[2017] UKUT 0132 (TCC)

Appeal number: UT/2015/0041

INCOME TAX – Reference – whether trades carried on on a commercial basis (ss. 380, 381 and 384 ICTA 1988, and ss. 64, 66, 72 and 74 ITA 2007) – No – whether partners non-active (ss. 118ZE, 118ZH ICTA 1988 and s. 103B ITA 2007) – Yes – whether one of main purposes to obtain sideways relief (s. 74ZA ITA 2007) – Yes – Appeal dismissed

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

SEVEN INDIVIDUALS **Appellants**

- and -

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

TRIBUNAL: MR JUSTICE NUGEE

Sitting in public at the Rolls Building, London EC4A 1NL on 4, 5 and 6 October 2016

Jolyon Maugham QC, instructed by Simkins LLP, for the Appellants

Jonathan Davey QC, Imran S Afzal, Nicholas Macklam, and Sam Chandler instructed by the General Counsel and Solicitor for HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by a number of individuals against a decision of the First-tier Tribunal (Judge Colin Bishopp and Mr Richard Law) (**"the FTT"**), and is a yet further round in the litigation between the "Icebreaker" partnerships and the Commissioners for HM Revenue and Customs (**"HMRC"**).

2. The proceedings heard by the FTT consisted in part of appeals by five of the Icebreaker partnerships (these are limited liability partnerships or LLPs and the particular LLPs were Acornwood, Bastionspark, Edgedale, Starbrooke and Hawksbridge) against various decisions of HMRC disallowing expenditure by them which they claimed to be deductible in the calculation of trading losses; and in part of a joint reference to the FTT of a number of questions by seven individuals, who were members of those or other Icebreaker LLPs, and HMRC. The joint reference was made under s. 28ZA of the Taxes Management Act 1970, which permits questions arising in connection with the subject-matter of an enquiry to be referred jointly to the FTT for determination.

3. The FTT released its decision (**"the Decision"**) on 7 May 2014: see *Acornwood LLP v HMRC* [2014] UKFTT 416 (TC). In summary, the FTT allowed the appeal of all five LLPs to a limited extent but rejected the most significant of the claims made by them, and largely rejected the contentions of the individual referrers in the joint reference.

4. An appeal by the five LLPs against the FTT's substantive Decision on their appeals was dismissed by me, sitting in the Upper Tribunal (**"the UT"**), in a decision released on 4 August 2016: see *Acornwood LLP v HMRC* [2016] UKUT 361 (TCC). A separate appeal by four of the LLPs (that is, all except Acornwood) against the FTT's decision on costs was also subsequently dismissed by me, again sitting in the UT, in a decision released on 5 October 2016: see *Bastionspark LLP v HMRC* [2016] UKUT 425 (TCC).

5. I now have to consider the present appeal, which is an appeal by the individual referrers against the Decision on the questions which were referred and which the FTT decided against them.

6. I will have to come to the details of the questions referred in due course, but in essence they raise issues which affect the question whether the individual members of the LLPs can obtain what is called sideways loss relief, that is whether they can set their individual share of their LLP's trading losses against other income for income tax purposes. So whereas the LLPs' appeals were concerned with what are called "partnership level issues" – namely whether the LLPs could include certain expenditure in the calculation of their trading losses – the individuals' appeals are concerned with what are called "member level issues".

7. As explained to me by Mr Maugham QC, who appeared for the individual referrers, the member level issues remain live and significant despite the fact that the FTT largely rejected the LLPs' arguments on the partnership level issues. This is partly because of the possibility of further appeals, but also because the FTT as I have said did allow the LLPs' appeals to a certain extent, and the losses which they did allow cannot be regarded as trivial: in the costs appeal the parties were agreed that the total allowable to the four LLPs there involved would ultimately amount to between 14.03% and 15% of the amounts claimed, or about £3.3m to £3.6m between the four of them: see *Bastionspark LLP v HMRC* [2016] UKUT 425 (TCC) at [10(5)]. The five LLPs that took part in the substantive appeals were however selected as lead cases under the FTT rules, each one representing one tax year from 2005-6 to 2009-10, and there were a further 46 LLPs involved in related cases. The four LLPs involved in the costs appeal were the lead cases for 40 of those, and if one added those in, the total allowable losses would be some £44m to £47m: *ibid* at [10(6)]. (This does not include Acornwood or the LLPs for which Acornwood was the lead case so the total for all 51 LLPs will be higher.) On any view these sums are sufficient to explain why the member level issues continue to be significant, even though the LLPs have largely lost the partnership level issues, and even without the possibility of a further appeal on those issues.

8. The seven individuals in question were chosen, with the agreement of HMRC, as a representative cross-section of the individual members of the Icebreaker LLPs. Mr Maugham told me that there were about 900 members in all, of which about half had joined the Icebreaker Members' Action Group, or IMAG. All of the members of IMAG agreed to be bound by the decision on the joint reference, and although the other members of Icebreaker LLPs have not so agreed, in practice, as the FTT said in the Decision at [14], the reference will necessarily be relevant to them as well.

9. In fact two of the individual referrers have settled their own position with HMRC. The formal position is no doubt that that means there is no outstanding appeal by them, but Mr Maugham invited me to express my views on the issues arising in any event because they would affect others who were in a comparable position. That seems to me to be a sensible course, whatever the technical position.

10. The seven individuals were each members of different LLPs, three for the tax year 2006-07 (Keepstone, Bastionspark and Ironmoat), one each for the tax years 2007-08 and 2008-09 (Edgedale and Starbrooke respectively), and two for the tax year 2009-10 (Moondale and Hawksbridge). They were referred to by the FTT in the Decision by the name of the LLP of which they were a member ("Mr Keepstone", "Mr Bastionspark" and the like) for the reasons given by them in the Decision at [17]. As the FTT said, this is not to provide them with anonymity (as the names of the members of any individual LLP are easily discoverable by search), but because they were selected as a fair cross-section of the membership and there is no good reason why the personal

details they gave in evidence should be linked to identified individuals while all the other partners escape similar scrutiny. I shall follow the same course.

Outline facts

11. The FTT gave a very full account of the facts in the Decision. It is not necessary for the purposes of this appeal however to give more than an outline of the facts, which I can conveniently do by reference to a simplified example which was put before me on the LLPs' substantive appeal, and which I referred to in my decision ([2016] UKUT 361 (TCC) at [6]) as follows:

> "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… 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."

12. What this account omits is the interest that an LLP, and hence its members, had in the profits if the particular projects with which the LLP was concerned were successful. The details varied from one LLP to another, but in essence the principal exploitation company (Centipede or Shamrock as the case may

be) had the right to assign (and did assign) a share of the revenues from exploitation of the product in question to the production company; the exploitation company would itself be entitled to a share of the remaining revenue; and the balance would belong to the LLP. In the substantive appeal I was taken through the relevant documents for one of the LLPs (Hawksbridge) concerning two separate products, one a large format luxury book on the band Kiss, and the other an album by the singer Sinead O'Connor. The details are set out in my decision ([2016] UKUT 361 (TCC) at [8]-[13]), and as there appears, in the case of the Kiss book, Shamrock agreed with the production company to assign to it 25% of the revenues, and was itself entitled to 10% of what was left; in the case of the Sinead O'Connor album, Shamrock agreed to assign 50% of the revenues to the production company and was itself entitled to 15% of what was left (see at [11], [13]). That means that the LLP was entitled to a varying amount of the total revenue derived from the exploitation of the product in question; it can be seen for example that Hawksbridge was entitled to 67.5% of the revenues from the Kiss book (90% x 75%) but only 42.5% of the revenues from the Sinead O'Connor album (85% x 50%).

13. I will have to look at the evidence of the actual and potential returns in more detail in due course, but it is worth recording here that the FTT had before it a spreadsheet setting out the income to March 2011 of each of the LLPs, of which they said (Decision at [407]):

> "the receipts to March 2011 recorded against many of the partnerships were nil, in other cases very modest and in none were they of a scale which might be termed "healthy", even though some of the partnerships had by then been active for a few years."

They gave a number of examples, of which the first was Acornwood where gross receipts earned to March 2011 were £37,952. That can be contrasted with the capital amount subscribed by the members to Acornwood, which was £5,355,000, of which 75% (£4,016,250) was borrowed and 25% (£1,338,750) was contributed by the members. Overall the FTT found that none of the LLPs had come close to earning a commercial rate of return on its members' personal contributions (Decision at [206]).

The legislation

14. The relevant legislation is quite intricate, not least because the facts span a number of different tax years, although the questions ultimately arising are not that complicated to state.

15. The starting point is certain provisions in Part 9 of the Income Tax (Trading and Other Income) Act 2005 (**"ITTOIA"**). Part 9 of ITTOIA, headed "Partnerships", was brought into force on 6 April 2005 and consisted at the relevant time of ss. 846 to 863 (some further provisions added more recently are of no relevance). s. 846 provides that the Part contains some special rules about partnerships, and s. 847(1) provides that in the Act persons carrying on a trade in partnership are collectively referred to as a "firm." s. 848 then

provides the general rule for assessment of partnerships as follows:

> "**848 Assessment of partnerships**
>
> Unless otherwise indicated (whether expressly or by implication), a firm is not to be regarded for income tax purposes as an entity separate and distinct from its partners."

An LLP is of course a body corporate, and as a matter of general law is therefore a distinct entity from its members, but this general rule is applied to LLPs by s. 863 which so far as relevant provides as follows (in this, and other provisions, I have highlighted certain particularly relevant parts of the text):

> "**863 Assessment of partnerships**
>
> (1) For income tax purposes, if a limited liability partnership carries on a trade, profession or business **with a view to profit**–
>
> (a) all the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),
>
> (b) anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and
>
> (c) the property of the limited liability partnership is treated as held by the members as partnership property.
>
> References in this subsection to the activities of the limited liability partnership are to anything that it does, whether or not in the course of carrying on a trade, profession or business with a view to profit.
>
> (2) For all purposes, except as otherwise provided, in the Income Tax Acts–
>
> (a) references to a firm or partnership include a limited liability partnership in relation to which subsection (1) applies,
>
> (b) references to members or partners of a firm or partnership include members of such a limited liability partnership…"

(This text incorporates some minor amendments to s. 863(2), which were brought into force on 6 April 2007 but on which nothing turns.)

16. The relevant point for present purposes is that s. 863 only applies to an LLP if it carries on a trade, profession or business "with a view to profit". Mr Maugham drew my attention to this and said that HMRC had accepted that s. 863 applied to the LLPs in question and had therefore accepted that the LLPs were carrying on business with a view to profit. Mr Davey QC, who

appeared for HMRC, expressly accepted before me that the trades of the LLPs were carried on with a view to profit within the meaning of s. 863. Mr Maugham sought to rely on this acceptance or concession for part of his argument, a point to which I will return.

17. Next it is necessary to refer to the various provisions which allow a member of a partnership to claim sideways loss relief for losses sustained by the partnership. The first relevant iteration of these was found in the Income and Corporation Taxes Act 1988 (**"ICTA"**), which was in force until 6 April 2007. ICTA provided for two types of sideways loss relief, one under s. 380 which applied generally, and one under s. 381 which applied only to the early years of a trade. Each was subject to certain restrictions, the relief in s. 380 being subject to restrictions in s. 384, and the relief in s. 381 being subject to restrictions in s. 381 itself. These provisions, in the form in which they stood at the relevant time and so far as material, were as follows:

> "**380 Set-off against general income**
>
> (1) Where in any year of assessment any person sustains a loss in any trade, profession, vocation or employment carried on by him either solely or in partnership, he may, by notice given within twelve months from the 31st January next following that year, make a claim for relief from income tax on—
>
> (a) so much of his income for that year as is equal to the amount of the loss or, where it is less than that amount, the whole of that income; or
>
> (b) so much of his income for the last preceding year as is equal to that amount or, where it is less than that amount, the whole of that income;
>
> but relief shall not be given for the loss or the same part of the loss both under paragraph (a) and under paragraph (b) above.
>
> (2) Any relief claimed under paragraph (a) of subsection (1) above in respect of any income shall be given in priority to any relief claimed in respect of that income under paragraph (b) of that subsection.
>
> **381 Further relief for individuals for losses in early years of trade**
>
> (1) Where an individual carrying on a trade sustains a loss in the trade in—
>
> (a) the year of assessment in which it is first carried on by him; or
>
> (b) any of the next three years of assessment;
>
> he may, by notice given on or before the first anniversary of the 31st January next following the year of assessment in which the loss is sustained, make a claim for relief under this section.

