[2017] UKFTT 0754 (TC)

TC06165

Appeal number: TC/2013/03759
TC/2014/03311

INCOME TAX – LOSSES – appellants were shareholders in companies investing, with the assistance of limited recourse loans, in a general partnership ("Vanguard") which acquired films from producers under distribution sale and purchase arrangements which included put options held by Vanguard and call options for the producer. Triggers for exercise of options and exercise price dependent on predicted revenue performance according to report made by film valuer shortly after public release of films. Cashflows from exercise of options linked to level of film budget and actual performance of film over time. Whether relief available on shares sold at loss dependent on whether Vanguard carrying on trade (s137 Income Tax Act 2007)? –Vanguard not carrying on a trade – whether loss for capital gains tax purposes? – no – whether HMRC's enquiries opened under correct statutory provisions? – yes – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

JOHN HARDY — **First Appellant**

RICHARD MOXON — **Second Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS — **Respondents**

TRIBUNAL: JUDGE SWAMI RAGHAVAN

Sitting in public at the Royal Courts of Justice, London on 5-7 and 10-13 October 2016. Notes on evidence received on 17 and 19 October 2016, and submissions on subsequent case law on 21 December 2016, and 10 January, 17 February, 9 May, and 9 June 2017.

David Southern QC, instructed by Simons Muirhead Burton solicitors for the Appellants

David Yates and Thomas Chacko, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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Introduction

1. The appellants were shareholders in companies ("PartnerCos") which invested in a general partnership governed by Jersey law ("the partnership"). The partnership entered into various transactions to acquire films from producers under arrangements including a put option which the partnership could exercise and a call option which could be exercised by the producer. The trigger thresholds for exercise of the options were linked to the predicted performance of the film as determined by a film valuer. The resulting cash-flows were linked in part to a percentage value of the film budget and in part to the actual performance of various film related revenue streams over time less certain deductions for costs and fees. The appellants, who acquired the shares with the assistance of substantial loans, sold their shares in the PartnerCos at a loss. Mr Hardy seeks to claim share loss relief for £1,153,717 for the 2008/09 tax year and Mr Moxon seeks to claim share loss relief for £137,564 for the 2008/09 tax year.

2. A number of issues arise as to the appellants' position, which in turn are disputed by HMRC. In broad terms these can be summarised as relating to: 1) the availability of share loss relief against income tax which is dependent in turn on whether the partnership was trading (and if it was, whether it was carrying on the trade on a commercial basis and with a view to the realisation of profit) 2) whether the loss was a loss for capital gains tax purposes and if so the extent of the loss 3) a procedural issue on whether HMRC's enquiries were opened correctly under the appropriate statutory provisions. Before setting out the particular issues the parties had identified as requiring determination it is necessary to say a little more about how the arrangements worked.

The arrangements in outline

3. The investor bought shares in the PartnerCo (Richmond Palace Ltd in the case of Mr Hardy, and Daivat 2 Limited in the case of Mr Moxon) using a sum made up of their own money but also borrowings from a lender (Alliance & Leicester Commercial Finance Plc ("ALCF")). The terms of the loan were limited recourse.

4. The PartnerCo contributed the sum to the partnership (The Vanguard No.1 Partnership) as partner. The partnership used the funds (less a fee amount which goes to the structurer, Matrix) to buy a film, meeting certain minimum qualitative criteria as to e.g. genre, director, script, from a producer. The producer "sub-participated" i.e. stepped into the shoes of the lender. At the same time the film was bought the partnership entered into a distribution agreement with the producer vendor under which the producer vendor agreed to distribute the film and the producer vendor agreed in return to pay "Defined Proceeds" (certain income arising from exploitation of the film less specified fees and costs). The partnership also at the same time entered into:

> (1) Put options (these gave the partnership the right to sell the film back for three varying amounts of consideration depending on whether Defined Proceeds fell within three sets of bands below 113.5% of the film budget, and
>
> (2) Call options (these gave the producer/vendor the right to buy the film back for a payment to the partnership of 113.5% of budget plus 12% interest per year from the film acquisition plus 6% of Defined Proceeds.

5. Because of the way the agreements interacted (as explained later) the situation where neither the Put option nor the Call option were exercised would not arise in practice. The only option scenario which would result in the possibility of a profit for the partnership was the one where the Call option was exercised. (Although, if the threshold was reached, it was acknowledged the producer/vendor was incentivised to go ahead and exercise the call option, one of HMRC's arguments is that the possibility of the call option threshold being reached was unrealistic).

6. The specific issues for the tribunal's determination were put as follows by the parties:

> (1) Whether the partnership (Vanguard 1 Partnership) was carrying on a trade during the periods in which the appellants held shares in the PartnerCo such that the conditions in s137 of the Income Tax Act 2007 ("ITA2007") were satisfied for the period required under s134.
>
> (2) Whether, if the partnership was carrying on a trade during either such period, such trade was conducted on a commercial basis and with a view to the realisation of profits within the meaning of s189 of ITA2007.
>
> (3) Whether each of the PartnerCos satisfied the trading requirement in s.137 of the ITA2007 on the date and for the period required under s134.
>
> (4) Whether the PartnerCos satisfied the control and independence requirements in s.139 ITA2007 on the date and for the period required under s134.
>
> (5) Whether the appellants' disposals of their shares in the PartnerCos were bargains at arm's length for purposes of s131(3) of the ITA2007.
>
> (6) Whether s17 of the Taxation of Chargeable Gains Act 1992 ("TCGA1992") applied to the appellants' subscription for shares in the PartnerCos such that their acquisition cost was lower than the amount of any subscription.

(7) In the event that Issue (6) was answered in the negative whether, when considering the expenditure of the appellants on subscribing for their shares in the PartnerCos, for the purposes of s38 of the TCGA1992, any expenditure attributable to any "loan" from ALCF could be ignored.

(8) Whether any alleged capital loss fell to be reduced on a just and reasonable basis as a result of the operation of ss30 and 125A(2) of the TCGA1992.

(9) Whether any alleged capital losses of the appellants in respect of their disposals of shares in the PartnerCos were outside the definition of "allowable loss" as a result of s16A of the TCGA1992.

(10) Whether HMRC was entitled to challenge the appellants' claims to share loss relief pursuant to an enquiry under s9A of the Taxes Management Act 1970 ("TMA1970") or whether HMRC was only entitled to challenge the appellants' claims to share loss relief pursuant to an enquiry under Schedule 1A to TMA1970.

Evidence

7. The witnesses' backgrounds are described more fully below. On behalf of the appellants, in addition to hearing evidence from John Hardy and Richard Moxon, I heard oral evidence from Timothy Nicholas, who acted as an agent of the film studios and assisted in the sourcing of films, and expert evidence from Gary Phillips in relation to film sales, distribution, and evaluation of prospects of success. All the witnesses had served witness statements in advance of the hearing and were cross-examined by HMRC.

8. It is useful, before immersing in the detail of the factual background, to set out the roles each of the entities played in the Vanguard 1 scheme and the names of the films which were the subject of the arrangements in issue by drawing on the helpful summaries in the parties' skeleton arguments:

(1) The Vanguard No. 1 Partnership ("the partnership"): a general partnership governed by Jersey law (although nothing in the parties' arguments and consequently this decision turns on that) and established under the provisions of a Partnership Agreement dated 4 June 2008;

(2) The Matrix entities: these devised and promoted the scheme. The two key Matrix entities were Matrix Structured Finance LLP ("MSF") and Matrix-Securities Limited ("MSL"). The key individuals were Mr Hardy, Guy Russell (finance), James Hindle and Donald Mackinnon (both in roles which involved liaising with investors and the studios);

(3) MSF Vanguard No 1 IC was executive partner and nominee of the partnership ("the Executive Partner");

(4) JTC: the provider of "management" services to both MSF Vanguard No 1 IC as well as each of the relevant partner companies (e.g. Richmond Palace Ltd and Daivat 2 Ltd);

(5) Lakeshore Entertainment Group: the vendor of the films Midnight Meat Train ("*MMT*"), Elegy and Henry Poole is Here ("*Henry Poole*"). The key individuals here were Eric and Mark Reid.

(6) Lionsgate: the vendor of both My Bloody Valentine ("*MBV*") and Madea Goes to Jail ("*Madea*"). It also played a role in distributing *MMT*, *Elegy* and *Henry Poole*.

(7) Centrespur Ltd: a representative of Lakeshore and Lionsgate. The key individuals here wer Mr Nicholas and Fintan O'Brien.

(8) ALCF: the finance provider to the various individuals who invested in the partnership.

(9) Salter Group a US film valuer operating in California. The key contact here was initially Bryan Hasegawa. After he left in March 2009 he was replaced by Brad Sharp.

9. The background of the witnesses who gave evidence was as follows:

(1) Mr Hardy was the managing director of MSF. He had started off in film production and distribution having worked for 20 years in the film industry as a producer and distributor, although from the turn of the millennium having obtained an MBA and become head of media at a specialist investment bank, he moved into advising and raising funds in respect of film finance structures. In 2001 he joined the corporate finance division of MSL and established the film investment side of the Matrix Group setting up MSF. Between 2001 and 2008 he raised several hundred million pounds of film investment principally through sale and leaseback structures for productions which included Oscar and Cannes Palme D'Or winning films.

(2) Richard Moxon is a non-practising solicitor who operates his own consultancy, Moxon Media Consultants Ltd which provides advice on structuring production and financing arrangements to TV and film media and entertainment clients. He practised for a number of years specialising in media law and was a partner in two London law firms, latterly Davenport Lyons. While a partner at that firm he subscribed for shares in the PartnerCo. (He was aware others in the firm were involved in advising and drafting various documents that related to the partnership but did not personally assist with drafting the documents.) Mr Moxon had been invited to participate in the partnership by Mr Hardy whom he had known professionally for a number of years. He had previous experience of film investment through another Matrix facilitated partnership (Enterprise).

(3) Timothy Nicholas is the CEO of his company Centrespur, which he used to carry out activities in the film financing industry from the 1980s acting for UK banks and corporate investors and then for US production companies as a form of broker or introducer between the US companies and MSF. He had met Mr Hardy around 2001 and had been asked then to identify films which were suitable for investments by partnerships made up of individuals.

(4) Gary Phillips is a film sales agent based in the UK. He sells film rights to the international markets to in country, or language segmented distributors, on behalf of producers and financiers both day to day and at film markets (at Berlin and Cannes). He has been performing this role both as an employee and as a business partner since 1995 (prior to which he worked in TV programme and film distribution). His evidence described

how local distributors would typically assess a film's revenue potential over a period between 5 to 15 years for cinema, video, DVD and TV markets and that his role was to assess what range each of the territories would be willing to offer (known as "minimum guarantee" in advance), or else to assess any distribution deal opportunities that did not involve a minimum guarantee.

10. The documentary evidence in the hearing bundle before the tribunal was extensive at just over 47 lever arch files which included the agreements, film reports, and correspondence passing between the various entities, although there turned out to be a much smaller sub-set of these documents, which were nonetheless voluminous, that were put in evidence before the tribunal and referred to at the hearing.

11. In terms of what I made of the evidence given by the witnesses of fact (Mr Hardy, Mr Moxon and Mr Nicholas) a general point to note going to its usefulness was, firstly the length of time which had passed since the transactions under consideration took place (around 2008 and 2009) and secondly the significant gap between that time period and the time they gave their written witness statements (they were each signed on 24 September 2015). Where their evidence sought to given an explanation of what had been said or referred to in certain documents it understandably reflected what they made of the documents now but could not necessarily provide a reliable guide to what their intentions and purposes were at the time. A particular concern arose in relation to their evidence of their perception of the commerciality and profitability of the arrangements and whether it was intended that they should result in losses. While, I do not accept, as HMRC submitted that Mr Hardy's evidence that he did not intend losses was to be disbelieved, all three witnesses, although basically honest, were unable on occasions, it appeared to me, to set aside their perception of the ramifications of the evidence they were giving on certain areas of controversy. In particular on issues such as their motivations, concerns with profitability and commerciality, I found their evidence to be self-serving and unreliable.

12. Mr Hardy had a tendency to talk up his own and the investors' concerns with profit (as set out [194] and [216] below). His evidence was prone to putting a positive spin on indicators of profit potential ([36]), and the extent of the partnership's discretion that was out of step with the reality of how the documents worked together in practice ([131]). He exaggerated the remit of the third party film valuer, Salter (who despite his initial evidence did not carry out any independent research but worked with the materials and inputs they were given). He also professed ignorance of what developing a new structure according to legislative change meant which was not plausible in view of his involvement in previous arrangements attractive to investors who wished to obtain tax relief, and given Matrix had on several occasions obtained detailed advice from specialist tax counsel on the legislation and case-law relevant to arrangements that were proposed. For his part, Mr Moxon gave vague and unconvincing answers in relation to his motivations for investing through a company ([240]). Mr Nicholas gave an implausible explanation in relation an e-mail he had written in relation to an earlier iteration of the scheme (see [169]). Mr Phillips, the appellant's expert witness was honest and helpful and was frank about the difficulties of applying expertise to the unpredictable business of films. His expert report, its limitations and his further oral evidence are considered in more detail below at [133].

Facts

13. While there were several disputed issues of fact which I come on to deal with in the discussion section of this decision, a large amount of the background to the development of the arrangements, the chronology of transactions and relevant terms of the underlying agreements were not in contention. These matters were helpfully set out in the parties' skeletons and in particular in HMRC's note of evidence, excerpts from which I gratefully incorporate with minor modifications into the findings below. (I should mention that although the appellants argued the extensive note of evidence HMRC filed in response to the tribunal's direction went beyond the scope of what was envisaged that criticism was not well founded. It is correct the document was lengthy but that reflected the fact that it collated in one place the material points that had already been raised in its skeleton together with the factual contentions HMRC had raised at the hearing and in doing so provided supporting cross-references to the evidence that had been heard and the documents the tribunal had been referred to. The note of evidence did not raise any significant arguments that had not been covered at the hearing).

14. Before setting out the detailed terms of the transaction documents it is useful to mention the run-up to the transactions and activities undertaken, how the scheme was presented to investors and the key features of the relevant films.

Background to Vanguard Scheme and the partnership

15. During the material period MSF comprised seven full-time members of staff including Mr Hardy and an in-house lawyer. The staff organised finance for the partnership, liaised with investor representatives and banks, drafted much of the relevant documentation, provided legal services to the Partnership and dealt with all intermediaries in the film industry including Mr Nicholas, film distributors and producers and the Salter Group.

