[2016] UKUT 361 (TCC)

Appeal numbers: UT/2015/0033
UT/2015/0036-39

Income Tax – loss relief – arrangements for exploitation of intellectual property rights – whether first-year losses incurred – whether large part of money paid for exploitation of rights or purchase of guaranteed income stream – whether remainder used within first accounting year and allowable loss in that year – appeals against First-tier Tribunal dismissed

IN THE UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

BETWEEN

(1) ACORNWOOD LLP
(2) BASTIONSPARK LLP
(3) EDGEDALE LLP
(4) STARBROOKE LLP
(5) HAWKSBRIDGE LLP

Appellants

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: Mr Justice Nugee

Sitting in public at The Rolls Building, Fetter Lane London EC4A 1NL on 15, 16 and 17 March 2016

Jonathan Peacock QC and **Hui Ling McCarthy** (instructed by **Rosenblatt Solicitors**) appeared on behalf of the Appellants

Jonathan Davey QC, **Nicholas Macklam** and **Sam Chandler** (instructed by **HMRC Solicitor's Office**) appeared on behalf of the Respondents

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DECISION

Mr Justice Nugee:

Introduction

1. This is an appeal by five limited liability partnerships, Acornwood LLP, Bastionspark LLP, Edgedale LLP, Starbrooke LLP and Hawskbridge LLP (**"the LLPs"**) against a decision of the First-tier Tribunal (Judge Colin Bishopp and Mr Richard Law) (**"the FTT"**) dated 7 May 2014 (**"the Decision"**). The Decision concerned two matters: appeals by the LLPs against various decisions of the Respondents, the Commissioners for HM Revenue and Customs (**"HMRC"**), disallowing expenditure by the LLPs which they claimed to be trading losses; and a joint reference to the FTT of a number of questions by seven individuals who were members of the LLPs or of similar partnerships. This appeal only concerns the appeals of the LLPs; there is outstanding a separate appeal by the individual referrers which has not yet been heard.

2. The LLPs are examples of what the FTT referred to as "Icebreaker Partnerships". The Icebreaker Partnerships were the "brainchild" of Ms Caroline Hamilton, who created the Icebreaker Partnership concept and promoted the partnerships to prospective members. In essence, the individual members who participated in the partnerships contributed some money of their own and a rather larger amount of borrowed money to the LLPs, in order to provide finance for a range of creative projects. Each LLP claimed to have made a significant trading loss in its first year which the individual members sought to claim as an allowable loss against their income tax liability. That required the resolution of two questions: first, whether the losses claimed to have been made by the LLPs were allowable trading losses; and second, whether the individual referrers could claim sideways loss relief in relation to

them. As already explained, these appeals only concern the first of those two questions.

3. The five appellant LLPs were selected to represent each of the five tax years from 2005-06 to 2009-10. They differ slightly in the detail of the arrangements which they entered into, but the essential structure of the arrangements was similar. The five appeals to the FTT by the LLPs were directed to be lead cases; there are a further 46 Icebreaker Partnerships which are appellants in related cases. The losses claimed by each LLP, and largely, although not entirely, disallowed by the FTT, were in the region of £4-6m each; the total amount claimed by all 51 partnerships is some £336m.

4. The main question is whether the expenditure claimed by the LLPs satisfies the requirement of s. 34 of the Income Tax (Trading and Other Income) Act 2005 (**"ITTOIA"**), which makes it a prerequisite before losses are allowable as trading losses that they arise from expenses incurred wholly and exclusively for the purposes of the trade. There are a number of subsidiary questions which I explain below.

Structure and arrangements

5. The FTT set out in great detail the contractual arrangements which the LLPs entered into. It is not necessary for the purposes of this decision to go into the same level of detail, and I will do no more than give an outline sketch of the relevant arrangements, as this is all that is required to understand the points at issue.

6. Mr Peacock QC, who appeared for the LLPs, posited a simple example using a figure of 100 to represent the sums contributed to an LLP by the individual members of it. This was a very convenient way to understand and label the various sums involved, and I will use that example throughout this decision. Of that 100 the members

contribute 20 from their own resources. The other 80 is borrowed by the members from a bank. (In fact it was not always 80% that was borrowed from a bank; in Acornwood's case it was 75%.) That bank borrowing was on full recourse terms, or in other words the individual members were personally liable to repay the 80 to the lending bank. The LLP takes the 100 and pays 5 to a management company, Icebreaker Management Ltd (**"IML"**). That 5 is in part what is called an advisory fee and in part an administration fee. I am not concerned with the administration fee; the FTT allowed a loss to be claimed in respect of part of that, and neither side seeks to disturb that on this appeal. I am however concerned with the remainder of the fee paid to the management company by way of advisory fee, where the FTT allowed part of it in the case of Acornwood but did not allow any of it in the case of the other LLPs. The LLP pays the remaining 95 to a company that can be referred to as the principal exploitation company, which in the case of most of the LLPs was a company called Shamrock Solutions Ltd (**"Shamrock"**); in the case of Acornwood a different company called Centipede Ventures Ltd (**"Centipede"**) was used. Shamrock agreed to pay a large part of the 95 (say 90) to a production company which would be responsible for producing the end product, be it a music CD, a book, or some other product. The production company simultaneously agreed to acquire a share of the revenues from exploitation of the product from Shamrock, the price for doing so being say 80. The net effect of those two agreements was that Shamrock paid 10 to the production company, leaving it with 85 of the 95 paid to it. Shamrock put 80 of this (or in one case 80 of its own money) on deposit as collateral for the issue of a letter of credit. The interest paid on the deposit of 80 is used by Shamrock to pay an income stream by quarterly payments to the LLP and that matches the quarterly interest payments which the members of the LLP are obliged to pay to the lending

bank for the initial borrowing of the 80 to fund their contribution to the LLP. The 80 on deposit is also used to pay the LLP what is described as the "Final Minimum Sum" due from Shamrock to the LLP; that is payable in a number of different circumstances but in effect the LLP is in a position to ensure that it is paid the 80 if it requires it at the end of 4 years, and that sum is then available to be used to repay the principal amount borrowed by the members of the LLP.

7. The main argument is in relation to 80 of the 95 paid by the LLP to the principal exploitation company. The FTT disallowed that on the basis that it was not wholly and exclusively incurred for the purposes of the LLP's trade, and on the further ground that it was a payment of a capital nature not an income nature. In relation to the 15, the balance of the 95 paid by the LLPs to the principal exploitation company, the FTT allowed the entirety of it in the case of Acornwood and a part of it in relation to the other LLPs. They were not able to identify how much of the latter was deductible, and left that to be agreed by the parties or determined after further argument if they could not agree it.

8. I was taken by Mr Peacock through the documents in relation to one of the LLPs, in fact Hawksbridge LLP. The terms of the contractual arrangements were, as I have said, not entirely identical in each case, but they were sufficiently similar for this to illustrate the nature of the transactions concerned. It starts with an LLP agreement in conventional form, the Initial Members being two companies, Lothbury Finance Ltd and Basinghall Ltd, whose capital contributions are £1 each. These companies are also the Designated Members. The purpose of the LLP is said to be to acquire Exploitation Rights and exploit the same from time to time, Exploitation Rights meaning all forms of rights to exploit any interest, right, know-how or creative

material, including copyright and all other rights in Intellectual Property, and Intellectual Property being defined in very wide terms and including rights in audio, visual or performance related work and a large number of other matters. Each individual member executes a Deed of Accession under which they specify what their capital contribution will be; the example I was shown concerned a capital contribution of £200,000 by a particular member. All this takes place on a single day, referred to as Financial Closing, which in the case of Hawksbridge LLP was 31 March 2010. On that day the individual members borrow from the lending bank, Barclays Bank plc, 80% of their capital contributions, which is paid to the LLP along with the 20% which they contribute themselves.

9. The LLP then wishes to acquire and develop and exploit some original intellectual property. It therefore enters into a licence from the creator of an idea. I was shown an example in the case of Hawksbridge which was a licence from a Mr Michael Sawyer in the form of an exclusive transferable worldwide licence for 10 years to exploit what was described as the Treatment and all rights of any kind arising from it, which was in this particular case the treatment for a book, the subject matter being the band Kiss. The LLP paid a relatively modest sum, in that case £5,000, for the licence. Another example which I was referred to was the acquisition from Sinead O'Connor of a licence in respect of at least 20 and no more than 22 musical compositions written by her to enable the LLP to exploit master recordings of those compositions.

10. Having acquired the licence, the LLP wishes to exploit the rights it has acquired, but it does not itself have the expertise to do so. It therefore needs to engage a company with the skills to exploit those rights. It therefore enters into an agreement called the Principal Exploitation Agreement, with the principal exploitation company, in this

case Shamrock. In that agreement Shamrock agrees to exploit the relevant rights by both arranging for the production of the materials with a view to maximising the revenue from them, and exploiting the materials with a view to maximising the total revenue. For that purpose the LLP licenses the rights to Shamrock, again for a term of 10 years. The LLP pays to Shamrock on signature of the agreement a fee, which in this case was £5,188,500. That represents the 95 of the 100 in Mr Peacock's example. That fee is expressed in the case of the Hawksbridge Principal Exploitation Agreement to be "solely in consideration of Shamrock's services under clause 2.1.1 of this agreement", that is in respect of Shamrock's obligation to arrange for the production of materials. In that respect the Hawksbridge agreement differs slightly from the other four agreements, a point I return to below.

11. Shamrock's remuneration for all other services under the agreement is expressed to be the "Shamrock Share". This was a percentage of the Available Revenue, the percentage varying according to the particular rights concerned. In the case of Mr Sawyer's Kiss book it was 10% of Available Revenue, in the case of Sinead O'Connor's songs it was 15%. Available Revenue was the Total Revenue less any amounts of revenue assigned by Shamrock to third parties, Shamrock being entitled to assign a share of Total Revenue to third parties. Shamrock also agreed that it would pay to the LLP the Quarterly Amounts and the Final Minimum Sum specified in the agreement; in the case of Hawksbridge, this was said to be expressly in consideration of the right that Shamrock had to assign a share of total revenue to third parties. The Final Minimum Sum represents the 80 in Mr Peacock's example which matches the amount repayable by the members of the LLP to the lending bank. The Quarterly Amounts are fixed for the first 4 years and match the interest payable by the members to the lending bank. Shamrock also agrees to provide appropriate security for its

obligations to pay the Quarterly Amounts up to the fourth anniversary, and the Final Minimum Sum. The Final Minimum Sum was prima facie payable on the 10th anniversary of the agreement, in this case 31 March 2020, but the LLP had an option which in effect enabled it to accelerate payment of the Final Minimum Sum to the end of the 4th year.

12. Under that agreement therefore the partnership engaged Shamrock to exploit the original intellectual property so as to turn it into an end product. The partnership has paid a fee to Shamrock for that. The partnership has also granted a licence to Shamrock of the original intellectual property in order to give Shamrock the freedom to develop and exploit it, and the partnership has engaged Shamrock to distribute the end product. The partnership has arranged for itself a right to a secure stream of income and it has allowed Shamrock to give away shares of revenue to third parties. Shamrock has received a fee (the 95) but it has an obligation not only to provide exploitation services but to provide a guaranteed stream of income and appropriate security. It also has to find a third party production company to create the finished product. In principle it could have put up the collateral to secure the requisite security, in the form of a letter of credit, from its own resources (and it did in fact do so in the case of Hawksbridge). But in the other four appeals the principal exploitation company used the sums paid by the partnership in part to put up the collateral. If therefore one traces the money, in all the cases but Hawksbridge 80 of the 95 goes into a blocked account to support the issue of a letter of credit.

13. Shamrock then enters into a production agreement with a commercial counterparty to develop each of the relevant end products. Such an agreement was typically called a Services and Licensing Agreement, although I was shown an example called a

Product Development and Production Agreement. That was entered into on 5 April 2010 between Shamrock and a company called First Light Publishing Ltd, and obliged First Light to produce a large format hand crafted luxury book on the band Kiss. For that Shamrock paid a fee of £2,250,000 to First Light. A similar agreement, this time called a Services and Licensing Agreement, was entered into by Shamrock with Dreamac Ltd to produce the Sinead O'Connor album. In that case the fee was £2,950,000. On the same dates as entering into these agreements, Shamrock and the relevant production company entered into agreements called Assignment of Revenues Agreements. That between Shamrock and First Light, also dated 5 April 2010, provided for the grant by Shamrock to First Light of a 25% share of the revenues it received from all forms of exploitation of the product in consideration for the payment of £1,852,000. That between Shamrock and Dreamac, entered into on 1 April 2010, contained a grant by Shamrock to Dreamac of 50% of the revenues it received from its exploitation of the Sinead O'Connor album in return for the payment by Dreamac of the sum of £2,625,000. In terms of Mr Peacock's example, the sums payable by Shamrock to the various counterparties who were going to undertake the production amounted to 90 of the 95 that it received from the LLP; it received back 80 from the counterparties under the Assignment of Revenues Agreements, and therefore it only had to pay a net 10 to the production companies. That left it with 85 of the 95, of which it paid 80 into the blocked account in order to provide the letter of credit that would secure the payment of the Quarterly Sums and Final Minimum Sum to the LLP, so leaving it with 5. (As already mentioned, in the case of Hawksbridge, it in fact paid the 80 into the blocked account out of its own resources, but was left with 85 so the net effect was the same.)