(2) Subject to section 492 and this section, relief shall be given under subsection (1) above from income tax on so much of the claimant's income as is equal to the amount of the loss or, where it is less than that amount, the whole of that income, being income for the three years of assessment last preceding that in which the loss is sustained, taking income for an earlier year before income for a later year.

(3) Relief shall not be given for the same loss or the same portion of a loss both under subsection (1) above and under any other provision of the Income Tax Acts.

(4) Relief shall not be given under subsection (1) above in respect of a loss sustained in any period unless **the trade was carried on** throughout that period **on a commercial basis** and **in such a way that profits in the trade** (or, where the carrying on of the trade forms part of a larger undertaking, in the undertaking as a whole) **could reasonably be expected to be realised in that period or within a reasonable time thereafter**.

…

384 Restrictions on right of set-off

(1) Subject to subsection (2) below, a loss shall not be available for relief under section 380 unless, for the year of assessment in which the loss is claimed to have been sustained, **the trade was being carried on on a commercial basis** and **with a view to the realisation of profits in the trade** or, where the carrying on of the trade formed part of a larger undertaking, in the undertaking as a whole.

…

(9) Where at any time a trade is carried on **so as to afford a reasonable expectation of profit**, it shall be treated for the purposes of subsection (1) above as being carried on at that time with a view to the realisation of profits.

…"

18. There were other relevant restrictions in ICTA on the availability of the relief under ss. 380 and 381, and they were found in ss. 118ZE and 118ZH, as follows:

"**118ZE Restriction on relief for non-active partners**

(1) This section applies to an amount which may be given to an individual under section 380 or 381 in respect of a loss sustained by him in a trade in a qualifying year of assessment.

(2) The amount may be given otherwise than against income consisting of profits arising from the trade only to the extent that—

(a) the amount given, or

(b) (as the case may be) the aggregate amount,

does not exceed the amount of the individual's contribution to the trade as at the end of that year of assessment.

(3) A *"qualifying year of assessment"* means a year of assessment—

(a) at any time during which the individual carried on the trade as a general partner or a member of a limited liability partnership,

(b) in which **he did not devote a significant amount of time to the trade** (within the meaning given by section 118ZH),

(c) which is the year of assessment in which the trade is first carried on by him or any of the next three years of assessment,

(d) the basis period for which ends on or after 10 February 2004, and

(e) which is not a year of assessment at any time during which he carried on the trade as a limited partner.

…

118ZH "A significant amount of time"

(1) For the purposes of section 118ZE the individual shall be treated as having "devoted a significant amount of time to the trade" in a given year of assessment if, for the whole of the relevant period, **he spent an average of at least ten hours a week personally engaged in activities carried on for the purposes of the trade**.

(2) *"The relevant period"* means the basis period for the year of assessment in question, except that—

(a) if the basis period is less than six months and begins with the date when the individual first carried on the trade, "the relevant period" means six months beginning with that date, and

(b) if the basis period is less than six months and ends with the date when the individual ceased to carry on the trade, "the relevant period" means six months ending with that date.

…"

Mr Maugham told me that it had been conceded before the FTT that if the members of the LLPs were "non-active members" (that is, did not satisfy the test in s 117ZH(1)) the practical consequence was that they could not avail themselves of any sideways loss relief, save for certain members who could take advantage of transitional provisions; it is not I think necessary to go into the detail.

19. With effect from 6 April 2007 ss. 380, 381 and 384 ICTA were replaced by provisions of the Income Tax Act 2007 (**"ITA"**). As enacted, the relevant provisions were as follows:

"**64 Deduction of losses from general income**

(1) A person may make a claim for trade loss relief against general income if the person–

(a) carries on a trade in a tax year, and

(b) makes a loss in the trade in the tax year ("the loss-making year").

(2) The claim is for the loss to be deducted in calculating the person's net income–

(a) for the loss-making year,

(b) for the previous tax year, or

(c) for both tax years.

…

(8) This section needs to be read with–

…

(b) sections 66 to 70 (restrictions on the relief)

…

66 Restriction on relief unless trade is commercial

(1) Trade loss relief against general income for a loss made in a trade in a tax year is not available unless the trade is commercial.

(2) The trade is commercial if it is carried on throughout the basis period for the tax year–

(a) **on a commercial basis**, and

(b) **with a view to the realisation of profits of the trade**.

(3) If at any time a trade is carried on **so as to afford a reasonable expectation of profit**, it is treated as carried on at that time with a view to the realisation of profits.

…

72 Relief for individuals for losses in first 4 years of trade

(1) An individual may make a claim for early trade losses relief if the

individual makes a loss in a trade–

(a) in the tax year in which the trade is first carried on by the individual, or

(b) in any of the next 3 tax years.

(2) The claim is for the loss to be deducted in calculating the individual's net income for the 3 tax years before the one in which the loss is made (see Step 2 of the calculation in section 23).

…

(5) This section needs to be read with–

…

(b) section 74 (restrictions on the relief)

…

74 Restrictions on relief unless trade is commercial etc

(1) Early trade losses relief for a loss made by an individual in a trade in a tax year is not available unless the trade is commercial.

(2) The trade is commercial if it is carried on throughout the basis period for the tax year–

(a) **on a commercial basis**, and

(b) in such a way that profits of the trade **could reasonably be expected to be made in the basis period or within a reasonable time afterwards**.

…"

It is common ground that these provisions are for present purposes materially identical to the provisions of ICTA which they replaced. There were in fact minor changes to the definition of the basis period, and there have been some minor amendments since ITA was introduced, but it is not suggested that anything turns on them in the present case.

20. The non-active partner provisions in s. 117ZH ICTA were also re-enacted, this time in s. 103B ITA (introduced with effect from 6 April 2007 by the Finance Act 2007), which, so far as material, provided as follows:

"**103B Meaning of "*non-active partner*" etc**

(1) For the purposes of this Chapter an individual carries on a trade as a non-active partner during a tax year if the individual–

(a) carries on the trade as a partner in a firm at a time during the year,

(b) does not carry on the trade as a limited partner at any time during the year, and

(c) does not devote a significant amount of time to the trade in the relevant period for the year.

(2) For the purposes of this Chapter an individual devotes a significant amount of time to a trade in the relevant period for a tax year if, in that period, the individual **spends an average of at least 10 hours a week personally engaged in activities carried on for the purposes of the trade**.

(3) For this purpose *"the relevant period"* means the basis period for the tax year (unless the basis period is shorter than 6 months).

(4) If the basis period for the tax year is shorter than 6 months, *"the relevant period"* means–

(a) the period of 6 months beginning with the date on which the individual first started to carry on the trade (if the basis period begins with that date), or

(b) the period of 6 months ending with the date on which the individual permanently ceased to carry on the trade (if the basis period ends with that date).

…"

21. As set out above, s. 103B ITA applied from 6 April 2007, that is for the tax years 2007-08 and thereafter. There was in fact an arcane dispute between the parties whether the provisions applicable for the tax year 2006-07 were ss. 118ZE and 118ZH, or was s. 103C ITA, which was inserted into ICTA by the Finance Act 2007 (or, to be more precise, whether ICTA had effect as if a provision corresponding to s. 103C ITA were included in it): see the Decision at [418]. This would not appear to make any practical difference.

22. s. 103B was amended by the Finance Act 2008, with effect for relevant periods ending on or after 12 March 2008, by amending s. 103B(2) as follows:

"(2) For the purposes of this Chapter an individual devotes a significant amount of time to a trade in the relevant period for a tax year if, in that period, the individual **spends an average of at least 10 hours a week personally engaged in activities of the trade** and those activities are carried on–

(a) **on a commercial basis**, and

(b) **with a view to the realisation of profits** as a result of the activities."

23. Finally it is necessary to refer to s. 74ZA ITA, which was introduced by the Finance Act 2010 with effect in relation to a loss arising in connection with arrangements entered into on or after 21 October 2009. It is an example of what is known as a targeted anti-avoidance rule and provides as follows:

> "**74ZA No relief for tax-generated losses**
>
> (1) This section applies if—
>
> (a) during a tax year a person carries on (alone or in partnership) a trade, profession or vocation ("the relevant activity"),
>
> (b) the person makes a loss in the relevant activity in that tax year, and
>
> (c) the loss arises directly or indirectly in consequence of, or otherwise in connection with, relevant tax avoidance arrangements.
>
> (2) No sideways relief or capital gains relief may be given to the person for the loss (but subject to subsection (5)).
>
> (3) In subsection (1) *"relevant tax avoidance arrangements"* means arrangements—
>
> (a) to which the person is a party, and
>
> (b) **the main purpose, or one of the main purposes, of which is the obtaining of a reduction in tax liability by means of sideways relief** or capital gains relief.
>
> (4) In subsection (3) *"arrangements"* includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).
>
> …"

Questions arising on the appeal

24. It is now possible to state the questions which arise on the appeal. Although the questions formally referred to the FTT were grouped by tax year and consisted of 18 questions in all, there was a considerable degree of overlap, and they can be regarded as in effect raising four separate questions. The FTT answered one of these (in relation to the so-called Restriction Regulations) in favour of the taxpayer, and HMRC has not appealed that. The other three were each answered by the FTT in favour of HMRC, and in each case the taxpayers have appealed.

25. Those three questions are summarised in Mr Maugham's written submissions as follows:

(1) In respect of each individual referrer, whether his or her LLP's trade was carried on on a commercial basis and with a view to profit (**"the Commercial Basis question"**).

(2) In respect of each individual referrer, whether s/he was active (**"the Active Member question"**).

(3) In respect of Mr Hawksbridge, whether the arrangements to which he was party had a main tax avoidance purpose (**"the section 74ZA question"**).

This is sufficient to indicate the nature of the issues: I give the precise questions dealt with by the FTT below.

26. I will address the questions in that order.

The Commercial Basis question

27. As set out above there are two sets of provisions under which sideways loss relief can be claimed, one being what I will call **"the general provisions"** (s. 380 ICTA and s. 66 ITA), and the other being what I will call **"the early years provisions"** (s. 381 ICTA and s. 74 ITA).

28. It can be seen from the legislation that in order to obtain relief, whether under the general provisions or the early years provisions, two limbs need to be satisfied. The first is that the trade was, or was being, or is, carried on "on a commercial basis" (s. 384(1) ICTA and s. 66(2)(a) ITA; and s. 381(4) ICTA and s. 74(2)(a) ITA respectively). I will refer to this limb, as Mr Maugham did, as **"the commerciality limb"**.

29. The second limb is a requirement as to profits, which is not worded identically. Under the general provisions, the requirement is that the trade was being or is carried on "with a view to the realisation of profits in the trade" (or "of the trade"), to which is added a deeming provision to the effect that if a trade is carried on "so as to afford a reasonable expectation of profit" then it is to be treated as carried on with a view to the realisation of profits (s. 384(1) and (9) ICTA, s. 66(2)(b) and (3) ITA). Under the early years provisions, however, the requirement is that the trade was or is carried on "in such a way that profits in the trade … could reasonably be expected to be realised in that period [or the basis period] or within a reasonable time thereafter" (s. 381(4) ICTA and s. 74(2)(b) ITA). I will refer to this limb, again as Mr Maugham did, as **"the profits limb"**.

