis.

409. The Commissioners contend that the real effect of the Licensing and Distribution Agreements is that in consideration of the Studio Benefit of £6 million, Disney provided to Eclipse 35 the opportunity to participate in the arrangements and the speculative right to Contingent Receipts. Whilst we accept Mr Gammie's submission that the cash flows set up by the transactions were fundamental to Eclipse 35's participation in the arrangements, we do not endorse this submission in the broad sense of characterising the transactions in this way. It is sufficient for us to conclude that on a realistic view of the facts – that is, on any commercially meaningful basis – Eclipse 35 had no "customer" and did not offer to provide any goods or services by way of business. The acquisition and sub-licence of the Rights by Eclipse 35, although having legal effect according to their terms, cannot be characterised realistically as the provision of services by Eclipse 35 to Disney by way of business, any more than the money paid into the bank account to the credit of Victory Partnership by LPI in *Ensign Tankers* could be characterised as a loan (*cf ibid.* per Lord Goff at 246).

410. These considerations plainly point to the conclusion that Eclipse 35 was not trading. Another factor pointing in the same direction is the conclusion we have reached that the amount of AODs payable to Eclipse under the Distribution Agreement was reduced below the level payable under the earlier Eclipse tranches (which broadly represented interest and principal payable over the lifetime of the transaction) by reference to the special feature

of the Eclipse 35 transaction, which was the prepayment of interest (see above at paragraphs 200 to 205). This demonstrates that the quantum of the putative trading receipts of Eclipse 35 was affected by the extraneous factor of the financing arrangements of the Members, which highlights the unreality of regarding them as trading receipts at all.

411. We have also to consider whether the Licensing Agreement and the Distribution Agreement can be regarded as trading transactions on the analogy of a sale and leaseback transaction. We conclude that they cannot be so regarded. Where the purchase of an asset by a lessor on terms that it is leased back by a finance lease is properly to be regarded as a trading transaction, the essence of the trade is the provision of finance by the lessor. Although sometimes called a leasing trade, it is in reality a financial trade. In the case of a single asset lessor (referred to be Mr Peacock – see at paragraph 388 above) we consider that the usual case is that the financial trading activities of the group, consortium or other association to which a single asset lessor may belong, effectively endow the leasing activities of the lessor with the characteristics of a financial trade. In this case, Eclipse 35 does not claim to be carrying on a financial trade and in any case did not provide finance. It is unrealistic to regard the payment of the Studio Benefit as the provision of finance for a consideration. In addition, a trade of acquiring and exploiting film rights would, we consider in agreement with Mr Gammie, usually involve the retention by the trader of some residual film rights having commercial reality – the example given in para. 56455 of the Commissioners' Business Income Manual (*cf* paragraph 386 above) seems to have that premise. Here, Eclipse 35 effectively and realistically sub-licensed to the Distributor everything it acquired from Disney. The right to Contingent Receipts can be ignored for this purpose because it had insufficient commercial significance.

412. We return to the question of whether the Members' financing arrangements and the banking and security arrangements entered into by Barclays and Eagle affected the commerciality of what Eclipse 35 did with the consequence that "the shape and character of the transaction is no longer that of a trading transaction" (see: per Millett J in *Ensign* [1989] STC at 763). This is the question posed by *Lupton v FA and AB Ltd* 47 TC 580. We do not go so far as to conclude that, even having regard to the context in which Eclipse 35 did what it did, Eclipse 35's "paramount object" was to procure a tax advantage for the Members (*cf ibid.* at 631, 632 per Lord Donovan). This is not a case where Eclipse 35 has entered into transactions having "elements of trading" but which, viewed as a whole, cannot fairly be regarded as a trading transaction (*cf ibid.* at 598 per Megarry J, approved by Lord Morris *ibid.* at 621, Lord Guest *ibid.* at 623 and Lord Simon of Glaisdale *ibid.* at 631). Eclipse 35's paramount object was to obtain the returns inherent in the Distribution Agreement. We agree with Mr Gammie that what Eclipse 35 actually did was not a trading transaction at all. But equally, what Eclipse 35 actually did is not to be characterised, on the authority of *Lupton*, as a mere device to secure a fiscal advantage.

413. We conclude for the reasons given above that Eclipse 35 cannot rely on the legal effect of the agreements it entered into to show that it was conducting a trade.

414. We regard the activities of Eclipse 35 viewed realistically as amounting to a business involving the exploitation of films which does not amount to a trade (a "non-trade business" within section 609 ITTOIA, giving that concept a purposive construction)."

The Appeal

38. There is a right to appeal to the Upper Tribunal on a point of law: section 11 of the Tribunals, Courts and Enforcement Act 2007.

39. The importance of classification of an activity as an activity in the nature of trade for tax purposes is very old. There is a considerable body of law on the approach to be adopted.

40. For a very long time, profits from a "trade, manufacture, adventure or concern in the nature of trade" were subject to income tax under Case 1 of Schedule D, e.g. as set out in the Income Tax Act 1918. In ICTA 1988, Case 1 of Schedule D imposed a charge to tax "in respect of any trade carried on in the United Kingdom or elsewhere." For the purposes of ICTA 1988, as applicable for the tax year in question in this case, section 832(1) ICTA 1988 provides that "'trade' includes every trade, manufacture, adventure or concern in the nature of trade". Now, section 5 ITTOIA imposes a charge to income tax "on the profits of a trade, profession or vocation."

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

> "Whether a given transaction or series of transactions is in the nature of trade is a question of fact for the commissioners [now, the FTT]. An appeal from their decision can succeed only if they have misdirected themselves in law or if the only true and reasonable conclusion from the facts found by them is contrary to their determination."

42. Mr Maugham presented an argument for Eclipse 35 on this appeal that a more intrusive standard of review is now appropriate, in view of observations made obiter by Lord Carnwath JSC in *R (Jones) v First-tier Tribunal* [2013] UKSC 19; [2013] 2 All ER 625, at [41]-[47]. Lord Carnwath endorsed suggestions made by Lord Hoffmann in *Moyna v Secretary of State for Work and Pensions* [2003] UKHL 44; [2003] 1 WLR 1929, at [26]-[27], and *Lawson v Serco* [2006] UKHL 3; [2006] ICR 250, at [34], to the effect that whether one characterises an evaluative assessment that a set of primary facts falls within a particular legal category (here, whether the

primary facts as found by the FTT mean that Eclipse 35 was carrying on a trade) as a question of fact or a question of law "depends upon whether as a matter of policy one thinks it is a decision which an appellate body with jurisdiction limited to errors of law should be able to review" (*Lawson v Serco*, at [34]). Mr Maugham submitted that the Upper Tribunal (Tax and Chancery Chamber), exercising its appellate function and with a view to providing guidance on principles of tax law for the FTT, should now apply a more expansive approach to what qualifies as a question of law than was laid down by the House of Lords in *Edwards v Bairstow.* In support of that submission, he pointed to observations by Judge Berner in *Ramsay v Revenue and Customs Commissioners* [2013] UKUT 226 (TCC); [2013] STC 1764, at [49]-[50], referring to *R (Jones) v First-tier Tribunal*, and also to the fact that in a range of film partnership cases at first instance some partnerships had been found to have engaged in activities which qualified as carrying on a trade and others not.

43. I reject Mr Maugham's submission that *R (Jones) v First-tier Tribunal* justifies any departure from the ordinary and well understood *Edwards v Bairstow* approach in this class of case. It may be that some issues of evaluative judgment in tax cases may be found to lend themselves to a more intrusive policy-based classification as questions of law (amenable to appeal) rather than as questions of fact, in circumstances where the Upper Tribunal can be confident that it really will be making a contribution to the coherent development and consistent application of the law applicable in its specialist field by doing so. However, I think that in the tax field such cases are likely to be unusual. The Tax Chamber of the FTT is staffed by very experienced and expert judges. A particularly clear policy-based reason would need to be shown to justify the Upper Tribunal departing on any particular issue from well established principles of classification of questions of fact and questions of law in the tax field, which are well understood by taxpayers and the Revenue alike.