14. Two further agreements should be referred to here. They are the agreements entered

into between the LLP, in this case Hawksbridge, and Icebreaker Management Services Ltd (**"IMSL"**). The first, dated 31 March 2010, is an agreement called the Advisory Services Agreement, under which the LLP appointed IMSL to provide commercial advice, for example in relation to the licence for the exploitation of the rights. The LLP agreed to pay IMSL a sum of £384,681 at the date of the agreement for advice already provided and further annual payments of £5,000 per annum for advice to be provided. The second agreement, also dated 31 March 2010 and also made between Hawksbridge and IMSL, was called the Administrative Services Agreement and provided for Hawksbridge to appoint IMSL to provide various administrative services such as maintaining the LLP's bank account, and preparing and submitting returns on behalf of the LLP as required by any relevant statutory requirements, including tax returns. In this case Hawksbridge agreed to pay the sum of £50,000 on the date of the agreement in consideration for services already provided, and further annual payments of £6,500 a year for services to be provided.

15. I have referred to the fact that the individual members borrowed a large part, usually 80%, of their capital contributions to the LLP. I was shown an example of a loan agreement for one of the participants in Hawksbridge. This was dated 31 March 2010 and made between Barclays Bank and the individual member, and provided for the bank to lend up to the sum of £160,000, being no more than 80% of the borrower's capital contribution to the LLP. The term of the loan was for four years, the borrower undertaking to repay the facility in one sum on the fourth anniversary of drawdown. The rate of interest was a fixed rate to be agreed between the bank and IMSL acting as attorney on behalf of the borrower, plus a margin of 0.5% per annum. The facility letter contained an acknowledgment by the borrower that the facility letter involved him/her in personal responsibility for repayment of the facility, and it is not disputed

that this was a full recourse loan. As security for the repayment the bank required the LLP to open a blocked account with the bank into which all income of the LLP and capital contributions to the LLP, unless otherwise agreed by the bank, would be paid, and also a debenture by the LLP incorporating fixed and floating charges and assignments of the contracts and assets of the LLP including the blocked account. There was an arrangement fee payable for the facility equal to 0.4% of the amount of the advance.

16. The borrowing arrangements were supplemented by security arrangements. There were three principal documents. The first was a charge of a cash deposit entered into between Shamrock Solutions UK Ltd (Shamrock's UK subsidiary, **"Shamrock UK"**) and Barclays Bank, which recited that in order to induce the bank to issue the letter of credit in favour of the LLP Shamrock UK had opened the deposit account, had agreed to deposit the amount equal to the Initial Deposit in the deposit account, and had agreed to enter into the charge. The Initial Deposit is the sum of £4,636,600. This is identical to the Final Minimum Sum payable under the Principal Exploitation Agreement by Shamrock to the LLP. The agreement contains an obligation on Shamrock UK to deposit the Initial Deposit in the deposit account, in order to induce the bank to issue the letter of credit in favour of the LLP. The cash deposit was held by the bank for the express purpose of funding payments to be made under the letter of credit and the bank was therefore authorised to pay on each interest date an amount equal to the amount due under the letter of credit on that day. The account was otherwise blocked until the bank would have no further liability under the letter of credit. Shamrock UK also indemnifies the bank against its liability under the letter of credit and charges the deposit with payment of such sums. The second document is the letter of credit itself issued by the bank in favour of the LLP as the beneficiary at

the request of Shamrock UK. That enabled Hawksbridge to draw down each quarter an amount equal to the Quarterly Payments due from Shamrock under the Principal Exploitation Agreement of roughly £25,000 a quarter from 1 July 2010 to 31 December 2013, and a final amount on 31 March 2014 of £4,661,751.97, equal to the Quarterly Payment due on that day from Shamrock together with the Final Minimum Sum of £4,636,600. The third document is a debenture by Hawksbridge in favour of Barclays Bank as the lending bank to secure the repayment of the individual borrower's liabilities; this expressly includes a charge over the letter of credit.

17. The sum deposited in the blocked account as security for the letter of credit accrued interest at a rate which would match that payable by the members (ignoring the 0.5% margin payable to the bank). The bank's margin and its 0.4% fee had been paid at the outset. In practical terms therefore the effect of the money being paid into the blocked account was that the bank would be repaid. As the FTT said (at [127] of the Decision):

> "The arrangements were always so structured that the interest earned on the deposit exactly matched the quarterly amounts, which in turn exactly matched the interest, net of the margin, payable by the members on their borrowings. Thus if all went according to plan and the letter of credit was not called upon, the interest earned by the deposit was paid to Shamrock, in order that Shamrock could pay the corresponding quarterly amount to Hawksbridge, which in turn distributed that sum to the members in accordance with their respective shares. The members used the sums paid to them to discharge their obligation to pay interest to Barclays. The money therefore went round in a circle; and in doing so it too merely passed from

> one Barclays account to another, never leaving Barclays' control."

Much the same applied to the principal sum borrowed by the individuals from the bank. As the FTT said at [128] of the Decision, the arrangements were not quite so simple, but:

> "in an ordinary case without unexpected complication this process, too, was essentially a bookkeeping exercise: when the loans to the members came to be paid off, the bank simply withdrew from the blocked deposit accounts the sums necessary to discharge the loans – the total required, as we have explained, invariably and exactly matching the deposited sums – while the interest arrangements were also structured so that, whenever redemption occurred, there was no shortfall in either direction."

The FTT's summary, at [122] of the Decision, was that:

> "the risk that the loans from the banks would not be repaid was effectively eliminated"

and, at [132] of the Decision, that although the members' borrowing arrangements constituted full recourse loans:

> "their exposure to any real risk of having to repay the loans from their own resources was illusory."

Was the 80 an expense incurred wholly and exclusively for the purposes of the trade?

18. I propose to consider first whether that part of the sums payable by the LLPs to the principal exploitation companies which matched the Final Minimum Sum payable by the principal exploitation companies back to the LLPs, was properly deductible as an

expense incurred wholly and exclusively for the purposes of the trade. In the case of the simplified example, this is the 80 of the 95 paid by Hawksbridge to Shamrock.

19. The relevant statutory provisions are found in ITTOIA. Section 25(1) provides:

> "(1) The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes."

Section 26(1) provides:

> "(1) The same rules apply for income tax purposes in calculating losses of a trade as apply in calculating profits."

Section 34(1) provides:

> "(1) In calculating the profits of trade, no deductions are allowed for –
>
> (a) expenses not incurred wholly and exclusively for the purposes of the trade, or
>
> (b) losses not connected with or arising out of trade."

The effect of that is that no deductions are allowed for expenses in computing the losses of a trade unless they were incurred wholly and exclusively for the purposes of the trade. It is not in dispute that the LLPs were trading with a view to a profit.

20. The FTT's conclusion on this aspect of the case is found at [264]-[272] of the Decision. In summary they found:

(1) Each partnership made a large payment to its principal exploitation company

in return for which it received two things, namely exploitation services, and a guaranteed income stream [264].

(2) The description of the right to assign a share of the revenue as the consideration for the guaranteed payments was a pretence. If the agreements were taken at face value, the guaranteed payments exceeded the true worth of the right to assign a share of revenue by so large a margin that neither party could realistically have believed that one was a fair price for the other. The reality is that part of the payment by each partnership to the principal exploitation company represented the price of the guaranteed income stream notwithstanding its description as something else [265].

(3) Once it was accepted that part of the payment was made to acquire the guaranteed income stream it followed that only so much of the fee as represented a payment for exploitation might represent an allowable deduction [270].

(4) The deposit which the partnership made possible by the members' borrowings invariably matched the Final Minimum Sum, which in turn invariably matched the amount borrowed, and the periodic payments invariably matched the amount earned on the deposit, which in turn exactly matched the interest payable on the borrowings. In those circumstances there was no basis to value the consideration for the guaranteed payments at anything other than the amount of the deposit [271].

(5) It necessarily followed, so far as the deductibility for tax purposes of that sum is concerned, that the reality was that the borrowed money was only ever available for use as the price of the guaranteed payments, and not for the

exploitation of intellectual property rights, and it was as a matter of fact used only for that purpose. The payment could therefore not be brought into the calculation of profit and loss by reason of s. 34(1) of ITTOIA [272].

21. In so doing the FTT followed the decision of Vos J, sitting in the Upper Tribunal, in *Icebreaker 1 LLP v Revenue & Customs Commissioners* [2010] UKUT 477 (TCC) (***"Icebreaker 1"***). This concerned the first of the Icebreaker partnerships, and one of the questions decided by Vos J was very similar to the question that arises on the 80, namely whether the entirety of the fee paid by the LLP to the exploitation company, in that case a sum of £1,273,866 payable to Centre Film Sales Ltd (**"Centre"**) was deductible as an expense wholly and exclusively expended for the purposes of the LLP's trade, or whether, as the FTT held and as in the event Vos J agreed, £1,064,000 of that was not so deductible, as it was paid for the purpose of securing the repayment of Annual Advances and the Final Minimum Sum.

22. Vos J approached that question as follows. First he considered what the purposive construction of the relevant statutory provision, in that case s. 74 of the Income and Corporation Taxes Act 1988 (**"ICTA"**), was. He concluded that the object of the provision was to allow a deduction from taxable profits for revenue expenses incurred by the taxpayer for the purposes of its trade: see at [38] of his decision. Although commenting that that might sound like a statement of the obvious, he said it was nonetheless clearly the purpose of the section. He added:

> "There is no indication in these words that the ultimate use of the monies by the recipient is to be relevant to a determination of the purpose for which they were expended"

and at [39]:

"The starting point in this case is the purposive construction of s. 74, which points the tribunal towards a consideration of the use that was made of the disbursement in question in relation to the taxpayer's trade, and does not require consideration of how the money was ultimately dealt with by the recipient."

23. Second he proceeded to construe the agreements that the parties had entered into and in particular the agreement that in that case was called the Head Distribution Agreement or HDA (which was the equivalent of the Principal Exploitation Agreement). In that case the relevant clause of the HDA provided that:

"in consideration of the rights and benefits obtained by Centre under [the HDA], Centre hereby undertakes and agrees to pay the Annual Advances and Final Minimum Sum to [Icebreaker] on the date specified".

As a matter of construction, Vos J held that one of the rights and benefits that Centre obtained and, therefore one of the rights and benefits for which it was granting the Annual Advances and Final Minimum Sum, was the right to receive the £1,273,866.

24. Third, having construed the HDA Vos J proceeded to an analysis of the entire transaction. That involved looking at the FTT's findings of fact which included findings that the loans from the lending bank (in that case the Bank of Scotland) would not have been advanced had it not been agreed that the £1,064,000 element, exactly matching the Bank of Scotland loan, would come straight back to the bank; that such instructions, although given by a director of Centre, were instructions that had to be given under the arrangements with the Bank of Scotland; and that Ms Hamilton knew that. Vos J rejected an attack on those findings of fact as not open to the Appellant. In those circumstances Vos J's conclusion was as follows (at [62]):

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

25. Mr Davey QC, who appeared for HMRC, submitted that the FTT in the present case had followed the approach adopted by Vos J in *Icebreaker 1* and their analysis and approach could not be faulted. First they had referred to the purposive construction of what is now s. 34 of ITTOIA. They said, at [270]:

> "The underlying question, as the legislation makes clear, is whether the payment, that is of the fee payable by each partnership to Centipede or Shamrock, is made wholly and exclusively for the purposes of the partnership's business. That business, as the appellant partnerships themselves argue, was the exploitation of intellectual property rights, and not

> the acquisition of an income stream which was guaranteed, irrespective of the success of that exploitation, and which was not even derived from it."

That description of s. 34 of ITTOIA might well be said to be doing no more, as Mr Davey accepted, than restating the statutory language; but I accept that this is a perfectly reasonable statement of the purpose of the statutory provision, and I further accept that the consequence which they identify, namely that the LLP's business did not include the acquisition of an income stream which was not derived from the exploitation of intellectual property rights, was also justified.

26. The next stage is the construction of the Principal Exploitation Agreement. Here the FTT said that the wording of the agreement in the first of the cases which they considered in detail, that of Acornwood LLP, was in substance the same wording as was used in cl 4.1 of the agreement in *Icebreaker 1*. In fact it was slightly different: whereas in *Icebreaker 1* the agreement of Centre to pay the Annual Advances and Final Minimum Sum was expressed to be in consideration of "the rights and benefits obtained by Centre under this agreement", in the case of Acornwood the relevant clause of the Principal Exploitation Agreement expressed Centipede's obligation to pay the Advances and Final Minimum Sum as being in consideration of "the privileges and benefits obtained by Centipede under this agreement". I need not however consider if there is any arguable distinction between "rights and benefits" and "privileges and benefits" as Mr Peacock did not rely on any such distinction. In any event, although the FTT said that in the case of Acornwood they could see little room to distinguish the conclusion in *Icebreaker 1*, it is apparent from the way in which they dealt with Hawksbridge (where the wording was different) that it would not have made any difference to their conclusion. In fact of the five appellant LLPs

the wording in Bastionspark, Starbrooke and Edgedale followed that of Acornwood.

27. In the case of Hawksbridge, Shamrock's agreement to pay the quarterly amounts and Final Minimum Sum was expressed to be in consideration of the right for Shamrock to be entitled to assign a share of total revenue to third parties and its rights to earn the Shamrock Share and acquire the LLP business. In that case therefore it cannot be said, simply as a matter of construction, that the 80 of the 95 was paid for the obligation of Shamrock to pay the Quarterly Amounts and Final Minimum Sum. That is why the FTT go on to find (at [265]) that the description of the right to assign a share of the revenue of the consideration for the guaranteed payments was a pretence.

28. That is an aspect of what Mr Davey characterised as the third stage in Vos J's approach to the question in *Icebreaker 1*, namely viewing the transaction as a whole. Here Mr Davey referred to the findings of fact which the FTT made in a number of areas. The first of these was the rationale for the borrowing arrangements. The FTT's conclusion on this was summarised by them at [133] as follows:

> "The essence of the appellant partnerships' case is that money was borrowed in order that there should be a greater sum available for the exploitation of the intellectual property rights each had acquired than would have been the case had the members put in only the sums they could provide from their own resources. HMRC's response is that none of the borrowed money was ever truly available for exploitation of the rights, and that the purpose of the borrowing coupled with the notional gross payment to each production company, was to create the illusion that the expenditure incurred by the partnerships in the first year was much greater than it truly was, in order to inflate the intended tax benefit. In our view, and for reasons we can explain

now, HMRC's case on this issue is unanswerable."