30. The precise questions referred to the FTT under this head were as follows (Decision at [349]-[350]):

(1) For the tax year 2006-07 (Messrs Bastionspark, Ironmoat and Keepstone):

> "In relation to the trade carried on by the relevant LLP in question was it: (a) being carried on "for the year of assessment" on a "commercial basis" and "with a view to the realisation of profits" in the trade as those terms are used in section 384 of the Income and Corporation Taxes Act 1988 ("ICTA 1988"); and/or (b) carried on throughout the "period" on a "commercial basis" and in such a way that profits in the trade could "reasonably be expected to be realised in that period or within a reasonable time thereafter" as those terms are used in section 381 ICTA 1988?"

(2) For each of the tax years 2007-08 (Mr Edgedale), 2008-09 (Ms Starbrooke), and 2009-10 (Messrs Moondale and Hawksbridge):

> "Was the trade carried on by the relevant LLP in question "commercial" as that term is used by such of sections 66(1) and 74(1) ITA 2007 as are relevant?"

Since the definition of "commercial" in ss. 66 and 74 ITA itself incorporated both the commerciality limb and the relevant profits limb (see s. 66(2) and s. 74(2) respectively), each of the FTT's questions addressed both the commerciality limb and the profits limb.

31. Having set out the parties' respective submissions, the FTT's discussion of these questions is at [368] to [416] of the Decision. Their conclusions on the law (at [368] to [371]) can be summarised as follows:

(1) The legislation implied a two-part test, and the two elements cannot be elided [368].

(2) The legislation requires only an aim to profit and not the realisation of profit; it is after all aimed at relieving losses and is not intended to penalise those who despite their best efforts are unsuccessful, but to exclude those who [369]:

> "despite their desire for profits do not conduct their trading activities in a manner which, all things being equal, are conducive to profits."

(3) The draftsman used the phrase "on a commercial basis" to mean "in accordance with ordinary prudent business principles, and not in the manner of the amateur or dilettante to which Robert Walker J referred". (This is a reference to his decision in *Wannell v Rothwell* [1996] STC 450, referred to below.) If it can be shown that at the moment the business was started the prospect of recovering the capital invested, even without a surplus, was dependent on the realisation of an unrealistically high profit with the consequence that loss was, if not certain, then much more probable than not, then it could not fairly be said that those who embarked on it can have entertained a serious profit motive, and their claim to have intended to conduct the business

on commercial lines must, at the least, be doubtful: the ordinarily prudent commercial person would not enter into a partnership whose business was more likely than not to result in a loss [370].

(4) They summarised the position as follows [371]:

> "In essence, the difference between the parties can be resolved only by an analysis of the evidence in order to determine whether the making of a trading profit by each partnership was a genuine, meaning real and earnestly pursued, objective, or, even though there was a hope of and potential for trading profit, any profit which did result would be little, or even nothing, more than a potential incidental benefit of an activity in reality pursued for other reasons."

(5) They were not persuaded that an analysis put forward by HMRC, based on the net present value (**"NPV"**) of the possible trading income was the most apposite [372]. Before me Mr Afzal, who argued the Commercial Basis question on behalf of HMRC, sought to repeat the NPV point as an alternative basis for upholding the FTT's decision.

32. They then considered the facts. I need not set out their findings here, which are extensive and detailed, but will draw attention to those that counsel specifically relied on as and when necessary. Their conclusions were summarised as follows [413]:

> "only a small proportion of projects of the kind pursued by the Icebreaker Partnerships can be expected to make significant profits although any one project might make very large profits; the adoption of a limited number, typically fewer than six, of such projects necessarily limits the chances that a project with true potential has been identified; the partnerships embarked on their trades without projections of likely income; projections produced later showed that, in the absence of outstanding success, no partnership could reasonably expect even to recover the capital invested; trading losses were considerably more likely than profits; the principal exploitation agreements into which the partnerships entered allowed the principal exploitation company to alienate all of the income stream; and the members of each partnership could have had no genuine expectation on joining that partnership that trading profits would be received."

33. On that basis they held that none of the appellant partnerships or their members could have had a reasonable expectation of realising profits of the trade, and hence held that they had not satisfied the profit limb of the test (whether in s. 384(1) ICTA/s. 66 ITA or in s. 381(4) ICTA/s. 74 ITA) [414].

34. They then said that that made it unnecessary to deal with the commerciality limb of the test, but that they should nevertheless make some brief observations [415]. The absence of revenue predictions at the outset was an indication that a prospective trade was unlikely to be conducted on commercial lines. Another was that there was no evidence that any of the

members of a given partnership had any expertise in the partnership's projects, although the absence of such expertise was not conclusive. Most important of all:

> "a trade which is virtually certain to lead to a loss might be carried on as a hobby, or on philanthropic or charitable principles, but cannot realistically be described as commercial."

On that basis they answered the commercial basis question as follows [416]:

> "although the individual referrers, in each case, aimed to make a trading profit in addition to the guaranteed payments, none could have had any reasonable expectation of doing so and, in addition, the trade of each partnership was not conducted on a commercial basis. The individual referrers therefore fail both parts of the statutory test."

35. There are two oddities with this analysis. First, the FTT's statement at [415] that their conclusion on the profits limb made it unnecessary to deal with the commerciality limb does not seem right. The FTT's conclusion on the profits limb is at [414]. There they found that there was no reasonable expectation of profit. This would have indeed been sufficient to decide the question of relief under the early years provisions as s. 381(4) ICTA and s. 74(2)(b) ITA each require that "profits of the trade could reasonably be expected". But the same is not true of the general provisions. It is true that these provide that if a trade is carried on so as to afford a reasonable expectation of profit, then the profit limb is deemed to be satisfied (s. 384(9) ICTA and s. 66(3) ITA). But it does not follow that if there is no reasonable expectation of profit, the profits limb cannot be satisfied. What is required by s. 384(1) ICTA/s. 66(2)(b) ITA is that the trade is carried on "with a view to the realisation of profits in [*or* of] the trade". That requirement is looking at the aim or purpose of the relevant person, which is (primarily at least) a subjective question, rather than whether profits could reasonably be expected, which is an objective question. The two are not therefore synonymous – indeed if they were the deeming provisions in s. 384(9) ICTA/s. 66(3) ITA would be of no effect. As Mr Afzal accepted, the FTT was therefore wrong to suggest that its conclusion at [414] that there was no reasonable expectation of profit made it unnecessary to deal with the commerciality limb. That would only be so if they had found (which they did not) that the LLPs' trades were not being carried on "with a view to the realisation of profits in/of the trade".

36. The second oddity is that HMRC did not invite the FTT to resolve the referred questions against the referrers in reliance on the profits limb. HMRC's argument was based on the commerciality limb. Although HMRC's statement of case before the FTT indicated that HMRC would contend that the answer to whether the profits limb was satisfied was No, in the skeleton argument served for HMRC there were clear statements:

    (i) that the fundamental element in relation to each of the relevant questions was whether the trades were carried on "on a commercial

basis"

(ii) (for the tax year 2006-7, where each taxpayer had claimed relief under s. 381 ICTA) that:

> "the Commissioners do not take any point in relation to whether the trades of the three LLPs were carried on in such a way that profits could reasonably be expected in the period in question or within a reasonable time thereafter, for the purposes of [s. 381 ICTA]"

(iii) and (for each of the remaining tax years, where claims to relief had been made under both s. 66 and s. 74 ITA) that:

> "the Commissioners do not take any point in relation to whether the trades of the [relevant LLPs] were carried on with a view to the realisation of profits for the purposes of [s. 66 ITA]"

and that:

> "the Commissioners do not take any point in relation to whether the trade was carried on in such a way that profits could reasonably be expected to be made in the basis period or within a reasonable time thereafter, for the purposes of [s. 74 ITA]."

Consistently with this, HMRC's arguments on this part of the case were confined to the commerciality limb. That makes it surprising that the FTT devoted most of their analysis to the question of a reasonable prospect of success. Mr Afzal submitted that the FTT, under a venerable principle of tax law, was entitled to apply the law to its own view of the facts regardless of the arguments advanced on either side. This may be so, but it is still a bit surprising that the FTT concluded at [415] that they did not need to deal with the commerciality question. Nevertheless, they did in fact go on to conclude that the trade of each partnership was not conducted on a commercial basis and it is that which the referrers seek to appeal.

37. With that introduction, I can turn to the arguments put forward by Mr Maugham.

38. His first submission was in effect that the commerciality limb was not concerned with profits at all. It looked at how the trade was organised – was it organised on commercial lines or as a hobbyist would? There are two limbs to the statutory test, the profits limb and the commerciality limb, and if you satisfied the express condition as to profits in the profits limb, it was not an acceptable way to read the legislation to require you to satisfy a further unexpressed condition as to profits in the commerciality limb.

39. He then said that there was no want of commerciality in how the LLPs' trades were organised. For that he referred me to some of the findings of fact by the FTT in the Decision as follows: (i) Mr Hutton (of Shamrock) spent a significant amount of time in undertaking due diligence into those proposals

which merited consideration, and he did so for the serious purpose of identifying those which he thought had a realistic prospect of succeeding and eliminating those (by his account the vast majority) which did not [39]; (ii) Shamrock, in the person of Mr Hutton and its employees, undertook work which Mr Hutton's experience qualified him to undertake or direct, such work was carried out in a professional manner, and Mr Hutton worked very hard, and endeavoured to identify and secure projects with potential [90]; (iii) a good deal of work was undertaken on assessing the profitability of prospective projects and on determining the balance between the magnitude of the partnerships' payments to their principal exploitation companies and the share of the future income which should be foregone in exchange for a payment by the production company [172]; (iv) Mr Hutton evaluated projects in a professional manner, the evaluation being based primarily upon the perceived prospect of financial success [378]; (v) negotiations were conducted at arms' length and on a commercial basis between Shamrock and those who (to take music projects as an example) were to perform, or to produce the resulting recordings [378]; (vi) Mr Andrews (an expert on the music industry) thought that Shamrock's portfolio of projects was balanced [387]; and (vii) the amounts paid to the owners of the intellectual property rights and the net amounts paid to the production companies were reasonable and commercially driven, and the substance of the arrangements was consistent with industry practice [386].

40. Even without reference to authority, I would have found it difficult to accept this submission. As a matter of ordinary language to run a trade or business "on a commercial basis" suggests running the trade or business in a way that is at any rate designed to succeed as a commercial venture, that is one which is worth doing from a financial point of view. It is true that this means that there is an inevitable overlap between the commercial limb and profits limb, but the alternative would be to empty the commerciality limb of any connection with profit or profitability, when that is a central part of what would normally be understood by a reference to acting commercially.

41. So far as authority goes the starting point is the decision of Robert Walker J in *Wannell v Rothwell*. Mr Wannell had set up in business buying and selling shares and commodities. There was no suggestion that he was doing anything other than trying to make money out of it – indeed aiming for quick profits – but in fact he had consistently made a loss. He claimed loss relief under both what was then s. 168 of the Income and Corporation Taxes Act 1970 (the equivalent of s. 380 ICTA/s.66 ITA) and what was then s. 30(1) of the Finance Act 1978 (the equivalent of s. 381 ICTA/s.74 ITA). These sections were subject to the same requirements later found in s. 384 and 381(4) ICTA, including in particular the requirement that the trade be carried on on a commercial basis. The deputy Special Commissioner had found that although Mr Wannell might have been trading, he had not been trading on a commercial basis. This was because of the lack of commercial organisation. Robert Walker J said of this at 461:

> "I was not shown any authority in which the court has considered the expression "on a commercial basis", but it was suggested that the best guide is to view "commercial" as the antithesis of "uncommercial", and I do find that a useful approach. A trade may be conducted in an uncommercial way either because the terms of trade are uncommercial (for instance, the hobby market-gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable costs of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby art-gallery or antique-shop where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante. There will no doubt be many difficult borderline cases well [*sic*] for the commissioners to decide; and such borderline cases could as well occur in Bond Street as at a car boot sale."