44. The clarity of the existing position in tax cases promotes cost-effective dispute resolution and settlements between taxpayer and Revenue. Further, the fact that a right of appeal has been created which is limited to points of law (section 11(1) of the Act of 2007) also ensures that the Upper Tribunal is not excessively burdened with appeals and so can deal with all business coming to it with reasonable expedition. Broadening the ambit of the classes of case which are regarded as involving appeal on a point of law would extend the business which the Upper Tribunal would have to conduct, which would be detrimental to its overall ability to cope with the business coming to it without delay. It is in the public interest that there should be cost-effective dispute resolution in the tax field and that there should not be substantial delays in the administration of justice. These factors indicate that the Upper Tribunal should not be overly ready to change the conventional approach in the tax field by reference to *R (Jones) v First-tier Tribunal*, and should only do so where strong reasons to justify such a change are made out.

45. In that regard, I think it is telling to see the approach adopted by Judge Berner, an experienced tax judge sitting in the Upper Tribunal, in *Ramsay v Revenue and Customs Commissioners*. Having referred to *R (Jones) v First-tier Tribunal*, Judge Berner nonetheless found it appropriate to adopt in substance the conventional

approach to identifying the basis on which it would be appropriate for the Upper Tribunal to intervene in relation to the issue in that case, namely whether the activities of the taxpayer constituted a business: see [50]. In my view, he was right to do so.

46. No clear policy-based reason to justify departure from the conventional approach has been made out on this appeal. When pressed by me to formulate with precision what additional point of principle should qualify as a question of law, beyond what was decided by the House of Lords in *Edwards v Bairstow*, Mr Maugham did not provide any satisfactory answer. In fact, the question whether an activity should be classified as being in the nature of trade is, in my view, a very poor candidate for a more adventurous and expansive approach to treating it as a question of law now to be adopted. The relevant test to be applied in making the evaluative classification assessment has been firmly established by cases at the highest level (not least, *Edwards v Bairstow* itself) for a very long time. There is no distinct contribution which the Upper Tribunal could reasonably expect or hope to make in that regard. The position is thus very different from that discussed by Lord Hoffmann in *Lawson v Serco* at [34], where the stage of development in the relevant jurisprudence was such that there was scope for a contribution to be made by the appellate tribunal and courts. Moreover, the application of the test whether a person is carrying on a trade will necessarily be fact-sensitive, as all the authorities make abundantly clear, and in policy terms there are strong grounds to think that it is overall suitable, and Parliament intended, that the FTT should be the primary body making the evaluative judgment in question and that the Upper Tribunal should intervene and find an error of law only on the classic, more restricted basis laid down so clearly in *Edwards v Bairstow*. Whilst it is clear why parties who lose at first instance before the FTT will wish to have a second bite at the cherry in the Upper Tribunal by encouraging that Tribunal to exercise a more intrusive form of appellate review, there appears to be no policy advantage in terms of the coherent administration of justice in allowing them to do so.

47. The mere fact that there have been film partnership cases before the FTT in which it has been found that the partnership carried on a trade and others in which it was found that it did not does not justify adoption of a new, more intrusive approach to identifying whether a question of law arises. In the event, Mr Maugham did not take me to the various cases to try to show how they might support his submissions. In fact, it is to be expected that different outcomes in terms of application of the legal classification of carrying on a trade will arise without there being any error of law. The facts of the cases will no doubt have been different, and that will in turn have informed in critical ways the evaluative judgments made by the tribunals hearing those cases. There is nothing untoward in this: see, e.g., *Procter & Gamble UK v Revenue and Customs Commissioners*[2009] EWCA Civ 407; [2009] STC 1990, [9]-[11]; *MA (Somalia) v Secretary of State for the Home Department* [2010] UKSC 49; [2011] 2 All ER 65, at [43].

48. It therefore transpires that the appeal has a traditional shape, and the arguments on each side were very much in the standard form. Mr Aaronson for Eclipse 35 sought to identify points in the FTT's reasoning and conclusions which

either showed it had misapplied the relevant legal test or had made findings of fact or drawn inferences which were unsupported or contradicted by the evidence or other findings. In particular, Mr Aaronson submitted that the FTT had (i) failed properly to take into account its own findings about the importance for Eclipse 35 of the negotiation about the identity of the Films to be included in the transaction, having regard to the possibility of generation of Contingent Receipts; (ii) failed properly to take into account its own findings about, or the evidence regarding, the marketing services which were provided on behalf of Eclipse 35; and (iii) misdirected itself in certain ways regarding the test to be applied to determine whether Eclipse 35 was carrying on a trade. Mr Aaronson emphasised that points (i) and (ii) were inter-related: Eclipse 35 had bargained for a role in marketing the Films because it hoped to assist in promoting their commercial success so as to generate Contingent Receipts. These features of the case, in particular, meant that the only rational conclusion was that Eclipse 35 had indeed been carrying on a trade in participating in the arrangements relating to the Films.

49. On the other hand, Mr Gammie for HMRC maintained that the FTT had not misdirected itself on the law and had a proper evidential basis for every finding of fact it made or inference which it drew. The conclusion that the FTT came to, that Eclipse 35 had not carried on a trade, was one which the FTT was entitled to reach as a matter of evaluative judgment, on the basis of the evidence in the case.

The Significance of Contingent Receipts

50. Mr Aaronson emphasised that there was a serious negotiation between Eclipse 35 and Disney regarding the rights which Eclipse 35 was to acquire in the transaction, including in particular its entitlement to Contingent Receipts: see in particular [84(1)], [89]-[90] ("Matters which were the subject of particularly intensive negotiation" included the identity of the Films, the marketing arrangements and the extent of entitlement to Contingent Receipts), [209] ("Disney had an expressed and legitimate concern that there should not be an implicit undervalue … of the Rights since that could have an adverse consequence for the values which third parties might attribute to the Disney portfolio of films …"), [210], [221], [222], [223]-[228] and [308]-[313]. The transactions were entered into so as to have, and they did have, genuine commercial effect in accordance with their terms: see e.g. [364]-[365].

51. The availability of Contingent Receipts was also part of the information given to prospective investors in Eclipse 35: see in particular [107]-[108], [110(4)], [112] and [114].

52. There was also a serious negotiation on the related topic of Eclipse 35 being involved in fashioning the marketing and release arrangements, which other film studios had been reluctant to accept, leading Eclipse 35 to prefer to enter into contractual arrangements with Disney: see in particular [83] and [93(4)].

53. The FTT properly took all these matters into account. However, as emphasised by Mr Gammie, there was also a range of countervailing factors which it was entitled

to, and did, take into account in reaching its conclusion about Contingent Receipts at [314] ("The prospect of earning Contingent Receipts, although a possibility, is too remote to qualify as a basis or justification for entering upon a trading venture on any commercial level …") and [401]-[403].

54. In particular, there was ample material before the FTT to justify its important finding at [402] that "The prospect of Eclipse 35 receiving anything from Contingent Receipts was clearly at all times considered by everyone as a 'bonus' rather than as a profit reasonably expected from entering into the acquisition and sub-licence transactions", as follows:

(i) At [312] the FTT noted that, according to the evidence of Mr Molner (the main negotiator of the arrangements for Eclipse 35), "no-one would be advised to invest in film rights by reference only to the prospect of what might be delivered by a participation such as the Contingent Receipts in this case," in view of the highly speculative nature of the chance that the Films would prove to be exceptionally successful to the level required to generate Contingent Receipts;

(ii) Evidence given under cross-examination by Mr Timothy Levy, the principal manager of companies in the Future group, was to similar effect;

(iii) Evidence given by Mr Sills, an expert witness put forward by HMRC with wide experience in the field of profit participation rights in film distribution arrangements, was to similar effect. The FTT gave weight to his evidence in relation to the subject of Contingent Receipts ([67]), and Mr Aaronson did not suggest that it was wrong to do so;