The detailed reasons for that conclusion then followed at [134]-[141] and [147]-[151].

29. In the course of argument I asked Mr Peacock for a statement by him of what the purpose of the borrowing was. His answer was as follows:

> *"The borrowing of the money allowed the individuals to invest 100 and not 20. That allowed them to have more money to pay Shamrock and that put Shamrock in a position whereby it could deal with third party production companies in relation to larger or more interesting projects, ie the more money in the deal as a whole, the easier it is to engage in exploiting the intellectual property in bigger and better projects."*

I have to say I did not understand this at the time, and having given the matter further consideration I still do not understand it. It is accepted that the only cash that Shamrock needed in order to enter into the production agreements and the assignment of share of revenues was (in terms of Mr Peacock's example) 10, that is the difference between the 90 payable to the production company and the 80 it received back from the production company for an assignment of the share of revenues. It did not need to receive 95 from the LLP in order to do a deal of that type. It could have received 15 from the LLP without the individuals undertaking any borrowing at all, and still entered into exactly the same agreements for the production of the product and the assignment of the share of revenues at 90 and 80 respectively, paying a net 10 to the third party commercial provider. The addition of the 80 which was borrowed from the bank and which, as the FTT said, was used to secure its own repayment, added absolutely nothing, so far as I can see, to the size of the projects that Shamrock undertook. In essence, what I understand the FTT to be saying is that the borrowing

had no commercial reason behind it at all: it does not do anything, it does not increase the return to the individuals, it does not increase the likelihood of the rights being exploited, it does not increase the upside, and it does not protect them against the downside, because if they had not borrowed the money they would not have that element of downside. So all that the borrowing does is multiply by roughly five times the amount apparently paid for the exploitation of the rights by the LLP without changing anything at all. Or as the FTT put it in their own words at [147]:

> "The borrowing arrangements gave them nothing at all, but merely discharged the interest as time passed and repaid the capital at the end of the term. Indeed, the irrecoverable cost to them of the arrangement fees and margin led to the members making a certain loss, without the prospect of even a speculative gain from the use of the borrowed money. The agreements for borrowing, guarantee and repayment were, and we are satisfied were always seen by all concerned as, a means of increasing, without risk, the apparent size of the amount paid for the exploitation of the intellectual property rights each partnership had acquired. That is HMRC's case and, again, it is in our view unanswerable. As we have already said the money was not, and could not be, used in the exploitation of the rights and the borrowing was an arrangement with no commercial but only a tax purpose."

30. The second aspect of the FTT's consideration of the transaction as a whole to which Mr Davey referred was the consideration by them of the security arrangements. Their conclusion at [122] was that:

> "The risk that the loans from the banks would not be repaid was effectively eliminated. In most cases the lending bank did not part with any money at

> all; in others it did so only when it had already received the equivalent amount in cleared funds."

Again, at [132] they said that:

> "The members' exposure to any real risk of having to repay the loans from their own resources was illusory."

31. The third aspect to which Mr Davey referred was the consideration by the FTT of the rationale for the guaranteed payments. Here, the FTT rejected the explanations given in evidence and found them disingenuous. They said at [151]:

> "Overall a great deal of effort was expended by Ms Hamilton and, in submissions, by Mr Peacock and Mr Maugham in attempting to persuade us that the guaranteed payments represented a revenue stream genuinely derived from the exploitation of intellectual property rights, and that they, as well as the put option were "downside protection" sheltering the members from the risk that the projects would be unsuccessful. Even a cursory examination of the arrangements shows that this is not a proper interpretation of them. As we have said already, the guaranteed payments were due not only irrespective of success or otherwise of the projects, but were payable from a different source, the sum deposited by the principal exploitation company with the bank. Neither the borrowings nor the guaranteed payments had in reality, any connection at all to the intellectual property rights the partnership had acquired."

32. The fourth aspect to which Mr Davey referred was the consideration by the FTT of the commercial realities of the arrangements. Here he referred in particular to [267]

where the FTT referred to the fact Mr Hutton, the director of Shamrock, regarded the borrowing arrangements as a nuisance and accepted that the borrowed money was never available, in a practical sense, for use in the exploitation of intellectual property rights.

33. The fifth and final point on which Mr Davey relied was the FTT's findings as to the knowledge of Ms Hamilton. That can be summarised in the words of the FTT at [137] where they said:

> "In our view there can be no doubt that she knew perfectly well from the outset that the money borrowed would be used, directly or indirectly, to secure its own repayment."

Ms Hamilton was not herself a member of the LLPs in this case as she was in the Icebreaker 1 LLP, but Mr Davey said that her knowledge was to be attributed to the LLPs as she was the sole shareholder and director of IML, the vehicle used for the promotion and management of the LLPs and to which the members of the LLPs delegated day to day management. She was also a director of the so called "Designated Members" of the partnerships, that is the two initial members who contributed nominal capital, and as such her knowledge again was to be attributed to the LLPs. In the end there was no dispute about this, Mr Peacock accepting in reply that Ms Hamilton, although not a member of any of the five LLPs with which this appeal is concerned, (she was a member of three other partnerships out of the total of 51), was a director of the Designated Members which in each case had management responsibilities for the LLPs; and that she knew about the design of the transactions, the entire Icebreaker concept being her brainchild. In those circumstances Mr Peacock accepted that there was no dispute that her knowledge was to be attributed to

the LLPs.

34. Before coming to the particular criticisms advanced by Mr Peacock of the FTT's decision it is worth pausing at this point. An appeal to the Upper Tribunal lies under s. 11 of the Tribunals, Courts and Enforcement Act 2007 only on a point of law. The five matters on which Mr Davey relies give every appearance of being factual conclusions rather than legal conclusions. As is well known, it is possible to challenge a factual conclusion reached by a lower court or tribunal even where an appeal only lies on a point of law, where the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal, the classic case being *Edwards v Bairstow* [1956] AC 14 (see at 36 per Lord Radcliffe). In the present case, when permission was initially sought from the FTT to appeal, the LLPs put forward a large number of challenges on *Edwards v Bairstow* grounds, but none of them have been advanced before me. I can therefore take quite briefly Mr Peacock's submissions as to the five matters on which Mr Davey relies because he does not challenge the factual findings which the FTT came to, but only the conclusions which they drew from those findings.

35. The first of those factors was the rationale for the borrowing arrangements entered into by the members of the LLP. Mr Peacock said that the FTT had formed a view about the rationale for the borrowing based on the fact that the borrowing was not going to be used by Shamrock in its exploitation of the relevant rights (at [138]), and that it was not needed for exploitation (at [129]). That led them to conclude at [141]:

> "Once the contention that the borrowed money was used in the exploitation of intellectual property rights (or, indeed, played any part in the pursuit of the partnership's business) is discarded, it inevitably follows that another reason

for the borrowing must be found since it is implausible that the members would knowingly incur arrangement fees and margin merely in order to borrow money they did not need."

Mr Peacock said that that was impermissible reasoning. It was impermissible because the FTT had proceeded from the use by Shamrock of the money to a conclusion that the borrowed money was not borrowed for exploitation. I do not accept that there is anything impermissible in this reasoning. I will have to look below at Mr Peacock's submission that it was wrong for the FTT to reason backwards from the use that was in fact made of the money, but this point seems to me to be a slightly different one. It is not a question of what the borrowed money was in fact used for, but a question of why the members of the LLP borrowed money at all.

36. I have already said that I reject the explanation given by Mr Peacock why they borrowed money, namely to inject more money into the system and thereby enable larger projects to be taken on; as already explained, the money was not needed for that purpose and did not in fact achieve that result. This I think is what the FTT had in mind when they said that not only was the borrowed money not in fact available for use in the exploitation of the rights, but that it was not needed for the exploitation of the rights or, as they put it at [129]:

> "The arrangements for exploitation of the acquired intellectual property would have been equally effective without borrowing."

Since, as the FTT explained at [141], there was a cost to the members of borrowing in the shape of the 0.5% margin and 0.4% arrangement fee, the conclusion that the borrowing was neither needed, nor in fact available, for the exploitation of the intellectual property rights raises the question why the borrowing took place at all.

The answer that HMRC gave, and the FTT accepted, was that the borrowing was an artificial inflation of the apparent size of the amount paid for the exploitation of the intellectual property rights, that is an arrangement with no commercial but only a tax purpose (at [147]). That seems to me to be a factual conclusion as to the purpose of the borrowing which the FTT was fully entitled to come to. Indeed, I suspect that it was the only conclusion that was legitimately open to them on the facts, but I need not go this far.

37. Mr Peacock, in another part of his submissions, took issue with the contention of Mr Davey that the identification of a transaction as having the purpose of tax avoidance is:

> "not simply a label or a conclusion applied at the end of the analysis but instead a valuable tool in arriving at a conclusion."

Mr Peacock said that that was a statement that was both bold and wrong: bold, because it begged the question as to what was meant by tax avoidance; and wrong, because labelling a transaction as tax avoidance could not serve as an analytical tool in deciding the application of a statute when a statute is not framed in terms of a tax purpose. The statutory provision in question here, being s. 34 of ITTOIA, does not say anything about a transaction whose purpose or effect is to avoid tax. Mr Peacock said, and I have no doubt that he is right, that there are statutory provisions which contain either a targeted anti-avoidance rule, or a general anti-avoidance rule, but neither of these were the case in relation to the statutory provisions with which this appeal is concerned. He referred me to a decision of the House of Lords in *Norglen Ltd (in Liquidation) v Reeds Rains Prudential Ltd* [1999] 2 AC 1, a decision about the validity of an assignment of a cause of action to a director of a company to enable the

director to obtain legal aid when the company could not. At 13G Lord Hoffman said:

> "If the question is whether a given transaction is such as to attract a statutory benefit, such as a grant or assistance like legal aid, or a statutory burden, such as income tax, I do not think that it promotes clarity of thought to use terms like 'stratagem' or 'device'. The question is simply whether upon its true construction, the statute applies to the transaction. Tax avoidance schemes are perhaps the best example. They either work (*Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1) or they do not (*Furniss v Dawson* [1984] AC 474). If they do not work, the reason, as my noble and learned friend, Lord Steyn, pointed out in *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991, 1000, is simply that upon the true construction of a statute, the transaction which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes. There is no need for such spooky jurisprudence."

38. I entirely accept that the question whether a transaction which is designed to have a particular tax consequence does or does not achieve that consequence is to be determined by whether the relevant taxation provision applies to it or does not. But I do not think that it follows, as Mr Peacock suggested, that the question whether a transaction was designed to take advantage of a provision in a taxing statute so as to avoid or mitigate or defer tax, is always irrelevant to the assessment of what the transaction does. In normal circumstances, if A enters into an arm's length transaction with B under which A agrees to pay £5m to B for certain services, that

would, in the absence of any other indication, tend to suggest that the value of those services to A was £5m and that the reason A paid the £5m was to secure those services. But it is a feature of transactions designed to have particular tax consequences that they may contain provisions which are not designed to reflect any true commercial reality, but are designed to obtain the benefit of the desired tax advantages. If therefore in a transaction which is designed to have beneficial tax consequences A agrees to pay B £5m ostensibly for some services, but in circumstances where A has borrowed £4m, where it is known to A that the £4m is not going to be used by B for providing those services, where B does not want the £4m for those services and regards the receipt of the £4m as a nuisance, and where B, to the knowledge of A, is immediately going to put the £4m in a blocked account the sole purpose of which is to repay A's borrowing, it is not surprising if a tribunal regards it as far from self-evident that the £5m is really being paid for services. That is not to invoke some spooky jurisprudence under which s. 34 of ITTOIA can be used to strike down transactions which are found to have an aim of avoiding tax; it is to take account of the motive of avoiding tax in considering the question that s. 34 does require to be answered, namely whether the whole of the £5m is truly paid wholly and exclusively for the purposes of the trade, or in this case for the exploitation services. I see nothing inappropriate in such an exercise or impermissible in such reasoning.

39. Mr Peacock also said that if it were legitimate for the FTT to inquire into why the members borrowed the money, then that line of enquiry should equally have been applicable in the case of *Barclays Mercantile Business Finance Limited v Mawson* [2004] UKHL 51 (***"BMBF"***). I will have to look at *BMBF*, a case on which Mr Peacock placed considerable reliance, below. At this stage in the analysis, it seems to me to be sufficient to say that the FTT was entitled to have regard to their conclusion

(at [147]) "that the money was not, and could not be, used in the exploitation of the rights and the borrowing was an arrangement with no commercial but only a tax purpose" when considering what the relevant part of the money was paid for.

40. The second of Mr Davey's five aspects was the FTT's conclusion as to the security arrangements. Mr Peacock said that he had never disputed that the banks would not have lent to the individual members without the repayment being secured, but said that this did not tell one anything about the purpose of the 95 paid by the LLPs to Shamrock. Again I think this is to underestimate the significance which the FTT attached to the security arrangements. It was not just that the bank would not lend without being secured. The nature of the security which the bank stipulated for and which was, as Ms Hamilton fully understood, an essential feature of the transaction, was that in order to advance the moneys the bank needed to have security in the form of a letter of credit, but in order to grant the letter of credit the bank (which happened to be the same bank but could have been a different bank) needed to have the security of the deposit of cash into a blocked account, the amount of cash matching the liability to pay the Final Minimum Sum. That seems to me to be not at all irrelevant to the question of what the 80 of the 95 was paid for. If the payer knows, as the FTT found that Ms Hamilton "knew perfectly well from the outset," that the money borrowed, "would be used, directly or indirectly, to secure its own repayment", then that seems to me to be something which the FTT was entirely justified in considering to be relevant to an assessment of what that is paid for. Mr Peacock also said that this feature, namely that the money was to be put on deposit to secure its own repayment, was a feature that was equally true of *BMBF*. Again that is a point I will come back to below.