On the facts, Robert Walker J held that if the deputy Special Commissioner had meant by "lack of commercial organisation" the external phenomena of organisation (office accommodation and equipment and staff) he would have been in error, the trade of a dealer in quoted securities not requiring any organisation beyond a telephone and some basic bookkeeping (and some capital or credit); but he thought that the deputy Special Commissioner also had in mind Mr Wannell's admission in cross-examination of some casualness and lack of self-discipline, and despite expressing some reservations as to what the facts actually were, dismissed the appeal on the basis that the deputy Special Commissioner's conclusion that this made Mr Wannell's trading activities uncommercial could not be said to be perverse or unsupported by evidence.

42. In *Samarkand Film Partnership No 3 v HMRC* [2011] UKFTT 610 (TC), the FTT quoted this passage from *Wannell v Rothwell* and said (at [253]):

> "It seems to us that the serious interest in a profit is at the root of commerciality."

On appeal to the UT (Judge Sinfield and myself), we said that we agreed with the FTT on this point, and upheld the FTT's conclusion that there was in that case a lack of commerciality: see [2015] UKUT 211 (TCC) at [96]-[97] where we said:

> "96 'Commercial' and 'with a view to profit' are two different tests but that does not mean that profit is irrelevant when considering whether a trade is being carried on on a commercial basis. The reference in *Wannell v Rothwell* to the serious trader who is seriously interested in profit is not only relevant to deciding whether a person is a serious trader or an amateur or dilettante. We consider that the FTT were right when they said, at [253], that the serious interest in a profit is at the root of commerciality. We also consider they were correct in regarding "profit" in the context of commerciality as a real, commercial profit,

taking account of the value of money over time, and not simply an excess of income over receipts.

97 The FTT were, in our view, right to conclude that a trade that involved transactions that were intended to produce a loss in net present value terms, with no compensating collateral benefits, was not conducted on a commercial basis. No-one who was seriously interested in running a business or trade on commercial lines would pay £10 for an income stream with a net present value of £7 unless there were some good reason to do so. Of course in this case the reason why the partnerships were willing to do this was because they believed that tax relief would be available to the partners."

43. On further appeal to the Court of Appeal, the appellant taxpayers challenged this: see [2017] EWCA Civ 77 at [88] where Henderson LJ referred to the submissions of Mr Furness QC for the taxpayers as follows:

> "The appellants challenge this reasoning on two grounds. First, they say that to import a stricter test for profitability into the commerciality test renders the profitability test redundant, which Parliament cannot have intended. Secondly, the commerciality test involves an assessment whether the manner in which the trade is run is commercial, not whether its profits are considered commercial. They argue that this approach reflects the presumption that Parliament intended every part of a statute to have some meaning and effect, and only thus can proper and separate meaning be given to the profitability test and the commerciality test."

This seems to me to be materially similar to the submissions made in the present case by Mr Maugham. Henderson LJ rejected these submissions at [90] where, having cited the same passage from Robert Walker J's judgment in *Wannell v Rothwell*, he said as follows:

> "That must in my view be correct, but it shows that considerations of profitability cannot be divorced from an assessment of the commerciality of a business. In my judgment it is wrong to regard the profitability and commerciality tests in the legislation as mutually exclusive, and they necessarily overlap to an extent which will vary from case to case. I therefore see no error of law in the approach which the FTT adopted to this question, and I agree with the observations of the UT in [96] and [97] of the UT Decision, quoted above."

44. This is of course binding on me and it seems to me that in those circumstances I must reject Mr Maugham's submission that the commerciality limb is only concerned with whether the way the trade is organised is commercial and has nothing to do with profitability.

45. Mr Maugham had a further variant on his submission which sought to respect Robert Walker J's reference to the serious trader who is seriously interested in profits. He illustrated this submission with three different classes of case. Class 1A is the trader who is disorganised, such as Mr Wannell. It does not matter that he is trying to make a profit; he fails the commerciality limb

because he is not running his business on commercial lines. Class 1B is the trader who is not interested in profit, such as a hobby potter. It does not matter how organised such a trader is; he fails the commerciality limb because he is not trying to make a profit. Class 2 however is the trader who is both organised and interested in making a profit. Such a trader does not fail the commerciality limb. In effect, the commerciality limb is about whether a trader is interested in making a profit, not about how likely it is that he will succeed. On the facts, he submitted that the way the LLPs went about their business (which was by sub-contracting the exploitation to Shamrock, which chose the projects commercially and paid a sensible price for them) was perfectly well organised and sensible or commercial; and that the fact that the members of the LLPs hoped to make a profit from it was sufficient to satisfy whatever profit element was required by the commerciality limb.

46. I do not accept this variant of the submission either. I agree that a trade can fail the commerciality limb in different ways. This is indeed what Robert Walker J says in *Wannell v Rothwell* where he refers to a trade being uncommercial either because the terms of trade are uncommercial, the prices not covering the costs, or because of the way the trade is conducted in other respects. So I agree that a trader can fail the commerciality limb either because of a lack of commercial organisation (Mr Maugham's class 1A) or because of a lack of any interest in making money (Mr Maugham's class 1B). But I do not think it follows that as long as the trade is sufficiently organised and the trader hopes to make a profit (Mr Maugham's class 2) that is always enough. Let us assume that a trade is well organised. The question whether such a trade is being carried on on commercial lines is not to my mind answered simply by pointing to a hope by the trader to make profits. A trade run on commercial lines seems to me to be a trade run in the way that commercially-minded people run trades. Commercially-minded people are those with a serious interest in profits, or to put it another way, those with a serious interest in making a commercial success of the trade. If therefore a trade is run in a way in which no-one seriously interested in profits (or seriously interested in making a commercial success of the trade) would run it, that trade is not being run on commercial lines.

47. That is in effect what we said in the UT in *Samarkand* at [97], which has been endorsed by Henderson LJ in the Court of Appeal. If that is right, it is not I think an answer to point to the hope of the trader that profits will nevertheless be made. In other words the concept of a trade carried on on commercial lines has an objective element to it, and cannot be satisfied by proof merely that the trade is well organised and that the trader had a purely subjective hope or desire to make a profit.

48. Mr Maugham's next submission was based on the concessions that he said HMRC had made. He relied on two matters. The first is that HMRC (as set out at paragraph 16 above) accepted that s. 863 ITTOIA applies to the LLPs, and that the trades of the LLPs were carried on with a view to profit within the meaning of s. 863. In that context he referred me to the decision of the FTT in

Ingenious Games LLP v HMRC [2016] UKFTT 0521 (TC) which discusses the meaning of "with a view to profit" in s. 863 ITTOIA: see below. Second he relied on the fact (as set out at paragraph 36 above) that HMRC made it clear in their skeleton before the FTT that they were not taking any points on the profits limb, but were concentrating their argument on the commerciality limb. That he said amounted to an acceptance by HMRC that the trades of the LLPs were carried on "with a view to the realisation of profits in the trade" within the meaning of s. 384(1) ICTA/s. 66(2)(b) ITA, and were carried on in such a way that "profits in the trade…could reasonably be expected to be realised" within the meaning of s. 381(4) ICTA/s. 74(2)(b) ITA. His overall submission was that once these points were accepted any requirement in relation to profits in the commerciality limb was satisfied.

49. Mr Afzal took me through a very thorough and careful analysis of these points. First he showed me the decision in *Walls v Livesey* [1995] STC (SCD) 12 at [6] where Special Commissioner Shirley said that the tests in s. 384 and s. 381 ICTA were not the same, that the test in s. 384 was a subjective test and that that in s. 381 was an objective test. That he told me was not the only authority to that effect but it nicely encapsulated the distinction between the s. 384 and s. 381 tests.

50. Then, so far as the test in s. 863 ITTOIA was concerned, he said that there was no case law on the point prior to *Ingenious Games*, and that one might have reasonably thought that "with a view to profit" in s. 863 had the same meaning as "with a view to the realisation of profits" in s. 384, and hence was also subjective.

51. In *Ingenious Games*, however, the FTT considered the meaning of "with a view to profit" in s. 863 ITTOIA at some length: see at [455]-[491]. Their conclusions are set out at [490] in sub-paragraphs (a) to (k), of which I need only cite the following:

> "(a) the test requires some element of purpose, intention or contemplation. That is apparent from the word "view" and the approach to it by other courts and tribunals…
>
> (g) *Dextra* indicates that there may be some objective element in "with a view to" although in a different statutory context. In the present context "profit" has a meaning independent of what the taxpayer considers it to be: that indicates an objective element in the test: an assessment of whether the intended conduct of the business has a realistic possibility of delivering a profit…
>
> (h) As a result, if the conduct or intended conduct of the business is such that there is no realistic possibility of profit, the business cannot be said to be carried on with a view to profit, no matter what the subjective intentions of the taxpayer as to profit are.

(i) That objective test is, however, about whether the conduct is such as to give a realistic possibility of profit, not about whether it is businesslike or commercial.

(j) If the conduct of the business is such that it is inevitable or almost certain that a profit will be made that will be the carrying on of the business with a view of profit….

(k) Between the two extremes, no realistic possibility of profit and almost inevitable profit, there is a hinterland in which the hopes and expectations of the taxpayer will be a significant factor and where the flexibility of the phrase "with a view to" permits the weighing of the subjective intentions of the taxpayer as to the financial results (not the "profit") of the business and the likelihood of the intended conduct and so those results yielding a profit."

Mr Afzal described this as a subjective test with an objective override.

52. Mr Afzal said that the decision in *Ingenious Games* had not come out at the time of the FTT hearing in the present case, and that before *Ingenious Games* the understanding was that s. 863 was a purely subjective test. All therefore that HMRC were accepting by saying that the s. 863 test was satisfied was that subjectively the LLPs had a view to profit, not that objectively there was a realistic possibility of profit; and that one could not later retrospectively re-characterise what HMRC were saying.

53. That raises a potentially interesting question as to what the effect is of a concession which was given before the FTT on the assumption that "with a view to profit" meant one thing, but where it now appears (assuming the FTT in *Ingenious Games* is right) that it means something else. But I do not think I need to form a view on that because there is in my judgment a much simpler answer to the point. As appears from [490(h)] to [490(k)] the FTT in *Ingenious Games* took the view that an LLP could not be said to be carrying on a business with a view to profit if, objectively, there was no realistic possibility of profit. But at [490(i)] they expressly said that that objective test was not to be equated with whether the conduct of the business was businesslike or commercial. I agree.

54. In this context, as the FTT said at [475], "profit" means the excess of income over expenditure – something they referred to as a "cruder, everyday understanding" of profit. The mere fact that there is a realistic possibility of profit in this sense does not entail that the LLP is carrying on a trade on a commercial basis. This is for three reasons:

(1) As Mr Afzal pointed out, s. 863 in fact applies if an LLP carries on a "trade, profession or business" with a view to profit, whereas the commerciality limb in each of the places where it appears (s. 384(1) ICTA/s. 66(2)(b) ITA and s. 381(4) ICTA/s.74(2)(b) ITA) requires a trade to be carried on on a commercial basis. Since a business may be

rather wider than a trade, this point is potentially of some significance.

(2) It may not make commercial sense to carry on a trade even if it is likely to make a profit in the crude, everyday sense. A trade which lays out 100 in year 1 and recovers 101 in year 10 is a trade which makes a profit in the simple sense that its income exceeds its expenditure, yet it is unlikely that anyone with a serious interest in making a commercial success of the trade would regard that as a satisfactory return, even if it were virtually certain to happen.