(iv) Statements in the Information Memorandum and the supplementary Addendum to Film Partnership Proposal given to prospective investors in Eclipse 35: (a) the Information Memorandum included the statement, with reference to Contingent Receipts (called "Net Proceeds" in the document), "Prospective subscribers should not subscribe on the expectation that Net Proceeds (if any) would constitute a material sum"; (b) the Addendum referred to provision in the Distribution Agreement to the effect that the Distributor has no obligation to distribute any film licensed to it, and if it does so has no obligation to maximise revenues from the Films ([110(4)]); and (c) the financial illustrations at Appendix 5 to the Information Memorandum and Schedule 4 to the Addendum showed what Future regarded as an attractive positive rate of return on capital invested without any borrowing by an investor (and hence without the tax benefit of off-setting interest thereon) and without any element of Contingent Receipts being paid (see [112] and [402]); and

(v) Statements in the Distribution Agreement: see [110(4)], [133] and, in particular, paragraphs 3.2 and 3.3 of Schedule 1 to Exhibit C, brought into effect by clause 4, and clause 20(d), as follows:

“3.2 No Representation

Distributor has no obligation to distribute any of the Designated Films and if it does so, LLP [Eclipse 35] acknowledges that Distributor has no obligation to maximize Accountable Receipts and has not made any representations with respect to the likelihood or amount of Accountable Receipts, deferments, contingent proceeds or Variable Distributions, if any, which will or may be derived from distribution of any of the Designated Films.

3.3 Control of Exploitation and Marketing

A. As between Distributor and LLP, Distributor shall have exclusive and perpetual control of the distribution, marketing, advertising, publicizing, exploitation, sale or other disposition of the Designated Films and may distribute, or withhold or withdraw any of the Designated Films from distribution at its sole discretion with respect to one or more territories or media. Distributor may distribute the Designated Films with other pictures whether or not Distributor has any interest in such other pictures.

B. For all purposes under this Schedule 1, allocations of Accountable Receipts, costs, rights and other matters relating to the Designated Films and other motion picture shall be allocated by Distributor in its business judgment and in accordance with Distributor’s prevailing business practice. …”

“clause 20(d) …LLP [Eclipse 35] further acknowledges that neither it nor its members are acting in reliance upon the likelihood of any gross revenues, gross proceeds, accountable receipts, contingent proceeds, contingent profits and/or any other amounts including without limitation Variable Distributions or LLP Contingent Receipts Share calculated by reference to the performance of any of the Designated films or the Rights becoming payable and Distributor represents that it has no expectation that any of the Designated Films or the Rights would or could achieve gross revenues, gross proceeds, accountable receipts, contingent proceeds, contingent profits and/or any other amounts including without limitation Variable Distributions or LLP Contingent Receipts Share…”

55. In my view, the issue of the significance of Contingent Receipts for the characterisation of the activity of Eclipse 35 as trading or not was classically an issue on which there was material which entitled the FTT to form its own evaluative judgment in light of all the evidence it heard and the circumstances of the case. There is no error of law in the FTT deciding that the speculative possibility of Contingent Receipts was so remote as to provide no material support for the submission of

Eclipse 35 that it was trading: [314] and [401]-[403]. Eclipse 35 is very far from being able to show that on the material before the FTT only one conclusion was rationally or lawfully possible on this issue, namely in favour of Eclipse 35's contention that the possibility of Contingent Receipts being paid (whether taken by itself or in conjunction with other factors) meant that it was carrying on a trade.

The Marketing and Release Arrangements

56. Eclipse 35 sought to suggest that its activities in relation to the marketing and release arrangements, acting by SCI, Mr Salter and WDMSP Ltd, represented a substantial contribution to the distribution of the Films and their potential for profit, which by itself or in combination with other factors (in particular, the possibility that Contingent Receipts might be paid: see above) indicated that Eclipse 35 was indeed engaged in carrying on a trade in relation to the acquisition of rights in and distribution of the Films.

57. The FTT found that there was a serious commercial negotiation between Eclipse 35 and Disney regarding the rights to be granted to Eclipse 35 to have a say in the marketing and release arrangements: see in particular [83], [90(4)], [93(4)] and [245]. The FTT discussed these arrangements and the parties' contentions about them at [163]-[182] and [242]-[252].

58. The FTT conducted an analysis of the position at [321]-[358]. At [343]-[344] the FTT held that WDMSP Ltd was not properly to be regarded as an agent of Eclipse 35 (see paras. [71]-[75] below). But at [345] it noted that this was not fatal to the case being presented by Eclipse 35, that ([342]) it was engaged in directing and supervising the marketing and release of the Films.

59. However, at [346] the FTT observed that the difficulty for Eclipse 35 was one of substance. None of Eclipse 35, WDMSP Ltd nor SCI "had any capability whatsoever to be a part of any strategic or day-to-day planning for the marketing or release of the Films, or to monitor or supervise the Distributor's performance relative to any agreed plan"; Mr Salter's involvement was limited; and "That capability resided within the Disney group and in particular in the various Buena Vista distribution companies."

60. The marketing and release plans were primarily prepared by the Designees, who were employed by the Buena Vista companies. Eclipse 35 argued that they did so acting for WDMSP Ltd as seconded staff: [347].

61. The FTT reviewed the contractual arrangements which set up these arrangements. It disbelieved this case on the evidence available to it: "… we did not have … convincing evidence that what the documents provided for was matched by what happened in fact. We saw the theory but not the practice" ([348]). The FTT noted that the Buena Vista companies would seek to maximise the return from the Films regardless of any involvement of Eclipse 35, and reasoned that therefore "clear and convincing evidence is required that the Designees stepped out of their position as

employees doing for their Buena Vista employer what they did on a daily basis and performed their duties instead for WDMSP Ltd" ([349]). No witness evidence from any of the Buena Vista staff involved was adduced by Eclipse 35 to shed light on the commercial reality of the arrangements ([349]).

62. Eclipse 35 relied instead on its initiative to produce an Initial Marketing and Release Plan for each Film, the activities of Mr Salter and the flow of information from Disney back to Eclipse 35 regarding the performance of the Films ([350]). The FTT proceeded to consider each of these.

63. It accepted that Initial Marketing and Release Plans had been drawn up at the instigation of Eclipse 35 ([246]-[247] and [351]), but in the absence of evidence from Buena Vista employees to explain whether in reality or as a matter of substance anything was done beyond what Buena Vista employees would have done in the ordinary course of their employment in any event, the FTT's assessment on this point was:

> "We do not know whether, in preparing the Initial Marketing and Release Plans (and we do not question that they were prepared) the Designees were simply doing, in a different format, what they would in any event do, or, indeed, were "re-packaging" material which had already been prepared by the Buena Vista companies. Eclipse 35 simply did not justify its case from the evidence it produced" ([351]).

64. In my view, this was a proper and legitimate approach for the FTT to take to its assessment of the commercial realities in relation to this part of the case. Against the background that the Designees, who were all employees of the Buena Vista companies, would be expected to do their utmost in that capacity to promote the success of the Films, irrespective of any involvement of Eclipse 35 or WDMSP Ltd, the FTT was fully entitled to look sceptically at the claim by Eclipse 35 that something more was being done by them, and that that additional element was of commercial substance and hence indicative that Eclipse 35 was itself carrying on a trade. The FTT was fully entitled to find, on the evidence presented to it, that Eclipse 35 had not shown that the Designees had contributed on behalf of Eclipse 35 and WDMSP Ltd anything of any substance more than they would have been expected to contribute in their ordinary work as Buena Vista employees.

65. Similarly, the FTT was not satisfied on the evidence that Mr Salter had made a contribution of any real substance beyond what the Designees would have done in any event: [352]-[356]. The FTT found that such insights into marketing strategy as Mr Salter put forward made no significant additional contribution to the marketing plans beyond what Buena Vista employees were already doing for themselves. On Mr Salter's own evidence, on the limited occasions when he discussed matters with Buena Vista personnel, he discovered that they were already thinking along the same lines ([354]-[356]). On the evidence before it, the FTT was fully entitled to come to its conclusion in [356] that "Eclipse 35 cannot be said to be directing and supervising

[the marketing and release of the Films] in circumstances where the Distributor had already come to a conclusion as to what it should do."