41. The third aspect on which Mr Davey relied was the FTT's analysis of the rationale for the guaranteed payments, that is the Quarterly Payments and the Final Minimum Sum. Mr Peacock said that the guaranteed payments were a part of the contractual deal whereby the LLP and Shamrock agreed that certain income would be payable, as part and parcel of the broader commercial deal between the LLP, Shamrock and the production companies, which entailed sharing of both the upside and downside in these transactions. He said that the FTT had not properly captured the nuanced balance of the commercial interests of all of the parties.

42. I do not think that this is a fair criticism of the FTT. The relevant passage of the Decision ([142]-[151]) contains a clear-sighted appreciation of the commercial realities. In that passage, the FTT consider the rationale put forward in the evidence called by the LLPs and the submissions made on their behalf. The first argument put forward was that members would not have joined the LLPs if they had not been assured of a certain level of return; this was in substance another iteration of the argument advanced about protecting the "downside" and was coupled with an assertion by Ms Hamilton that the Quarterly Payments and Final Minimum Sums came first, and it was only when they were in place that the banks were willing to offer loans to the prospective members. The FTT rejected this as disingenuous. They said (at [146]) that it:

> "puts into sharp focus how artificial the borrowing was; if Ms Hamilton's assertion is right, it follows that the members entered into, or put in place the possibility of their entering into, arrangements which had no purpose but to guarantee the servicing and repayment of loans, in order that they could borrow the money which would be used, directly or indirectly, to make the

> interest payments and eventual repayment of the borrowing. The borrowing had, and could only ever have had, that entirely circular purpose."

43. The second justification put forward was that the members' right to the guaranteed payments was the consideration for the grant by the LLP to Shamrock of valuable rights, an essential course if the projects were to succeed. Again the FTT rejected that as an explanation. They accepted that the effect of exploitation of the intellectual property rights which each partnership had acquired necessitated the assignment or grant to Shamrock of rights to the finished product, some of which it could use as incentives or as payment to others. But they said (at [148]) that:

> "it is plain from the description of the security arrangements as we have set them out that the payments of the quarterly amounts and the final minimum sum had nothing to do with that assignment or grant. The quarterly amounts were met from, and only from, the interest generated on the amount Shamrock was required to deposit with the lending bank (which in turn was derived, at least in the majority of cases, from the sum paid to it by the partnership), and the final minimum sum was met from that same deposit. Shamrock's ability to meet the guaranteed payments was wholly unaffected by its deployment of the rest of the money paid to it since, as we have said, it was only ever intended that it would pay the difference between the nominal gross cost of production and the sum paid for a share of the rights of the production companies and, thereafter, it made not a jot of difference to its ability to meet the guaranteed payments whether the project earned money or simply wasted it; the funds were in place and ring fenced so that they could be used for no other purpose."

44. I have already quoted their conclusion at [151]: see paragraph 31 above. Far from failing to capture the balance of the commercial interests of all the parties, this seems to me to be a perceptive analysis of the true commercial interests. But at the very least it is a factual conclusion which the FTT, having heard the evidence, was entitled to reach.

45. Mr Peacock had another submission which was that even if the rationale for the guaranteed payments was to support the borrowing, and that alone, one cannot escape from the fact that the guaranteed payments were income of the partnership; and indeed he said (although Mr Maugham, who represents the seven individual referrers in their appeals, does not entirely agree with him) that the guaranteed payments were trading income. That raises a rather different point which I will return to below.

46. The fourth factor on which Mr Davey relied was what the tribunal had to say about the commercial realities of the arrangements. Mr Peacock commented on two aspects of that. The first was the statement by the FTT that Mr Hutton, the director of Shamrock, regarding the borrowing arrangements as a nuisance. Mr Peacock took me to the transcript of Mr Hutton's evidence in order to elucidate precisely what it was that he has said was a nuisance. The relevant passage was as follows:

> *"Judge Bishopp: Now, the last point I wanted to raise with you is this. Looking at the arrangement from a purely Shamrock point of view, what was the benefit to you of taking money from the LLP, putting it on the deposit and then giving it back four years later?*
>
> *A: Well, it was part of the deal.*
>
> *Judge Bishopp: I know it was part of the deal, but from Shamrock's point of*

view what was the commercial advantage of it? You took money – let's take a simple example. The PEA fee was £5 million.

A: Yes.

Judge Bishopp: Final minimum sum was £4 million. So you have £1 million to use in promoting the project. 4 million has to go into a bank account. You can't touch it. There is no benefit to you out of it, because the interest it earns is paid immediately to the LLP, and at the end of the four years or whatever the period turned out to be, you just hand it back again. And you have all the hassle in the meantime of going into all these agreements. What, from Shamrock's point of view, is the commercial advantage of being that?

A: I see, sir. Specifically putting the money on deposit so that the letter of credit can be –

Judge Bishopp: Well, I understand that. But you could have just have easily have said, "We don't need 5 million; 1 million will do. Keep the other 4"?

A: But that is where the figures in the services and licensing agreement and having those two separate ones are – having the two separate agreements, I think is vital.

But for the cash to actually be there and to get the letter of credit, I completely agree, on that specific part of the deal it is just a nuisance for Shamrock, I do agree, yes.

Judge Bishopp: I still don't understand what the commercial advantage to Shamrock of doing it was. Taking the money, putting it into a sterile account

and then handing it back again.

A: I see. Yes, as I think as far as I am concerned a commercial advantage is that Shamrock has a lot business from Icebreaker LLP.

Judge Bishopp: I see, so you did it because Icebreaker asked to?

A: Yes.

Judge Bishopp: Nothing more to it than that?

A: None at all.

Judge Bishopp: OK that answers my questions."

47. Mr Peacock said that getting the cash of 80 of the 95 and putting it on deposit to get the letter of credit was a nuisance, but Shamrock did that as the price of their earning fees from the partnership's business. That I accept. Mr Peacock then said that Mr Hutton's personal view as payee about the convenience of the security arrangements could not and should not tell us anything about the purpose or the expenditure by the payers and here the LLP. There was a grave danger that Mr Hutton's answer, honest although it was, be taken out of context. Shamrock was going to make money from the fees that Mr Hutton makes on the process and although it might be a nuisance from his point of view to have to put up the money to get the letter of credit that was the price for him to do business with the partnerships.

48. Again, I do not think that the FTT's conclusions on the facts of the case can be dismissed quite so lightly. As the full quotation from Judge Bishopp's questioning indicates, the significance of this is not that entering into the arrangements was all a bit of a nuisance, but that there was no commercial advantage to Shamrock in

receiving £5m as opposed to £1m, other than the fact that this was what Icebreaker wanted him to do. In most transactions where A is engaging B to provide a service, A is not going to pay 100 to B for a service where B is willing to do the service for 20. It is only in the artificial world where transactions are structured in such a way as to generate tax advantages, that A would agree to pay B 100 when B only required a payment of 20, on terms that B would not be able to touch the 80 but would put it in a box marked not to be opened, to be returned to A at the end of four years. The fact that B is willing to do it, although he regards putting the 80 in the box as a nuisance, because that is the price of doing business with A, just illustrates that it is not B who wants payment of 100 for the service he provides but A who wishes to pay 100 (or appear to pay 100) for the service that B provides. That seems to me to be very relevant to the question whether when A pays B 95, he is really paying the whole 95 for B's services or whether he is really paying 15 for these services and 80 for something else.

49. The second aspect of this part of the case to which Mr Peacock referred was the focus of the FTT on the payments made by Shamrock under the Services and Licensing Agreement to the production company (the 90) and the corresponding payment back by the production company to Shamrock under the Assignment of Revenues Agreement (the repayment of 80). Mr Peacock said that HMRC saw that as a proxy line of attack for an attack on the 95, so there was a lot of focus on it in the FTT, the suggestion being that it could have been done for 10, or 10 plus a share of the revenues. Mr Peacock said that that element of the debate was not directly material, or not material at all, because the focus had to be on the 95. It is true that the FTT did say that they could not understand why the arrangements between Shamrock and the production company were structured in the way they had been. At [165] they said

this:

> "Both Mr Hutton and Ms Hamilton were asked why the arrangements could not have been made in a single document providing for production (taking the Planeteer agreement as a simple example) of the recordings in exchange for a single payment of £160,000 and 50% of the revenue, and neither could give to us what we can regard as a convincing, or even coherent, explanation of the reason why there were two agreements rather than one, and two payments rather than one."

They then at [264] said:

> "We have concluded that the arrangement by which the principal exploitation company supposedly made a payment to the production company offset by a payment for a share of the revenues was a pretence, designed, if we may say so rather crudely, to confer some plausibility on the claim that the borrowed money was available for use in the exploitation of intellectual property rights. In our judgment it failed in that objective."

50. In the light of Mr Peacock's acceptance that this was not in the end material, I can deal with this very shortly. There is no reason to think that the FTT was not entirely right to reach the conclusion that it did that the splitting of the arrangements between Shamrock and the production company into two parts was a pretence that served no commercial purpose. But even if this were wrong, it would not, it seems to me, have any material effect on the conclusion that the FTT came to. Whether the arrangements between Shamrock and the production company were expressed as a single agreement under which Shamrock agreed to pay the production company 10 and assign it a share of revenues, or whether expressed as two simultaneous

agreements under which Shamrock agreed to pay 90 and the production company agreed to repay 80, the reality was that Shamrock only ever paid 10 in cash. It therefore only needed to find 10 in cash. It follows that even if there had been good commercial reasons for splitting the transaction into two separate transactions, it would not affect the FTT's conclusion that the borrowed money (the 80) which was paid by the LLP to Shamrock was not needed in order to secure the production company's agreement and hence to exploit the rights.

51. The fifth and final factor relied on by Mr Davey was Ms Hamilton's knowledge of the use of the 80 by Shamrock. As I have already said Mr Peacock accepted that her knowledge was to be attributed to the LLPs. The FTT's finding as to her knowledge (at [267]) was that:

> "Even if it was not spelt out to each member that Shamrock would deposit a sum equivalent to the members' aggregate borrowings with the bank, Ms Hamilton knew that to be the case; we are satisfied, as was the First-tier Tribunal which heard *Icebreaker 1* (see [110] of its decision), that she knew perfectly well, and could have told any member or IFA who enquired, that the only security the bank would accept, in any of these cases, was a cash deposit and that, whether or not the exploitation fee was the direct source of the deposit, the amount borrowed could never be available in practice for exploitation. It is nothing to the point that Shamrock *might* have used the whole payment for the exploitation of the intellectual property rights the partnership had acquired and met the guaranteed payments by some other means; the reality is that all concerned knew, or would have learnt if they enquired, that it would not do so, and that it was never intended that it

should."

52. Mr Peacock said that although Ms Hamilton knew about the design of these transactions, that did not tell us anything of any real relevance about the purpose of the partnership paying 95 to Shamrock. The FTT did not accept this. What they said (at [266]) was:

> "We recognise that what the recipient does with the money it receives is not the test, but it is nevertheless unrealistic to disregard the application of the money when, as we are satisfied is the case here, the payer knows and intends that the money will be used in a particular way: such use becomes the payer's purpose. That is, we think, what Millett LJ meant by propositions (2) and (4) in the extract of his judgment in *Vodafone* which we have set out above."

53. The reference to *Vodafone* is to *Vodafone Cellular Ltd v Shaw (Inspector of Taxes)* [1997] STC 734 at 742 where Millett LJ derived a number of propositions in relation to what he describes as "the exclusively test". Propositions (2) and (4) are as follows:

> "(2) To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his objective in making the payment. Save in obvious cases which speak for themselves, this involves an enquiry into the taxpayer's subjective intentions at the time of the payment… (4) Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made."

54. I agree with the FTT. It is established, as the FTT said, that what is significant is the purpose of the payer, not what the recipient does with the money. That is a proposition derived from *BMBF*, which I will look at in more detail below, but which the FTT had in mind. It was indeed Mr Peacock's submission that the FTT had impermissibly taken into account what the recipient (here Shamrock) did with the money (here the 80), rather than what the payer paid it for. But if the payer knows that the payee is going to use the money in a particular way, and intends that the payee should do so – indeed has been responsible for devising the transaction in such a way as to make it essential that the payee does use the money in that way – then it is wholly unrealistic to say that the payer does not intend the money to be used for that purpose. And if that is what the payer intends, it is very difficult to see that the payer can have had any other object in making the payment. In this way what the recipient is going to do with the money, as the payer both knows and intends, is indeed the purpose of the payer. As Millett LJ said this is a consequence which is so inevitably and inextricably involved in the payment that it must be taken to be a purpose for which the payment was made.

55. Having examined each of the five factors on which Mr Davey relies as underpinning the FTT's conclusion, and the criticisms made of them by Mr Peacock, it seems to me that the attack on the conclusion of the FTT that the 80 of the 95 was not paid wholly and exclusively for the purpose of exploiting intellectual property rights, is one that must be rejected. As the FTT said (at [269]):

> "The proposition that the exploitation services fee was paid wholly and exclusively for the purpose of exploiting intellectual property rights is, therefore, to be rejected. It requires us to disregard the reality that all those

concerned knew and intended that a relatively modest part of the total fees would actually be used in the exploitation of those rights, while the greater part would not; and the obvious fact is that the partnership would not have handed over the money if there had been no assurance of a guaranteed income stream."

56. As I have already said, that seems to me to be fundamentally a factual conclusion, not one of law and not one that is capable of being displaced on appeal.