(3) Most significantly, however, all that the FTT decided in *Ingenious Games* was that there should be some realistic possibility of a profit. This cuts out the "extreme" case see where there is no realistic possibility of a profit (see [490(k)]), but says nothing about how probable or likely such a profit needs to be. But when assessing whether a trade is being carried on on commercial lines, the likelihood of profit seems to me to be central to an assessment of its commerciality. The question is whether the trade is being carried on in a way that a person seriously interested in commercial success would carry it on. Such a person would be unlikely to regard a trade which had a remote possibility of a small profit as worth carrying on as a commercial venture, even though it could be said that there was a realistic possibility of profit.

55. For these reasons, I am not persuaded that HMRC's acceptance that the LLPs were carrying on their trades (or businesses) with a view to profit within the meaning of s. 863 ITTOIA, even if that is now to be understood in the sense expounded by the FTT in *Ingenious Games*, carries with it an acceptance that the LLPs' trades were being carried on on a commercial basis.

56. That leaves under this head Mr Maugham's reliance on the fact that HMRC made it clear in their skeleton before the FTT that they were not taking any points on the profits limb but only on the commerciality limb, both in relation to s. 380 ICTA/s.66 ITA and in relation to s. 381 ICTA/s.74 ITA. He characterised that as a concession by HMRC that the profits limb in each case was satisfied.

57. Here I think the position is much simpler. By saying that they were not taking a point on the profits limb, HMRC were not conceding anything. They were choosing to rely on the commerciality limb to defeat the claim to relief, and they were choosing not to put forward any particular case on the profits limb. But that cannot it seems to me be equated with an acceptance or agreement or concession that the profits limb was in each case satisfied. It simply meant that they were not arguing the point, not that they agreed anything.

58. For these reasons I do not accept Mr Maugham's argument based on HMRC's so-called concessions.

59. I can now consider Mr Maugham's overall submission that the FTT erred in law. He referred me to the Decision at [415] where the FTT gave their "brief observations" on the commerciality question. They referred there to three matters (see paragraph 34 above): the absence of revenue predictions at the outset; the members' lack of relevant expertise; and the fact that a loss in the trade was virtually certain.

60. Mr Maugham said that there were in fact revenue predictions, referring to evidence which the FTT accepted at [394]-[396] in relation to three non-musical projects in particular. He also said that some of the members did have relevant expertise – in particular one of the members of Ironmoat was a producer of one of the bands that Ironmoat invested in – but he also said that the fact that the members themselves may have lacked expertise did not matter in circumstances where the LLPs were subcontracting the exploitation of the rights they had acquired to someone else, that is Shamrock.

61. But he accepted that the real finding is the third one. Mr Maugham did not suggest that the FTT got it profoundly wrong in its findings of fact; they were perfectly entitled to find that profits were unlikely. He did however say that they were entitled, indeed on the evidence compelled, to find that there was an outside chance of substantial profits, and that that in essence is what the FTT did find. He referred me to what the FTT had said in *Ingenious Games* at [455]-[457] about investment in films being risky, and said that that applied to the creative industries generally: it was very unlikely that the LLPs would identify profitable projects, but if they did so, the returns could be considerable. He referred to this as a "moonshot" by which I understood him to mean a highly speculative venture, but one which if successful could bring large rewards.

62. If one puts on one side the possibility of a moonshot success, the relevant factual findings of the FTT, with my comments added, can be summarised as follows:

(1) In relation to the music industry, Mr Andrews' expert evidence was that the vast majority of acts sell only a very small number of albums [385].

The FTT referred to him as saying that in broad terms one project in a hundred might succeed in the sense of making a worthwhile return on the investment in it [385]; counsel were unable to identify any evidence by him to that effect but he did say, in his witness statement, that 95% of albums released in the UK sell less than 1,000 copies.

(2) Mr Andrews in his report set out the sources of revenue which might be earned from each of ten music projects adopted by one or other of the partnerships as a means of demonstrating how the gross sum might be recovered, "gross sum" meaning the fee notionally payable by the exploitation company (Shamrock) to the relevant production company

[388].

In his witness statement, Mr Andrews confirms that he was given a revenue target for each project equivalent to these gross sums and that the exercise he embarked on was one of showing how Shamrock might have achieved those targets, together with his opinion that it was entirely reasonable for Shamrock to expect that these targets could have been achieved. But this does not mean that these targets were likely or probable or that it was reasonable to expect that they *would* be achieved. In fact, if one looks at the figures, set out in Appendix 3 to his report, one sees for example that for the Sinead O'Connor album commissioned by Hawksbridge (where the gross sum payable was £2,950,000), the calculations assume UK sales of 175,000, and sales in the rest of the world of 500,000; and even for a much less expensive project, that of Traverso, for which Bastionspark paid £500,000, the calculations assume sales of 75,000 in the UK and 50,000 in the rest of the world. Sales of this magnitude self-evidently depend on a much greater success than the 1,000 sales that 1 in 20 albums might achieve. They represent what the FTT described either as projects that were "reasonably successful" [389], [392] or as "successful" [404].

(3) If one assumes that each of Mr Andrews' projections was realised, the projects taken collectively would barely break even. It is possible that any of them could have achieved greater success, but Mr Andrews' own evidence was that such success was a rarity, and that it was much more likely that the projects would fail. The success of the projects he identified would be offset by numerically greater failures. Thus the partnerships were virtually guaranteed to make a trading loss on their music projects [392].

There is an element of circularity in this: as Mr Andrews was asked how the gross sum might be recovered, it is not surprising that if his figures were achieved the projects would barely break even. But this does not undermine the force of the point the FTT make that if an LLP has a number of projects, then each such project is more likely to fail than succeed, and hence that a trading loss will be suffered even if one or more of the projects achieved revenue in line with Mr Andrews' figures.

(4) A relatively simple analysis of the projects of one partnership (Bastionspark, which had five music projects) illustrates that without the intended tax advantage none of the partnerships had a reasonable prospect of even recovering the members' contributions let alone of showing a return on them [403]. This analysis shows that in order for the LLP to recover the sums contributed by the members, three out of the five projects would have had to achieve the success shown by Mr Andrews' figures. Since one act in a hundred might be expected to succeed, it would be unrealistic to expect that three acts out of five

might do so [404].

Even without the reference to one act in a hundred, this analysis seems to me to remain sound: if only 5% of albums sell as many as 1,000 albums, it is indeed unrealistic to expect three out of five acts to achieve the much greater success that Mr Andrews' figures required.

(5) It was not quite so easy to undertake a similar analysis in the cases of the other partnerships because of their mix of projects, but, although it was entirely possible that any or more of the projects would be successful, no intending investor could conceivably have had any confidence that he would see either a return on his capital or the return of the capital. At best, and leaving the tax advantages out of account, investment in an Icebreaker partnership was speculative; realistically it could only be viewed as likely to lose money [406].

63. That forms the basis for the FTT's conclusion at [415] that a trade which is virtually certain to lead to a loss cannot realistically be described as commercial. That should be read with their earlier comments at [370] that:

> "No business is certain to succeed, and the making of a loss, or of only modest profits, is not necessarily an indication that its proprietor has not pursued the trade on commercial lines. But if, as Mr Blair demonstrated, it can be shown that at the moment the business was started the prospect of recovering the capital invested, even without a surplus, was dependent on the realisation of an unrealistically high profit with the consequence that loss was, if not certain, then much more probable than not, it does not seem to us that it can fairly be said that those embarking on the trade can have entertained a serious profit motive, and their claim to have intended to conduct the trade on commercial lines must, at the least, be doubtful. The amateur may be content to make a loss since the pleasure of the activity is reward in itself; the ordinarily prudent commercial person would not enter into a partnership whose business was more likely than not to result in a loss."

It might I think be possible to quibble with the statement in the last sentence taken by itself. Suppose a person invested 100 in a partnership whose business consisted of a project which was only likely to be a success one-third of the time, but which if successful would be likely to return 500. Such a business would be more likely than not to result in a loss, as two-thirds of the time the 100 would not be recovered; but a prudent commercial person might nevertheless think it worthwhile taking that risk for the one-third chance of receiving 500. But it seems difficult to take issue with the statement that a person with a serious profit motive would not embark on a trade which was dependent on the realisation of an unrealistically high profit and hence where loss was much more than probable than not. If one just looks therefore at the prospect of Mr Andrews' returns from reasonably successful projects being achieved, the conclusion therefore seems unassailable.

64. Mr Maugham says that does not however take account of the moonshot possibility. The LLPs were not transacting for the prospect of receiving their percentage of the returns from a reasonably successful project; they were transacting for the possibility of a very successful act which would deliver them their percentage of a very large number.

65. The FTT did not ignore the fact that there was the possibility of any particular project being much more successful than the reasonable success represented by Mr Andrews' figures. They refer to it repeatedly as follows:

> "We also accept … that any one or more of the projects could have been successful, and could have earned substantial profits for the partnership which had adopted it as well as for Shamrock itself." [378]

> "The essence of Mr Andrews' evidence was that … the potential rewards of a successful music project are enormous" [385]

> "Although Mr Andrews said (and we have already accepted) that some projects could earn considerably more than his appendix indicated, he agreed that it is a characteristic of the industry that only a small proportion of the performers whose projects are financed do meet with great success, and many more fail." [391]

> "It is, as we recognise, possible that any of them could have achieved greater success, but Mr Andrews' evidence was that such success is a rarity." [392]

> "…a significant success, recovering much more than the amount invested in it, for at least one project would be needed if any partnership were to make an overall profit." [400]

> "We recognise that any one act might perform better, even considerably better…However all these possibilities were, on Mr Andrews' evidence, no better than speculative." [404]

> "We have already accepted that it was possible that any project would turn out to be successful, even highly successful." [411]

> "…only a small proportion of projects of the kind pursued by the Icebreaker Partnerships can be expected to make significant profits although any one project might make very large profits; the adoption of a limited number, typically fewer than six, of such projects necessarily limits the chances that a project with true potential has been identified;…projections produced later showed that, in the absence of outstanding success, no partnership could reasonably expect to recover the capital invested;…the members of each partnership could have had no genuine expectation on joining the partnership that trading profits would be received." [413]

66. In the light of those passages it cannot be said – nor did Mr Maugham suggest – that the FTT failed to have regard to the possibility of a moonshot success. They were well aware that the evidence was that it was possible that any one (or more) of the projects could achieve enormous success or very large profits,

and that if it had done so, the trade of the relevant LLP would have been profitable and hence a commercial success. They nevertheless concluded that such success was a rarity and speculative. It was not suggested by Mr Maugham that these factual findings were not open to them (see paragraph 61 above). The only remaining question is whether they supported the conclusion that the trades were not being carried on on a commercial basis. Mr Maugham submitted that that involved an error of law, but once it is accepted that the correct test is whether the trade is being carried on in a way that commercially-minded people might, I do not see that their conclusion involves any error of law, or was not open to them. Questions of fact are questions for the FTT. This includes not only questions of primary fact (such as whether a trade was virtually certain to make a loss) but also evaluative questions (such as whether a trade that was virtually certain to make a loss can realistically be described as commercial).

67. In my judgment therefore the FTT are not shown to have made any error of law in their conclusion on the commerciality limb.

68. It is not necessary in these circumstances to consider a cross-appeal by HMRC seeking to revive the NPV point which the FTT said they were not persuaded was the most apposite. That sounds to me like a polite way of saying they disagreed with it, and I will simply say that I can see why they took that view. The facts of this case are very different from those in *Samarkand* where the return from the investment was measurable at the outset (leaving aside the possibility of extra returns if the films were very successful, which were always going to be minimal at best). In the present case by contrast no meaningful estimate of the returns from the projects could be made at the outset as it would entirely depend on how successful they were, something which on the evidence was impossible to predict.