66. The FTT was also entitled to conclude that, although there was a flow of information from Disney to WDMSP Ltd and Eclipse 35 about the performance of the Films, which was monitored and commented on by Mr Salter, this was not something which established the case which Eclipse 35 sought to make out, that it had a meaningful part in directing and supervising the marketing and release of the Films by the Distributor: [357]-[358].

67. In his criticisms of this part of the FTT's decision, Mr Aaronson time and again submitted that the FTT's findings and conclusions are inconsistent with its findings at [246]-[247] that Initial Marketing and Release Plans for the Films had indeed been drawn up at the instigation of Eclipse 35 and that the drawing up of such plans was not something Disney had done for other films produced by it. He also submitted that in producing a very long decision which took a long time to prepare, the FTT may simply have forgotten what it had found or decided in earlier parts of its decision.

68. I do not accept these submissions. There is no inconsistency. The FTT took account of its findings in [246]-[247] and weighed them against other features of the case in reaching its conclusions on this part of the case. There is nothing to indicate otherwise, and its observations in [351] show that it had Eclipse 35's case about the reality and substance of the Initial Marketing and Release Plans well in mind. The FTT's approach was entirely conventional and proper. It was well entitled to weigh different items of evidence and factors pointing in different directions as it did. Weighing matters in this fashion is a completely ordinary part of the FTT's task in a case like the present.

69. More generally, I was entirely unpersuaded by Mr Aaronson's suggestion that, by the end of its decision, the FTT had forgotten or disregarded factual findings made earlier on in the decision. On a fair reading, nothing in the FTT's decision lends any support to this suggestion. On the contrary, the decision as a whole shows every sign of painstaking care being taken by the FTT to ensure that it did properly consider all features of the facts in making its assessment and arriving at its ultimate conclusion.

70. For all these reasons, I conclude that there was no error of law by the FTT in relation to its findings and conclusion on this aspect of the case.

Agency: the Relationship Between WDMSP Ltd and Eclipse 35

71. Mr Aaronson submitted that the FTT erred in its reasoning at [343]-[344], in rejecting Eclipse 35's submission that WDMSP Ltd should be regarded as the agent of Eclipse 35 in relation to the marketing and release arrangements. Clause 1 of the Marketing Services Agreement purported to appoint WDMSP Ltd as agent of Eclipse 35, and the FTT should have accepted that this correctly stated the legal relationship between them. The FTT erred in law in concluding that, since other provisions in the

Marketing Services Agreement stated "that any duties or obligations which WDMSP Ltd may have in its capacity as a Disney group member must prevail over the duties it would otherwise owe as agent to Eclipse 35" ([344]), this had the effect that WDMSP Ltd could not truly be regarded as agent for Eclipse 35.

72. There are two points to be made about this submission. First, even if Mr Aaronson were correct, it would not provide a basis on which the appeal should be allowed. As set out above, the FTT made it clear at [345]ff that its finding of absence of agency was not fatal to Eclipse 35's case; what was fatal to it was the FTT's finding that in relation to the marketing and release arrangements Eclipse 35 made no contribution of any substance. That finding would equally have been fatal to Eclipse 35's case even if the FTT had accepted that WDMSP Ltd could be regarded as an agent for Eclipse 35 under the Marketing Services Agreement. I have already explained that Eclipse 35's criticism of that part of the decision fails.

73. Secondly, I do not in any event accept Mr Aaronson's criticism of [343]-[344]. The Marketing Services Agreement is a curious document, and I agree with the FTT that it contains an irreconcilable tension within it between the apparent appointment of WDMSP Ltd as agent of Eclipse 35 and a number of detailed terms of the agreement which expressly denuded that role of any real or substantive content. In particular, clause 5.1 provided as follows:

> "The parties acknowledge that; (a) MSP [i.e. WDMSP Ltd] is an Affiliate of Studio and its Affiliates (including, without limitation, Distributor) and, as such MSP will and may have certain obligations and duties (including, without limitation, fiduciary duties) to Studio and/or its Affiliates and/or their shareholders generally and, in particular, in relation to the Designated Films and other motion pictures owned, controlled and/or distributed by Studio and its Affiliates ("Studio Films") which will or may compete and/or conflict with MSP's obligations and duties to LLP [i.e. Eclipse 35] hereunder and in the event of any such competing interests or conflicts LLP hereby acknowledges and agrees that MSP can and will act in the best interests of Studio and its Affiliates which may not be in the best interests of LLP; … LLP hereby waives any right to make any claim or seek any relief, whether at law or in equity (specifically including injunctive relief), asserting the existence of any conflict of interest or breach of fiduciary duty express or implied in connection with MSP, Studio, Distributor or any of their Affiliates acting in their best interest … which may not be in the best interests of LLP. LLP further acknowledges and agrees that neither MSP's performance of its obligations and duties owed to any of the entities listed above not any actions of Studio and/or its Affiliates … shall constitute a breach of this Agreement or any of the obligations owed by MSP to LLP hereunder or any other agreement that any of those parties have entered or may enter into with LLP or any rights of LLP generally. Subject to the proviso in the next following sentence, LLP further acknowledges

5

10

15

20

25

30

35

40

45

> and agrees that Clause 2.1.3 sets forth the sole standard of care to which MSP shall be subject in the performance of all of its duties hereunder, to the exclusion of any other standard including, without limitation, any fiduciary, agency or other standards or obligations, whether implied by law or otherwise. Nothing in this clause 5.1 or otherwise in this Agreement shall in any way remove or in any other way limit MSP's duty and obligation to comply with the strict obligations set out in clauses 2.1.1, 2.1.5, 2.1.6, 2.1.9, 2.1.11, 2.1.12, 2.1.13, 2.2 and 2.3."

74. In my judgment, on a proper interpretation of clause 5.1 and the rest of the Marketing Services Agreement, the FTT was correct to conclude that it did not constitute WDMSP Ltd an agent for Eclipse 35 in the full and proper legal sense. Such duties as WDMSP Ltd owed to Eclipse 35 under the Marketing Services Agreement were strict contractual duties (such as those referred to at the end of clause 5.1) and a contractual duty of care as set out in clause 2.1.3.

75. In the event, Mr Aaronson made this particular criticism of the FTT's decision only very faintly, and did not take me to any authority on the point. I was unpersuaded by his submissions on the agency issue. I agree with the submission made by Mr Gammie that the authorities show that it is a hallmark of a true agency relationship that the agent is obliged to put the interests of his principal before his own or those of anyone else, and that clause 5.1 and other provisions of the Marketing Services Agreement meant that this feature was absent from the relationship between Eclipse 35 and WDMSP Ltd.

Speculative Aspect of Trading Transactions

76. Mr Aaronson submitted that the FTT erred in law at [398]-[403] in directing itself that "an element of speculation is a characteristic of the concept of trade" ([398]) and also in concluding that "the transactions entered into by Eclipse 35 did not have the speculative aspect which we would expect to see in trading transactions" ([403]).

77. I reject both of these submissions. As to the first, in my judgment the FTT was correct to say that an element of speculation is a characteristic of the concept of trade. It did not say that this is an indispensable requirement, but it treated it as a highly significant factor to be taken into account in assessing whether the activity of Eclipse 35 constituted the carrying on of a trade. It was right to do so. The FTT was entitled to attach the weight it did to this aspect of the case.

78. I agree with the FTT's analysis of the authorities bearing on this, at [398]-[399], set out above. In my view, an element of speculation in the sense of conducting an activity which might result in a profit or a loss is strongly indicative of that activity being capable of having the character of trading, and the absence of such an element is strongly indicative that it is not a trading activity.

79. That interpretation is also supported by the way in which "trade" was defined at the relevant time and has been defined in tax legislation for a long time, as including "every trade, manufacture, adventure or concern in the nature of trade" (see e.g. section 832(1) ICTA 1988, set out at [398]). In a list of terms like this, the meaning of each item naturally takes some colour from those listed with it. In old legal language, the "noscitur a sociis" principle is relevant: the meaning of a term is given or informed by its fellow terms deployed in the same list. Here, the use of the word "adventure" is redolent of business activity of a speculative kind, and this informs the meaning to be given to "trade".