16. Matrix consulted with tax counsel on what became the Enterprise Scheme on 18 October 2007 and on the Vanguard Scheme on 23 May 2008. Some sort of planning in the form that became the Enterprise and Vanguard Schemes had been described by Matrix to Mr Nicholas by January 2008, as he began approaching film producers to source films that could be purchased by a partnership. On 27 January 2008 he wrote to Paramount seeking films which were about to commence principal photography (filming). In that email he wrote:

> "I am acting for a few US production/distribution companies in connection with a new proposal. It will work for a film:-
>
> 1. About to commence pp [*principal photography*]
>
> 2. Can be made anywhere;
>
> 3. Costs can include all financial costs – unlike the old UK S&L [*sale and leaseback*], ie Rights, bank interest and bond fee.
>
> In simple terms, if there is such a thing, this is most suitable for a film which does not recoup its costs or where Studio overheads delay recoupment for a considerable time.
>
> …"

17. On 29 January 2008, ALCF considered taking part in the Enterprise structure. An internal memo from their Credit & Risk department stated the following:

> "As noted by LCF we take no film production risk, no film performance risk, and no risk on the Studio or partners. There is no tax risk, and no interest risk as we receive purely a fee on Day 1.
>
> …
>
> Given the non-use of balance sheet on this nominal £75m transaction, CBCC can authorise this request."

The partnership

18. Various presentations and information memoranda were prepared for investors. Mr Hardy accepted in cross-examination that the presentations showed how the planning worked. According to him the partnership was "a structure designed to facilitate investment whilst providing the prospect of considerable profits, and mitigating the risk of the investors losing their investment". His evidence explained that box office figures following the release of a film gave a good indication of the profits which the film was likely to yield in the future – the value of the film was therefore capable of being more accurately determined at that critical juncture (as opposed to earlier points such as before principal photography had started).

19. Mr Hardy's evidence was that the formation of partnership was for the purpose of trading in intellectual property rights in films. His view was that the use of limited companies by investors (as opposed to investing directly) made the structure more flexible enabling investors to participate or withdraw by selling of subscribing for shares and also provided for limited liability. He acknowledged that investors were aware that through using a company their losses would be relievable. He explained that the tax relief provided some protection against possibility that partnership might make a loss in its trade. According to him, the hope and intention of the participants was the partnership would generate a profit not a loss. It was specifically not the intention of the investors that they would be forced to rely on share loss relief. The purposes of the partnership and the use of companies are matters of controversy which are considered further in the discussion section of this decision.

20. More specifically the arrangements as outlined to investors worked as follows. An investor acquired shares in the partnership company, using £150,000 of his or her own money and borrowed £1m from ALCF giving a total of £1,150,000. The loan was on limited recourse terms; essentially it was only repayable out of funds deriving from the partnership. The PartnerCo then contributed this sum to Vanguard 1 as a partner. Using the simplified facts of the partnership only having one PartnerCo, the partnership then used £1,080,000 of these funds to acquire a film from a producer. The remaining £70,000 went as a fee to Matrix.

21. The price paid to the film producer was based on a formula of 108% of the production cost of the film. The film producer "sub-participated" (acquired) the loan from ACLF. As described in ALCF's own memoranda "[the film producer] assumes all lending risks in the transaction…".

22. At the same time as the partnership acquired the film, it entered into: (1) a distribution agreement with the film producer vendor; (2) put and call options with the film producer vendor.

23. Under the distribution agreement, the film producer undertook to distribute the film in return for paying "Defined Proceeds" (also referred to elsewhere as the "Producer Gross"). (The Defined Proceeds were in broad terms the sum of gross receipts from various sources (box office, film rental, royalties) less distributor fees, costs and participations and due to others (e.g. shares due to actors directors etc.). Under the Put Option, the partnership had the right to sell the film back to the film producer if a post-release report obtained from Salter predicted that the Defined Proceeds were to fall within certain bands. Conversely, the film producer under the call option had the right to acquire back the film if the Defined Proceeds were predicted to be above a certain level. The relevant thresholds (in percentage terms of the budget) were the same regardless of the film that was acquired:

(1) Defined Proceeds > 113.5% of budget = call option exercisable - payment to the Partnership 113.5% of budget (plus 12% interest per year from the film acquisition) plus 6% of Defined Proceeds

(2) Defined Proceeds are less than 113.5% of budget but over 75%

- put option exercisable (Case I)

- payment to the Partnership: 65% of budget

(3) Defined Proceeds are less than 75% of budget but over 50%

- put option exercisable (Case II)

- payment to the Partnership: 47.3% of budget

(4) Defined Proceeds under 50% of budget

- put option exercisable (Case III)

- payment to the Partnership: 13.5% of budget

24. As is explained more fully later at [125] both the partnership and the producer were strongly incentivised to exercise their puts and call options respectively if the relevant threshold was a hit. The situation whereby the options were triggered but not exercised would not realistically arise.

25. There were three rounds or phases of going through the exercise of attracting investors and purchase of a film or a number of films. These appeals are concerned with Phases 1 and 3.

Phase 1 of Vanguard Scheme (between July and November 2008)

26. Phase 1 involved the purchase of three films: *Midnight Meat Train ("MMT")*, *Henry Poole is Here ("Henry Poole")*, and *Elegy*). Phase 3 which is dealt with in more detail later concerned one film: *Madea goes to Jail ("Madea")*. (Phase 2 involved a film called *My Bloody Valentine*.)

Marketing of Vanguard scheme to investors

27. MSF produced Information Memoranda (IMs) which were provided to potential investors along with presentations on the operation of the Vanguard Scheme.

28. The IMs were issued by MSL who were authorised and regulated under the Financial Services and Markets Act 2000 and were only sent to intermediaries who

were similarly regulated. Generally it was those intermediaries who contacted investors (with the exception of Mr Moxon). MSF gave presentations on Vanguard to potential investors who had been contacted by the intermediaries and planned screenings of films which the partnership was proposing to purchase.

29. The IM recorded under the heading "Business" and after setting out a proposal that one or more distribution agreements would be entered into after purchase, that :

> "…as the partnership intends to sell the films shortly after acquisition and realise a profit, it is not anticipated that the partnership will receive significant, if any, distribution revenues."

30. From an investor's point of view the above different cases of put and call option scenarios were set out in the presentation (including tax relief available). There were a series of iterations of the presentation. The end result, for Phase 1 was as follows:

> (1) Case III put option – investor profit of £256,000 (171% return on cash). This was based on a "Cash Flow Summary" which showed £150,000 being spent (the investor's own money) and £406,000 being received: the source of this was not stated but I accept HMRC's assumption as correct that the figure reflects the expected 40% tax relief on the £1,015,000 loss made.
>
> (2) Case II put option – investor profit of £120,800 (81% return on cash) This was based on a "Cash Flow Summary" which showed £150,000 being spent (the investor's own money) and £270,800 being received: the source of this was not stated but similar to the point above reflected the 40% tax relief on the £677,000 loss.
>
> (3) Case I put option – investor profit of £85,000 (57% return on cash) This was based on a "Cash Flow Summary" which showed £150,000 being spent (the investor's own money) and both £35,000 and £200,000 being received: the source of these was not stated but the first is the 3.5% of budget that an investor got to keep in a Case I put option, and the second was the 40% tax relief on the £500,000 loss made.
>
> (4) Call option – investor profit of £41,042 (27% return on cash). This was based on a "Cash Flow Summary" which showed £150,000 being spent (the investor's own money) and receipts of £116,000, £19,200 and £55,842.
>
> The £19,200 figure was not explained but HMRC's suggested analysis which assumes that various tax payments needed to be accounted for seemed entirely plausible and I find as fact that this was the basis on which the figures were provided. The model assumed that the sale took place 6 months after purchase, which meant that there was 6% interest paid on the loan, being £60,000, and also that the Call Option Price had grown by £60,000. As HMRC point out this would actually be incorrect on the documents as executed, as the 12% interest on the loan is on a total equal to the film's budget, whereas the 12% growth of the Call Option Price was on a total equal to 113.5% of the budget).The partnership was assumed to make a trading profit of £66,000 but would then pay £18,500 corporation tax. The remaining value in the company (ignoring the 6% right to Defined Proceeds) was therefore £1,176,000, which was what the company was sold for. The investor claimed interest relief on £60,000 but would have to

pay CGT of £4,800 on his or her shares, meaning that he or she would receive £19,200 from HMRC. Separately (for reasons which were not explained) the investor would sell the company's right to 6% of Defined Proceeds for an estimated figure of £55,842 after tax. This "Cash Flow Summary" made it explicit that an investor needed a certain amount of taxed income to make use of the £60,000 interest relief.

31. The returns depicted once fees and various tax relief were taken account of can be summarised as follows:

Phase 1 (3 films)	**Return on cash**
Case III Put	171%
Case II Put	81%
Case I Put	57%
Call	27%
Phase 3 (Madea)	
Case III Put	156%
Case II Put	72%
Case I Put	49%
Call	22%

Calculations on returns on equity in different call or put option scenarios

32. The narrative and table above set out the investor returns that were marketed for each of the different put and call option levels.

33. While, at the outset of the hearing, it appeared there was some confusion between the parties as to the levels of return on equity for the various films it became clear by the end of Mr Hardy's evidence that the underlying figures and calculations of each party were agreed by the other and that the differing percentage returns they had referred to depended on how far the different stages of the calculation were worked through which in turn affected whether particular items were excluded or omitted. The relevant calculations based on the Salter "High" calculations appear in the Annex to this decision. Mr Hardy's return on equity figures (in italics) referred respectively to the return firstly just taking into account the 6% defined proceeds, then adding to that the additional return on call option (the 5.5% of budget being 113.5% of budget minus 108% of budget). HMRC's return on equity figures applied further adjustments by taking account of the anticipated share sale proceeds, tax liabilities and reliefs to derive an adjusted return on equity figure. Whatever measure of return on equity is taken, as HMRC point out, what is clear from the figures in the presentations is that the financial benefits of a put option (i.e. the Partnership making a loss rather than a profit) are greater than those of a call option, and those benefits become larger the worse the loss is.

34. It is also clear that for the partnership to be even capable of achieving a profit (putting aside any question of loss relief available to an investor) the Call Option would need to be exercised. In that case as HMRC explained the partnership would receive 113.5% of the film's budget, having paid 108% for it. This represented a profit, and tax would be paid on it. However, the partnership would still make a loss, as it was required to pay a fee of up to 7% of the total spent on films to MSF. In fact MSF did not demand its full entitlement but only 7% of the film's budget, as

otherwise the partnership could not have afforded to pay, having only 115% of budget available, including the "loan" and the investors' own funds. The partnership would only actually make a profit if the ongoing income stream of 6% of Defined Proceeds (net of the tax that would be charged on it) outweighed the 7% fee.

35. The presentation (8 May 2008) gave details of the "Potential Film Product" as follows:

> "Midnight Meat Train, $14m, Principal Cast: Vinnie Jones, Cinematic release: August 1st, 2008
>
> Henry Poole is Here, $14m Principal Cast Luke Wilson, Cinematic Release: August 15th, 2008
>
> Elergy, $18m Principal Cast: Penelope Cruz, Ben Kingsley, Dennis Hopper, Cinematic Release, August 8th, 2008".

36. Mr Hardy's evidence mentioned the significance of well-known talent as a performance indicator and in that context referred to Bradley Cooper (who was a cast member of *MMT)* as a well-known actor. This was despite the fact that he was not particularly well-known at the time (the Hangover series films in which he starred came out later). Unsurprisingly the details in the presentation above did not mention him as principal cast.

The Films

37. On 3 April 2008, Eric Reid of Lakeshore emailed Mr Nicholas with a list of completed films that he had available. There were four: *Game*, with a budget of $60 million and an expected release in early 2009; *Midnight Train* (which became *MMT*), with a budget of $14 million and an expected release in August, on which Lakeshore were "worldwide partners with Lionsgate"; *Henry Poole*, with a budget of $14 million and an expected release in late summer 2008, which was to be distributed by Overture in the US; and *Elegy*, with a budget of $18 million and an expected release in July 2008, which was licensed to Goldwyn Films (otherwise referred to as Samuel Goldwyn) in the US. This email was forwarded to Mr Hardy on 21 April 2008.

38. The same day the above e-mail was forwarded, an article mentioning the release of the *Henry Poole* trailer which was posted on the website WorstPreviews.com stated: "…movie is scheduled to hit theaters on August 15th in limited release." An article from the same website dated in May in relation to the trailer for *Elegy* referred to the film being: "scheduled to hit theaters on August 8th in limited release."

39. On 1 May 2008 Mr Nicholas e-mailed Eric Reid mentioning that Mr Nicholas and Tim Johnson of SJ Berwin had just finished a conference call with Matrix and had a number of requests for Mr Reid:

> "…4. We were asked for evidence of the forthcoming release of each film. In that regard can you let us have, as and when available, the following:-
>
> 4.1 Details re theatre bookings
>
> 4.2 Details of any guaranteed release deals
>
> 4.3 Details of TV advertising;

> 4.4 Copies of any posters – as and when available please send a few to me.
>
> ..
>
> 6. They raised the issue of flexibility re their cash price. The possibility of buying 2.5 films as opposed to 3 was raised. Let us hope this does not become a real issue but we will have to review.
>
> 7. As to closing Tim and I suggested June – but John Hardy mentioned early/mid July. The sooner we get on with thew (sic) documents the better."

40. Eric Reid emailed Mr Nicholas on 28 April 2008 with more specific release dates as follows: 1 August for *MMT*, 8 August for *Elegy*, and 15 August for *Henry Poole*.

41. On 14 May 2008, Matrix engaged Salter to value the three films. Salter then circulated a draft Summary Support Schedule on 29 May 2008, giving estimated Producer's Gross (also referred to as Defined Proceeds) on a "Low Case", "Mid Case" and "Highest Case" for each of the three films. On 5 June 2008, Mr Hardy asked Bryan Hasegawa of Salter to change the description of "Highest Case" to "High Case". Salter complied with this request. An updated version of the Salter projections was sent on 5 June 2008.

42. Further updates, to the "High Case" were sent on 13 June (*MMT*) and 19 June (*Elegy*), and on 17 July 2008 (*Henry Poole*). Also on 5 June 2008, a Framework Agreement was finalised between MSF and Lakeshore, which set out the budgets (described as "Base Price") for each film and fixed the purchase and option prices and the option thresholds, in the proportions described at [21] and [23] above. The only divergence (on those matters) between the agreement and the transaction documents was that clause 5.3 provided for the Call Option price to grow at 12% p.a. on the "Base Price" rather than the film price of Base Price plus 8%.