57. I have not however yet addressed the grounds of appeal which Mr Peacock specifically relied on. There are I think two main grounds, and one subsidiary one. The two main grounds are firstly, that HMRC made a concession below that the FTT ignored; and second, that the FTT's reasoning was inconsistent with the decision of the House of Lords in *BMBF*. The subsidiary one, which only really emerged in the course of argument, was that even if the FTT was right that the 80 was paid for the purpose of securing a guaranteed income stream rather than for the purpose of exploitation of the intellectual property rights, nevertheless it was not a non-business purpose for a trader to generate a stream of income to be received by the partnership which facilitated and was designed to support the borrowing of the individuals. I will deal with each of these in turn.

The "market value concession"

58. At the forefront of his argument, Mr Peacock said that HMRC before the FTT had made five important concessions. The first four of these do not give rise to very much dispute. The first so-called concession was that the LLPs were trading with a view to a profit. Mr Davey said that it was not properly characterised as a concession, it having always been HMRC's position that the LLPs were trading with a view to

profit; but he accepted that there was no dispute about it.

59. The second concession was that the arrangements were not a sham. Mr Davey accepted, as HMRC had accepted below, that the transactions were not a sham in the classic sense explained by Diplock LJ in *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786. Mr Davey however said that the fact that HMRC accepted that the documents were not shams did not mean that the legal rights and obligations arising from the documents were the same as the actual rights and obligations that the parties expressed them to create. He drew a distinction between the doctrine of sham and the doctrine of mislabelling. Thus for example a document which purports to grant a licence to a person to occupy land may be a sham if the parties intended the document to be a pretence, concealing the true transaction between the parties. However even if a document is not a sham in that sense, it is commonplace that the labels which the parties use in their contract are not determinative of the true legal effect of what they have done: see the well-known example given by Lord Templeman in *Street v Mountford* [1985] AC 809 of the five-pronged implement for digging, which is a fork even if the manufacturer insists that he intended to make and has made a spade; or the less well known but equally vivid example given by Bingham LJ in *Antoniades v Villiers* [1990] 1 AC 417 at 444B: "a cat does not become a dog because the parties have agreed to call it a dog." I accept that the two doctrines, of sham and mislabelling, are different doctrines; and I also accept that in this case HMRC's acceptance that the contractual documents entered into by the parties were not shams or pretences does not preclude them from contending that a statement in a contract that £x is paid in consideration of Y is not reflective of what the consideration truly was for which £x was paid.

60. The third concession was that all payments from the LLPs to third parties were actually made. Again Mr Davey does not dispute that; he said that the question being pursued in this litigation has never been whether the LLPs made the particular payments in question, but what they were made for.

61. The fourth so-called concession was that "the various agreements all did precisely what they purported to do". That is something that the FTT said at [43]. Mr Davey said that that added nothing to the sham concession as a sham is a contract which does not do what it purports to do. I agree, and I do not read the FTT statement at [43] as intended to mean that the FTT was accepting that there was no mislabelling in the sense which I have already explained. Had they meant that, and had they understood HMRC to concede that, they could not have concluded, as they did at [265], that:

> "We also accept HMRC's argument, drawn from *E V Booth v Buckwell*, that it is open to them, and by extension us, to view the agreements for what they are, rather than for what they purport to be. In short, the reality is that part of the payment by each partnership to the principal exploitation company represented the price of the guaranteed income stream notwithstanding its description as something else".

The reference to *E V Booth v Buckwell* is to *E V Booth (Holdings) Limited v Buckwell (Inspector of Taxes)* [1980] STC 578 where Browne Wilkinson J said at 584:

> "In my judgment, where parties to a composite transaction have, as a result of negotiations between themselves, provided that part of the consideration is to be paid for one part of the transaction and part for another, they cannot subsequently seek to re-allocate the consideration for tax purposes. They have chosen to carry through the transaction in a particular manner, and the

taxation consequences flow from the manner adopted."

62. It was submitted to them on behalf of the LLPs that the same must be true when it was the tax authority which was seeking to reallocate the consideration; but they did not accept that. Instead they accepted HMRC's submission that the extract from the judgment relied on by the LLPs was incomplete since it omitted two further sentences as follows:

> "The Crown's position may well be different in certain cases. After all, the Crown was not a party to the transaction."

HMRC's submission was that those sentences made it quite clear that, while the parties to a transaction might, indeed normally would, be bound by what they had agreed, and could not seek to re-characterise it for fiscal advantage, the Crown was not so bound and could treat the arrangement for what it was, and not for what it appeared to be. That submission, as appears from the passage which I have cited from [265] of their decision, was one which they accepted. In my judgment they were right to do so.

63. The fifth concession, and the one on which Mr Peacock particularly relied, was what he described as the "market value concession", namely that all fees charged under the central agreements at issue were at market value. Mr Davey denied that any such concession had been made and it is necessary to look at the available material in some detail.

64. The facts, so far as they appear from the material before me, are as follows:

(1) On Day 1 of the combined hearing of the appeals of the LLPs and the reference by the seven individuals to the FTT, which was 1 November 2012,

an issue arose that was said by Mr Peacock to be one which might have a bearing on timetabling. He explained that it had recently popped up in the skeleton argument of the Revenue in the reference cases (that is the reference by the seven individual members). Mr Maugham, who appeared for the seven individuals, referred the FTT to paragraph 52.8 of HMRC's skeleton argument. That read as follows:

> "In *Samarkand* the Tribunal stated (at §292) that *"it was very unlikely that they [i.e. the rights to future profits] would have produced any significant sums, and we do not believe that there was any real chance or expectation that they would deliver a return big enough to compensate for the net present value losses"*. It is submitted that it is equally clear that the value of Bastionspark's rights to a share of revenues will have been less than the deficit. Creative projects of the type with which Bastionspark was involved were very risky, and the majority of such projects will not generate any, or any significant, revenues. Indeed, this is demonstrated by the poor performance of the various projects with which the Icebreaker LLPs were involved. In turn, the value of Bastionspark's rights to a share of revenues will clearly have been less than the deficit mentioned above."

It is apparent from the other parts of paragraph 52 that the "deficit" here referred to is the difference between what Bastionspark paid to Shamrock (ie the 95 in Mr Peacock's example) and the value of the guaranteed payments that it received back, namely the Quarterly Payments and the Final Minimum Sum (the 80 in Mr Peacock's example). The point that was being made by

HMRC was that it was necessary in order for the individual referrers to be able to claim sideways loss relief that the trade carried on by the LLP in question was being carried on "on a commercial basis" and "with a view to the realisation of profits" (see s. 384 ICTA 1988); and that since the net present value of the guaranteed payment was only 80 and the amount paid by the LLP was 95 there was a deficit of 15 which meant that the trade could only have been carried on on a commercial basis if the value of the LLP's right to a share of revenues was worth more than the 15.

(2) Mr Maugham protested that that was a new allegation which required an amendment, and that it was an allegation for which he would need expert valuation evidence. Mr Peter Blair QC, who then appeared for HMRC, then addressed the FTT on the basis that no application to amend was necessary, but in the course of his submissions he said that he had no objection to Mr Maugham calling some expert evidence. There was then a long discussion between Mr Maugham and the tribunal, the upshot of which was that Judge Bishopp suggested to Mr Maugham that he investigate the practicalities of finding an expert who would be able to give the sort of evidence that he wanted and that if that could be done the problem was solved, but if not it would be necessary to revisit it.

(3) That discussion, including the submissions of Mr Blair, Mr Maugham and the resolution by the tribunal, takes up some 23 pages in the transcript. At that point Mr Peacock said the following:

> *"Sir – it is a matter really between Mr Maugham and Mr Blair, but can I just make clear my understanding that that point is only being*

taken in the individual references, and I understand –

Judge Bishopp: It is irrelevant to your client's case, is it not?

Mr Peacock: My belief is it's not relevant, but I would be grateful for my learned friend Mr Blair's –

Mr Blair: I have already confirmed that outside court, I am happy to confirm it.

Judge Bishopp: All right, well, it's not a part of the statutory test, so that is that, is it not?

Mr Peacock: We don't want to find ourselves also suddenly needing some music expert.

Judge Bishop: Perhaps join forces with Mr Maugham.

Mr Peacock: That may be suitable."

(4) It can be seen that Mr Blair was happy to confirm that "that point was not being taken in the LLP appeal but only in the individual references"; but the transcript unfortunately does not make it entirely clear what Mr Peacock meant, or Mr Blair understood, by "that point". Mr Peacock told me that he had a very clear recollection of what Mr Blair had said to him outside court but he was understandably reticent about giving evidence. Nevertheless, in the course of his reply he did indicate what his recollection was of what Mr Blair said. What he said to me was as follows:

"When I asked – I am now giving evidence – Mr Blair was he taking

'that point', ill defined, undefined, or its equivalent, which is what I did ask him, it was: was he taking valuation points of the type found in paragraph 52.

Mr Justice Nugee: Yes, and he said no.

Mr Peacock: He said no"

(5) I asked Mr Davey if he was able to tell me what Mr Blair's recollection of the conversation outside court was. Having initially said that he was not, he subsequently made inquiries of Mr Blair, who is now his HHJ Peter Blair QC, and I was told that he had indicated that he did not consider it appropriate now that he is on the Bench to comment on out of court communications which took place several years ago when he was at the Bar. However, he had asked to see the transcript of the appeal hearing and had confirmed there was nothing that counsel for the Revenue said on the matter that he felt needed to be corrected. That is a reference to what Mr Davey told me which was as follows:

"Mr Justice Nugee: Can I ask you what your submission is as to what the point is that Mr Peacock says:

"My understanding is that it is only being taken in the individual references."

And Mr Blair says:

"I have already confirmed it outside court, I am happy to confirm it."

What is "that point", in line 19, in your submission?

Mr Davey: It is a submission because I don't know what Mr Blair said outside court. But my submission is that "that point" is the meaning of "on a commercial basis" in the context of section 384 and/or 381 of ICTA, and, in particular, the potential value of the right to a share of revenues. I mean that I think is a fair reading of what has come before."

(6) Mr Peacock also referred me to various other parts of the transcript, where he periodically reminded the FTT that valuation was not a point that was being relied on by HMRC against the LLPs. It is not necessary to refer to them all but one example is on Day 9 where Mr Peacock said:

> *"If you hark back to the debate Mr Blair and Mr Maugham had on Day 1, Mr Blair confirmed that he was not taking any valuation question in the partnerships' appeals."*

Another example is on Day 10 when Mr Peacock said:

> "*But the counterparty who you are engaging with, here Shamrock, has promised to provide services to you and you have agreed a fee for those services, and it is not said that there is anything either under or over market value about the fee that has been agreed."*

65. In the end, I do not think that there is any significant dispute between the parties. I am quite prepared to assume that what Mr Blair confirmed to Mr Peacock outside court was that he was not taking a valuation point in relation to the LLPs' appeal. But I do not regard that as equating to the market value concession as formulated by Mr Peacock in his skeleton argument, namely that it was conceded that all fees charged

under the central agreements at issue were market value. As I understand the position Mr Blair did not ever say that he accepted that the fees of 95 paid to Shamrock represented a market value for the services provided by Shamrock. All that he accepted was that he was not relying in the LLPs' appeal, as he was in the individual referrers' appeal, on a comparison between the value of what the LLPs paid to Shamrock, and what they received in return. He was therefore not putting in issue the value. That does not mean that he accepted that the services were worth 95. I put it to Mr Davey in argument as follows:

> *"Now, am I right in thinking, can I put it this way: one way in which the Revenue might choose to, in a particular case, attack a payment as not being wholly and exclusively for X is to show that 95 was paid for X but the real value of X was 15?*
>
> *Mr Davey: Yes.*
>
> *Mr Justice Nugee: You did not set out to do it that way. You did not call evidence. You did not plead the real value of X was 15. You did not call evidence that the real value of X was 15. You did not put the value of X directly in issue in that way. But you say that that is not the only way in which you can show what the 95 was paid for was not wholly for X. You can show it by showing that the 80 never became available for any other purpose than to repay the 80 that had been borrowed. It was never intended to become available for any other purpose than to repay the 80 that was borrowed. That's not a valuation point. It may logically follow from that that the value of the services were likely to be about 15. But you are not relying on a valuation point to get to a conclusion. You are getting to a*

conclusion through use of other factual findings. So you have not directly attacked the value of the services or called evidence as to the value of the services, or put that in issue. Equally, you have not anywhere said, "we accept the services are worth 95". Is that a correct summary of your position?"

Mr Davey accepted that it was. Mr Davey gave the analogy of an arrangement whereby he paid his junior Mr Macklam £1000, in return for which Mr Macklam cleaned his car and agreed to give him £900 back in a year's time. It would be possible for someone to assert that the £1000 was not paid wholly for the cleaning of the car, without having to call evidence as to the value of the services of cleaning the car. You could simply rely on the argument that it was necessarily implicit in the arrangement that part of the payment was in return for the obligation to repay the £900.

66. I accept Mr Davey's submission. In the example he gave a person pays £1000, and in return he gets his car washed and a promise to pay him back £900 in a year's time. You could attack that by saying that nobody in their right mind would pay £1000 to have their car washed. You could call evidence that other people would wash the car for a few tens of pounds. And you could then draw the inference that the £1000 could not have been spent on getting it washed and must have been spent on something else. But you do not need to attack it that way. You can attack it a different way, which is to say: "Look at the contract. As well as the car washing you get the £900 back. That £900 back is worth £900 because you also get interest in the meantime. So you cannot have spent the £900 on getting the car washed". Now it logically follows from that that what you were paying for the service of having the car washed is only £100,

but you have not attacked it on the basis that you were paying over the odds for the car wash. You have simply attacked it on the basis you are getting something additional, which is not car washing, in return for the £1000. I accept that there is a distinction between "we are not relying on the valuation point to prove our case" and saying "we accept that the services were worth 95", just as there is a difference between saying "we are calling a car wash expert to tell you how much it costs to get your car washed and it is only £100, so the £1000 must have been spent on something else" and saying "we are not calling a car wash expert; we are relying on what it says in the contract about getting £900 back. It does not mean we accept that £1000 is a market price for having had your car washed".