80. As to the second criticism, in my opinion it is unsustainable. A large part of the FTT's decision constitutes a careful analysis of the transactions entered into and an assessment of their commercial substance. In short summary, the FTT found that there was no significant speculative aspect to the terms of the arrangements relating to AODs or variable distributions/royalties. The amount of AODs to be paid was determined at the outset, and in relation to them Eclipse 35 simply purchased a known income stream (see, in particular, [401] and [410]). The credit risk in relation to that income stream was assumed by Barclays under the Letter of Credit, and certainly in 2007 this was thought to be a very remote risk indeed ([401]). The variable distributions and variable royalties operated back to back: what Eclipse 35 received from the Distributor by this income stream was immediately to be paid on by Eclipse 35 to Disney. As with the AODs, this income stream involved no prospect of loss or gain for Eclipse 35.

81. That left the Contingent Receipts as the only other income stream which might accrue to Eclipse 35 under the arrangements. It is true that this was an income stream which was speculative. But in its decision, the FTT explained that the prospect of Contingent Receipts arising was so very highly speculative and remote as to make it implausible to think that it was of any real substance or provided any significant commercial reason why anyone would enter into the arrangements (see, in particular, [402]). It was thus a peripheral speculative feature of the arrangements which was remote from the true commercial basis of those arrangements. This meant that it was not significant in the context of the exercise which the FTT was seeking to undertake, to evaluate whether the activity of Eclipse 35 constituted the carrying on of a trade.

82. In my judgment, this was, again, an evaluative judgment which the FTT was well entitled to make on the evidence before it. I have explained above why Eclipse 35's criticism of the FTT's findings about the highly speculative nature of the Contingent Receipts cannot be accepted.

Need for a Customer

83. Mr Aaronson also criticised the next part of the FTT's decision, at [404]-[410], in which it considered whether Eclipse 35 had any discernible customer. As with its investigation whether the arrangements had a speculative aspect, the FTT did not treat the presence or absence of an identifiable customer as determinative in itself,

but as one factor to which it was appropriate to give weight in making its overall evaluative assessment on the question of trading.

84. In my judgment, the FTT was again correct in its approach. The presence or absence of an identifiable customer is a factor which is relevant to the assessment whether an activity of trading is taking place, as the speech of Lord Wilberforce in *Ransom v Higgs*, cited by the FTT at [399] and [404], as set out above, indicates. On the basis of the evidence it heard and the findings it made, the FTT was entitled to conclude that, on a realistic view of the facts, "Eclipse 35 had no 'customer' and did not offer to provide any goods or services by way of business" ([409]).

Sale and Leaseback

85. Mr Aaronson next criticised the FTT's reasoning on the question whether an analogy could or should be drawn with sale and leaseback transactions which qualify as the carrying on of a trade: [411]. Contrary to his submission, I can detect no error of law in this part of the decision. The activity Eclipse 35 engaged in was, in my view, very far indeed from a sale and leaseback transaction in the nature of carrying on a trade. I agree with the FTT that the analogy proposed by Eclipse 35 is not an apt or helpful one.

Section 609 ITTOIA

86. Mr Aaronson and Mr Maugham between them made submissions to the effect that [414] revealed that the FTT had misdirected itself regarding the nature of trading activity, because it erroneously thought that section 609 ITTOIA reflected a dichotomy in the law between a business involving the exploitation of films and the carrying on of a trade. The FTT thought that the activities of Eclipse 35 could be charged to tax as a non-trade business, whereas on a proper view section 609 is part of a set of provisions which are intended simply to have the same effect as the previous relevant part of the tax code, contained in what was Schedule D (as latterly set out in section 18 ICTA); and under Schedule D, the only basis on which activity of the kind Eclipse 35 had engaged in could be chargeable to tax was if it constituted the carrying on of a trade. There had been very little attention given to section 609 at the hearing before the FTT, but on a proper understanding the FTT could not have properly concluded that the activity of Eclipse 35 fell within the scope of section 609.

87. Mr Maugham developed this argument by reference to the background to the passing of the ITTOIA. This emerged from the Inland Revenue's Tax Law Rewrite Project to re-draft tax legislation in clearer and simpler language to make it more accessible and easier to understand. The ITTOIA was new legislation drafted as part of the Tax Law Rewrite Project to give effect to this objective. The long title of the ITTOIA is:

> "An Act to restate, with minor changes, certain enactments relating to income tax, trading income, property income, savings and investment income and certain other income; and for connected purposes."

88. Mr Maugham took me to the Explanatory Notes prepared by the Tax Law Rewrite Project at the Inland Revenue, which were issued at the time the ITTOIA was passed in order to assist the reader in understanding the Act. For the most part, the intention in passing the ITTOIA was not to change the law when re-writing it; but it did contain some minor changes, which were identified in Annex 1 to the Explanatory Notes. The group of sections which included section 609 was not identified in Annex 1 as containing minor changes in the law. Those sections were just intended to rewrite the law without making substantive changes to it.

89. Paragraphs 5 and 6 of the Explanatory Notes state as follows:

> "5. The purpose of the [ITTOIA] is to rewrite income tax legislation relating to trading, property and investment income so as to make it clearer and easier to use.
>
> 6. The Act does not generally change the underlying law when rewriting it. The only changes to the law which it does make are minor ones which are within the remit of the Tax Law Rewrite Project and the Parliamentary process for the Act."

90. The Parliamentary process referred to, as I understand it, allowed for a truncated form of consideration of the legislation in Parliament, reflecting the very limited scope of amendment of the already existing substantive law.

91. The Explanatory Notes in relation to section 609 state as follows:

> "913. This section charges to tax income from businesses involving the exploitation of films and sound recordings where the activities fall short of trading. It is based on section 18 of ICTA.
>
> 914. *Subsection (1)* imposes a charge on UK or foreign businesses involving the exploitation of films or sound recordings where the activities do not amount to a trade. Reclassifying the income according to its nature makes sense. The special allocation rules for films and sound recordings in sections 40A to 40D of F(No 2)A 1992 [the Finance (No. 2) Act 1992] (and sections 41 to 43 of F(No 2)A 1992 for films) apply to both trades and businesses. The creation of a new charge and Chapter for this income provide a convenient link with the special allocation rules for films and sound recordings businesses (where the activities fall short of trading) which might otherwise be missed.
>
> 915 The new charge on income from non-trading film or sound recordings businesses has been carved out of the general sweep up charge (see section 687) of this Act and included in a separate Chapter together with a signpost to the special allocation rules for expenditure relating to such activities."

92. The effect of the Explanatory Notes, therefore, is that section 609 was intended to reflect the law in section 18 ICTA and was not intended to change that law. Mr Maugham referred to the admissibility of Explanatory Notes as an aid to interpretation of legislation, as explained by Lord Steyn in *R (Westminster City Council) v National Asylum Support Service* [2002] UKHL 38; [2003] LGR 23 at [5], where he said this, obiter:

> "5. The question is whether in aid of the interpretation of a statute the court may take into account the Explanatory Notes and, if so, to what extent. The starting point is that language in all legal texts conveys meaning according to the circumstances in which it was used. It follows that the context must always be identified and considered before the process of construction or during it. It is therefore wrong to say that the court may only resort to evidence of the contextual scene when an ambiguity has arisen. In regard to contractual interpretation this was made clear by Lord Wilberforce in *Prenn v Simmonds* [1971] 1 WLR 1381, 1384-1386, and in *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989, 995-996. Moreover, in his important judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912-913, Lord Hoffmann made crystal clear that an ambiguity need not be established before the surrounding circumstances may be taken into account. The same applies to statutory construction. In *River Wear Commissioners v Adamson* (1877) 2 App Cas 743, 763, Lord Blackburn explained the position as follows:
>
> > "I shall . . . state, as precisely as I can, what I understand from the decided cases to be the principles on which the courts of law act in construing instruments in writing; and a statute is an instrument in writing. In all cases the object is to see what is the intention expressed by the words used. But, from the imperfection of language, it is impossible to know what that intention is without inquiring farther, and seeing what the circumstances were with reference to which the words were used, and what was the object, appearing from those circumstances, which the person using them had in view; for the meaning of words varies according to the circumstances with respect to which they were used."
>
> Again, there is no need to establish an ambiguity before taking into account the objective circumstances to which the language relates. Applied to the subject under consideration the result is as follows. Insofar as the Explanatory Notes cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are therefore always admissible aids to construction. They may be admitted for what logical value they have. Used for this purpose Explanatory Notes will sometimes be more informative and valuable than reports of the Law Commission or advisory committees, Government green or white papers, and the like. After all, the connection of Explanatory Notes with the shape of the proposed legislation is closer than pre-parliamentary aids which in principle are already treated as admissible: see Cross, *Statutory Interpretation,* 3rd ed (1995), pp 160-161. If

used for this purpose the recent reservations in dicta in the House of Lords about the use of Hansard materials in aid of construction are not engaged: see *R v Secretary of State for the Environment, Transport and the Regions, Ex p Spath Holme Ltd* [2001] 2 AC 349, 407; *Robinson v Secretary of State for Northern Ireland* [2002] UKHL 32, The Times, 26 July 2002, in particular per Lord Hoffmann, at paragraph 40. On this basis the constitutional arguments which I put forward extra-judicially are also not engaged: "Pepper v Hart: A Re-examination" (2001) 21 Oxford Journal of Legal Studies 59."

93. Perhaps one needs to approach these dicta with a little caution, since none of the other members of the Appellate Committee referred to them or endorsed them. However, for the purposes of the argument in this case I proceed on the footing that they contain a correct statement of the law.

94. Section 18 ICTA provides as follows:

"**18.-Schedule D.**

(1) The Schedule referred to as Schedule D is as follows:-

SCHEDULE D

Tax under this Schedule shall be charged in respect of –

(a) the annual profits or gains arising or accruing –

(i) to any person residing in the United Kingdom from any kind of property whatever, whether situated in the United Kingdom or elsewhere, and

(ii) to any person residing in the United Kingdom from any trade, profession or vocation, whether carried on in the United Kingdom or elsewhere, and

(iii) to any person, whether a Commonwealth citizen or not, although not resident in the United Kingdom from any property whatever in the United Kingdom or from any trade, profession or vocation exercised within the United Kingdom, and

(b) all interest of money, annuities and other annual profits or gains not charged under [not charged under [Schedule A or under ITEPA 2003 as employment income, pension income or social security income]], and not specially exempted from tax.

(2) Tax under Schedule D shall be charged under the Cases set out in subsection (3) below, and subject to and in accordance with the provisions of the Tax Acts applicable to those Cases respectively.

(3) The Cases are –

Case I: tax in respect of any trade carried on in the United Kingdom or elsewhere [but not contained in Schedule A] …

5 Case VI: tax in respect of any annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of [Schedule A or by virtue of ITEPA 2001 as employment income, pension income or social security income.] …"

95. Mr Maugham submitted that the only way in which the activities of Eclipse 35
10 could have been subject to tax under Schedule D was if they were classified as carrying on a trade so as to fall within Case I. So, if the FTT considered that they were chargeable to tax now under section 609, it ought in fact to have addressed the question how they could have been chargeable to tax (if at all) under Schedule D. Under Schedule D, according to Mr Maugham, there is no middle ground between
15 trading and investment; yet the FTT treated section 609 as having the purpose of taxing the profits of activities which, while they cannot properly be regarded as investing, may lack some of the features that would typically be present in a trade. Since it was implicit in the FTT's approach that it thought that Eclipse 35's activities would have been chargeable to tax previously under Schedule D (and it would be
20 curious if they were not), consideration of this aspect of the case should have led the FTT to consider more carefully its conclusion that there was no trading activity and instead to conclude that there was.

96. I reject this part of Eclipse 35's submissions for three reasons. First, the
25 general orientation in approaching the task of interpretation of section 609 which is to be derived from consideration of the Explanatory Notes in accordance with the statement by Lord Steyn is that this part of the ITTOIA was intended merely to consolidate existing statutory provisions in a more user-friendly format without changing their content or legal effect. That is, the Explanatory Notes indicate that this
30 part of the ITTOIA should be approached and interpreted in the same way as a Consolidation Act. The reference in paragraph 6 of the Explanatory Notes to the special truncated parliamentary processes used to enact the ITTOIA reinforces this impression: Consolidation Acts are similarly enacted by use of special truncated parliamentary processes.

35

97. The law regarding the approach to construction of a consolidating statute was explained by the House of Lords in *Farrell v Alexander* [1977] AC 59 and is well settled. When construing a consolidating statute, which is intended to operate as a coherent code or scheme governing some subject matter, the principal inference as to
40 the intention of Parliament is that it should be construed as a single integrated body of law, without any need for reference back to the same provisions as they appeared in earlier legislative versions: see *Farrell v Alexander* [1977] AC 59, 73B-C (Lord Wilberforce), 82B-D and 83D-H (Lord Simon of Glaisdale) and 97B-E (Lord Edmund-Davies). An important part of the objective of a consolidating statute or a
45 project like the Tax Law Rewrite Project is to gather disparate provisions into a

single, easily accessible code. That objective would be undermined if, in order to interpret the consolidating legislation, there was a constant need to refer back to the previous disparate provisions and construe them. Therefore the court's main task in this case must be to construe the ITTOIA without reference back to section 18 ICTA and Schedule D. However, where, after undertaking such an exercise, a provision which falls to be applied is found to be ambiguous, a subordinate presumption comes into play, namely that it is presumed that there was no intention to change the meaning of the provision which has been repeated in the same language in the consolidated code. In such circumstances, it may be relevant to try to determine the meaning of the relevant provision by looking to see what it meant when it was previously enacted: see [1977] AC 59 at 73B (Lord Wilberforce), 84D-H (Lord Simon of Glaisdale) and 97B (Lord Edmund-Davies).

98. In my view, there is no ambiguity in section 609. It plainly contemplates that two types of case may exist and be subject to tax under the code set out in the ITTOIA, namely businesses involving the exploitation of films where the activities do amount to a trade and businesses involving the exploitation of films where the activities do not amount to a trade. There is no warrant for referring back to section 18 ICTA to assist in the interpretation of section 609. The FTT's interpretation of section 609 at [414] cannot be faulted.

99. Secondly, even if (contrary to my primary view) it were appropriate to go back to section 18 ICTA, I do not agree that the only basis on which the activities of Eclipse 35 could have been subject to tax within the scheme of Schedule D was if they amounted to the carrying on of a trade within Case I. Rather, I accept the submission of Mr Gammie that the profits of Eclipse 35 under the arrangements could properly be regarded as "annual profits or gains arising or accruing … from any kind of property whatever" (paragraph (a)(i) of Schedule D; the contract rights of Eclipse 35 under the arrangements constitute a form of property, as choses in action) or as "other annual profits and gains not charged under [other provisions] and not specifically exempted from tax" (paragraph (b) of Schedule D), which would then in each case have been chargeable to tax as falling within Case VI. Accordingly, the interpretation given to section 609 ITTOIA by the FTT was in fact in line with the previous law.

100. Thirdly, and in any event, even if (contrary to my judgment) the FTT had somehow misconstrued section 609 and misunderstood its effect, that does not indicate that it had erred in its assessment of the primary issue it had to decide, namely whether Eclipse 35 was carrying on a trade. Before it came to [414] in its decision, the FTT had already arrived at its conclusion that Eclipse 35 was not carrying on a trade (see, in particular, [410] and [413]). The reasons given by the FTT for coming to that conclusion are unassailable in law and are unaffected by (and uninfected by) any error in its observations about section 609 at [414].