43. The Framework Agreement also provided for Loans to be made in an amount equal to the Base Price, and that Lakeshore would sub-participate those loans: (clauses 3.2 and 3.4). On 6 June 2008, Eric Reid and Mr Hardy emailed each other to discuss reductions in Distribution Fees "under the call option scenario" (the e-mails mentioned a proposal that distribution fees all should reduce prospectively for MMT, Elegy and Poole at $35m, $50m and $60m). The Salter High Case models from this date (there were no more mid and low case models) apply these adjustments. There is an email from Mr Nicholas to Mr Hardy of 9 June 2008 stating that he understood that all of the core transaction documents would be agreed by the end of the following week, and that the transactions could close the week after if funds were available. (The transactions did not take place until 25 July 2008).

44. On 19 June 2008, Mr Nicholas and Guy Russell (of Matrix) agreed that for the purposes of the film purchase, the exchange rate would be fixed at $1.90 to the pound. This was below the current rate at the time, and Mr Nicholas accepted in cross-examination that it meant that the films cost the investors more than they would have had they used the actual rate.

45. On 20 June 2008, Mr Nicholas sent Matrix cost reports giving the budgets of the three films. In the run up to June and through that month as described below, there were a number of website reports suggesting that Lionsgate were intending to release *MMT* on a very limited basis. HMRC suggest it became public knowledge, whereas

the appellant say this was internet "tittle-tattle". The disputed issue is considered further in the discussion section of the decision.

46. On 12 June the website "Shock till you drop" recorded in an article entitled "EXCL: Midnight Meat Train Release Plans" that:

> "Studio insiders confirmed for us this afternoon that Lionsgate is planning a *limited* 100 theater run of the Clive Barker adaptation on August 1st. An unceremonious release for Ryuhei Kitamura's stylish American directorial debut."

47. On 20 June 2008 Clive Barker, the author of the story which MMT was based on, wrote an open letter to a horror film convention (Fangoria Weekend of Horrors) saying that:

> "To be perfectly honest, I need your help…There have been signs for a long while that Lionsgate, the company releasing the movie, was going to screw around with it. Release dates were changed and changed again. And my phone calls to the people at Lionsgate, asking for answers were not returned. I was finally told Lionsgate only planned to open the movie in a tiny number of theaters – somewhere between 100 and 300 – run it for a week, then put it on DVD…in other words, they were going to dump our movie…so I'm fighting back…If you want to see The Midnight Meat Train on the big screen the way it should be seen, please contact Joe Drake at Lionsgate and tell him your feelings…"

48. On 10 July 2008, Mr Nicholas sent Mr Hardy the participations for the three films. (Participations are additional remuneration for individuals connected to the film (e.g. writers, directors, and cast) dependent on the film's success.

Transaction documents

Phase 1: The Documents

Partnership Agreement

49. The Partnership Agreement was entered into on 4 June 2008. The initial partners were the Executive Partner, which was an incorporated cell of an incorporated cell company owned by Matrix and Guy Russell, who resigned from the partnership once there were more members. The Partnership Agreement made provision for the addition of partners by execution of an Adherence Agreement and acceptance by the Executive Partner.

50. The Partnership Agreement took account of the documentation that would be entered into to carry out a film transaction. The "Transaction Documents" were defined as: the Film Purchase Agreement; the Put and Call Options; the Film Security; the Distribution Agreement; the Laboratory Pledgeholder Agreement and the Payment Instructions Agreement.

51. Clause 2.3 of the Partnership Agreement provided:

> "The purpose of the partnership is to carry on the business and the purposes for which the partnership has been formed are strictly limited to business."

> "business" is defined as "…the business of trading in films and/or film rights…and performing and exercising the partnership's obligations and rights under the transaction documents."

52. The Agreement included the following provisions relating to the partners' rights and obligations and governance of the partnership:

53. In relation to the role of the Executive Partner, Recital C stated that:

> "it is intended that… the [other] Partners will (save as expressly set out or permitted herein) have no right or authority to act for the Partnership or to take any part in or in any way to interfere in the operation, conduct or management of the Partnership save as expressly set out or permitted herein."

54. Further provisions set out that:

> (1) Without the Partners' Unanimous Approval (therefore, HMRC note, requiring the agreement of MSF No 1), the business could not be carried on "except in accordance with the Transaction Documents" (clause 2.3.2).
>
> (2) To adhere, a new partner had to enter into "such Nominee Agreement as the Executive Partner may require in its absolute discretion" (clause 2.6.3).
>
> (3) The Executive Partner was appointed "to exercise all rights vested in or granted to the Partnership with regard to any aspect of or matter concerning the Transaction Documents…" (Clause 4.2.1(a)).
>
> (4) The Executive Partner was specifically authorised to "negotiate, approve, execute and enter into the Transaction Documents…" (Clause 4.2.2(f)).
>
> (5) Each partner appoints the Executive Partner as its attorney for the purposes of the Partnership's business (Clause 4.2.3).
>
> (6) Clause 4.8 provided that the Executive Partner (MSF Vanguard No.1 IC) would receive no remuneration, but authorised a fee to MSF (Matrix Structured Finance).
>
> (7) At Clause 6.4.1, the partners "irrevocably" directed the Executive Partner to apply profits and capital receipts to pay off their loans as required by the Payment Instructions Agreement, and to grant the Lender security as required by their loan agreement.
>
> (8) Clause 7.1.1 provided that the partners could vote by 75% to remove the Executive Partner.

55. Regarding selection of films, Clause 8.4 provided that the first meeting was to approve the proposed Film(s) and the terms of the Transactions Documents. Clause 8.4.1. required the partner in considering the suitability or otherwise of a Film and/or Film rights to have regard to various criteria ("unless it was considered there was a sufficiently compelling case"). These were that :

> "i) the screenplay has been developed by reputable writers; and
>
> ii) The key elements such as principal cast lead actors and/or actresses, director and cinematographer are reputable and of "leading" quality; and

> b) The relevant Film Revenues Report should indicate a reasonable prospect of success of the Film and/or Film Rights and earnings performance;"

56. The Adherence Agreement committed the new partner to "contribute its Capital Contribution in accordance with the Partnership Agreement on it becoming a Partner and against demand by the EP" (Clause 2(a)). The standard form Adherence Agreement set out the total contribution and the Partner Loan.

57. The Partnership Agreement was amended on 14 January 2009 and again on 29 January 2009, 19 February 2009 and 19 March 2009. These amendments changed the partnership capital shares to take account of each phase of the transaction, in which the different companies would put up different amounts of funding.

58. In his witness statement Mr Hardy explained that following the disappointing initial release of the films, Matrix were advised by Salter to delay commission of the post-release reports. Following the sale of films the shareholders, including Mr Hardy, decided to sell their shares. There was no point holding onto them as the partnership was not in possession of films and had no ongoing rights to profits. Mr Hardy maintained that had the films been successful shareholders might have held onto their shares to continue to benefit from share of defined proceeds. His evidence was that investors took a keen interest in the films which the partnership was considering purchasing and the possible profits. Investors and intermediaries also made specific enquiries about the potential returns on investments and were interested in the contents of the post-release reports. Those subjects were covered in presentations to investors. Screenings of films were also staged for investors.

59. The Nominee Agreement was signed by every company who was a partner. The executive partner could act as a nominee in relation to arrangements for acquisition and disposal of the films, in relation to options and sale of films pursuant to an option and in relation to charges over partnership property.

60. The Partnership agreed a Consultancy and Administrative Services Agreement with MSF on 4 June 2008. MSF was required to assist the Executive Partner in sourcing suitable Films, among other administrative tasks. It would be paid up to 7% of the total expenditure on Films in the first accounting period. This was amended for later Phases to allow MSF to take further fees: for Phase 3 the maximum fee was 8%.

61. Mr Hardy applied to join the Partnership on 21 July 2008. The application, which was executed as a deed, stated,:

> "The Applicant irrevocably and unconditionally applies …to become a Partner… and undertakes to contribute the Capital Contribution…" (clause 2); and "will deliver to the Executive Partner (or cause the Partner Company to deliver) all of his or her Capital Contribution immediately on demand by the Executive Partner…" (clause 5(h)).

62. The Capital Contribution stated in this Application (£1,307,167.05) included the "loan" amount. The sum that came from Mr Hardy's own funds (£170,500.05) was stated to be payable immediately.

63. Mr Hardy was personally liable to procure the additional contribution of £1,136,667 on demand by the Executive Partner. The same day Mr Hardy made a loan application to ALCF for £1,136,667.

64. On 24 July 2008, Mr Hardy subscribed for shares in Richmond Palace Ltd and the company adhered to the Partnership. Notice was also given to the Partners of a meeting to discuss and approve the proposed Films and Transaction Documents.

The Loan agreement

65. Mr Hardy's Loan Agreement was dated 25 July 2008. Recital A stated that:

> "The Borrower intends subscribing for [shares in a Company] for the purposes of enabling the Company to make the contribution to the capital of the Partnership… and thus being admitted as a partner thereto…",

66. Mr Hardy had already subscribed on 24 July 2008 and Richmond Palace Ltd had already adhered to the Partnership. ALCF was under no obligation to make any advance to Mr Hardy until it was satisfied that it could find a Sub-Participator for the loan (clause 2.2(e)) and until the Payment Instructions Agreement had been executed (clause 2.2(f)). The Payment Instructions Agreement assumed that the particular proposed films (*MMT*, *Henry Poole* and *Elegy*) were being bought, and provided, (clause 2.2), that the payment of the Loan Advance was to take place by the Sub-Participator (Lakeshore) paying the seller the borrowed amount under the Sale and Purchase Agreement for the films (also Lakeshore). Clause 2.1(d) required the Borrower to execute a power of attorney, and authorised MSF No 1 to agree the amount to be borrowed, the drawing down of the Loan and the agreement of the Payment Instructions Agreement. The Power of Attorney was irrevocable for 120 days.

67. Mr Hardy's Loan Agreement contained the following provisions:

> (1) The Loan was to be of up to 88% of the contribution his company was making to the Partnership, with the actual amount determined by the appointed Attorney (MSF No 1) (Clause 1.2).
>
> (2) The Repayment Date was defined as the date of sale of the Company interest, or the sale by the Company of its Partnership Interest, or the sale of the last of the Films, or 3 years from drawdown, whichever was earliest (clause 1.6).
>
> (3) The loan became due and payable on an Acceleration Event (clause 5.7). These included the lapsing of the last-arising Option, where any of the exercisable Put Options have not been exercised (5.8(k)). It also included the failure to pay the loan on its repayment date (5.8(a)).
>
> (4) If an Acceleration Event took place, ALCF could enforce its security (Clause 6.1).
>
> (5) Clause 6 made clear that ALCF was not to have any recourse against Mr Hardy personally, or to make any entry in any credit rating system should he default. The Fee was 1.275% (clause 4.1).

68. Clause 3.1(a) defined the Security Documents, which were the Subscription Shares Charge, the Partnership Guarantee and the Partnership Charge/Debenture. Clause 2.1 of the Partnership Guarantee of 25 July 2008 required the Partnership to pay any obligation of the Borrowers that was unpaid. Clause 3.5 of the Partnership Debenture of 25 July 2008 granted a fixed charge over the Films to the Bank. Clause

3.4 granted a fixed charge over the credit balance in the Partnership account. If the Security became enforceable, the Bank could appropriate them (Clause 9.2(a)). The Payment Instructions Agreement dealt with the money flows of this at clause 7.

69. Clause 8.1(a) of the Partnership Debenture stated that the Partnership would not enter into any transaction or series of transactions to sell, lease, transfer, loan or otherwise dispose of any Security Asset (which included the Films), other than as contemplated by the Distribution Agreement (i.e. the agreement by which all rights to distribute the Films went back to the selling studio) or the Put/Call Options.

70. The Sub-Participation Agreement of 25 July 2008 provided (clause 2(b)) that, as provided for in the Payment Instructions Agreement, the Sub-Participant would pay the Bank an amount equal to the aggregate of the loans made. In clause 3, the Bank stated that it was holding all its rights in the finance documents on trust for the Sub-Participant, and that if the Sub-Participant wished security to be enforced, the Bank might (and could be required to) transfer all its rights under all the loan agreements and security documents to the Sub-Participant.

71. On 25 July 2008, at the same time as agreeing the Sub-Participation Agreement, the Bank and the Sub-Participator agreed a Side Letter: Retirement of Loan. This provided that 24 months after the enforcement of security following the date on which the loan fell due, the Bank would write to the Borrower saying that they had written off the Loan. For Mr Hardy, Lakeshore notified the Bank accordingly on 21 November 2008 and he was told that the loan had been written off on 9 October 2012.

72. In each case, the Sub-Participant was the person who sold the Partnership the films and also the person who agreed to distribute them.

The agreements with Lakeshore

73. The Phase 1 Sale and Purchase Agreement ("SPA") was dated 25 July 2008. In each case, the price of a film (clause 4) was 108% of the film's budget, as reported by Salter Group. The SPA was entered into alongside a Distribution Agreement under which Lakeshore was given back all rights to distribute and publicise the films (clause 4). The Distributor was given "sole and exclusive control of the distribution, marketing, advertising, publicizing, exploitation, sale or other disposition of the [films]…" and could:

> "distribute, exhibit or otherwise exploit the [films] or refrain from doing so… at its absolute discretion, and …the manner in which it does so shall not subject the Distributor to any liability to the [Partnership] of any kind or nature…" (Clause 4(c)

74. Contrary to Mr Hardy's evidence as to the guaranteed US distribution of the films being an attractive feature, Lakeshore did not promise to distribute the films in the US: in clause 4(d). Their agreement was to:

> "cause the theatrical release of the Pictures in one or more of the following territories: USA, Canada, UK, France, Germany, Italy or Spain on or before: (i) in respect of MMT 1 August 2008; (ii) in respect of HPH 15 August 2008; and (iii) in respect of Elegy 8 August 2008 subject, in each case, to an extension of 90 days…"

75. Together with execution of the SPAs and Distribution Agreements, the Partnership and the Studio entered into Put and Call Options. For each film, the Options were exercisable within 10 days of the production (by Salter Group) of a Film Revenues Report, which would give an Anticipated Producer's Gross ("APG") figure. There was a figure fixed, which in all cases was 113.5% of the film's budget, and if the APG was above this the Call Option could be exercised by the Studio. If the APG was below this, the Put Options could be exercised by the Partnership. If a Put Option were exercised, the film would be sold back to the Studio for a price that depended on which of three bands the APG fell within. If a Call Option was exercised, the price was a 113.5% of the film's budget, increasing by 12% per year from the date of the SPA, plus 6% of "Defined Proceeds" of the film. (The Defined Proceeds were in essence the various amounts of revenue generated by rights in the films less certain fees and other deduction – further detail on these appears in the schedules Salter used – see [86] above.)