67. In these circumstances I do not accept that the market value concession was made in the form in which it is set out in Mr Peacock's skeleton argument, namely that the fees charged under the central agreements at issue were market value; on the material before me I accept only that the point confirmed by Mr Blair to Mr Peacock outside the tribunal and confirmed inside the tribunal, was that HMRC was not running as part of their case a positive allegation that the market value of the services provided by Shamrock was less than 95. It was not an acceptance that the services were worth 95. And for the reasons I have given, on that basis, I do not think that the confirmation has the consequences which Mr Peacock seeks to derive from it, and that there is nothing inconsistent in HMRC having sought to establish, and indeed having persuaded the FTT, that the 80 of the 95 was not paid for Shamrock's services.

BMBF

68. *BMBF* is a decision as to whether Barclays Mercantile Business Finance Ltd (**"BMBF"**) was entitled to capital allowances for expenditure of somewhat over £91m

under s. 24(1) of the Capital Allowances Act 1990, which provided for allowances to a person carrying on a trade who had incurred capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade. The plant in question was a natural gas pipeline between Scotland and the Irish Republic which belonged to BGE (The Irish Gas Board). BMBF entered into contracts to purchase the pipeline from BGE for the £91m, and then entered into a lease agreement with BGE leasing the pipeline back to BGE on finance lease terms. Those terms included a primary period of 31 years, the primary period rentals being carefully calculated to recoup to BMBF over the 31 years its outlay and leave it with a worthwhile margin over its own cost of funds. The primary period rentals, payable annually in advance, were of fixed but escalating amounts. BGE, having taken the leaseback of the pipeline, immediately entered into a sub-lease of the pipeline to a UK subsidiary, BGE (UK) Ltd. This too contained the same primary period and the same primary rental, although there was a provision for adjustment of rentals in the event of changes in UK tax law and tax rates which might have the effect of causing the rentals and sub-rentals to diverge. BMBF, BGE and BGE (UK) then entered into an agreement called the Assumption Agreement under which BGE (UK) would pay its sub-lease rentals directly to BMBF in discharge of its own liability to BGE for the sub-rentals and of BGE's liability for rentals under the head lease to BMBF. So far, the transaction is similar to the ordinary case of a sale and leaseback, save for the added complication of the addition of the sub-lease. In return for the payment of the £91m, BGE agreed effectively to repay that money through the rentals and the leaseback, that obligation in fact being discharged by the subsidiary BGE (UK). BGE also entered into an agreement with BGE (UK), called a Gas Transportation Agreement, under which it agreed to pay BGE (UK) various payments for gas transportation

services, the minimum payments being sufficient to fund BGE (UK)'s liability to BMBF under the Assumption Agreement. As security for the payment of the sublease rentals by BGE (UK), BMBF obtained a guarantee from Barclays Bank Plc, guaranteeing the payment of the sublease rentals.

69. The remaining agreements concerned what happened to the £91m. BGE did not, and could not, get its hands on the money. It was obliged to deposit it with a Jersey company called Deepstream Investments Ltd; Deepstream then deposited the £91m with another Barclays company, Barclays Finance Company (Isle of Man) Ltd (**"Barclays IoM"**); and Barclays IoM placed the £91m on deposit with the Group Treasury of Barclays Bank. There were other arrangements including in particular an agreement by Deepstream to indemnify Barclays Bank against liabilities under its guarantee under which Deepstream charged the benefit of the deposit of £91m which had been made with Barclays IoM. Park J, who set out the facts in his judgment at [2002] EWHC 1527 (Ch), also explained how the monies deposited went round in a circle to discharge all the various obligations when the rental payments fell due each year. In effect Barclays Bank Group Treasury pays Barclays IoM a part of its deposit; Barclays IoM repays to Deepstream a part of Deepstream's deposit; Deepstream pays to BGE the sums provided for in the BGE/Deepstream deposit agreement; BGE pays money to BGE (UK) under the Transportation Agreement; BGE (UK) then pays the sub-rent direct to BMBF under the Assumption Agreement; and BMBF, or at any rate so Park J assumed, pays the money to Barclays Bank to repay the loan which BMBF had originally taken out from Barclays Bank to finance the whole transaction in the first place.

70. The Special Commissioners, whose decision is set out in full in the report of Park J's

decision at [2003] STC 1068, rejected the claim for capital allowances, on the basis that the purpose of the expenditure by BMBF was not the acquisition of the plant and machinery but the obtaining of capital allowances, and the transaction had no commercial reality. Park J dismissed an appeal. He agreed that BMBF did not incur expenditure wholly and exclusively for the purposes of its trade. That was largely in reliance on the decision of the House of Lords in *FA & AB Ltd v Lupton (Inspector of Taxes)* [1972] AC 634 which drew a distinction between transactions which have fiscal elements in them but which are nevertheless trading transactions, and transactions where the fiscal elements are present to such an extent that the transactions are not trading transactions at all.

71. The Court of Appeal allowed an appeal by BMBF, reported at [2002] EWCA Civ 1853. Peter Gibson LJ said at [36] that the transaction had a commercial reality to it which included risks both for BMBF and for BGE. In particular whilst BMBF was protected against any risk arising from changes in tax rates or capital allowances, it had no security other than the pipeline for the "strip risk" estimated at £25m, being the difference between the maximum sum payable by BMBF on termination and the amount of the guarantee by Barclays Bank. His conclusion (also at [36]) was:

> "To my mind the commerciality of the transaction is plain. I respectfully disagree with the contrary inferences of the Special Commissioners and the Judge on this point: they seem to me to be based on an incorrect appreciation of the facts."

72. He then considered at [37] the statutory provisions, namely s. 24 of the Capital Allowances Act 1990. On this he said:

> "Section 24 focuses on the incurring of expenditure by the trader on the

provision of plant or machinery wholly and exclusively for the purposes of his trade. It therefore requires one to look only at what the taxpayer did. To the test posed in s 24 it is immaterial how the trader acquires the funds to incur the expenditure or what the vendor of the provided plant or machinery does with the consideration received."

73. Carnwath LJ in his concurring judgment said at [56] that BMBF was an established trading company, that it gave apparently credible evidence that it had a distinct business purpose for this transaction, which was seen as identical in kind to its normal finance leases, and that it was not concerned with the details of the BZW scheme (the BZW scheme was the scheme, devised by Barclays de Zoete Wedd, for the deposit of the £91m so as to provide security for the payment of the rentals). At [57] he said that:

> "One cannot ignore the reality of the pipeline, nor can one ignore the fact that ownership was transferred to BMBF with whom it remains, and that leases were granted to BGE and BGE (UK). On any view those are real transactions of lasting consequences in the real world"

and at [58]:

> "Once one accepts the transfer of ownership, it is difficult to question the reality of the expenditure by which the purchase price was discharged. Furthermore, BMBF gave evidence that it financed the purchase price in the normal way by a loan from its parent bank, in accordance with its standard drawing facility, and that it was not concerned with the security arrangements made by the bank. There is no indication that this evidence was disbelieved."

74. An appeal by the Revenue to the House of Lords was dismissed. The opinion of the committee was given by Lord Nicholls. He effectively agreed with the approach of the Court of Appeal. At [39] he said:

> "Section 24(1) requires that a trader should have incurred capital expenditure on the provision of machinery or plant for the purposes of his trade. When the trade is finance leasing, this means that the capital expenditure should have been incurred to acquire the machinery and plant for the purpose of leasing it in the course of the trade."

At [40] he said:

> "These statutory requirements, as it seems to us, are in the case of a finance lease concerned entirely with the actions of the lessor. The Act says nothing about what the lessee should do with the purchase price, how he should find the money to pay the rent or how he should use the plant."

At [41] he said:

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

> pipeline for the purposes of its finance leasing trade."

At [42] he said:

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

75. I have cited extensively from the facts and decisions in *BMBF* because at various stages in his submissions Mr Peacock placed considerable reliance on the decision, the thrust of his submission being that the various features relied on by HMRC, and accepted by the FTT, as indicating that the 80 of the 95 was not paid wholly and exclusively for the purposes of the LLP's trade, were matched by similar features in *BMBF* so that if HMRC and the FTT were right, *BMBF* should have been decided the other way. Moreover, Mr Peacock said in particular that it was clear from both the decision of the House of Lords, and the decision of the Court of Appeal which it

approved, that it was impermissible to have regard to what the recipient of a payment did with the money in determining whether the payer had incurred expenditure on the provision of machinery or plant wholly and exclusively for the purposes of his trade; and that the same must apply in determining whether the LLPs had incurred expenditure wholly and exclusively for the purposes of their trade.

76. So far as this latter point is concerned I accept that the same principle must apply. The way it was put by Vos J in *Icebreaker 1* was as follows (at [38]):

> "Section 74(1)(a) in particular [ie of ICTA 1988], specifically makes clear that only monies "wholly and exclusively laid out or expended for the purposes of the trade" are to be deductible. There is no indication in these words that the ultimate use of the monies by the recipient is to be relevant to a determination of the purpose for which they were expended. The focus is always on the taxpayer's own business. In other words, the statute directs attention to a single end of the telescope."

However that did not prevent him from concluding that the equivalent of the 80 in that case was not incurred for the purposes of the trade. He dealt with that at [62] (already cited at paragraph 24 above) where he said that the FTT's analysis was not a matter of looking at what Centre did with the money but of looking at what Icebreaker paid the money for. He continued at [64]:

> "In these circumstances, it seems to me that analysing the transaction as a whole, and looking at the matter exclusively from Icebreaker's end of the telescope, the payment of £1,064,000, as part of the global payment of £1,273,866, was not made wholly and exclusively for the purposes of Icebreaker's trade. Indeed, that part of the payment was not made for the

film distribution trade at all. It was made so that Icebreaker could be assured that it, and therefore, its members would recover the loans that its members had borrowed from BoS, and which had been used to finance precisely that sum by way of investment into Icebreaker.… The payment of £1,064,000 was never intended to be used for any film production or distribution purpose…. The sum of £1,064,000 was expended and disbursed for the sole purpose of investment and security, and not for Icebreaker's film trade properly so regarded."

77. As can be seen, Vos J took the view that that was a conclusion which could properly be reached, and had properly been reached by the FTT in *Icebreaker 1*, by looking through the right end of a telescope, that is by looking at the purpose of the LLP that paid the money rather than just looking at the use made by the recipient of the money. The FTT in the present case took the same view. At [242] they cited the passage from Vos J's judgment in *Icebreaker 1* which refers to directing attention to a single end of a telescope, describing it as a passage which it was common ground accurately stated the law. At [266] they said:

> "We recognise that what the recipient does with the money it receives is not the test, but it is nevertheless unrealistic to disregard the application of the money when, as we are satisfied is the case here, the payer knows and intends that the money will be used in a particular way: such use becomes the payer's purpose."

78. I agree with Vos J in *Icebreaker 1* and the FTT in the present case. The statutory language requires one to focus on the purpose of the payer in paying the money. As the House of Lords said in *BMBF*, it does not direct attention to what the recipient

does with the money. But when the purpose of the payer is to secure a particular result, that remains the purpose of the payer even if the result is one which depends upon the recipient doing certain things with the money and being obliged to do certain things with the money. As a matter of fact I can see no problem with the factual conclusion that the FTT came to, namely that the purpose of the LLP is in paying the 80 of the 95 to Shamrock was to secure a guaranteed income stream. That seems to me to be a finding of fact, and not to involve either any flaw as a matter of logic or any impermissible legal reasoning. I therefore reject this particular ground of appeal.

79. As to Mr Peacock's more general invocation of *BMBF* in an attempt to persuade me that since various features relied on in this case were also features present in *BMBF* – such as the obligation to deposit the money, the use of the money in a circular transaction, the fact that BGE did not have the use of the money to itself, the fact that all the steps were preordained and the money went round in a circle – I do not see that this takes the argument any further. The question whether expenses have been incurred for the purposes of a trade depends on the purpose for which they were paid. That, as I have already said, seems to me to be a factual question. It is certainly how it was treated by Millett LJ in *Vodafone*, where he referred to an enquiry into the taxpayer's subjective intentions. Questions of intention are not questions of law, they are questions of fact. I do not think it is a proper use of authority to look at the facts of a previous case, however eminent the Court which decided it, with a view to finding factual features of that case which may or may not be present in the present case, as a means of drawing a factual conclusion. The principle of law for which *BMBF* stands as ratio is that the relevant statutory requirements (in that case s. 24 of the Capital Allowances Act 1990, in the present case s. 34 of ITTOIA), are concerned entirely with the acts and purposes of the lessor. It is not, and cannot stand as,

authority for the proposition that certain factual features lead to certain factual conclusions. In that case there was no doubt that BMBF had acquired a pipeline. It was not disputed that BMBF had paid £91m for the pipeline. Indeed that is what Lord Nicholls says at [42]. The only question therefore was whether the payment of £91m by BMBF, in circumstances where Mr Boobyer had given unchallenged evidence that from its point of view the purchase and leaseback was part of its ordinary trade of finance leasing, (see per Lord Nicholls at [41]) and there was evidence, which was not disbelieved, that BMBF was not concerned with the security arrangements made by the bank (per Carnwath LJ at [58]), was a payment that qualified as being wholly and exclusively incurred for the purposes of BMBF's trade. There was no question in that case of splitting the £91m such that part of it was paid for the pipeline and part of it for something else. In the present case there is no doubt that the LLPs paid the 95 to Shamrock. There is no doubt that in return Shamrock agreed to provide certain services, but it also agreed to provide guaranteed payments in the shape of the Quarterly Payments and the Final Minimum Sum. The question that the FTT had to decide was whether any part of the 95 was in reality paid for the guaranteed payments. They decided for the reasons that they gave that 80 of the 95 was so paid. I do not begin to see how the different conclusion reached on different facts in BMBF can possibly amount to a reason for holding that those factual findings by the FTT in this case involved some impermissible reasoning or error of law.