The Respondent's Notice

101. By the Respondent's Notice and by reference to the new evidence admitted in the form of the text of the Prior Agreements and the expert evidence of Mr Marks, HMRC sought to bolster the FTT's reasons for concluding that Eclipse 35 was not carrying on a trade. Since I have come to the conclusion that the appeal should be dismissed for the reasons given above, I can deal with the Respondent's Notice quite shortly. In my view, had the appeal succeeded on the basis of any of the grounds of appeal considered above, the decision would not have been saved by the point raised under the Respondent's Notice.

102. I should record the facts which I find on the basis of the additional evidence admitted at the hearing before the Upper Tribunal:

(1) The Prior Agreements comprised (i) a licence agreement dated 3 October 1990 between Disney and Buena Vista Pictures Distribution Inc. in relation to US theatrical distribution rights (i.e. for cinema distribution in the USA and other places in North America) ("the US Prior Agreement"); (ii) a licence agreement dated 31 May 1992 between Disney and Buena Vista International Inc. in relation to theatrical distribution rights in the entire world other than the territory covered by the US Prior Agreement ("the international Prior Agreement"); and (iii) a licence agreement dated 18 April 2005 between Disney and Buena Vista Home Entertainment Inc. in relation to distribution of videos and DVDs anywhere in the world ("the home entertainment Prior Agreement").

(2) The Prior Agreements each covered the two Films at issue in this case. The Prior Agreements can be brought to an end on the giving of notice, as set out in those Agreements; but they had not and still have not been terminated under these provisions.

(3) Apart from any amendment (see sub-paragraph (4) below), the Prior Agreements have the effect that the various Buena Vista entities have the full and exclusive distribution rights in relation to the Films in respect of their distribution in cinemas throughout the world (by combination of the US Prior Agreement and the international Prior Agreement) and in respect of distribution of videos and DVDs throughout the world (by the home entertainments Prior Agreement). However, the Prior Agreements do not cover television distribution rights, which (as between the Buena Vista entities and Disney) remained with Disney.

(4) There has been no relevant amendment of the international Prior Agreement and the home entertainment Prior Agreement. However, the US Prior Agreement was validly and effectively amended by a letter dated 11 August 2005 by the addition of a new clause 18 (or, as it was termed, section 18), as follows:

> "18. Financing and Other Arrangements. From time to time, Disney may enter into, or cause its affiliates to enter into, financing or other arrangements whereby Disney may transfer all or any portion of the rights to a Picture that would be otherwise subject hereto. The parties hereto acknowledge that the obligations of Disney under this Agreement are subject to any such financing or other arrangement. In addition, any reference to the rights in such Pictures licensed hereunder or retained by Disney hereunder shall be deemed to refer to such rights to the extent retained by Disney or transferred or licensed to Disney pursuant to such financing or other arrangement."

On the evidence of Californian law given by Mr Marks, since the letter of 11 August 2005 referred only generally to the amendment being "for good and valuable consideration" and did not refer to any specific consideration given in respect of it, there is no presumption based on the terms of the letter itself that the amendment was made on the basis of good consideration. However, he also gave evidence that valid consideration for an amendment such as this could be provided extraneously, outside the letter itself (very much as would be the position under English law). Although there was no evidence from any Disney or Buena Vista personnel, I find on the balance of probabilities that valid extraneous consideration was given for the amendment. The amendment was plainly drawn up and countersigned on the basis that it was intended to amend the US Prior Agreement. It is highly likely that the Disney and Buena Vista group has access to good legal advice about Californian law; that advice would have been given in line with the evidence of Mr Marks; and Disney and Buena Vista would have arranged for valid extraneous consideration to be given in respect of the amendment in order to give it the legal validity they intended it to have.

103. I find that these facts do alter somewhat the picture regarding the Prior Agreements as set out in the findings of the FTT (see, in particular, [264]-[273] and [293]-[300]). The rights in fact granted by Disney to Buena Vista entities under the Prior Agreements were more extensive than the FTT thought, based upon the evidence given to the FTT by Mr Molner about his understanding of their effect. Mr Molner had not seen the Prior Agreements, but had discussed them with Disney ([267]) and made various assumptions about their contents which the FTT found persuasive. He did not think that the Prior Agreements conferred distribution rights on the Buena Vista companies which materially reduced the distribution rights which appeared to be conferred on Eclipse 35 under the Distribution Agreement and the Licensing Agreement.

104. However, I find that the distribution rights granted to Buena Vista companies under the international Prior Agreement and the home entertainment Prior Agreement were full and exclusive. The rights granted to Eclipse 35 in the Distribution Agreement and the Licensing Agreement were expressed to be "subject to the Prior Agreements", which in my judgment means as a matter of construction that the rights granted to Eclipse 35 were conferred subject to the prior distribution rights already

granted to Buena Vista companies under the Prior Agreements. I was not impressed by any of the arguments on interpretation presented by Mr Aaronson in his attempt to escape this straightforward conclusion. Therefore, the Distribution Agreement and the Licensing Agreement did not confer any substantive distribution rights on Eclipse 35 in relation to international cinema distribution or worldwide video and DVD distribution, save in the unlikely event that the international Prior Agreement and the home entertainment Prior Agreement were terminated.

105. The position was different in relation to cinema distribution in the USA and North America, because the addition of clause 18 by amendment of the US Prior Agreement meant that Disney reserved the right under that agreement to remove the rights in respect of such distribution from the Buena Vista company in the circumstances specified. This meant that Disney was entitled to enter into the arrangements with Eclipse 35 and to confer these distribution rights on Eclipse 35, which it did by the terms of the Distribution Agreement and the Licensing Agreement.

106. In my judgment, there are two reasons why the change in the factual picture as regards the Prior Agreements does not affect in any material way the reasoning or conclusions of the FTT. First, even on the new factual picture, the statement that the arrangements with Eclipse 35 were subject to the Prior Agreements did not render the licensed Rights valueless. As against the Buena Vista companies, Disney retained the right to grant to Eclipse 35 the distribution rights for television release of the Films anywhere in the world (these rights fell completely outside the terms of the Prior Agreements), for cinema release in the USA and North America, for cinema release elsewhere in the world (if the international Prior Agreement were terminated) and for video and DVD release anywhere in the world (if the home entertainment Prior Agreement were terminated). Disney granted all these rights to Eclipse 35 under the arrangements between them.

107. Although, on the new factual picture, the value of the rights ostensibly granted to Eclipse 35 was considerably reduced by reason of the prior grant of distribution rights under the international Prior Agreement and the home entertainment Prior Agreement, in my opinion this does not affect the main thrust of the FTT's reasoning. Genuine rights with material value were granted to Eclipse under the arrangements with Disney. Even on the new factual picture, I do not consider that the Upper Tribunal could or should go behind the FTT's conclusion that the transactions should not be viewed as a composite whole or as transactions which did not have the legal effect they purported to have or that they had a purpose divorced or different from their commercial effect: see [364]-[367] and [395]-[396]. Therefore, in my view, the new factual picture does not in the end materially assist HMRC in its case in this regard, which was rejected by the FTT.

108. Secondly, and in any event, in my judgment the new factual picture regarding the true effect of the Prior Agreements does not touch on the FTT's assessment regarding the question whether Eclipse 35 was carrying on a trade, by reason of the state of mind of Mr Molner and Eclipse 35 regarding the contents and effect of the Prior Agreements. Mr Molner was the chief negotiator for Eclipse 35 with Disney.

Neither he nor anyone else for Eclipse 35 saw the Prior Agreements. Eclipse 35, acting principally by Mr Molner, negotiated the arrangements on the basis of its understanding of the contents and effect of the Prior Agreements. That understanding of the underlying position was what the FTT found the underlying position in fact to have been (albeit I have concluded that the true underlying factual position was somewhat different). Therefore, in so far as the FTT's analysis on the trading question proceeded or should have proceeded by reference to the understanding of Eclipse 35 regarding the Prior Agreements rather than by reference to what may have been the true underlying facts, its assessment on that question is unaffected by the new facts which I have found.