76. All the Put Options originally gave Salter 14 days from release to produce a Film Revenues Report (clause 3.1). The thresholds and prices under the various Options were as follows:

> (1) For *MMT*, the Call Option Threshold was $15,470,294. If this were met the Partnership would be paid £8,142,260. If this was not met, but there were Defined Proceeds of $10,222,662, the partnership would be paid £4,662,968. If there were only Defined Proceeds of $6,815,109, then the Partnership would be paid £3,389,619. For lower Defined Proceeds, the Partnership would be paid £968,463.
>
> (2) For *Elegy*, the Call Option Threshold was $20,498,260. If this was met the Partnership would be paid £10,788,588. If this was not met, but there were Defined Proceeds of $13,545,106, the partnership would be paid £6,178,469. If there were only Defined Proceeds of $9,040,071, then the Partnership would be paid £4,491,272. For lower Defined Proceeds, the Partnership would be paid £1,283,221.
>
> (3) For *Henry Poole*, the Call Option Threshold was $13,882,539. If this was met the Partnership would be paid £7,306,600. If this was not met, but there were Defined Proceeds of $9,173,484, the partnership would be paid £4,184,396. If there were only Defined Proceeds of $6,115,657, then the Partnership would be paid £3,041,734. For lower Defined Proceeds, the Partnership would be paid £869,067.

77. The Payment Instructions Agreement ("PIA") of 25 July 2008 governed many of the interrelated transactions. In respect of the purchase of the films:

> (1) Recital F stated that the Partnership would enter into the Film Purchase Agreement and the Film Distribution Agreement.
>
> (2) It provided that the borrowed funds of all the partners were to be dealt with by the payment of the "Total Advance" by the Sub-Participant (the Studio) to FilmCo (the Studio) (Clause 2.2(b)(i)).
>
> (3) The money put up by a borrower (the Borrower's Equity) was to be pre-positioned in an account of MSF Vanguard No1 IC, who would pay part to MSF and part to the Studio (Clause 2.2(b)(ii)).

(4) The ALCF Fee was to be paid out of the Total Borrower's Equity (Clause 2.2(c)).

78. The PIA, clause 9 covenanted that no other films (or assets) could be purchased until all sums owing to the bank or sub-participant were paid, and all Call/Put options had expired.

79. The PIA dealt with what was to happen upon an exercise of a Put Option in clause 5,

> (1) If it was not the highest Put Option price, then it is applied to discharge the principal of the loan, and then the interest (clause 5.2)
>
> (2) If it was the highest Put Option price, then 61.5/65 of the price is applied as above ("the Lending Bank's Put Option Share"), with the remainder retained "either for use in furthering the business of the Partnership, or for application under, and in accordance with, the Partnership Agreement…" (Clause 5.3).

80. However, if "at or around the time of any disposal of Option Rights" under a Put Option, the shares were sold, then:

> (1) If it was not the highest Put Option price, the Borrower was to pay the share proceeds to the Sub-Participant (clause 5.4(a)(i)), and any sums so paid would reduce the amount payable to discharge the loan under clause 5.2;
>
> (2) If it was the highest Put Option price, then the borrower would pay the Lending Bank's Put Option Share amount (as defined in clause 5.3), to the Sub-Participant, and that amount paid would reduce the amount required to be paid in discharge of the debt out of the Put Option consideration.

The release of the films and completion of Phase 1

81. On 1 August 2008, *MMT* was released in the US on 102 screens.

82. On 5 August 2008, Laurie Cooke (a lawyer working for Matrix) emailed Mr Hardy saying:

> "FYI – the film appears to have been dumped by Lakeshore. It was (according to IMDB) only released in 'one dollar' cinemas with no advertising…"

83. Eric Briggs at Salter emailed Mr Hardy on 5 August 2008 suggesting that the post-release report be delayed until 30-45 days from initial release (rather than the 14 agreed in the transaction documents). He suggested that this was particularly important with a film like *MMT* that had had a limited release as it could be released more widely over time.

84. There was internal Matrix discussion on whether time could be extended. They decided that it could be: Robert Charlton of Matrix said, on 6 August 2008, that:

> "I recall that a quick turn around was desirable for trading reasons…"

85. Salter were unaware of the release plans for *MMT*, as they wrote to Lakeshore on 15 August 2008 asking why it had only been released on 102 screens and whether

there would be any further release. None of the three films *MMT, Henry Poole,* or *Elegy* were released in wide distribution in the US. *Elegy* was released in the US on 8 August 2008 on 6 screens, later expanding to 142. *Henry Poole* was released in the US on 15 August 2008 on 527 screens. For each Phase 1 film, the time period from release to Salter Report was extended to 45 days. *MMT's* Put Option was amended on 27 August 2008; *Elegy's* on 28 August 2008; and *Henry Poole's* on 17 September 2008. On 11 November 2008, MSF wrote to the Executive Partner enclosing a preliminary Film Revenues Report.

86. The format of the report was a one page table for each film with the following headings and sub-headings and figures next to them in US dollars:

> (1) Assumptions (Budget, Domestic Box Office, Foreign Territory Pre-Sales, Foreign Overages, Domestic Retention Rate, Domestic P&A [*print and advertising*].
>
> (2) Gross Revenue made up of: Domestic (Box Office broken out into various ranges – 0-34.9M, 35 -49.9M, 50-64.9M and 65+), Video (on a 20% royalty basis), TV, Total Domestic Film Revenues, Foreign Pre-Sales and Foreign Overages broken out into Video (20% Royalty and Other)
>
> (3) Waterfall of Gross Receipts (this took the Total Gross Revenues total and broke it down into:
>
> > (a) Distribution fees split US/Canada and Theatrical (broken down into threshold ranges above
> >
> > (b) TV- broken down into various "foreign" categories.
>
> (4) The total of the above fees was subtracted from gross receipts to give a remainder from the following were further subtracted (Advertising and Publicity costs, residuals, general, participations, interest on distribution costs to give a further remainder which was then transposed to a row described as "Defined Proceeds".

Events post-film release report

87. On 12 November 2008, the Executive Partner wrote to the directors of Richmond Palace Ltd, informing them of the contents of the 11 November 2008 letter. On 13 November 2008, the directors of Richmond Palace Ltd wrote to Mr Hardy enclosing a copy of the letter from the Executive Partner. On 18 November 2008, MSF wrote to the Executive Partner with a final Film Revenues Report and Matrix Partnership Services Ltd ("MPSL") wrote to the shareholders in the Partner Companies, setting out the Put Option consideration and indicating that MPSL and Lakeshore Filmco LLC would each be interested in buying 50% of each shareholder's shares for an aggregate price equivalent to the company's put option share.

88. On 18 November 2008 Mr Hardy sold his shares in Richmond Palace Ltd (along with all of the other Phase 1 investors who sold their shares in their respective PartnerCos) to MPSL and Lakeshore (on a 50:50 basis).

89. On 19 November 2008, the Executive Partner wrote to the PartnerCos enclosing the final Film Revenues Report, and indicating the put option consideration. Mr Hardy sold half his shares to Lakeshore FilmCo LLC and half to MPSL on 21 November 2008. The Put Options were exercised the same day.

90. A Payment Instructions Agreement (Put Option Price) of 21 November 2008 provided that the put option price was to be paid by Lakeshore (as FilmCo) straight to Lakeshore (as Lender): clause 2.2(b).

91. A Second Payment Instructions Agreement (Share Sale Proceeds) of 21 November 2008 provided that Lakeshore had lent MPSL and Lakeshore FilmCo the funds to buy the shares. The money lent, the Option Price and the share price were all stated to be £3,120,750. Lakeshore did not pass funds to those two companies and they did not then pay the Borrower. Instead Lakeshore (as lender) paid itself (as Sub-participant) (at clause 2.2(b)).

Summary of payment obligations and payment flows

92. As summarised by the appellant the obligations were as follows:

93. The Partnership agreed to buy three films for £23,116,667 + 8% (£1,849,333) which came to £24,966,000. To finance this the borrowers agreed to deposit £3,467,500 with ALCF and to borrow £23,226,667 from ALCF giving a total of £26,584,167. This sum was used to subscribe for shares in the partnership companies and those companies paid the sums by way of capital contributions to the partnership.

94. The partnership paid £24,966,000 to Lakeshore and £1,618,167 in fees. Lakeshore agreed to pay £23,116,667 to ALCF in return for the assignment of all ALCF's rights and securities in respect of ALCF's advance as a pre-condition to the making of that advance (under the PIA clause 2.2(a)(i). Thus the payment obligation, the appellant says, went in a circle:

Lakeshore=>ALCF=>Borrowers=> PartnerCos=> Partnership=>Lakeshore

95. No money actually moved. Under Clause 2.2(b)(i) £23,116,667 was retained by Lakeshore and it was provided that this discharged all subsequent obligations in respect of that sum. Hence the appellant argues, other than ledger entries, no movement of funds was required to perform various transactions which the sum was to be used to effect.

96. The "Payment Instructions Agreement" provided for netting off of the sub-participation, the loan, the share subscription, the partnership contribution and the film purchase so that the "borrowed" amount (usually referred to as the "Total Advance") for all investors was required to be paid by the film producer to itself.

97. The only actual movements of funds was the total borrower's equity of £3,467,500 deposited with ALCF in the name of the Executive Partner. The Executive Partner paid £1,849,333 to Lakeshore (the 8%), £297,737 in fees and £1,323,427 to Matrix Structured Finance in fees. From this a number of other fees and expenses were paid (e.g. £25,838 to JTC).

98. Clause 2.2(b)(i) of the PIA provided:

> "to the extent such payments relate to the payment and onward transmission of an amount equal to the Total Advance, such payments shall be made by the Sub-Participant [*Lakeshore*] paying an amount equal to the Total Advance directly to FilmCo *[Lakeshore]*, or as it directs, and such payment shall be treated as discharging the

> obligations of each relevant party to make payment to the next relevant party of amounts referable to the Total Advance, as per sub-clauses 2.2(a)(i) to 2.2(a)(v) above;…"

99. As regards stamp duty on the share purchase MPSL and Lakeshore Filmco were unable to pay it without additional funds. An e-mail from Marcus Darnell at SJ Berwin set out the stamp duty bill, and showed that MPSL did not have the money and needed MSF to pay it. On 21 November 2008, Lakeshore wrote to ALCF confirming that it had taken enforcement action and instructing it to write off Mr Hardy's Loan after 24 months. ALCF released the Partnership Guarantee and Debenture and their charge over Mr Hardy's shares. In the latter document, ALCF state that "no further amounts of principal or interest are due to be paid to the Bank under the Loan Agreement…" A new Partnership Guarantee and Debenture were entered into by the Executive Partner in favour of Lakeshore, securing Lakeshore's loans to MPSL and Lakeshore Filmco. Mr Hardy maintained he sold his shares at a significant loss, if the loan (whose status as such was a matter of dispute) was treated as part of his acquisition cost. He claimed loss relief against income tax under s131 ITA 2007.

Phase 3

100. *Madea* was first suggested to the Partnership on 3 December 2008, along with *My Bloody Valentine* ("*MBV*"). *MBV* was to be released on 16 January 2009 and *Madea* on 20 February. Both of these were acquired: Vanguard Phase 2 used *MBV* and Phase 3 used *Madea*. Salter emailed Eric Reid asking whether Mr Hardy would be engaging them to produce reports on *Madea* on 13 January 2009.

101. The transactions documents and stages for Phase 3 were essentially the same as those for Phase 1.

102. One significant difference was that because Matrix had been unable to raise sufficient funds to meet the amount stated to be the price for the film the Price was divided into two amounts, £13,136,563 which was payable immediately and £12,741,638 of deferred consideration which was payable out of receipts from the exploitation of the film (if any arose). The original put and call option agreement erroneously overstated the threshold amounts for the options which were reduced to reflect the proportion of actual consideration over total consideration, and consideration amounts which were reduced proportionately twice over rather than just once. These errors were corrected in amended Put and Call Options on 24 February 2009.

Participations and distribution fees

103. On 26 January 2009 Laurie Cook (Matrix's solicitor), in response to an e-mail of the same date from SJ Berwin (acting for Lionsgate) enclosing various transaction documents, sent an e-mail reply which asked, in relation to the distribution agreement for details of Exhibit B (Defined Proceeds) Schedule 1 (Picture Spec) and Schedule 3 (Existing Distribution Agreements) and details of the Participations.

104. On 28 January 2009 Mr Nicholas e-mailed Mr Hardy copying Laurie Cook and Eric Reid (Lionsgate) stating that:

> "For the purpose of the definition of Defined Proceeds there will be no participations. LGF will absorb them all."

105. There were various valuations one on 30 January 2009 and the other at 2 February 2009 and one at 12 February 2009. The first two did not include participations within the modelled defined proceeds, whereas the last one did. Mr Hardy's evidence was that the changes passed him by.

106. Another different feature, and one which HMRC rely on in part to support an argument that the partnership intended to make a loss or was indifferent as to loss relates to the arrangements for distributions fee whereby the fee was 35% where Domestic Box Office (DBO) was less than $90 million but then reduced retroactively to 10% where DBO exceeded $90 million.

Mr Moxon's involvement and release of Madea

107. On 3 February 2009 Mr Moxon applied to join the Partnership, making materially identical commitments to those made by Mr Hardy for Phase 1. He promised an immediate payment of £32,000 and a total capital contribution (termed a "Commitment" on his form) of £232,000. This was below the minimum permitted figure and so required MSF's consent. He explained that this was because he was a longstanding acquaintance of Mr Hardy. Mr Moxon applied for a loan of £200,000 on 3 February 2009. Mr Moxon also signed a Power of Attorney the same day which could not be revoked for 120 days. This Power of Attorney authorised a Matrix employee (Mr Charlton and in default of him Mr Hardy) to take out a Partner Loan in his name, and to exercise all the rights exercisable as a shareholder. Mr Moxon subscribed for shares in Daivat 2 Ltd on 19 February 2009.

108. Daivat 2 Ltd was already a Partner, having adhered on 24 July 2008. On 19 February 2009, notice was given of a meeting, also to be on 19 February 2009, for the purposes of "considering, discussing and if thought fit approving (or disapproving as the case may be), the disposal of the Put Option for the Phase 2 film (which neither Mr Hardy nor Mr Moxon invested in) and the execution of the transaction documents for Phase 3. As for Mr Hardy, Mr Moxon's Loan Agreement of 19 February 2009 was conditional on sub-participation, execution of the Payment Instructions Agreement and execution of a Power of Attorney irrevocable for 120 days. The provisions as to fees, acceleration, repayment, security and recourse were the same for Mr Hardy and Mr Moxon. The Sale and Purchase Agreement for *Madea* was executed on 19 February 2009.

109. There were iterations of the Salter Pre-release report on 30 January, 2 February and 12 February 2009. *Madea* was released on 20 February 2009. No final version of the Salter Pre-release report for the film was available (HMRC highlight that this was despite their repeated requests for it before the hearing).