80. Mr Peacock also referred me to the decisions of the House of Lords in *Ensign Tankers (Leasing) Ltd v Stokes (HM Inspector of Taxes)* [1992] 64 TCC 617 (***"Ensign"***), and of the Supreme Court in *Tower MCashback LLP 1 v Revenue & Customs Commissioners* [2011] UKSC 19 (***"Tower"***) in each of which a transaction failed to secure the tax advantages which it was designed to do. Neither of them casts any

doubt in my judgment on the analysis which the FTT adopted and which I have upheld. At points in his submissions, Mr Peacock came close to treating *Tower MCashback* as if it contained a checklist of factors which could cause a transaction to fail for tax purposes as opposed to one which succeeded; Mr Peacock identified from the judgment of Lord Walker four particular factors, namely (i) that the software in question was acquired at an overvalue; (ii) that the software was reportedly sold in bits which is why it was commercially ineffective (iii) that the purchasers had the benefit of non-recourse and interest free finance; and (iv) that the monies purportedly paid for the software were not even paid to the vendor but were paid to a different party. Mr Peacock then said that none of those features were present in the present case. Taking the latter three, he was at pains to establish that the transactions between the LLPs and Shamrock were on genuine commercial terms, that the loans taken out by the members of the LLPs were full recourse loans (and also at a commercial rate of interest), and that the payments due to Shamrock were actually paid. That left the question of whether the payment had been at an overvalue, which is why he placed so much reliance on the market value concession. If it could be established that HMRC had conceded that the fees payable to Shamrock were at market value, there would then be none of the four features in *Tower* which caused the Supreme Court to disallow the expenditure in that case, and in that way Mr Peacock sought to persuade me that the FTT must have gone wrong in failing to allow the whole of the expenditure in this case. The short answer to this is that the FTT did not proceed by identifying the features in *Tower MCashback* which caused the claim for allowances to be disallowed and then apply them by analogy to this case; what the FTT did was look at the evidence in this case and come to a factual conclusion on the evidence. For reasons I have already given they were in my judgment fully entitled to reach the

conclusion they did on the evidence that they had.

81. Since this was central to Mr Peacock's argument, I will give a longer answer as well. Mr Peacock as I have explained said that one has to identify the features or factors that distinguish this case from *BMBF*, and that the Revenue cannot rely on factors or features that were present in *BMBF* as that would have led the House of Lords in *BMBF* to a different answer, at any rate unless it had subsequently been held that *BMBF* was no longer good law. In *Tower* however Lord Walker had expressly said that *BMBF* was still good law. He also said that *Ensign Tankers* was still good law. So we now have a world, said Mr Peacock, in which *Ensign* and *BMBF* and *Tower* are all good law; and he posed the forensic question how one rationalised those three: what factor was present in *Tower*, not present in *BMBF*, but present here? There are, he submitted, none.

82. As I have said, that is not I think a wholly appropriate way to address questions of this sort. One cannot determine such questions by a tick box approach. It is insufficient to say here is a factor (the money moved in a circle) which was present in *BMBF* so that cannot be a relevant feature; here is a factor (the recipient was required to put it on deposit) which was present in *BMBF*, so that cannot be a relevant feature; here is another feature which was present in *Tower* (it was a non-recourse loan) but that is not present here; here is another feature that was present in *Tower* (the payment was not actually made to the vendor), but that is not present here. That is to reduce what is essentially a factual question – what was the purpose of the LLP in paying money to the principal exploitation company – into a series of mechanical tests. One can see that those who devise and operate schemes designed to take advantage of beneficial tax provisions might wish it to be so, but to reduce a question of a person's subjective

purpose to a list of factors such as these seems to me to be a misunderstanding of the exercise the tribunal is engaged upon.

83. In *BMBF* there was a real pipeline. It was acquired by BMBF. It was bought on commercial arms' length terms. It was then leased back on commercial arms' length terms. If one stops there that was a perfectly ordinary, standard part of BMBF's trade. There was nothing artificial about that part of the arrangements, that is the sale and leaseback. It was a simple case of payment by BMBF of a capital sum to acquire an asset which was then leased back in return for rentals. The rentals were guaranteed by Barclays Bank Plc, and that again was a standard and common feature of such arrangements; if the rentals had not been guaranteed, then BMBF would be taking a significantly higher risk, and would no doubt have wished to charge significantly more for that risk, which would affect the economics of the transaction. The only part of the arrangements which might be criticised as artificial was not the sale and leaseback but what happened to the £91m after it was paid by BMBF to BGE. That sum did go round in a circle, but that was nothing to do with BMBF, and did not affect the reality and commerciality of the sale and leaseback. I think the case would have looked very different if £91m had not been paid for a pipeline, but had been paid for some chattel that was worth a few pounds. That feature would have indeed cast real doubt on whether BMBF was really paying £91m for the acquisition of plant and machinery to be used in its trade. But those were not the facts.

84. *Ensign* was another case in which a partnership claimed a capital allowance, in this case in respect of sums claimed to have been spent on the making of a film. Lord Goff described the transaction as one in which in common sense terms the partnership contributed $3.25m to the cost of making the film. However a number of documents

were signed, the function of which was "to present a different picture" under which the partnership appeared to incur a total cost of $14m, the balance over and above $3.25m being lent to the partnership to enable it to finance the remainder of the film. On that basis the partnership's contention was that it was entitled to a capital allowance of $14m: see per Lord Goff at 680-681. Lord Goff said that it was impossible to characterise the money paid into the bank account to the credit of the partnership as in any meaningful sense a loan; various arrangements were inconsistent with the concept of a commercial loan and it was a misuse of language to describe the payments as a loan. He added (at 682-3):

> "In short, this is indeed a case in which, as though by magic, the appearance is given that the taxpayer has incurred capital expenditure, but the truth is otherwise. The structure created to achieve the conjuring trick is, as usual in such cases, both complex and artificial."

85. In the present case the key point is that the 80 was not paid for exploitation at all. It was not needed by Shamrock, who only needed to spend 10 of the 15 to secure the production, and that is so, as I have said, whether the 90 and 80 in the production agreement and the assignment of revenues agreement are genuinely separate payments, or a single payment of 10 artificially split into two. Not only was it not needed by Shamrock, it was not wanted by Shamrock who found it a nuisance. It was not in any sense used by Shamrock in fact for exploitation. That last point of course does indeed look at what the recipient does with the money, but in circumstances where this is to the knowledge of, and indeed intended and required by, the payer. The borrowing of the 80 and its payment to Shamrock by the LLP was in short artificially designed to multiply the losses. There is no commercial difference

between the members paying 15 for Shamrock's services without having borrowed 80 and without any rights to guaranteed repayment of the 80, and the members paying 95, of which they have borrowed 80 and are guaranteed to be repaid 80 (save for the extra costs in terms of margin and arrangement fees in the latter). The only practical difference is that in the first case the LLPs' expenditure would clearly be limited to 15 and that would be the most that they could argue qualified as a trading loss for tax purposes. In the artificial world, since the money that is actually paid over is 95 that enabled them to argue that the whole 95 amounts to a deductible trading loss. The conclusion that the 80 was injected into the system to increase the apparent size of the amount paid for the exploitation of the intellectual property rights (as the FTT said at [147]) is not only one which they were entitled to come to, but was I think an inevitable conclusion from the facts that they found. It seems to me to be comparable to the so-called loan in *Ensign* which was held not to be a loan in any meaningful sense at all; or to the expenditure in *Tower MCashback* where Lord Walker said (at [75]):

> "The facts of that case [*Ensign*] were different, since in that case there was not 'in any meaningful sense' a loan at all. In this case there was a loan but there was not, in any meaningful sense, an incurring of expenditure of the borrowed money in the acquisition of software rights. It went into a loop in order to enable the LLPs to indulge in a tax avoidance scheme."

Nothing in *BMBF*, or the factors which these cases happen to share with *BMBF*, can turn these wholly artificial and manufactured arrangements into a genuine commercial transaction under which 95 was really paid for the exploitation services. I therefore do not see any difficulty in rationalising the three decisions in *Ensign*, *BMBF* and

Tower, nor do I find in *BMBF* any principle of law which would enable the Upper Tribunal to declare that the factual decisions come to by the FTT involved erroneous legal principles or impermissible reasoning.

The subsidiary argument

86. The subsidiary argument is that even if the FTT was correct, or entitled, to find that the purpose of the payment by the LLP of 80 of the 95 was to secure the guaranteed income stream, that was still capable of being a trading purpose. This argument does not seem to have been articulated in Mr Peacock's skeleton argument, and did not really feature as a separate standalone argument in his oral submissions. He did however at one stage in his reply articulate the argument as follows:

> "What is said to be the non-business purpose here, can only be expressed as generating a stream of income to be received by the partnership which facilitates, and is designed to support, the borrowing of the individuals….
>
> That, I say, is a false line of reasoning. It assumes that generating a stream of income as a trader is necessarily and automatically a non-business purpose, just because that stream of income is to be used to support the borrowing by the individuals."

87. As I say it is not clear to me that was really intended to be a separate line of argument, but in case it was I should deal with it briefly. In my judgment there is nothing in it. Both Vos J in *Icebreaker 1* and the FTT in the present case dealt with this point in similar fashion. The way in which Vos J expressed it in *Icebreaker 1* was at [64], which I have quoted above (paragraph 76), where he said that the equivalent of the 80 was paid for the sole purpose of investment and security and not for Icebreaker's film

trade.

88. The way in which the FTT expressed the similar point in the present case is at [270], where they said that the LLPs' business was the exploitation of intellectual property rights, and not the acquisition of an income stream which was guaranteed irrespective of the success of that exploitation (cited at paragraph 25 above).

89. It is I think sufficient to say that I entirely agree with these analyses. The trade in which the Icebreaker partnerships were engaged was the exploitation of rights whether, as in *Icebreaker 1*, the exploitation of film rights, or, as in the appeals before me, the exploitation of various other rights such as rights in the format for a book or for songs. Once the FTT had found that the purpose of the LLPs in paying 80 of the 95 was not for such exploitation but for the securing of the guaranteed income stream, it follows that it was not for the purposes of the trade. Mr Peacock at one stage in his submissions referred to the fact that certain institutions such as banks and other financial institutions may be engaged in the trade of purchasing income streams in the form of financial instruments of one form or another. That is no doubt the case, but I do not see how the acquisition of a guaranteed income stream on the facts of these cases can be said to be part of the LLPs' trade of exploiting intellectual property rights. I should add, for the avoidance of doubt, that I am not purporting to decide anything about the taxability of either the Quarterly Payments or the Final Minimum Sum; those matters were not before me and Mr Maugham intervened to make it clear that as far at any rate as his clients are concerned there is a question whether the Final Minimum Sum would or would not be taxable as trading income. I heard no argument on such points and do not intend to be taken to be expressing any views on them.

90. That is sufficient to dispose of the appeal in relation to the 80. There was a further question raised as to whether the FTT was right to regard the expenditure of the 80 as capital expenditure, but in the light of the conclusions that I have already come to it is unnecessary to consider that further. It was accepted, I think, by both Mr Peacock and Mr Davey that it did not raise any question which required separate decision. In the light of my conclusions, I dismiss the appeals against the decision of the FTT in relation to the 80, that is that part of the sums paid by the LLPs to the principal exploitation company (Centipede or Shamrock) which was the equivalent of the Final Minimum Sums under such agreements.

The balance of the 95 (the 15)

91. There is no dispute that the balance of the 95 paid by the LLPs to the principal exploitation company, after deduction of the 80, was paid to Centipede or Shamrock for the services which the latter provided and was therefore wholly and exclusively paid for the purposes of the LLPs' trade. There was also no dispute that in order to be deductible in year 1, such payment had to be in respect of services rendered in that year rather than a prepayment for services to be rendered in future years. That, as I understand it, is because s. 25(1) of ITTOIA provides that the "profits of a trade must be calculated in accordance with generally accepted accounting practice" (commonly abbreviated to GAAP); and the expert accountants were agreed that one of the principles drawn from GAAP, which is well established, is that entities should prepare their accounts on the accruals basis of accounting, which requires that payments made by an entity in respect of services received by it should be treated as expenses in the accounting period to which they relate. Thus, as the FTT said at [231]:

> "The starting point for determining the correct accounting treatment of

whatever we find to be an allowable revenue expense is the requirement of FRS18 that the payments made by the partnerships in respect of services received by them should be treated as expenses in the accounting period to which they relate."

92. The FTT distinguished between the case of Acornwood and that of the other LLPs. In the case of Acornwood, cl 4.1 of the Principal Exploitation Agreement provided:

> "The LLP shall promptly pay all invoices received by it in relation to Exploitation Costs up to a maximum amount to be agreed. The LLP undertakes to pay an amount of £1,315,000 in respect of such Exploitation Costs to Centipede immediately upon signature hereof."

The FTT said that was materially indistinguishable from the relevant clause in *Icebreaker 1*, where Vos J had held that since the relevant clause provided for the LLP to discharge future exploitation costs, the implication was that the upfront payment was for past exploitation costs. It was therefore all allowable in year 1. The FTT followed that decision in relation to the balance paid by Acornwood to Centipede. There is no appeal by HMRC in relation to that decision.