69. I will therefore dismiss the appeal on the Commercial Basis question. Mr Maugham accepted that that knocked out all claims to relief so strictly the other two questions do not arise, but I will deal with them in any event.

The Active Member question

70. The Active Member question arises out of the terms of s. 118ZH ICTA and s. 103B ITA under which the question is whether an individual has spent an average of at least 10 hours a week personally engaged in activities carried on for the purposes of the trade, or (under the amended version of s. 103B) engaged in activities of the trade carried on on a commercial basis and with a view to the realisation of profits as a result of the activities.

71. The precise questions referred to the FTT under this head were as follows (Decision at [417]-[423]):

    (1) For the tax year 2006-07 (Messrs Bastionspark, Ironmoat and Keepstone):

> "During the applicable "relevant period", was he a "non-active partner" as those words are used by section 103C ITA 2007 as inserted into Chapter VII of Part 4 ICTA 1988 by section 26 and Schedule 4 paragraph 3(1) of the Finance Act 2007 ("FA 2007")?"

(2) For each of the tax years 2007-08 (Mr Edgedale), 2008-09 (Ms Starbrooke), and 2009-10 (Messrs Moondale and Hawksbridge):

> "During the applicable "relevant period" was he [or she] a "non-active partner" within the meaning of section 103(B) ITA 2007?"

It was not in dispute that the relevant period in each case was the period of 6 months beginning with the day on which the individual member joined the partnership: Decision at [422].

72. It was also common ground that if there were any change of substance between the earlier and later versions of s. 103B(2) ITA, it would make no difference to the outcome on the facts of the present case; the FTT therefore assumed, without deciding, that the same test was to be applied to each of the individual referrers [451]. Mr Maugham did not seek to go behind that approach on appeal.

73. Having set out the legislation and the questions referred, the FTT considered the issues at [424]-[463]. I will identify only the key findings. Since HMRC had accepted that the members had spent an average of at least 10 hours per week carrying out various activities, the FTT proceeded on the assumption that each of them did [426]. They found that a typical member could have spent about two hours a week on average on what they called management activities [452]. They were satisfied that at least some of this met the relevant test, such as supervising those appointed to run the partnership's affairs [453]. On the other hand, some of the management activities, such as resolutions to approve the accounts and reappoint the auditors, had no effect on the trading activity and did not meet the statutory criteria [455]. Their impression was that an equal division (that is of the management activities into those that did, and those that did not, satisfy the statutory criteria) would be fair [456].

74. The FTT were willing to assume that a typical member spent in addition 8 hours or more per week engaged on what they said might loosely be termed research activities, namely tasks such as listening to music, reading periodicals and attending sports events or concerts [457]. It was not suggested that these activities were designed to, or could, affect the exploitation of the intellectual property rights the partnerships had acquired at the outset; they were said to be carried out with the purpose of recommending potential projects to their fellow-members [458]. But the FTT considered that there were two difficulties with this argument. First there was no consensus between the members of a partnership that they would be willing to commit further funds should a suitable project be found. Without such a consensus, the activities were not undertaken in pursuit of or a business aim [459]. Second, there was

no basis on which it might be thought that any of the individual referrers' activities could realistically have led to the claimed outcome. The activities were unfocussed and of questionable utility, which not only did not advance the trade of any partnership but had no realistic prospect of ever doing so [460].

75. Mr Maugham commenced his criticism of the FTT by saying that they erred in law in finding that *Mallalieu v Drummond* [1983] 2 AC 611 was directly in point. The facts in *Mallalieu v Drummond* are well known: the taxpayer, a barrister, claimed to deduct the cost of upkeep of clothes suitable to be worn in court (black suits and the like) as expenses of her profession. That depended on whether the expenses were "wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation". The House of Lords held that they were not deductible, as the taxpayer's object was both to serve the purposes of her profession and also to serve her personal purposes: see per Lord Brightman (who alone of the majority gave a reasoned speech) at 875E.

76. At 870A, Lord Brightman said this:

> "The words in the paragraph "expended for the purposes of the trade, profession or vocation" mean in my opinion "expended *to serve the purposes* of the trade, profession or vocation"; or as elaborated by Lord Davey in *Strong & Co. of Romsey Ltd. v. Woodifield* [1906] A.C. 448, 453 "for the purpose of enabling a person to carry on and earn profits in the trade etc." The particular words emphasised do not refer to "the purposes" of the taxpayer as some of the cases appear to suggest: as an example see the report of this case [1983] 1 W.L.R. 252, 256. They refer to "the purposes" of the business which is a different concept although the "purposes" (i.e. the intentions or objects) of the taxpayer are fundamental to the application of the paragraph."

77. Mr Maugham made three points on *Mallalieu v Drummond*. The first is that it was concerned with the question of duality of purpose. This is obviously right, and it is also obviously right that in *Mallalieu v Drummond* there was no dispute that the taxpayer had spent money for the purposes of her profession, the question being whether this was the only purpose. But this does not affect that fact that the words which Lord Brightman was considering, namely "for the purposes of the trade, profession or vocation" are materially indistinguishable from those which have to be considered on the Active Member question, namely whether activities are carried on "for the purposes of the trade", and what Lord Brightman says about what those words mean does seem to me equally applicable to the present context. In effect the point he was making in the passage cited is that the words require a focus on the purposes of the trade etc, not the purposes of the taxpayer. The FTT was in these circumstances justified in my view in saying (at [447]):

> "It is also to be noted that, whichever version of the legislation one examines, the relevant activity must be for the purpose of the trade, and not the purpose of the partnership or of the member himself. Although the

> authorities to which we were referred must be treated with a degree of caution, since they relate to the expenditure of money rather than of time, we are satisfied that *Mallalieu v Drummond* is directly in point in this respect."

78. Mr Maugham's second point was that Lord Brightman in effect did not add anything very much to the statutory language, simply restating the statutory test. Again there is some truth in that, but that does not undermine the relevance of his statement that what one is looking for is something (in that case expenditure, in this case activities) done for the purpose of the trade. At the risk of introducing another gloss or paraphrase on what seems to me quite a straightforward idea, this is something which is undertaken in order to advance or benefit the business.

79. Mr Maugham's third point was that *Mallalieu v Drummond* makes it clear that the test is a subjective one: you are looking to see what is in the taxpayer's mind. That too I accept: see at 870D where Lord Brightman says that it is necessary to discover the taxpayer's "object" in making the expenditure, and that in order to do that it is necessary to look into the taxpayer's mind at the moment when the expenditure is made (although he went on to reject the notion that the object of a taxpayer is inevitably limited to the particular conscious motive in mind at the moment of expenditure, and indeed reversed the Court of Appeal on the basis that it was inescapable that one of the taxpayer's objects, though not a conscious motive, was the provision of clothing she needed as a human being).

80. So far as the management activities are concerned, Mr Maugham submitted that all of them were for the purposes of the trade, on the basis that activities which were necessary for the trade were for the purposes of the trade. Mr Davey, who argued the Active Member and s. 74ZA questions for HMRC, said this was too broad, giving the example of a partner getting lunch, something that might well be necessary in order for the trade to be carried on, but could not really be thought to fall within the statutory provision.

81. I did not find that example, admittedly an extreme one, very illuminating. As a general principle, Mr Maugham's submission that anything which a partnership needs to do in order to trade is done for the purposes of the trade, does seem to have a certain logic to it. Mr Davey referred in passing to the decision of the House of Lords in *McKnight v Sheppard* [1999] 1 WLR 1333 as illustrating that work done on tax returns is not for the purposes of a trade. In fact in the course of his speech Lord Hoffmann referred to the earlier decision of the House of Lords in *Smith's Potato Estates Ltd v Bolland* [1948] AC 508 as an example of a case where the costs of contesting an assessment to tax were not deductible, but the reason he gave was that since the dispute was about the computation of profits, it involved an illogical circularity to include the costs of the dispute as an element in the computation. The actual decision in *McKnight v Sheppard* was that the legal costs incurred by a stockbroker in defending himself against charges of misconduct were deductible, the taxpayer

being a sole trader whose expulsion or suspension would have destroyed his trade. The costs were therefore laid out for the purpose of preserving the trade, and hence for the purposes of the trade. That to my mind indicates that things done to enable a trader to continue trading can quite properly be characterised as done for the purposes of the trade.

82. The examples given by the FTT of management activities which in their view did not qualify were the passing of resolutions approving the accounts and re-appointing the auditors, of which they said (at [455]):

> "however necessary, the approval and reappointment do not have any effect on the trading activity. They might perhaps be regarded in the same way as the activities of the member carrying on the company secretarial function, to whom we have already referred; but, in our judgment, are more properly to be viewed in the same way as the black clothing in *Mallalieu v Drummond*."

I agree that the approval of the accounts and reappointment of the auditors has no immediate effect on the trading activity. Consistently with the view I have expressed above, however, this may not be a complete answer to the question. If it is necessary to do these things in order to enable the LLPs to carry on trading, and if that is why they were done, then I consider they can be said to have been carried out for the purposes of the trade. It is a question of fact whether they were necessary to enable the LLPs to continue to trade, and the FTT did not, I think, make any finding on that question. I asked Mr Davey if there were statutory requirements for LLPs in relation to accounts, to which he said he did not know the answer, but it in fact appears that there are statutory obligations in that respect: see the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008/1911, the general effect of which is indicated by the title. The question of what the practical effect would have been for the LLPs, and hence for their trades, if they had failed to comply with such of these requirements as applied to them, was not considered at the hearing before me, and since it is a question of fact would not have been a matter for me in any event. It is at least possible however that the consequences would have been significant. If the point had been a live one, therefore, I would have remitted the question to the FTT to consider whether management activities such as these were or were not carried out to enable the LLPs to continue to trade.

83. Mr Davey said that the accounts and audit would not necessarily be confined to the trade, but would extend to other matters. Thus for example the accounts would deal in the present case with "the 80" in Mr Peacock's example, which did not form part of the trade of exploitation of intellectual property rights, but was used to secure a guaranteed income stream. That I accept, but is not I think an answer to the point. If compliance with statutory requirements for accounts and audit is necessary to enable the LLPs to continue to trade, then it does not matter that the accounts also deal with other matters. The provisions in question do not include a "wholly and exclusively" test, so unlike the black

clothing in *Mallalieu v Drummond* it does not matter if the activities had more than one purpose, as long as they were carried out for the purposes of the trade.

84. The more significant question however is as to the research activities. Here Mr Maugham referred to the FTT's Decision at [458] where they said:

> "The individual referrers claimed, in their witness statements and in their oral evidence, that these activities were earnestly undertaken, into genuine potential projects, and that they carried them out with the serious purpose of recommending to their fellow-members that any they found and considered to have sufficient potential should be adopted by means, if necessary, of further capital injections. It is plain that additional capital injections would be required if any new project were to be adopted since the prospect that any of the partnerships would ever generate sufficient revenue from existing projects was, as we have explained, almost negligible. It is not suggested that these activities were designed to, or could, affect the exploitation of the intellectual property rights the partnerships had acquired at the outset."

That, he said, contained the FTT's key error. The question whether the members carried out their activities for the purposes of the trade was a subjective one. So one had to ask the members if at the time they carried out the activities they were subjectively intending them to be for the purposes of the trade. There was evidence that the members hoped for a profit from the initial projects. So it was erroneous to answer the question "did you subjectively think that these activities were being carried on for the purposes of the trade?" with the answer "objectively, there was not going to be a profit" as it was not an answer to the question.