110. An internet article by Joal Ryan dated Sunday 22 February 2009 reported:

> "Madea goes to Jail…grossed a whopping $41.1 million in its weekend debut, its studio estimated today, the biggest Friday-Sunday take since Twilight's bow back in November…Madea Goes to Jail is not only based on Perry's most popular character, it's based on Perry's most popular stage show, so Lionsgate was expecting something big. Just not $41.1 million big. "We were cautiously optimistic we could do 30-

> plus," Steve Rothernberg, the studio's domestic distribution president, said today"
>
> MGTJ is not only Perry's top opener of all-time besting Madea's Family Reunion ($30million), it's Lionsgate's top opener of all-time, besting *Saw III* ($33million). Even better for the studio accountants, *Madea Goes to Jail*, like Perry's other movies was Hollywood cheap, costing under $20million".

111.On 23 February 2009 Laurie Cooke e-mailed Mr Hardy with a website link to ScreenDaily and a new article dated 22 February 2009 and entitled "Tyler Perry's latest Madea film tops domestic box office with $41.1m".

112.MSF wrote to the Executive Partner on 10 March 2009, enclosing a preliminary Film Revenues Report, and indicating that the mid-level Put Option could be exercised. On 11 March 2009 the Executive Partner wrote to the directors of Daivat 2 Ltd, informing them of the contents of the 10 March 2009 letter; and the directors of Daivat 2 Ltd wrote to Mr Moxon enclosing a copy of the letter from the Executive Partner.

113.On 19 March 2009, Baligay Ltd offered to buy Mr Moxon's shares in Daivat 2 Ltd. Mr Moxon gave evidence that this letter came out of the blue though he said that he "clearly understood that there might well be a purchaser for my shares if the film didn't perform". He did not negotiate at all with Baligay but instead asked Matrix what everyone else was doing. On 23 March 2009, the final Film Revenues Report was released. The share sale took place on 2 April 2009 as did the exercise of the Put Option. Mr Moxon sold his shares in Daivat 2 Ltd (along with all the other Phase 3 investors who sold their shares in their respective PartnerCos) to Baligay Ltd, a company wholly owned by Lionsgate.

114. A Payment Instructions Agreement (Put Option Price) of 2 April 2009 provided that the put option price was to be paid by Lionsgate (as Distributor) straight to Lionsgate (as Lender) (clause 2.2(b)).

115. A Second Payment Instructions Agreement (Share Sale Proceeds) of 2 April 2009 provided that Lionsgate had lent Baligay the funds to buy the shares. Lionsgate (as lender) paid itself (as Sub-participant) (clause 2.2(b)). Also on 2 April 2009, the Partnership (by the EP) executed a new Partnership Guarantee and Partnership Debenture, in favour of Lionsgate, securing Baligay's debt over the assets of the Partnership (i.e. its rights to the consideration for the Put Option).

116.*Madea* performed well at the box office. The previous films had reached $50 million and $63 million respectively. At the time of the post-release report it had grossed around $87million. The figure increased to $90,299,408 by 10 April 2009 and $90,485,233 by 17 April 2009.

Stamp duty

117.As Lakeshore lent exactly the amount due as Put Option consideration to MPSL and Lakeshore Filmco so they could buy the shares in the companies, those two companies would not have been able to pay the stamp duty unless they had separate funds.

118.On 15 September 2008, Mr Hardy had written to Mr Nicholas saying that:

> "There are no funds within the deal for these amounts to be picked up by either the Partnership or by Matrix. Lakeshore is the big winner in this deal, these costs will be for their account."

119.On 23 September 2008 Mr Nicholas said that Lakeshore would assist in purchasing the investor's companies but that they would

> "need to be assured that their disbursements / costs will be covered though – e.g. stamp duty and professional fees…"

120.It appears that MSF paid at least half the stamp duty on the share purchase. On 21 November 2008, SJ Berwin asked for funds to pay it: On 24 November 2008, MSF transferred £8,000 to cover the liability of MPSL. This was sorted out in advance for Phase 3.

121.At the time the partner companies' shares were sold to Baligay, there was a Side Letter: Stamp Duty agreed, according to which Matrix and Lions Gate agreed to pay half the stamp duty each. (In Phase 1 there had been a dispute as to whether Lakeshore or Matrix would bear the cost of the stamp duty (they ended up sharing it): On 26 January 2009 Guy Russell wrote

> "This time around I will ask for the Stamp Duty amount to be agreed beforehand so we get it right…"

122.In the Phase 3 sale, as for Phase 1, the total price for the shares (in all the partner companies) was the same as the put option consideration and was also the amount lent to Baligay to carry out the purchase.

123. ALCF released the Partnership Guarantee and Debenture and their charge over Mr Moxon's shares. In the latter document, ALCF stated that "no further amounts of principal or interest were due to be paid to the ALCF under the Loan Agreement…".

Analysis of the transaction documents

124.There was no real dispute between the parties over the interpretation of the terms of the various transaction documents or the fact a number of them assumed the existence of others and that they were essentially a suite of interlocking agreements that were intended to take effect together. As well as explicit cross-references the linkages were apparent from the substance of what was agreed for instance as regards the payment due under the Call Option the 12% p.a. increase provision (whether 12% of budget as appeared in the framework agreement or 12% of budget + 8% as appeared in the documents that were then executed) meant that the payment would always be sufficient to pay off the Partner Loan (which was always equal to the budget of the Film(s) with 12 % interest). Before moving on from the transaction documents it is worth pausing to note various features, highlighted by HMRC and which were not challenged by the appellant, that emerged from looking at how the documents fitted together and what matters they incentivised or otherwise as regards the participants in the arrangements.

Inevitable that either put or call option would be exercised

125.There was no real dispute that if the put option thresholds were triggered then the partnership was incentivised to exercise them. The security documents and the terms of the sub-participated loan meant that, while the Put Option was described as an

option, the partnership was in fact compelled to exercise it if the film's estimated Defined Proceeds were below 113.5% of budget. This was because a failure to exercise the option would count as an "Acceleration Event" under clause 5.8 of the Loan Agreement, which meant that the loan would fall due and the film producer, as sub-participant, would be entitled to seize the film rights over which it had a charge. Similarly, if the call option was triggered then the producer / vendor was incentivised to exercise it. As Mr Hardy accepted in cross-examination, if the film was very successful then Lakeshore / (the distributor), if acting rationally would exercise its call option. He also accepted that at the partnership level that either the put or call options were going to be exercised. In that sense the option of choosing not to exercise an option was not a real option. The appellants did not propose to hold onto the rights in the films purchased over the long term.

Incentives to sell shares

126.If a Put Option was exercised, a certain percentage of the film's budget would be payable by the film producer to the partnership but the sum would need to be applied to paying off the sub-participated loan. The loan and security arrangements provided that Put Option (and Call Option) consideration would not actually be paid to the partnership, but rather to the sub-participator.

127.HMRC note the consequence of the above was that, if the Put Option was exercised, the borrower was incentivised to sell their shares. If they did not sell their shares, then the price obtained by the Company in return for exercise of the Put Option would be applied to discharge the Borrower's debt (this was made explicit by 5.2(c) and 5.3(c)), which would be a distribution taxable as income.

128.If the Call Option were exercised, then the Call Option Price was applied first to the Loan and interest, and then retained by the Partnership (Clause 6.2 of the Payment Instructions Agreement). If the shares were sold, there were similar provisions in 6.3 as for the Put Options. If there was a revenue stream, however, then clause 3.1 (Film Exploitation Proceeds) would apply. If a taxable distribution were to be avoided, the shares would have to be sold, so no revenue stream would arise. HMRC highlight that if the highest Put Option case applied, then the only way the borrower could obtain their 3.5/65 of the price (see [79]) was by selling their shares. This was because they were not required to pay over that amount to the Sub-Participant under clause 5.4, and so they received it themselves. If they did not sell their shares, the partnership would retain that (clause 5.3), but it could do nothing with it, as the accounts were charged to the lender and as no further investments could be carried out until the debt was fully repaid.

129.HMRC also explained why it was that the shares could not be sold for a value less than the Put Option consideration held by the company. If they were then that would require the excess consideration under the Put Option to be paid to the Sub-Participant (rather than being retained by the Partnership and therefore passing, in part, with the sale of the Company). This was because the provisions of clause 5.4 only reduced the payment under 5.2/5.3 to the extent the Sub-Participant had been paid out of the share sale proceeds, rather than replacing it (under clauses 5.4(a) and (b)). For example, if the company received Put Option consideration of £400,000 and the shares were sold for £390,000, then £10,000 of the Put Option consideration would need to be applied to discharging the loan, so the person buying the shares would only acquire a company with a right to £390,000. This point was significant because any genuine

third party purchaser who wished to acquire a PartnerCo would, not least to take account of the 0.5% stamp duty charge, expect to buy at a discount.

Consequences of lapse and why the films can't be dealt with prior to options becoming exerciseable:

130.HMRC also pointed out that if any of the Put Options were not exercised (which was a matter for the Executive Partner under the Partnership Agreement), then the loan fell due. The Lender was then entitled to enforce the Security Documents. Clause 8.1(a) of the Partnership Debenture stated that the Partnership would not enter into any transaction or series of transactions to sell, lease, transfer, loan or otherwise dispose of any Security Asset (which includes the Films), other than as contemplated by the Distribution Agreement (i.e. the agreement by which all rights to distribute the Films go back to the selling studio) or the Put/Call Options. This meant the Partnership could not deal in the Films prior to the Options becoming exercisable.

No real freedom to select films and no dealing in films

131.A further feature which emerged from HMRC's close examination of the documents was that there was no real freedom on the part of the partners at the first Partnership Meeting to refuse to approve the purchase of the films. Mr Hardy was personally liable to procure the difference in amount (£1,136,667) between the capital contribution on his application and the sum that came from his own funds (see [63]). If he were unable to borrow that money (as he was able to – he made an application to ALCF for the very same amount) he would have had to have met it from his own funds. Putting this more generally given there was nothing to suggest Mr Hardy's documents were atypical the partners had agreed that they would procure Partnership Contributions which assumed that they would be able to borrow 88% of their contributions. That would need to be met from their own contributions if no Loans were advanced but the Loans would only be advanced if the payment instructions and sub-participation arrangements were agreed and that depended on Lakeshore selling the three identified films to the partnership.

132.As HMRC point out, once the films were purchased the Partnership Debenture prohibited the Partnership from dealing in them except under the Put and Call Options and the Payment Instructions Agreement prevented any other investments being made.

Mr Phillips' evidence

133.In his expert report of October 2015, Mr Phillips was asked by the appellants' advisers to address the following questions:

> (1) *The potential for earning profits and the risk of making losses by exploiting film rights in the film industry.* Mr Phillips' report makes the point that for every "winner" (which could deliver multiples of an investment over a time) there were many "losers" and that predicting the success or otherwise of any one particular film was tough. He mentioned a range of relevant factors (such as scale, script, genre, director and cast). In relation to genre he explained that while horrors and thrillers were

generally considered to be attractive to distributors (given the appeal of that genre to the largest cinema-going demographic (15-25 year olds) there was "no set rule and for every example that confirms it, there is another that contradicts".

(2) *Whether the arrangements of the type entered into by the partnership were a potential means of profitably exploiting film rights.* Mr Phillips considered the attributes of each of the films noting a number of "commercial pluses" for each e.g. that Penelope Cruz was on the cast of *Elegy,* that *Henry Poole* premiered at the Sundance film festival, that *MMT* had well known "names" such as Vinnie Jones, and that *Madea* featured a major US star, Tyler Perry. His report concluded that the mechanisms and formulae were reasonable and that all reasonable steps were undertaken to mitigate the potential risks. His view was that the films had been in a good position to be commercially successful when the rights had been acquired.

However having evaluated Mr Phillips' evidence in its totality and taking account of the explanations he gave orally, with the exception of *Madea* those conclusions in relation to the commercial prospects of success of the films, or that all reasonable steps had been taken to mitigate the risks cannot be accepted as findings of fact particularly once the question of the relevance of distributor size and screen release are taken into account. Mr Phillips accepted that a buyer would be expected to have known the details of the limited screen releases of the Phase 1 films and also that a buyer would want to ask for sales estimates for international territories. In those respects it cannot be said that all reasonable steps had been taken to mitigate the risks. As to Mr Phillips' conclusion on the reasonableness of the mechanisms and formulae used this turned out on closer examination to be of limited assistance. He had not seen arrangements such as those in issue in these appeals before. He was not sighted on the totality of the interlinking agreements including the financing obligations and had made his assessment of the puts and calls (not unreasonably given their complexity) on the basis they could be freely exercised (which as discussed above was not the case in practice). In cross-examination Mr Phillips accepted it was unlikely the films would get near the high or even mid-case modelled by Salter or that the films would hit turnover of $30-$40million. (By way of comparison with *MMT* Mr Phillips' evidence covered analogous films *House on Haunted Hill* (which was released on 2,700 screens) grossing $41million and the *Exorcism of Emily Rose* (released on 2,981 screens) grossing $75million. Even though these films had bigger budgets (films that typically hit $80 /$90m tended to have bigger budgets) and larger releases they did not achieve $88m (the Salter High case). Again, relevant factors were the limiting factors of small screen release and the minor distributors, and in addition that that none of the directors had any track record.

(3) *Whether the reports on the valuation of the films which were prepared by Salter were reasonable in their approach and methodology and (4) whether those reports were reasonable in their conclusions.* Mr Phillips concluded both the approach and conclusions were reasonable. It should be noted there was no challenge by HMRC to Salter's approach, or their conclusions – their case was that Salter simply worked with inputs and figures they were given. In cross-examination Mr Phillips accepted that

some of the figures that had been around print and advertising expenditure were not reasonable (e.g. in relation to Phase 1 it would not have been feasible to have increased expenditure from $350,000 to $30,000,000 between July and September 2008). I am unable to accept Mr Phillips' conclusion that the methodology of analysing "high", "medium" and "low" scenarios was reasonable and indeed that this was the only way to assess a film's commercial prospects. It is self-evident that the question of prospects of success would need to take due account of the probability of certain scenarios occurring. In that key respect the scenario calculations were incomplete as a means of assessing commercial prospects of success.

Law

Issues

(1)Whether the Vanguard 1 Partnership was carrying on a trade during the periods in which the Appellants held shares in the PartnerCos such that the conditions in s.137 of the Income Tax Act 2007 were satisfied for the period required under s.134.