93. In the case of the other four LLPs, however, the relevant clauses in the principal exploitation agreements did not contain any provision for the LLPs to discharge future exploitation costs. Thus for example in the case of Bastionspark the relevant clause, again cl 4.1, simply provided that:

> "Immediately upon signature of this Agreement the LLP will pay to Shamrock a fee in the sum of £4,729,000 (the "Fee") for provision of its services hereunder…."

The Principal Exploitation Agreement was in the case of Bastionspark initially for a term of 10 years, although it could be terminated early or extended. The services provided by Shamrock are all services that are expressed as continuing obligations, rather than limited to one off obligations to be carried out in the first year. Thus cl 2.2 provides:

> "Shamrock hereby agrees to exploit the Rights, procure Materials and seek to maximise Revenue to the best of its skill and ability. Shamrock will incur Exploitation Costs and enter into Service Agreements and Licence Agreements for this purpose."

Cl 2.3 provides:

> "The LLP and Shamrock shall work together to procure Materials and generate Revenue and shall consult each other frequently in relation to all matters relating to the Rights of whatsoever nature, giving due and proper consideration to each other's views."

Cl 2.4 provides:

> "….Shamrock shall procure that one of its senior representatives will be available on reasonable notice to attend meetings and discuss the Rights and their exploitation with the LLP's representatives."

Cl 3.1 provides:

> "Shamrock shall work with the LLP and, if directed by the LLP, the Original Licensors to exploit the Rights in accordance with this Agreement. Shamrock shall ensure that the Rights are at all times given fair and equitable

treatment and are not discriminated against in favour of any other rights or activity with which Shamrock and/or its senior representatives may be involved."

94. In these circumstances, the FTT said (at [291]-[292]) that:

> "It is plain from the intermediate (Bastionspark, Edgedale and Starbrooke) version that events which can occur only in the future are included, a fact emphasised by the repeated use of the word "shall". …... Although it is less clearly stated there is, in our view, a contemplation of future work in the Hawksbridge version too.
>
> 292. It would, we think, be artificial and wrong in principle to treat a payment which, even if the bulk of it is attributable to work already undertaken, contains an element of payment for future work, even contingent future work, as one which has no prepayment component at all. There was an obligation on Shamrock to undertake work in the future should that be necessary, and the evidence showed that Shamrock did in fact undertake some continuing work for which the monitoring fees could not be regarded as the reward. The work might not have amounted to a great deal by comparison with what had been done in advance, but for example, and possibly most significantly in this context, Mr Hutton or one of his colleagues regularly attended partnership meetings and provided information and advice, in particular about such matters as the disposal of the Far-fetch business, and such work cannot be dismissed as *de minimis*."

95. In those circumstances the FTT decided that part of the fee paid by each partnership to Shamrock should properly be regarded as the cost of work done in the relevant year

and part as the cost of future work. They therefore left it to the parties to agree on an apportionment if they could, or return for further argument if they could not.

96. Mr Peacock in his skeleton argument suggested that there was no evidence on which to base the finding that part of the payment under the Principal Exploitation Agreements in the case of the LLPs other than Acornwood was for future work. As I read the decision of the FTT, their decision in principle was not so much based on the evidence before them, although they regarded that as confirming the view that they had reached, but on the fact that under each Principal Exploitation Agreement there was a contractual obligation on Shamrock to provide services throughout the term, and it therefore could not be said that a single payment upfront was all attributable to services to be provided in the first year. In oral argument Mr Peacock said that the vast bulk of the work that was done, the meaningful work to procure the projects, was all done in the first year; and it was unsound to say that the fee paid on day 1 was somehow attributable to things that Shamrock might do in year 2 onwards, just because Shamrock was going to do some relatively minor things in years 2 onwards.

97. I accept, as the FTT did, that the vast bulk of Shamrock's services were provided in year 1, but I do not see that this undermines the point the FTT made. There was a continuing obligation on Shamrock to provide services during the term of the Principal Exploitation Agreement. The fact that those services might not be very extensive compared to the services provided on day 1, does not mean that the entirety of the fee paid on day 1 was attributable to the services which had been provided. It is a point which goes only to the appropriate apportionment, a matter which the FTT did not attempt to resolve, although they commented that it was likely that the cost of work done in year 1 would significantly exceed the cost of future work. I see no flaw

in the FTT's reasoning; indeed, the contrary view would seem to entail either the proposition that despite the form of the Principal Exploitation Agreement Shamrock was never in fact intended to provide any services at all beyond day 1, or, that it was to provide all future services from year 2 onwards in return for no part of the fee which was paid as a single fee for its services under the agreement as a whole. Neither seems to me remotely justified.

98. I therefore dismiss the appeal in relation to the 15.

The fees (the 5)

99. The remaining part of the 100 in Mr Peacock's simple example is the 5 that was paid to IML or IMSL. This was paid under two agreements, one the Advisory Services Agreement, and the other the Administrative Services Agreement. No question arises over the fees payable under the Administrative Services Agreement; the FTT decided that the immediate administrative services fee in each case, as opposed to an ongoing annual fee, was to be treated as revenue expenditure of the LLP in year 1. There is no challenge to that by HMRC.

100. That simply leaves the advisory fees paid under the Advisory Services Agreements. Here the FTT made a distinction between (i) Acornwood, (ii) Bastionspark and (iii) the other three LLPs (Edgedale, Starbrooke and Hawksbridge). In the case of the latter three LLPs the decision of the FTT was that no part of the advisory fee was to be treated as a prepayment for future services; this was because the agreements provided for separate annual payments for future services. However, the FTT decided that the initial fee was not in truth paid for advisory services, but for the purchase of a package. As such it was a capital payment and was not deductible as a revenue expense. In the case of Bastionspark, where there was no provision for future annual

payments, the FTT decided that some part of the fee was to be attributed to a prepayment for future years, following the similar decision of Vos J in *Icebreaker 1*. But they concluded that the balance of the payment to Bastionspark was again for a package, and hence capital. They were unable to apportion the fee paid in Bastionspark's case between the two, but the practical result was that none of the advisory services fee represented an allowable expense in the relevant year. In the case of Acornwood, they again held that part was a prepayment for future years and part for a package, neither element being deductible as a revenue expense in the relevant year, but they held that part was to be attributed to work done by IML in respect of a further set of projects which Acornwood took on after it had closed. That element therefore, unlike the other two elements, was deductible.

101. In his skeleton argument, Mr Peacock took issue with the conclusion of the FTT that in each of the five LLPs all or part of the fee was for the purchase of a package; but in all of them he said that the treatment of the advisory fees would follow that of the 80. By that he meant that if he was wrong on the 80 then the tribunal's conclusion that in part the advisory fee was for some kind of package would follow. As I understood it, that was an acceptance that if, as I have found, the FTT were right on the non-deductibility of the 80, then Mr Peacock would not pursue a challenge to the conclusion that part or all of the advisory fee was payable for a package and hence capital rather than revenue expenditure.

102. That then leaves the question of whether the FTT was right to regard, in the case of Acornwood and Bastionspark, part of the fee as being a prepayment for future services. Mr Peacock took issue with that, but the point in my judgment is similar to that which arose in relation to the 15. The advisory service agreements were for terms

of 10 years, subject to early termination. The services were described in the agreement with Acornwood as follows:

> "We will provide you with advisory services relating to the acquisition, licensing and exploitation of distribution rights in all forms of intellectual property. We will advise you on all of the areas of business set out in the LLP agreement of today's date, including the negotiation and entry into the agreements of sub-contractors and other third parties for the exploitation of such distribution rights. We confirm that upon receipt of a written request from the members of Icebreaker 7 LLP (the "Members"), we will be obliged to attend any meeting of the Members that may be notified to us."

The provision in relation to Bastionspark, although not identically worded, was to the same effect and included in particular the obligation to attend any meetings of Members that might be notified to IML. In his skeleton argument Mr Peacock said that there was no evidence to support the FTT's finding that part of the fee was for future services. But in oral argument he accepted, as I understood it, that the FTT were in fact right about this. I put to him that when the LLP paid the money in year 1 it acquired a right to future services if called on; such services might never be called on, but the members of the LLP clearly could request a meeting in year 9 and require IML to attend such a meeting. In that case the LLP would not be paying anything extra for that service because it had already paid for it. In those circumstances although the LLP could not know when it paid in year 1 whether any services would in fact be provided in future years, it was still paying for the right to have them if asked for. Mr Peacock accepted that, and accepted that Bastionspark was to the same effect. It seems to me to follow that there is nothing left for me to decide in relation

to the advisory fees.

Rule 24

103. That is sufficient to decide the appeals. There is however one point of general importance which was argued before me, and which it was suggested that I might like to express a view on in any event. It arises on the Tribunal Procedure (Upper Tribunal) Rules 2008 SI 2008/2698. Rule 24 of the Upper Tribunal Rules, headed "Response to the notice of appeal" provides as follows:

> "(1) This rule and rule 25 do not apply to a road transport case, in respect of which Schedule 1 makes alternative provision.
>
> (1A) Subject to any direction given by the Upper Tribunal, a respondent may provide a response to a notice of appeal.
>
> (2) Any response provided under paragraph (1A) must be in writing and must be sent or delivered to the Upper Tribunal so that it is received –
>
> (a) if an application for permission to appeal stands as the notice of appeal, no later than 1 month after the date on which the respondent was sent the notice that permission to appeal had been granted;
>
> (aa) in a fast track case, two days before the hearing of the appeal;
>
> (ab) in a quality contracts scheme case, no later than 1 month after the date on which a copy of the notice of appeal is sent to the respondent; or
>
> (b) in any other case no later than 1 month after the date on which the

Upper Tribunal sent a copy of the notice of appeal to the respondent.

(3) The response must state –

(a) the name and address of the respondent;

(b) the name and address of the representative (if any) of the respondent;

(c) an address where documents for the respondent may be sent or delivered;

(d) whether the respondent opposes the appeal;

(e) the grounds on which the respondent relies, including (in the case of an appeal against the decision of another tribunal) any grounds on which the respondent was unsuccessful in the proceedings which are the subject of the appeal, but intends to rely [on] in the appeal; and

(f) whether the respondent wants the case to be dealt with at a hearing.

(4) If the respondent provides the response to the Upper Tribunal later than the time required by paragraph (2) or by an extension of time allowed under rule 5(3)(a) (power to extend time), the response must include a request for an extension of time and the reason why the response was not provided in time.

(5) When the Upper Tribunal receives the response it must send a copy of

the response and any accompanying documents to the appellant and each other party."

104. In this case HMRC said that it did not intend to provide a response to the notice of appeal, and it did not do so. However when it came to agreeing the bundles for the appeal hearing, a disagreement arose as to whether HMRC was entitled to rely upon documents which had not been relied upon by the FTT. In that connection, HMRC contended that there was no requirement for a respondent to file a response to a notice of appeal in order to be able to rely on reasons not relied on by the FTT or indeed to rely upon grounds which were unsuccessful before the FTT. That was because rule 24(1A) provides that the respondent *may* provide a response to a notice of appeal. HMRC's position was that although of course it was important that an applicant should know in advance what arguments a respondent intended to rely upon, that did not need to be done in a response to the notice of appeal, and could be provided, for example, in a skeleton argument.

105. Mr Peacock said that that could not be what the intention of the rules was, because it would have absurd practical consequences. It would mean that it would never be in the interests of a respondent to provide a response. If HMRC were right, a respondent who did not provide any response would be at liberty to run any arguments they wanted to on appeal, whether they were grounds on which they had been unsuccessful below or not. Moreover rule 24(4) provides that the Upper Tribunal has power to extend time, but if the response is purely voluntary, and there are no consequences for a respondent in not providing a response at all, it is very difficult to see what the purpose is of requiring the respondent to include a request for an extension of time, and explain why the response was not provided in time, or to understand what the

consequences would be if the Upper Tribunal refused an extension of time.

106. Mr Davey suggested that perhaps the solution to the difficulties would lie in a general principle that a respondent had to serve a response in any case in which failure to do so might prejudice the appellant; or in the Upper Tribunal giving directions as to service of a response, as contemplated by rule 24(1)(a). Mr Peacock countered that the first of these solutions would simply lead to further work for the tribunal in determining whether failure to serve a notice was prejudicial; and the second, if correct, would mean that any well advised appellant would automatically apply to the tribunal for a direction that the respondent serve a response. Neither seemed a very practical solution.

107. As I have already said, this point does not need to be resolved for the purposes of this litigation. But I think I should say that I prefer the submissions of Mr Peacock on this point. It is indeed impossible to see why rule 24(1A) is worded so as to provide that the respondent "may" provide a response; given the matters that such a response must state by rule 24(3) include whether the respondent opposes the appeal and an address where documents may be sent or delivered, one would have thought it would make for administrative convenience if a respondent were obliged to provide a response to every appeal regardless of whether it intended to oppose it or not. It may be that it was thought that some respondents would in practice not wish to take any part in the appeal and should not be put to the trouble of serving a response. I think it likely however that the drafters of the rule contemplated that any respondent who did intend to oppose the appeal should put in a response giving the name and address of any representative and an address for service and specifying the grounds on which the respondent relied. It is not suggested that in this case HMRC's failure to serve a

response should disentitle them from being heard at the hearing; and I do not think that I should decide that point, which is a point which may have far reaching consequences. But I do think that if a respondent wishes to rely on any grounds in support of his opposition to an appeal (other than simply relying on the decision which is being appealed) then he should say so; and if he fails to say so, and fails to obtain an extension of time, then the consequence is that he cannot run such arguments on the appeal without the permission of the tribunal.

108. I am conscious that I did not have extended argument on this point, but since I was asked to express a view I have expressed my own view, albeit for the reasons I have given it is not something that is determinative on this appeal.

Conclusion

109. For the reasons I have given above I dismiss these appeals.

MR JUSTICE NUGEE

RELEASE DATE: 4 August 2016