85. I accept that Mr Maugham is right that the question is why the members undertook the activities, and that if they undertook them subjectively in the hope of advancing the LLPs' trade (and in the hope that there would be sufficient profits from the initial projects to finance them), then it is ultimately no answer to say that those hopes were misplaced or unrealistic. A trader who runs a shop that is failing to cover its costs and opens a second shop with the genuine aim of turning the business's fortunes around is entitled to say that he has done so for the purposes of the trade even if every objective indication is that the second shop will fare no better than the first. But this does not mean that the question whether there is, objectively, any realistic possibility of the second shop succeeding is irrelevant to assessing what the real intentions of the trader were.

86. In the present case, the FTT went on at [461] to make findings of fact as to the members' actual reasons for spending the time that they did, as follows:

> "We recorded, at para 424 above, the individual referrers' awareness of the need to spend a minimum amount of time on partnership-related activities; we were not persuaded that they properly understood the nature of the activities which were required, though they can perhaps be forgiven for that. However, whatever their understanding, and despite their professed

> interest and enthusiasm, we are satisfied that the individual referrers spent the time because they had been told they must, and that they undertook activities such as they described, not in the expectation or even hope that anything useful might come of them, either for that reason alone or, because they happened to enjoy the particular activity for its own sake, as a pleasurable means of fulfilling a statutory requirement. For reasons we explain elsewhere we are satisfied that these were, and were recognised by the individual referrers to be, tax avoidance schemes and, although it is by no means a factor determinative of that issue, we are bound to say that the assiduity with which they spent time and (in most cases) kept records supports the conclusion that the tax relief was of considerable importance to them. We are equally left in no doubt that IML supplied such items as music recordings in order to assist the individual referrers in satisfying the statutory requirement, and not because it had any real expectation that its doing so would serve any other purpose."

The critical finding here is that the individual referrers spent the time because they had been told they must, and not in the expectation or hope that anything useful might come of them.

87. That is a finding of the members' (subjective) purposes in carrying out the activities. It does not seem to me to be based solely on the objective likelihood of the initial projects being successful. Undoubtedly the FTT's conclusion that the likelihood of the initial projects being profitable was negligible was part of the factual background to this finding, as was their conclusion that in the absence of any profit from the original projects, any new projects would have required injections of capital, and that there was no consensus that this would be done, or enthusiasm for the idea. But the language in which the FTT express themselves indicates that they were looking at *why* the members themselves carried out the activities, namely that they had been told they had to do it to fulfil a statutory requirement, in order to access the tax relief which was important to them. Reading the Decision naturally, that is not a conclusion the FTT reach solely, or even mainly, because the initial projects were unlikely to succeed.

88. Mr Maugham said that there was evidence that the members hoped for profits; he also referred back to the concessions which he relied on (and which I have considered above). I accept that there was evidence of the members hoping that the initial projects would be successful, but I see no inconsistency between the members hoping for a (possible but unlikely) moonshot success on the initial projects, and the conclusion of the FTT that they were not carrying out the research activities in the expectation or even hope that anything useful would come of them but because they had been told they must.

89. Mr Maugham also said that the basis of the FTT's decision at [458] that because the initial projects would not generate profits, the research activities done in anticipation of such profits were not for the purposes of the trade, was not something advanced before the FTT. It may not have been put in exactly

that way but HMRC's skeleton before the FTT did include a submission (at para 26.1) that activities relating to the evaluation of new projects did not serve the purposes of the LLPs' trade since there was no realistic prospect of new projects being adopted. That I think justified the FTT in forming their own view as to the realistic likelihood of the new projects being adopted. As I have sought to explain, that was not because they made the error of thinking that the (objective) likelihood of new projects being adopted was determinative of the question, but because it was capable of shedding light on why (subjectively) the members spent the time they did on the research activities.

90. Subject to one point therefore I reject Mr Maugham's criticism of the FTT's decision. The finding that the members carried out the activities because they had been told they had to and not in the hope that anything useful would come of them is a factual finding that I have not been persuaded rests on any error of law.

91. The last point Mr Maugham made was that not all the activities were research activities on identifying new projects. He gave the example of Mr Ironmoat, where he said that the evidence was that he and his fellow-members spent a lot of time learning about the music industry, not in order to identify new projects but in order to assist Ironmoat LLP when the music acts had finished recording. Mr Maugham made the point that insofar as matters such as this varied from one LLP or one individual to another, no attempt had been made to identify whose activities qualified and whose did not, and if that meant that the matter had to be remitted for findings in individual cases, so be it.

92. I can see that such evidence might well support a case that in the case of Mr Ironmoat the activities were designed to further the LLP's trade. The FTT however said at [458] that it was not suggested that the activities were designed to or could affect the initial projects (see paragraph 84 above). That statement is plainly at odds with Mr Maugham's submission, and had it been of any practical consequence I would have wanted to look in detail at quite how the case had been presented to the FTT, both as a matter of evidence and as a matter of submission, because I accept Mr Maugham's point that the question is ultimately an individual one for each member, and if there were material that indicated that some members' activities might qualify and some might not, there would indeed seem to be little alternative but to remit the matter for consideration of the evidence for each member separately. But in the light of my conclusion on the Commercial Basis question, these points are accepted to be academic, and in those circumstances I do not regard it as necessary to go into the question any more deeply.

The s. 74ZA question

93. This question arises out of the terms of s. 74ZA ITA. It only applies to the tax year 2009-10, and although the question was initially referred in respect of both Mr Moondale and Mr Hawksbridge, it was accepted by HMRC before

the FTT that it only in fact applied to Mr Hawksbridge.

94. The precise question in relation to Mr Hawksbridge which was referred to the FTT under this head was in two parts as follows (Decision at [490]):

> "Was he a party to any "arrangements" which were "relevant tax avoidance arrangements" as those terms are used in subsections (3) and (4) of section 74ZA ITA 2007?
>
> If that question is answered in the affirmative, then did the person make a loss which arose in consequence of, or in connection with, those "relevant tax avoidance arrangements", and, if so, did that loss arise in circumstances falling within the commencement provisions in paragraph 11, schedule 3, Finance Act 2010?"

95. Only the first of these was in the event contentious. Having set out the statutory provisions and the parties' submissions, the FTT dealt with it quite briefly at [502] to [505]. At [502] they rejected a submission that Mr Hawksbridge was not asked the right question. At [503]-[504] they found that Mr Hawksbridge's primary motive in joining the partnership was to secure sideways relief. At [505] they therefore answered the referred question in the affirmative. It is convenient in the light of the arguments addressed to me to set out the relevant parts of [503]-[505] as follows:

> "503 …It is quite true, as Mr Maugham emphasised, that Hawksbridge, like the other partnerships, was engaged in trade with a view to profit. But it is also true, as we have found, that profit, in the true sense of the term, was an unlikely prospect, and that Mr Hawksbridge, like the remaining individual referrers, knew very well when he joined the partnership that it was unlikely. We have already said, but repeat without rehearsing the reasons, that none of the individual referrers could rationally have joined a partnership believing that it was a serious conventional investment, whatever their hopes that profits might in fact result. Their motives for doing so must, therefore, have been other than an investment purpose.
>
> 504 We need to discern that motive only in Mr Hawksbridge's case, though there is in reality nothing to distinguish him from the other individual referrers. We are quite satisfied that he knew that profits, in the true sense, were unlikely and that, absent a tax advantage, this was not a prudent investment since he was much more likely than not to lose the money paid in from his own resources. We are also satisfied that his primary motive for joining the partnership was to secure sideways relief; no other plausible conclusion is possible. In so far as his evidence was to the contrary, we reject it.
>
> 505 Accordingly we answer this question as follows. Mr Hawksbridge was a party to relevant tax avoidance arrangements within ITA s 74ZA(3) and (4) in that he was aiming to obtain sideways relief, he made a loss which arose in consequence of, or in connection with, those tax avoidance arrangements, and the arrangements which gave rise to that loss were

entered into after the commencement provisions in para 11 of Sch 3 to the Finance Act 2010 came into effect."

96. The referred question was whether Mr Hawksbridge was a party to any arrangements which were "relevant tax avoidance arrangements". There is no dispute that Mr Hawksbridge was a party to arrangements, a term which is defined widely in s. 74ZA(4) ITA so as to include a scheme, transaction or series of transactions. The relevant question is therefore whether such arrangements were "relevant tax avoidance arrangements", a term defined by s. 74ZA(3). The key part of the definition is that it means arrangements "the main purpose, or one of the main purposes, of which is the obtaining of a reduction in tax liability by means of sideways relief."

97. That raises the question of how one ascertains whether the, or a, main purpose of arrangements is the obtaining of tax relief. Mr Maugham submitted that this was a purely subjective question, that is that the answer is to be found by looking at the purpose of the taxpayer. That in principle requires looking into the taxpayer's mind to divine what his intention was, and you divine that intention from what he says his purpose was, together, in the usual way, with what other evidence reveals his purpose is likely to have been. But it remains a wholly subjective test.

98. Mr Davey submitted that it was not quite as simple as that. In his submission, the identification of the purpose of the arrangements is not limited to the exercise of looking at the subjective intention of the taxpayer in entering into them. That is a relevant consideration, but there are also objective elements to be taken into account – one looks at all the evidence, including the features of the scheme, the way the scheme was marketed, and the views of those who were involved in creating, promoting and advising on the scheme and so on.

99. Purely as a matter of language, there is I think considerable force in what Mr Davey says. If the legislative intention had been to confine the inquiry to the purposes or motives or intentions of the taxpayer in question, one would have expected the statutory provisions to be worded differently. Under s. 74ZA(3) there is already a reference in (3)(a) to the taxpayer ("to which the person is a party") and it would have been the natural thing to do, had this been the sense intended, to continue in (b) with some words such as "and where that person's main purpose, or one of his main purposes, in becoming a party to such arrangements was the obtaining of a reduction in his tax liability by means of sideways relief." That would clearly and unambiguously confine the inquiry to the individual taxpayer's purposes. But that is not the language adopted. Instead the legislation appears to proceed on the basis that the arrangements themselves have a purpose or purposes – the words "of which" in the phrase "the main purpose, or main purposes, of which" referring back to "arrangements" – and that the taxpayer joins arrangements which have such a purpose. That appears to require one to ask what the purposes of the arrangements themselves are, not what the purposes of the taxpayer were in adhering to them.

100. In some contexts it undoubtedly makes sense to ask what the purpose of a transaction is. To take a simple example, it can readily be said that the purpose of a conveyance of land is to transfer the ownership of the land from A to B, or that the purpose of a lease of land is to transfer possession of the land from A to B for a limited period in return for rent and covenants. Another example, to which I was referred by Mr Davey, can be found in *PI Consulting (Trustee Services) Ltd v The Pensions Regulator* [2013] EWHC 3181 (Ch). This concerned a number of schemes or arrangements which created, or purported to create, pension schemes, and the question was whether each such scheme was an "occupational pension scheme" within the meaning of s. 1 of the Pension Schemes Act 1993. That depended, among other things, on whether the scheme in question was "for the purpose of providing benefits to" certain people. Morgan J accepted as correct a submission that the relevant purpose was the purpose of the scheme and not the purpose of one, or even all, of the parties to the documents which established the scheme, and that this was an objective matter which turned upon the meaning and effect of the scheme and not upon subjective matters such as the motives or intentions or beliefs of one or even all of the parties: see at [36] where the submission is set out and at [39] where Morgan J accepts it as correct.

101. In such a case the question being asked is, in effect, what is the effect of the transaction – what does it do? But Mr Maugham said one could not apply that meaning in the present context. That was for two reasons, one being based on certain authorities, but the other being a matter of logic. So far as the latter is concerned, the s. 74ZA question could only arise in circumstances where there would otherwise be a tax advantage – in a case like the present sideways loss relief – because otherwise the section is not engaged. So the statutory question cannot be answered by looking at what the effect of the arrangements is, as *ex hypothesi* the effect of the arrangements is to generate an entitlement to sideways loss relief.