Statute

134.Section 137 provides where relevant:

> **"137 The trading requirement**
>
> (1) The trading requirement is that—
>
> (a) the company, ignoring any incidental purposes, exists wholly for the purpose of carrying on one or more qualifying trades, …
>
> …
>
> (7) In this section—
>
> "qualifying trade" has the meaning given by section 189, and
>
> "research and development" has the meaning given by section 1006.
>
> (8) In sections 189(1)(b) and 194(4)(c) (as applied by subsection (7) for the purposes of the definitions of "excluded activities" and "qualifying trade") "period B" means the continuous period that is relevant for the purposes of section 134(3).
>
> (9) In section 195 as applied by subsection (7) for the purposes mentioned in subsection (8), references to the issuing company are to be read as references to the company mentioned in subsection (1)"

135.Subsection 7 provides that "qualifying trade" has the meaning given by section 19 which in turn provides:

> "189 Meaning of "qualifying trade"
>
> (1) For the purposes of this Part, a trade is a qualifying trade if—

> (a) it is conducted on a commercial basis and with a view to the realisation of profits…"

136.Before considering whether there was a qualifying trade it must first be established that there was a trade.

Legal test – Trade?

137.The approach to be taken was summarised by the Court of Appeal in *Eclipse 35 v HMRC* [2016] STC 1429 at [112]:

> "The Income Tax Acts have never defined trade or trading further than to provide that ... trade includes every trade, manufacture, adventure or concern in the nature of trade ...whether or not a particular activity is a trade within the meaning of the tax legislation, depends on the evaluation of the activity by the Tribunal of fact...It is a matter of law whether some particular factual characteristic is capable of being an indicator of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not in the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles."

138.There was a large measure of agreement in the basic approach to be taken as to what constituted a trade, in view of the case law. As is clear from the extracts below, the focus was very much on considering the activities carried on, and the particular facts relating to them. The task was to strip down the transaction to its essential elements and then ask whether they constituted a trade. Where the parties differed, was on the application of the test to the relevant facts, in particular as to whether it was the intention of those operating the partnership to make a loss, but also as to whether the facts disclosed that the activities amounted to something that was more akin to an investment in film rights.

139.Mr Yates, for HMRC, referred the tribunal to House of Lords' decision *Ransom v Higgs* [1974] WLR 1594. In relation to the definition of trade Lord Reid stated:

> "Leaving aside obsolete or rare usage, it is sometimes used to denote any mercantile operation, but it is commonly used to denote operations of a commercial character, by which the trader provides to customers for reward some kind of goods or services."

140.Lord Morris set out that:

> "In considering whether a person carried on a trade, its seems to me to be essential to discover and examine what exactly it was that the person did"

141.*Ransom v Higgs* was mentioned by the Court of Appeal in *Eclipse* as follows. (This was in the context of the court's discussion of Ribeiro PJ's well-known statement in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 that the ultimate question was "…whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically") :

> "The concepts of an unblinkered approach to the analysis of the facts and a realistic approach to the transaction derive at least in part from the speeches in *Ransom v Higgs*."

> "It is necessary to stand back and look at the whole picture and having particular regard to what the taxpayer actually did, and ask whether it constituted a trade"

142.In the Court of Appeal's decision in *Samarkand Film Partnership No. 3 v Revenue and Customs Commissioners* [2017] EWCA Civ 77 (which was given after the hearing but in relation to which both the parties had opportunity to comment on in post-hearing submissions), Henderson LJ endorsed the Court of Appeal's approach in *Eclipse*.

143.Mr Southern, for the appellants, referred to the principles Millet J set out in the High Court's decision in *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1989] STC 705:

> '(1) In order to constitute a transaction in the nature of trade, the transaction in question must possess not only the outward badges of trade but also a genuine commercial purpose.
>
> (2) If the transaction is of a commercial nature and has a genuine commercial purpose, the presence of a collateral or ulterior purpose to obtain a tax advantage does not "denature" what is essentially a commercial transaction. If, however, the sole purpose of the transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose.
>
> (3) Where commercial and fiscal purposes are both present, questions of fact and degree may arise, and these are for the Commissioners. Nevertheless, the question is not which purpose was predominant, but whether the transaction can fairly be described as being in the nature of trade.
>
> (4) The purpose or object of the transaction must not be confused with the motive of the taxpayer in entering into it. The question is not why he was trading, but whether he was trading. If the sole purpose of the transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose. But it is perfectly possible to predicate a situation in which a taxpayer whose sole motive is the desire to obtain a fiscal advantage invests or becomes a sleeping partner with others in an ordinary trading activity carried on by them for a commercial purpose and with a view of profit.
>
> (5) The test is an objective one. In *Newton v Commissioner of Taxation of Australia* (1958) AC 450 at -165, Lord Denning said ... "The purpose of a contract, agreement or arrangement must be what it is intended to effect and that intention must be ascertained from its terms". The objective nature of the enquiry appears clearly from both the dividend-stripping case and the cases of intra-group transactions .... In each of these cases the purpose of the transaction was objectively ascertained by a detailed analysis of the terms and circumstances of the transaction itself without enquiry into the motive and subjective aspirations of those who effected it.
>
> (6) In considering the purpose of a transaction, its component parts must not be regarded separately but the transaction must be viewed as a whole. That part of the transaction which is alleged to constitute trading must not be viewed in isolation, but in the context of all the surrounding circumstances. But this must mean all relevant surrounding circumstances; that is to say, those which are capable of

> throwing light on the true nature of the transaction and of those aspects of it which are alleged to demonstrate a commercial purpose.
>
> (7) If the purpose or object of a transaction is to make a profit, it does not cease to be a commercial transaction merely because those who engage in it have obtained the necessary finance from persons who are more interested in achieving a fiscal advantage from their investment. Even where the trader is the creature of the financier, the two activities are distinct and the object of one is not necessarily the object of the other.
>
> (8) In *FA and AB Limited v Lupton*, Lord Morris said, 47 TC 580 at 620:
>
> "It is manifest that some transactions may be so effected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction. The result will be not that a trading transaction with unusual features is revealed but that there is an arrangement or scheme which cannot fairly be regarded as being a transaction [in the nature of trade]."
>
> In my judgment this is the true significance of a fiscal motive. Fiscal considerations naturally affect the taxpayer's evaluation of the financial risk and rewards of any proposed venture, and are often the decisive factor in persuading him to enter into it. First year allowances, enterprise zones, government grants and the like operate as financial inducements to businessmen to engage in commercial activities which would be financially unattractive or unacceptably speculative without them. Such motivations, even if paramount, do not alter the character of the activities in question. But while a fiscal motive, even an overriding fiscal motive, is irrelevant in itself, it becomes highly relevant if it affects, not just the shape or structure of the transaction, but its commerciality so that, in Lord Morris' words, "the shape and character of the transaction is no longer that of a trading transaction". But nothing less will do.
>
> (9) Accordingly, in my judgment, and adapting the words of Lord Simon in *Thomson v Gurneville* (17 TC 633 at 679), the question is whether, in the light of all relevant circumstances, the transaction is capable of being fairly regarded as a transaction in the nature of a trade, albeit one intended to secure a fiscal advantage or even conditioned in its form by such intention,' or is incapable of being fairly so regarded but is in truth a mere device to secure a fiscal advantage, albeit one given the trappings normally associated with trading transactions.'

144.Mr Yates submitted the above principles are not on point; they referred to the approach to be taken when there was a trade but that was then negated by an intent to avoid tax (dubbed the *Lupton* point). That was not relevant, to the prior question of whether or not there was a trade in the first place. However, given the agreed approach of the parties that the court or tribunal should stand back and strip the transactions down to their basics it is questionable, in my view, whether much turns on the question of whether and the extent to which Millet J's principles are relevant. Read as a whole they are consistent with looking objectively at the activities and surrounding facts (and endorsed by Lord Templeman to the extent his judgment reminds us that actions speak louder than words (at pg743)). In my view the *Lupton* point as dealt with by Millet J in *Ensign* does not speak to the sort of two stage approach HMRC was advocating. The essential point that emerges from his

discussion of fiscal motive is that there will be transactions motivated by tax which do not amount to a trade but that this is not because of the tax features per se but because the tax features are such that the activity is not trade-like.

145. As regards the question of how a transaction or set of transactions made up of individual steps should be analysed HMRC referred to the Upper Tribunal's decision in *Samarkand* (at [86]) where the court endorsed the FTT's approach of looking at what the partnership did and upheld its conclusion that the particular sale and lease-back transaction there did not amount to a trade even though constituent elements of the transaction e.g. a single purchase and leasing, or the purchase of a film with a view to its distribution or exploitation, were capable of amounting to a trade.

Parties' submissions

146. The appellants' case is that they were investors in a scheme whose intentions were twofold: 1) to make profits by buying film rights and 2) if the films were not commercially successful to secure tax allowable losses. The intention was to make profits and the likelihood of profit was not so fanciful or negligible to be disregarded. Also if there was an intention to make profits but in fact losses were made the activity did not cease to be commercial because investors, assuming losses were tax allowable would be financially better off if the films failed rather than succeeded. The partnership carefully selected real commercial films distributed by proper studios with well-known stars and producers. The partnership's success was entirely dependent on the commercial fortunes of the selected films. These were released by the film studio in the hope (usually disappointed) that every new film would prove to be a blockbuster. Any argument that it was somehow pre-determined or practically certain that the partnership would realise a loss was untenable given that until the films were released for public showing in cinemas no-one could foretell what their commercial success would be. Mr Southern submits the evidence of Mr Phillips and Mr Nicholas confirmed the films were good commercial films and that they were not destined to be obvious failures. Stripping down what happened to its basics the partnership was carrying on a financial trade in a kind of film performance derivative where the return depended on box office returns. The loan element of the transaction was real, it needed to be taken into account to establish budget cost, purchase price and return. It geared up both profits and losses.

147. HMRC argue no trade was carried on because:

> (1) matters were arranged without any regard to achieving a profit and/or with the intention of ensuring a financial loss to maximise investor returns after taking into account tax relief. The factual circumstances by which this occurred differed between Phase 1 and Phase 3 in that in Phase 1 the films were doomed to failure whereas in Phase 3 changes were made to the partnership's documentation (the budget was inflated for tax purpose, the defined proceeds figures upon which the put and call triggers were based were changed such that even though *Madea* was commercially successful it resulted in a loss for the partnership – for instance by including an unusual distribution fee arrangement whereby at a certain cut-off of box office performance the fee would retrospectively reduce to 10%).
>
> (2) even if the partnership intended to achieve a profit through the exercise of the call option, looking to the essence of what the parties were

> actually doing, the exercise of the call would only have entitled the partnership to a 6% stream of profits. That was more akin to making an investment as opposed to trading. The insertion of a contingency (the extent of film success) made no difference to this analysis. This was a bet for future income rights.

148. HMRC also referred to the FTT's decision in *Brain Disorders Research Limited Partnership and Neil Hockin v HMRC* [2015] UKFTT 325 (TC) and asked the tribunal to note a number of similarities with the present transactions concerning its findings in relation to: the marketing and reality of the scheme, the fees charged, the speculative prospects of royalties being akin to a bet, and the effect of the insertion of wholly non-commercial arrangements.

149.Following the hearing of the current appeals the Court of Appeal issued its decision on *Samarkand* and the Upper Tribunal issued a decision on *Brain Disorders* [2017] UKUT 176 (TCC) (which upheld the FTT's decision). The parties provided further written submissions, HMRC arguing that the core reasoning that HMRC had drawn from the case-law remained intact.

150.In their written submissions HMRC refer in particular to the UT's discussion in *Brain Disorders* concerning trade at [44] – [57]. In essence the UT upheld the FTT's finding there was no trade. Analysing the purpose of the transactions it was to create a vehicle for losses with any income from royalties being icing on the cake. At [57] the UT held:

> "The essence of the FTT's reasoning is that the research, though entirely genuine from BRC's perspective, was, from the Partnership's perspective, no more than the vehicle by which it was hoping to generate huge tax losses. It is inherent in the FTT's conclusions, as the observations at [117] make clear, that the possible generation of royalties from the fruits of the research was a side issue: if any royalties did result they would be icing on the cake, but the Partnership and its members were in reality indifferent to the matter. We do not agree that the FTT focused on motive; as we read its decision, it analysed the purpose of the transactions rather than the purpose of the participants. In our judgment the FTT's decision contains no error of approach and reaches a finding which was open to the tribunal on the evidence…"

151.The appellants suggest the case is of limited relevance to this appeal (a "loss on shares" case) highlighting that the facts involved a long-term programme of activity and fixed licence payments of 15 years rather than a series of short-term acquisitions and disposals. They also point to the fact that the Vanguard partnership did not have extraneous activities (namely an agreement with Contractor). It simply, they maintain, bought and sold film rights.

Was the partnership trading?

152.HMRC have put their case that the partnership was not trading as two alternative arguments which in very basic terms can be tagged: 1) "deliberate loss/no regard to profit" and 2) "trade vs investment?". However, in my view, it would be more in keeping with the guidance in the case-law (*Eclipse*), that as well as evaluating the

activity and the facts relating to it, the court or tribunal should "stand back and look at the whole picture", if both arguments were considered in the round. A finding that there was a deliberate intention to create losses would, I agree, point against a conclusion that there was a trade. But, such a finding would not be conclusive any more than a deliberate intention to make profits would be conclusive of a trade. Nor would it obviate the need to look at what activities were actually carried out. I therefore consider the issues of "deliberate loss/ no regard to profit?" and "trade v investment?" together as part of the evaluation of whether there was a trade. Having said that the various factual contentions underpinning those issues will inevitably first need to be considered in sequence.

153.I turn then to the question of whether there was a deliberate intent to create losses noting that the particular facts HMRC rely on are different as regard Phases 1 and 3.

Deliberate loss? Phase 1

154.In building up a picture of facts which point towards deliberate loss as regards Phase 1, HMRC rely on the appellant's knowledge of limited screen release, and their knowledge of the implications of the small size of the distributors as indicating that the appellants deliberately wanted to make losses.

Significance of limited release for Phase 1 films?

155.Before considering the partnership's knowledge of limited release it is necessary to consider the significance of a limited screen release. The appellants refer to Mr Phillips' evidence that the number of screens on which a film was released was not a reliable guide to its commercial prospects. It was "a cost-benefit analysis". Mr Philipps explained this as a comparison between a distributor releasing on 1000 screen as opposed to a 100 and reaching the view that 1000 screens would not deliver returns but that the distributor might decide to do what was called a "platform release" namely releasing in a modest way and then trying to build on that. He commented that it was less of a benefit these days because people checked online reviews themselves. One of the Phase 1 films (*Henry Poole)* had premiered at the Sundance festival which Mr Phillips' evidence suggested was a "big platform". That evidence must however be viewed in the light of his other evidence which was that where for example a film was released in 100 second run "$1" cinemas it was almost impossible that it would be a blockbuster and that the post-release results were consistent with the cinematic release.