109. Since the FTT found the underlying facts regarding the effect of the Prior Agreements to be in line with Mr Molner's understanding, it did not have to distinguish these two things for the purpose of its assessment of the trading issue. However, in this Tribunal the new evidence has established that there is a difference between the two, so it becomes relevant to assess whether this has any material impact on the FTT's assessment on the trading issue. In my view, it does not.

110. The issue to be decided by the FTT was ([3]), "in the tax year ended 5 April 2007 was Eclipse 35 carrying on a trade?" In addressing that issue, what is important is the activity of Eclipse 35 itself. In assessing the characterisation to be given to that activity, I consider that the proper approach is to focus primarily on the state of mind of Eclipse 35 and the circumstances as they appeared to Eclipse 35. It is the purpose of Eclipse 35 and of the transactions which it took itself to be entering into which is central to assessment whether it was carrying on a trade, as the summary of the law given by Millett J in *Ensign Tankers* [1989] STC 705, at 761-763; [1989] 1 WLR 1222, 1231-1234, makes clear. This summarises the guidance which the FTT treated as applicable on the trading question, as follows:

> "It has been conceded by the Crown throughout that the question is not whether *the taxpayer company* was carrying on a trade but whether *the limited partnerships* were doing so. In each case the taxpayer company was merely a sleeping partner or investor in a joint venture carried on by the general partner on its behalf; the expenditure was made by the general partner out of money belonging to or borrowed by the partnership; and the question is whether the venture on which the partnership embarked was in the nature of trade. The production of a film, or the completion of an uncompleted film or, I might add, the purchase of a completed film, in each case with a view to its distribution and exploitation for profit, are all typical, though highly speculative, commercial transactions in the nature of trade. It is with those words "for profit" that the questions in the present case are primarily concerned.
> Many aspects of the law have been usefully summarised by Sir Nicolas Browne-Wilkinson V.-C., in the recent case of *Overseas Containers (Finance) Ltd v Stocker* [1989] 1 WLR 606. I take the law to be as follows:
>
> (1) In order to constitute a transaction in the nature of trade, the transaction in question must possess not only the outward badges of trade but also a genuine commercial purpose.

(2) If the transaction is of a commercial nature and has a genuine commercial purpose, the presence of a collateral or ulterior purpose to obtain a tax advantage does not "denature" what is essentially a commercial transaction. If, however, the *sole* purpose of the transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose.

(3) Where commercial and fiscal purposes are both present, questions of fact and degree may arise, and these are for the commissioners. Nevertheless, the question is not which purpose was predominant, but whether the transaction can fairly be described as being in the nature of trade.

(4) The purpose or object of the transaction must not be confused with the motive of the taxpayer in entering into it. The question is not *why* he was trading, but *whether* he was trading. If the sole purpose of a transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose. But it is perfectly possible to predict a situation in which a taxpayer whose sole motive is the desire to obtain a fiscal advantage invests or becomes a sleeping partner with others in an ordinary trading activity carried on by them for a commercial purpose and with a view of profit.

(5) The test is an objective one. In *Newton v Commissioner of Taxation of Commonwealth of Australia* [1958] AC 450, Lord Denning said, at p. 465, approving the statement of Williams J.: "'The purpose of a contract, agreement or arrangement must be what it is intended to effect and that intention must be ascertained from its terms.'" The objective nature of the inquiry appears clearly from both the dividend-stripping cases and the cases of intra-group transactions. In *Finsbury Securities Ltd v Inland Revenue Commissioners* [1966] 1 WLR 1402 and *Lupton v F.A. & A.B. Ltd* [1972] AC 634, the transaction was designed to make a loss (or had no hope of making a profit) if the claim to recover tax was disregarded. Without the fiscal element, the transaction had no purpose at all. In *Thomson v Gurneville Securities Ltd* [1972] AC 661, a similar transaction was designed to make a profit but the profit was artificially built into the transaction from the outset, was very small in relation to the size of the transaction, and could on purely objective grounds be properly regarded either as a fee for those who put the scheme forward or as a colourable device for giving the semblance of a commercial profit to what was merely a scheme for extracting money from the exchequer: see pp. 678–679, per Lord Simon of Glaisdale. In each case the transaction was "a wholly artificial device remote from trade"; it was "incapable of being fairly regarded as a trading transaction." In *Coates v Arndale Properties Ltd* [1984] 1 WLR 1328 and *Overseas Containers (Finance) Ltd. v. Stoker* [1989] 1 WLR 606 the alleged commercial profit consisted of a payment from one wholly-owned subsidiary to another in the same group; such a payment disappears on consolidation and serves no commercial purpose of any kind. In each of these cases the purpose of the transaction was objectively ascertained by a detailed

analysis of the terms and circumstances of the transaction itself without inquiry into the motives and subjective aspirations of those who affected it.

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

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

(8) In *Lupton v. F.A. & A.B. Ltd* [1972] AC 634, 647, Lord Morris of Borth-y-Gest said:

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

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

(9) Accordingly, in my judgment, and adapting the words of Lord Simon of Glaisdale in *Thomson v. Gurneville Securities Ltd* [1972] AC 661, 678–679, the question is whether, in the light of all relevant circumstances, the transaction is capable of being fairly regarded as a transaction in the nature of trade, albeit one intended to secure a fiscal advantage or even conditioned in its form by such intention; or is incapable of being fairly so regarded but is in

truth a mere device to secure a fiscal advantage, albeit one given the trappings normally associated with trading transactions."

111. Similarly, in *Edwards v Bairstow* [1956] AC 14, at 36-37, Lord Radcliffe's analysis of the facts in the case shows the importance of focusing on the intentions and plans of the person carrying on the activity falling for assessment:

> "If I apply what I regard as the accepted test to the facts found in the present case, I am bound to say, with all respect to the judgments under appeal, that I can see only one true and reasonable conclusion. The profit from the set of operations that comprised the purchase and sales of the spinning plant was the profit of an adventure in the nature of trade.
>
> What other word is apt to describe the operations? Here are two gentlemen who put their money, or the money of one of them, into buying a lot of machinery. They have no intention of using it as machinery, so they do not buy it to hold as an income-producing asset. They do not buy it to consume or for the pleasure of enjoyment. On the contrary, they have no intention of holding their purchase at all. They are planning to sell the machinery even before they have bought it. and in due course they do sell it, in five separate lots, as events turned out. And, as they hoped and expected they make a net profit on the deal, after charging all expenses such as repairs and replacements, commissions, wages, travelling and entertainment and incidentals, which do in fact represent the cost of organizing the venture and carrying it through.
>
> This seems to be, inescapably, a commercial deal in secondhand plant. …"

112. The purposes, intentions and plans of Eclipse 35 cannot sensibly be assessed other than by focusing on what it thought was going on, even if in some respects its appreciation of the underlying factual position may have been mistaken. The change in the findings regarding the underlying position regarding the Prior Agreements does not affect the FTT's view of the understanding of Eclipse 35 about that. So far as is relevant to the FTT's assessment on the trading question, therefore, the factual position is essentially unchanged by the new evidence and it does not ultimately assist HMRC.

113. Nor does the new evidence introduce any good grounds for thinking that the case should be remitted to the FTT to give further consideration to the question of the understanding of Mr Molner and Eclipse 35 regarding the effect of the Prior Agreements. The FTT found that Mr Molner was a credible witness ([53]). His evidence was that he had not seen the Prior Agreements, but had been given (misleading) assurances by Disney regarding their contents ([267]). On a fair reading of the decision, the FTT accepted all this (see in particular [53], [267], [295] and [301]). The new evidence of the actual terms of the Prior Agreements, which Mr Molner did not see, does not provide any new basis for thinking that the FTT would

think it right to allow further cross-examination or to make any different findings of fact regarding his understanding.

Conclusion

114. For the reasons set out above:

(1) I dismiss the appeal on the trading issue;

(2) I allow the appeal on the minor and essentially technical point, that the FTT should have allowed the appeal against the closure notice on the footing that Eclipse 35 was carrying on a business involving the exploitation of films with a view to profit.

THE HON. MR JUSTICE SALES
RELEASE DATE: 20 DECEMBER 2013