102. So far as authority is concerned, I was not shown any authority on s. 74ZA itself. But I was referred to authorities on other similar provisions. In *IRC v Brebner* [1967] AC 18, the relevant provision was s. 28(1) of the Finance Act 1960 which applied to transactions in securities and in effect prevented such transactions being used to obtain a tax advantage unless the taxpayer showed:

> "that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained…"

The argument in the particular case was that the Special Commissioners should have looked separately at the second part of the transaction, and had they done so must have concluded that that part had as its main object the tax advantage since that was the only reason for it. The House of Lords rejected this on the basis that the Special Commissioners were entitled to look at the overall transaction as a whole. In the course of his speech however Lord

Pearce said (at 27C) that:

> "The "object" which has to be considered is a subjective matter of intention"

and Lord Upjohn said (at 30B) that:

> "I agree that the question whether one of the main objects is to obtain a tax advantage is subjective, that is, a matter of the intention of the parties, and…is essentially a task for the Special Commissioners unless the relevant Act has made it objective (and that is not suggested here)."

He also agreed with a statement of the Lord President in the judgment under appeal that the question that the Special Commissioners had to determine was:

> "what was the object in mind of the respondent in entering into the transactions in question."

103. *Brebner* therefore undoubtedly proceeds on the basis that the question was a subjective one, although the contrary does not appear to have been argued. I was shown some other examples. In *Lloyd v HMRC* [2008] STC (SCD) 681, the Special Commissioner, Dr Avery Jones, was concerned with s. 703 ICTA 1988 which was a re-enactment of, and in similar terms to, the section considered in *Brebner*. He referred to the object (which he equated with purpose) as what the transaction hoped to achieve, and he answered the statutory question by considering whether one of the main objects in the mind of the taxpayer was to obtain the tax advantage. In *Snell v HMRC* [2008] STC (SCD) 1094, another Special Commissioner, Mr Barlow, was also concerned with s. 703 ICTA, and on the basis of *Brebner* held that the taxpayers' specific intentions were highly relevant, although the taxpayers' representative accepted that the intentions of the taxpayers' advisors were relevant as well. (On that latter point Mr Maugham told me that in a case called *Marwood Homes*, which I was not shown, a tribunal known as the s. 703 tribunal had said that one could look at the advice which a taxpayer had acted on in order to look into his mind, and he accepted that that must be right.)

104. I have not found this entirely easy but I am inclined, despite what was said in these cases, and despite the high authority of *Brebner*, to accept Mr Davey's submission and hold that in considering what the object of a set of arrangements are, one can look more widely than what was in the taxpayer's own mind. The reality is that complex arrangements such as were involved in the Icebreaker partnerships are not devised by the taxpayer. They are devised with considerable care and sophistication by those who are responsible for coming up with the idea and turning that idea into a series of transactions or arrangements. They are then promoted to members of the public, who are invited to participate in them. It does seem to me that when the statutory question is whether the main purpose, or one of the main purposes of the arrangements, is the obtaining of reduction in tax liability by means of sideways relief, it would be surprising if that question were intended to be answered by looking at the intentions, motives or purposes of the individual

taxpayer alone without regard to the wider context of why the arrangements took the form they did, how those who devised the arrangements hoped they would work, and the way in which they were promoted to potential participants.

105. If that is right, Mr Davey was able to point to other findings of the FTT. These included firstly their finding that the borrowing by the members served no commercial purpose but only a tax purpose, its purpose being 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 (Decision at [133], [147]), a conclusion that in the LLPs' appeal I held was one that they were fully entitled to come to ([2016] UKUT 0361 (TCC) at [36]). It also included the way in which the Icebreaker schemes were marketed, which was dealt with by the FTT at [188]-[194], with reference to a document called the Icebreaker Information Memorandum, a PowerPoint slideshow to be used at presentations, and an example letter written by an IFA to a potential investor, which included the statement that:

> "the key benefit of taking out this investment is to reclaim income tax you have paid in the previous three tax years."

The FTT's conclusion at [194] was that it was perfectly clear that the tax consequences were the central feature of both the Information Memorandum and the PowerPoint presentation, and that the IFA's letter demonstrated how a typical IFA viewed the scheme, namely as a means of reducing the investor's tax liability rather than as a conventional investment product.

106. Those findings seem to me to support the conclusion of the FTT at [506] which they expressed as follows:

> "The underlying, and fundamental, conclusion we have reached is that the Icebreaker scheme is, and was known and understood by all concerned to be, a tax avoidance scheme. The aim was to secure sideways relief for the members, and to inflate the scale of the relief by unnecessary borrowing, coupled with the illusion that the borrowed money was available for use in the exploitation of intellectual property rights by the device of the purported payment of a large production fee offset by the equally purported payment of a fee for a share of the resulting revenue."

It is to be noted that the FTT here refer to "the aim" being to secure sideways relief for the members. As I read this, this is not a finding as to the purposes of any individual participant in the scheme, but as to the aim of the scheme itself, in the sense of what it was that those who devised and promoted the scheme were aiming to achieve by it. If Mr Davey is right that the statutory question in s. 74ZA(3) requires looking more broadly than the subjective intentions of the individual taxpayer, then it seems to me that this finding (which is not in itself challenged, and is supported by the other factual findings I have referred to above) is in effect a finding that the purpose of the arrangements (not as something ancillary to another purpose but as *the*

purpose) was to secure sideways relief for the members, and that is sufficient to mean that the arrangements were relevant tax avoidance arrangements.

107. But I do not think I need ultimately to come to any conclusion on the appropriate test. I will assume that Mr Maugham is right, and that the statutory question is to be answered strictly by looking at the subjective intentions of the taxpayer, Mr Hawksbridge. Although the analysis is different, it does not seem to me to make any difference to the result.

108. Mr Maugham made three points in support of his submissions. The first was based on HMRC's concession that the trade was carried on with a view to profit. I do not think this is inconsistent with the FTT's findings. They expressly said that it was quite true that Hawksbridge was engaged in trade with a view to profit [503], but this is not inconsistent with the findings that profit was unlikely, that Mr Hawksbridge knew this [503], that he also knew that absent a tax advantage, this was not a prudent investment [504], and that his primary motive was to secure sideways relief [504]. A taxpayer may join a scheme with a view to profit, without that being his only purpose, and with his main purpose or one of his main purposes being to take advantage of a tax relief.

109. Mr Maugham's second point was that the FTT ignored Mr Hawksbridge's evidence of why he entered into the arrangements, that evidence being that he regarded the projects as potentially very desirable. He said that lots of people make small highly speculative bets and the fact that profits are unlikely does not mean that their motivation is not to obtain them, and does not mean that they must be motivated by something else. He complained that the FTT had not engaged with Mr Hawksbridge's evidence.

110. This seems to me an unfair characterisation of the FTT's careful findings. They did not say that Mr Hawksbridge did not hope to make a profit. They said that none of the individual referrers could rationally have joined a partnership believing it was a serious conventional investment [503]. That was a finding that was open to them – an investment which is very likely to produce no meaningful return cannot be regarded as a conventional investment. That was the context in which they found as a fact not only that Mr Hawksbridge knew that it was not a prudent investment absent tax relief but also that his primary motive was to secure sideways relief [504]. That is expressed as a further finding. They had the advantage of seeing him give oral evidence, and far from not engaging with his evidence explicitly rejected it insofar as it was to the contrary [504]. Indeed they commented that on occasion he avoided answering awkward questions, particularly about the advice offered to him by his IFA (which was not disclosed) [502]. (It is apparent from the transcript that the FTT asked him if he could find it and provide it.) The advantages which a tribunal who has seen a witness give oral evidence enjoys are too well-known to need repeating, and I see nothing here which amounts to an error in the FTT's approach.

111. The third point made by Mr Maugham was that HMRC had failed to ask Mr Hawksbridge the right questions in cross-examination, a submission that was also made to the FTT and rejected by them at [502]. The relevant principles can be found in the decision of the House of Lords in *Browne v Dunn* (1893) 6 R 67. This case, described by the Court of Appeal in *Markem Corp v Zipher* [2005] EWCA Civ 267 as only reported in a very obscure set of reports, and not as well known to practitioners here as it should be (although apparently well known to Australian and Canadian practitioners), was given renewed prominence by the decision in that case where it was extensively cited and applied: see at [50]-[61]. The principles can be seen from the speech of Lord Herschell LC, namely:

> "it seems to me to be absolutely essential to the proper conduct of a case, where it is intended to suggest that a witness is not speaking the truth on a particular point, to direct his attention to the fact by some questions put in cross-examination showing that that imputation is intended to be made, and not to take his evidence and pass it by as a matter altogether unchallenged, and then, when it is impossible for him to explain, as perhaps he might have been able to do if such questions had been put to him, the circumstances which it is suggested indicate that the story he tells ought not to be believed, to argue that he is a witness unworthy of credit. My Lords, I have always understood that if you intended to impeach a witness you are bound, whilst he is in the box, to give him an opportunity of making any explanation which is open to him; and, as it seems to me, that is not only a rule of professional practice in the conduct of a case, but is essential to fair play and fair dealing with witnesses."

There is however no obligation to raise such a matter in cross-examination in circumstances where it is:

> "perfectly clear that (the witness) has had full notice beforehand that there is an intention to impeach the credibility of the story which he is telling".

These principles apply as much in the FTT as in the courts: *Okolo v HMRC* [2012] UKUT 416 (TCC) at [34] per Arnold J.

112. Mr Maugham said that Mr Blair QC, who cross-examined Mr Hawksbridge, never squarely put to him that his main purpose, or one of his main purposes was to obtain sideways relief. I have read the transcript. It is I think correct that that exact question was never put to Mr Hawksbridge in terms. But it was put to him in terms that one of his purposes was to obtain tax relief. Some of the exchanges are set out in the Decision at [500], and include the questions:

> *"Tax had an impact on your decision to enter into this, didn't it?"*

and:

> *"One of your purposes, I suggest of your entering into this Icebreaker partnership called Hawksbridge was because it provided a benefit to you of reducing tax liability with sideways tax relief. That's right isn't it?"*

That was in my judgment sufficient to draw Mr Hawksbridge's attention to the fact that his evidence on this point was not accepted, and give him the opportunity of giving his explanation.

113. The rule in *Browne v Dunn* is a rule of basic fairness, and prevents a witness's evidence being impugned if there has been no suggestion, either before the evidence starts or during the cross-examination, that the tribunal of fact will be asked to reject it. In *Browne v Dunn* itself, six witnesses had given evidence that they had signed a retainer of the defendant and that the retainer was genuine, and there was no suggestion to any of them that this was not the case. The plaintiff however submitted to the jury that the retainer was not genuine and asked the jury to disbelieve their evidence. One can see immediately that that is not an acceptable way to conduct a trial.

114. But the rule should not be applied in an over-technical way. So long as it is clear from the thrust of cross-examination (or from notice given beforehand) that a witness's evidence will be challenged, I do not see that it is necessary to continue exploring a point in detail when the witness has already had an opportunity to state his case. As Mr Maugham himself said, Mr Hawksbridge denied that tax considerations were a purpose at all, and having done that, it was inevitable that he would deny that obtaining sideways relief was his main purpose, or one of his main purposes. Having obtained the answers he did, and having challenged them, I do not see that it was necessary for Mr Blair to continue to ask the main purpose question. It would have been an empty technicality. This is effectively what the FTT said at [502].

115. Assuming, therefore, contrary to the views I have expressed above, that Mr Maugham is right that the only relevant inquiry was Mr Hawksbridge's subjective purposes in joining the LLP, I would nevertheless reject the criticisms made of the FTT's findings as to those purposes.

Conclusion

116. For the reasons I have given I will dismiss the appeals of the individual referrers.

MR JUSTICE NUGEE

RELEASE DATE: 31 March 2017