156.Viewing the evidence in the round, I find that while there may not necessarily be a direct or linear correlation between screen release and box office success it is clear that where there is a small cinematic release this radically dampens down the prospects of success. While it is not inevitable that failure will follow a limited release it is pretty likely. Success from the so-called platform release would require time for word of mouth, assuming it was positive, to spread. As Mr Phillips had himself noted the type of release was less important in time when audiences were readily able to check reviews on-line. If successful there could well be issues with securing capacity given Mr Phillips' evidence that screens were typically booked 3 to 6 months in advance. A limited US release therefore, in my view, indicated success was less likely. It certainly pointed towards a lack of confidence on the part of those in the business of releasing films in the success of the film (putting aside the inherent uncertainty in any film's box office success). The cost benefit analysis approach of

only devoting more resource when positive feedback was received would not be necessary if confidence was higher. This conclusion is consistent with the internet furore that took place around the limited release. In particular, in relation to *MMT*, the fact someone with a vested interest (the writer) was so antagonised about the limited release indicates the negative signalling for the film's prospects of a limited release was commonly understood by those in the business. The language Laurie Cook used when talking about the limited release in her e-mail to Mr Hardy (of the film being "dumped") is also consistent with the view that a limited release did not bode well at all for box office success (see below at [82]).

157.The fact the Phase 1 films had a limited release in turn limited their prospects for commercial success. Therefore someone who knew about the limited release ought reasonably to know the prospects of commercial success for a film released in such a way were dim.

Did the Partnership know that the Phase 1 films were slated for a limited release before the film rights were bought?

158.HMRC point to Mr Nicholas' e-mail of 1 May 2008 asking pertinent questions but not then following them up. It was public knowledge that all three films were getting a limited release; the information was publicly accessible if searched for. HMRC submit these features indicate it was unlikely that Matrix did not know about the limited release. HMRC also refer to the fact Matrix were only "disappointed" that the film had been dumped.

159.For the appellants Mr Southern pointed out that Mr Hardy had, in relation to the Phase 1 post-release reports, asked Salter on 13 November 2008 for more information on the losses shown because the partners were interested. He had described the losses as "catastrophic". Mr Hardy's evidence was that he was not aware of stories like the ones set out in the internet articles referred to and that, if he had known about them, he would not have paid attention to them. More generally, Mr Southern posited that if the intention was to create a charade one might expect lots of e-mails enquiring about prospects of success.

160.As regards the website reports were they unreliable "internet tittle-tattle" (as Mr Southern put it)? The website "Shock till you Drop" recorded on 12 June that "Studio insiders confirmed" a "100 theatre run" (which is to be compared to 2000 or 2500 theatres for a major release). There was also a campaign started by the author of the story on which MMT was based, Clive Barker, to widen its release: on 20 June 2008 (see [47]), he wrote an open letter to the Fangoria Weekend of Horrors (a horror film convention) saying that, after chasing Lionsgate, he was "finally told that Lionsgate only planned to open the movie in a tiny number of theatres – somewhere between 100 and 300 – run it for a week, then put it on DVD. In other words, they were going to dump [the] movie…".

Significance of distributor size and partnership's knowledge of size

161.Mr Philipps' evidence made the point that smaller distributors could make returns. Their costs were correspondingly smaller. a film released by such a distributor could, as he said, do well in the framework of its own market. But, in terms of big box office returns a smaller distributor would lack the muscle for a big release and therefore a film with them would be unlikely to achieve the Salter high case figures as

compared with a larger distributor. Overture and Samuel Goldwyn (the distributors for *Henry Poole* and *Elegy* respectively) were acknowledged to be small distributors.

162.Taking that evidence into account I find that, while not inevitable, the selection of a smaller distributor would, all other things being equal, lead to a lower likelihood of significant profit being made and moreover would signal to others more generally a lower likelihood of such profit and returns becoming available.

163.In terms of Matrix's awareness, it was not in dispute that they were aware that distribution agreements had already been made between Lakeshore and US distributors, being Lionsgate for *MMT*, Overture for *Henry Poole* and Samuel Goldwyn for *Elegy,* by the time the relevant transactions were entered into.

Significance of Mr Nicholas' 27 January 2008 e-mail

164.On 27 January 2008 Mr Nicholas wrote to Paramount seeking films which were about to commence "principal photography" (Mr Hardy had explained in evidence that principal photography referred to the time when actual filming took place). In the e-mail (an extract of which appears in more detail at [16] above) Mr Nicholas wrote:

> "this is most suitable for a film which does not recoup its costs or where Studio overheads delay recoupment for a considerable time…"

165. Mr Yates argues the e-mail "let the cat out of the bag" (a suggestion that was vehemently denied by Mr Nicholas) and submits Mr Nicholas' explanation given in re-examination, that there was a typing error, was extremely unlikely. HMRC also say the explanation Mr Nicholas gave in his evidence that a request for unprofitable films did not "actually make sense". On the contrary the e-mail made good sense if the objective was to achieve tax losses and was also consistent with the self-interest of a seller who would collect their 8% on budget irrespective of profitability.

166.The cumulative picture painted by the release information asked for but not pursued, the publicly accessible information on the limited release, distributor, and Mr Nicholas' e-mail to Paramount meant, HMRC say, that there was real doubt over claim that Matrix did not know about the limited screen releases.

Tribunal's views

167.In relation to knowledge of the screen release figures I accept Mr Hardy's evidence that he did not know about the limited release in advance of the film purchase. The information relied upon would have required some internet searches, albeit ones which would not have needed to be particularly sophisticated, to be carried out. There was no evidence that Mr Hardy or his employees had performed such searches or did so as a matter of routine. While the website reports were publicly available they were not commonly known and it appears that even Salter, a professional film valuer, did not know about the limited release (Mr Phillips' evidence indicated that Salter would not have known the actual screen release plans, because if it did, it would not have modelled its high case at $88million and even its modelling of a $23million scenario would be bizarre). As regards the low level of disappointment expressed this is just as consistent with someone who did not care too much about profit as it is with someone who already knew the film had been dumped.

168.As regards the size of the distributors the appellants clearly knew the distributors for *Henry Poole* and *Elegy* were small although there did not appear to any evidence that they had actively turned their minds to the ramifications of that fact.

169.In relation to the e-mail of 27 January 2008 I reject Mr Nicholas' explanation that it was a typing error. It is difficult to see what typing error could extend to the whole sentence construction – it could not for instance be an errant "not" in "does *not* recoup its costs" because the sense of the remainder would not be maintained. If the e-mail had meant to refer to a film which did recoup its costs or where studio overheads were not delayed for a considerable time this would not then be consistent with the caveat in the preface "In simple terms, *if there is such a thing*". If the intention had been to refer in an e-mail to a well-known studio such as Paramount, whose business it was to exploit films successfully, that what was sought was a film which recouped costs or where studio overheads did not delay recoupment this could have been expressed very simply in any number of ways. Having said that I am not persuaded this e-mail is quite as significant as HMRC would have it. It relates to a different kind of film scheme arrangement (where a film was sought which was about to commence principal photography). It is not of direct relevance to the particular film acquisitions which are the subject of these appeals. At best it might indicate that the appellants and their contacts were aware that there were film schemes which involved using unprofitable films.

170.I have also, as HMRC invited me to, considered the various factors cumulatively to see whether they would change my view expressed above that Mr Hardy was not aware of the limited screen release but have concluded they do not. I deal with HMRC's arguments as to the significance of his lack of awareness later at [229].

Deliberate loss: Phase 3 and Madea – whether various matters manipulated to ensure loss even though Madea was box office success?

171.HMRC highlight that despite *Madea* grossing $90 million for the US Box office (previous films had reached $50 million and $63 million) the appellant made a Case II loss. As indicated by articles on the internet (extracts from an article dated 22 February 2009 appear at [110] above) *Madea* was viewed as a success and furthermore the level of success was seen as unexpected. HMRC rely on various oddities in relation to this Phase which ultimately adversely affected the bottom line on defined proceeds: the late addition of participations, over-statement of the film's budget and a distribution fee arrangement they submit was peculiar.

Late participations

172.Participations (remuneration for talent e.g. writers, directors, actors based on the film's success) were added into the schedules at a late stage. HMRC flag that the early Salter reports (30 January 2009 and 2 February 2009) did not include any participations for *Madea* and that it had in fact been confirmed by Mr Nicholas that there would be none (see [104]). Mr Phillips' evidence indicated that participations were generally indicated before a film started photography. However in this case the participations appeared from 12 February 2009. Bryan Hasegawa of Salter wrote to Mr Hardy to enclose an updated draft version of the *Madea* Analysis which incorporated "certain feedback received regarding the applicable distribution fees". The amounts of participations had a negative effect on the amount of defined proceeds and were significant at least in the High and Mid Cases: $15,700,000 for the

High Case where the Domestic Box Office ("DBO") was $101,000,000 and the Defined Proceeds were $69,849,700, and $9,300,000 for the mid case where DBO was $65,000,000 and the Defined Proceeds were $19,394,354.

173. As HMRC point out Mr Hardy gave no explanation for the late insertion despite his saying they were a feature he saw as important (in essence his evidence had explained how they represented a vote of confidence by the talent in that actors' agents would be prepared to accept a lesser fee if there was a participation that was triggered by a successful film – so the more remuneration that was in the form of participation, the greater confidence others had in the film being a success.)

174. The effect of participations coming back in meant that it would be more difficult for the call option threshold (the only option scenario which could lead to profit) to be hit in that the greater the amount of participations, the less the defined proceeds.

Whether budget over-stated?

175. HMRC query whether the $35 million budget for *Madea* was correct. A lower figure of $17.5m was repeatedly reported in the press. HMRC suggest that it may be that the later models were effectively counting participations and deferrals twice and highlight that Matrix continued to refuse to give a detailed budget for the film. Overstating the budget meant it was more difficult to trigger the call option thresholds.

176. Although HMRC express doubt, I find the press reports an insufficient basis to outweigh such evidence as there was from the appellants, and that the budget figures that were provided to Salter were correct. In contrast to for instance information on screen release plans which might be verified through multiple sources e.g. the cinema chains, the budget figures appear to me less susceptible to independent verification. As to the fact the figure was mentioned repeatedly I put little store by that given the tendency, once a figure is reported, to be adopted by other articles and media outlets without further checks on veracity necessarily being carried out.

Distribution fees

177. HMRC also highlight the unusual distribution fee arrangement for *Madea*. The fees were set at 35% until $90 million box office was achieved but then dropped to 10% retrospectively if that threshold box office figure was met. Mr Phillips' evidence indicated that typical fees for theatrical distribution were between 25-35%. He had never come across retrospective discounting of a distribution fee to 10%.

178. This feature had a large effect on the defined proceeds in the high case and was marked as a footnote in in the Salter reports ("Per Management, distribution fees are calculated on a by-media basis as a retroactive fee of 35% at DBO <$90m and 10% at DBO>$90m"). It meant that the Call Option threshold would easily be met if *Madea* hit $90million (because the fees were deducted from gross receipts – a lower fee meant more Defined Proceeds which then made it easier to hit the Call threshold). However if DBO was less than $90 million then there would be a large loss. The difference at the cross-over point was about $21 million in distribution fees meaning that rather than a case I Put there would be a case II Put (which HMRC highlight was more valuable from a tax loss point of view).

179.Did Mr Hardy know about the unusual feature of the *Madea* distribution agreement? His evidence was the feature passed him by but HMRC say this evidence should not be believed. They submit the feature made no commercial sense for either Mr Hardy (who had accepted he had been personally involved in negotiating the distribution fee waterfall) or for Lionsgate but only made sense for the purposes of the scheme.

Were the arrangements deliberately structured to achieve a loss?

180.HMRC argue it is most unlikely the features discussed above were due to sheer commercial incompetence and that it is more likely the arrangement was structured with a view to achieving a loss.

181.At the hearing Mr Southern objected to Mr Yates' questions in cross-examination that, in relation to *Madea*, Mr Hardy and the studio negotiated and tailored an arrangement that would superficially make the film look feasible from the partnership's point of view but which would mean it was certain or at least very likely that the partnership would never be in a position where the call option could be exercised. Mr Southern's objection was that the allegation amounted to one of dishonest conduct, indeed of dishonest conspiracy, and that such dishonesty allegations had not been pleaded, or particularised in advance as required by general legal principles of law as referred to in *E-buyer v HMRC* [2016] UKUT 123 (TCC). His submission was the tribunal should accordingly disregard the allegation.

182.At the hearing I invited the parties to address me on the relevant case-law and in particular the Upper Tribunal's decision in *Ingenious Games LLP & Ors v HMRC* [2015] UKUT 105 (TCC). Having reflected on those I agree with Mr Yates' submission on behalf of HMRC that there was no issue with the allegation being put to Mr Hardy in the way that it was and that it is right that the tribunal should proceed to consider it.

183.At [62] to [64] of *Ingenious* [2015] UKUT 105 (TCC) Henderson J, as he then was, made clear that the general principles applying in ordinary civil litigation (that it was not open to put allegations of dishonest, or other serious forms of misconduct, to the other party's witness or to invite the court or tribunal to make adverse findings of fact on such a basis unless the relevant allegations had been pleaded with full particularity and the appellants had been given a proper opportunity to respond to them), applied in cases where the burden of proof was on HMRC to establish fraud or dishonesty. Those principles did not however apply in that case as no burden lay on HMRC to establish that the relevant businesses were not carried on with a view to profit.

184.Despite the appellants' arguments to the contrary, there is nothing in the Upper Tribunal's decision in *E-buyer* which cuts across the propositions the UT set out in *Ingenious* and which stipulates that in every situation, irrespective of burden, where an allegation of dishonesty is made, it must be pleaded in advance. It should be noted that *E-buyer* concerned allegations relating to MTIC fraud, where the burden was on HMRC.

185.In this case the burden lies on the appellant to show there was a trade. HMRC were entitled to test any evidence put forward by the appellant on the issue in cross-examination.

186. The passage referred to above in *Ingenious* also set out that as a separate matter of professional conduct, before questions of dishonesty or fraud are put, counsel may not put questions to a witness suggesting fraud or dishonesty unless they have clear instructions to do so, and have reasonably credible material to establish an arguable case of fraud. Also it was not open for a tribunal to make a finding of dishonesty in relation to a witness unless (at least) the allegation has been put to him fairly and squarely in cross-examination, together with the evidence supporting the allegation, and the witness has been given a fair opportunity to respond to it. Mr Yates confirmed he had instructions, and I agree that the combination of participations coming in, the unusual distribution agreement feature and the fact that were it not for the alterations the defined proceeds would have triggered a call option scenario are enough of a foundation to at least make the allegation. The allegation and the basis for it were fairly and squarely put to Mr Hardy and he had the opportunity to answer them. It is open in principle to the tribunal to consider the allegation HMRC make and if satisfied to find that there was a deliberate plan on the part of Mr Hardy in the way suggested. Given my conclusion it is not necessary to consider Mr Southern's argument, which is disputed by HMRC, that any case in relation to dishonest conduct was not in fact pleaded or not pleaded with sufficient particularity. I therefore move on to consider the allegation.

187.As regards the issue of whether Mr Hardy was aware of the participations and the distribution fee arrangement I find it more likely than not that he was so aware despite him not being able to recollect or offer an explanation for their appearance now. The documentary evidence in the form of e-mails between Mr Hardy and Lakeshore reveals he was heavily involved in settling the detail of the distribution fees according to various thresholds with Lakeshore in previous deals. Those e-mails (referred to at [43] above) mention distribution fees all reducing prospectively for *MMT*, *Elegy* and *Henry Poole* at $35m, $50m and $60m (implying the possibility that retrospective calculation was a possibility in other deals). There is nothing to suggest Mr Hardy was any less immersed in the detail of the transaction in later deals. While I accept, given the passage of time that has passed, that Mr Hardy might not recollect the fine detail now, it seems implausible to me that a witness who was in other respects generally so on the ball and so heavily involved in the construction and implementation of the transactions would not have noticed the change in participations or the distribution fee arrangements at the time.

188.However as to the significance of the features and Mr Hardy's awareness of them they do not in my view lead to the conclusion HMRC invite the tribunal to make which was that the features were introduced deliberately to steer the partnership towards to loss.

189.The feature of the distribution fee arrangement which made losses more likely was not the retrospective 10% at the tipping point at $90 million but the fact the fee was as high as 35%. That feature was there all the while. There was no indication that before the box office opening that it was known how successful the film would be and according to Mr Phillips, for *Madea* to hit $101m would have been a massive feat based on the historic performance of the film. There was certainly not any evidence of the appellants knowing in advance the film was going to be successful and then reengineering matters. The contents of the press reports at the time indicate to me the level of success was unexpected.

190.As regards the late insertion of participations there was again no evidence that it was known in advance *Madea* would be successful and therefore that the participations had to be inserted to damp down the effect of the success which, at least on HMRC's version of the partnership's priorities was unwelcome, as it did not yield as much advantage from a tax loss relief point of view.

191.The allegation, that the appellant deliberately manipulated matters so as to achieve a loss, although legitimately put forward as I indicated above is not made out on my evaluation of the evidence. But having said what is more significant about the late participation and distribution fee features is the attitude and behaviour of the participants to them. They reveal, as HMRC submit, a lack of interest / indifference to the making of profit. The participations were for significant amounts and were pivotal. However, there was no explanation for why they came in, or evidence of any concern around the negative impact they had on the ability to hit the call scenario and therefore make any profit.

192.HMRC also highlight the lack of audit of the $87 million estimate in Salter post-release report despite it being a marginal situation. They suggest *Madea* did reach $90m. (They referred to information on Lionsgate on the internet film database IMDbPro which indicated "US Gross" of $90 million. I note that as at the time of the post release report the gross was around $87 million but it had increased to $90,299,408 by 10 April 2009 and $90,485,233 by 17 April 2009). However, the lack of interest in flexing the post-release date given the trajectory of domestic box office receipt which would have quite easily pushed matters into a call scenario is also notable. Given the difference it made and the trickle effect of box office receipts that came in shortly afterwards (which cannot have been unexpected as there was no reason to suppose the box office receipts would reduce to zero with an abrupt halt) it is curious that there was no attempt to delay the post-release report. Mr Hardy's evidence was that in Phase 1, following Salter's advice, the documents were amended to allow for post-release reports to be executed with the producer within 45 days of release to accommodate the possibility that films might perform better over a longer period. It was odd then given that he did not pursue that possibility with *Madea* especially given the box office figures profile and its trajectory would take them very close to $90 million domestic box office at which point the 10% retrospective distribution fee arrangement would kick in to mean the call would be triggered.

193.In terms of managing investor expectations there would not have been an issue; the Information Memorandum for *Madea* had said:

> "After first theatrical release of "Madea Goes to Jail" the Partnership would commission a further Film Revenues Report in order to assess the probable earnings performance of the Film Rights using actual release figures…If the Film had been a box office success, the Partnership should be able to sell the Film Rights at a profit. It is intended that the Film Revenues Report would be delivered and a sale arranged, shortly after release, but in any event within a period of 12 months from the date on which the Partnership acquires "Madea Goes to Jail".

194.The picture painted is that there appears to have been some lee-way around when the post-release report was produced. But that flexibility was not used in a way consistent with someone interested in profit so as to enable the call option and therefore the possible profit scenario to emerge. There was also a surprising air of

resignation in reaction to the lack of profit. There was none of the pushback or enquiry, or even dismay that might expected to be seen, as to why a film which had exceeded box office expectations nevertheless did not result in any kind of profit for the partnership. (That of itself does not in my view cause me to consider that losses were deliberately sought but is relevant to the question of whether the partnership was indifferent to profit, an issue which I come on to discuss shortly).

Conclusion on deliberate loss:

195. In both Phases 1 and 3 there was, in my view, insufficient evidence to establish that losses were deliberately sought.

The nature of the partnership's activities

196.Mr Southern argues that what the partnership was doing constituted a financial trade. Films were bought with borrowed money and investors' cash with a view to profitable resale. In effect the partnership was trading in a derivative of film rights.

197.Mr Yates says that once the arrangement is stripped down to its bare essentials it is not trading but a bet for some future income rights. In essence HMRC's case is the partnership invested a sum in return for a stream of income (6% of "defined proceeds"). The partnership puts in 150 of real cash 80 of which went to Lakeshore 70 of which (increasing to 80 for Phase 3) went to Matrix. If the film did not meet the threshold the partnership lost all the money. It could not hold on to the film and wait and see the distribution agreements came through because a) that was not what was intended (from the Investment Memorandum) and b) because it was going to be forced to exercise the put option). If the call option was exercised the partnership got 135 back having invested 150. But in order to break even the defined proceeds needed to supply the extra 15 which might well be a gradual process taking a number of years (up to 10 years as understood by Mr Hardy and up to 30 years as assumed by the Salter reports). Putting this another way HMRC say the Partnership pays 8% of budget for a right to a 13.5% sum and a 6% income stream if the film hits Defined Proceeds of 113.5% of budget; or for a 3.5% payment to the investors (the shareholders in the partners) if it hits 75% of budget. This was akin to an investment (it made no difference, HMRC say, that the sum based on defined proceeds was not fixed).

198.Before considering the issue it is worth recording some preliminary points which are not in issue. Firstly there was not dispute that the various agreements were meant to, and did, interlock with each other and that therefore they are to be viewed as a composite transaction. The question which then arises is whether the composite transactions which were carried out amounted to a trade. Secondly there is no dispute that whatever the activity amounted to, it was not a trade in the films themselves – and the appellants does not seek to argue this. Once the films were purchased they would be dealt with in accordance with the put and call options either of which would inevitably be exercised because of the way the agreements operated together. The analysis (set out above at [125]) explains why it was inevitable that the put option would be exercised, and also that the distributor, if acting rationally would exercise the call option and further that the partners envisaged that either the put or call options would be exercised. The arrangement was not in these circumstances one of the separate acts of buying a film and then choosing to sell the film to turn a profit. It was buying a film subject to certain pre-determined obligations to pay amounts whereby

puts and calls would be exercised in return for consideration. Any profit arose from the obligation to pay over 6% of the defined proceeds following exercise of the call option – not on the sale of the film. Nor was there any mention in the Information Memoranda of the films being retained for ongoing revenue and sold for a profit. It simply described that the consideration on exercise of the call option would be a fixed price and ongoing payments calculated as a percentage of revenues payable as and when film revenues were received.

199. Although the activity was not about buying and selling of films the question is whether it amounted to trading in film rights or a type of film derivative as the Mr Southern put it. Before deciding whether that was the case it is necessary to examine a variety of factors principally the nature of the activities undertaken.

Formation of partnership and activities undertaken in relation to Phase 1

200. The partnership agreement was entered into on 4 June 2008. Mr Hardy applied to join on 21 July 2008 and his company Richmond Palace Ltd subscribed on 24 July 2008. In the Information Memoranda the business of the partnership was stated to be:

> "trading in intellectual property rights in films through buying and selling such rights as a commercial activity with a view to making profits from such activities."

201. On 4 June 2008 the Partnership agreed a Consultancy and Administrative Services Agreement with MSF on 4 June 2008. MSF was required to assist the Executive Partner in sourcing suitable films among other administrative tasks. By the time the partnership had been formed there had already been various activities that had been carried out informing the negotiation of various agreements and in relation to film selection.

202. As to negotiation of the suite of agreements which governed the sale and purchase of films Mr Hardy's evidence described how some of the key terms had previously been negotiated by MSF on behalf of the Enterprise partnership when it purchased *Crank 2* from Lakeshore but that some of the figures had been renegotiated e.g. the 6% of defined proceeds had been increased from 5.5%.

203. The negotiation of agreements was not tailored to individual films as can be seen in relation to Phase 1 where although three different films were selected the option levels and triggers did not vary in percentage terms according to the particular films that were being bought.

204. As to the activity of film selection, Mr Hardy's evidence described how a number of criteria were set regarding prospects of profit: genre, budget, talent, source materials, and advance distribution pre-sale agreements termed "minimum guarantee". Mr Hardy's evidence was that the partnership also considered two films by a German producer, *Constantin*, as well as a number of Clint Eastwood films, that they were marketed to investors as potential purchases for the partnership until it was decided they were not suitable following the Salter reports. *Synecdoche*, and *Management* by Sidney Kimmel entertainment, and *Brothers Bloom* by Summit were also considered. There were presentations and screenings organised. For example an e-mail of 15 September 2008 referred to discussions for the arrangement of a screen of *Game* and a teaser for *Elegy*.

Was there the ability to choose films?

205.As HMRC highlight, despite the apparent opportunity in the first Partnership Meeting to refuse approval to the purchase of the Films (as suggested by the preamble to the Notice of Meeting), there was no real freedom to do anything else (see analysis at [131] above).

Phase 3 – negotiation and structuring of agreements

206.The agreements followed the same template as the previous phase. Beyond variables to do with matters which affected the calculation of defined proceeds (participations and distribution fees) there appeared to be little indication of any significant areas that were susceptible to negotiation around the terms of the agreements. Key terms such as the call and put thresholds consideration payable upon exercise were all set by reference to the same percentages of budget.

207.Prior to *Madea*, MSF had also been considering other films such as *The Horseman* and *Valkyrie*. The terms which MGM sought to renegotiate were said to have negatively affected the commercial prospects of the film.

208.In answer to the tribunal's questions Mr Hardy thought *Woman in Berlin* was rejected because coming from Constantin there were not sufficient revenues and that there was too minority a type audience. With *Valkyrie* he believed the rejection stemmed from the way MGM wanted to arrange the waterfall - their fees were such that the bottom line did not give sufficient return. This contrasted with the evidence of Mr Nicholas whose evidence was that *Valkyrie*, was an expensive picture but which did well. However it was one where Matrix were unable to find sufficient investors

209.As to the level of the research undertaken in relation to the films and whether and how they met the applicable criteria, this appeared to me to be minimal. No explanation was given of how the partnership or those it instructed went about doing this, the time spent, what it involved, and what comparisons were made. Such evidence as there was indicated Matrix was sent an information sheet by Mr Nicholas constituting one page of details of the director, writer, producer, cast and synopsis.

Set-up / Organisation

210.As to premises, physical resources and set-up of the partnership I was not taken to any specific evidence as regards the Vanguard partnership itself but I note that it effectively outsourced its activities to Matrix – who itself had seven full-time members of staff including Mr Hardy and an in house lawyer. Those staff concerned themselves with finance, investors and drafting documentation. A much smaller cohort were involved in film selection and research.

Discussion

211.The question of whether the partnership was carrying on a trade calls for an evaluation of a number of factors but as set out in the case-law discussed earlier, chief among these is analysing what the partnership did and it is to that matter I now turn. On the appellants' evidence the main activities carried on pertain to negotiating agreements with the studios and other parties and work done in selecting the films which were to be the subject of the negotiated arrangements.

212.The first point to note, at least in relation to Phase 1, was that the activity as regards negotiation and film selection had already taken place. It was not carried out by the partnership because by this stage there had already been e-mails passing between Lakeshore, Mr Nicholas and Mr Hardy regarding possible films. By the time the partnership came into existence it was already a "done deal" what films were to be used. It is difficult to say in those circumstances that the partnership was responsible for film selection activity (although the fee it paid was expressed to be for that in part).

213. The partnership had come into existence by the time of Phase 3 and Mr Hardy's evidence was that MSF's employee, James Hindle, researched the *Madea* franchise and that careful consideration was given to film selection. More generally, Mr Hardy's evidence was that he used his own judgment and that in selecting films: the main criterion was that the films should have a good prospect of producing profit for the partnership.

214.However in terms of elaborating on what exactly time and other resource the research and consideration involved there is little evidence that any significant amount of time or effort was spent on the process. There was no evidence of any extensive background checking of the cast or directors etc. although by definition factors such reputability ought to have been readily ascertainable by reference to common knowledge or simple internet searches.

215.While I accept that certain films that were considered went on to be rejected the precise details about what it was about the films (e.g. *Effi* and *Woman*) which made them unsuitable remained mysterious. As to the concerns around their profitability I was not referred to details of the estimates that had been produced, or any work that had been done by way of comparison with other potential films

216.The account Mr Hardy gave for rejecting films did not require expertise in selecting the film rather it involved going through the distribution fee waterfalls and other fee and revenue components to see what the defined proceeds, given certain parameters, would be. He referred to some handwritten calculations of return on the margins of Salter's high case schedule for *MMT* (showing a 94% return on equity). It is surprising that such a key part of the decision making was recorded in such a way and was only available for one film (which as discussed was a film that was selected before the partnership came into existence). Furthermore there appears to have been no enquiry into the probability of the high scenario happening. Without that element it is difficult to see how this sort of calculation process, even if repeated for other films would have revealed anything about whether the film would have a good prospect of producing profit for the partnership. The films *Horseman* and *Valkyrie* were also mentioned as rejects but there was no clear indication in the exhibits as to why it was those films were unsuitable from the partnership's point of view.

217.As to the presentation and screenings of films organised it was not suggested that these formed part of the partnership's activities and I note these took place after the films had been selected under the suite of agreements. The presentation and screening activity were done for the benefit of attracting and reassuring investors. They were not part of any activity of the partnership itself (whether that was trading or investing). Given the template nature of the deals with the studios (which worked off the same percentages of film budget) there was no significant activity in negotiating the various agreements. That work had already been done in that the put and call threshold

percentages had already been set and just needed to be applied to the films which had already been selected. (The exceptions are that there were some bespoke elements as is apparent in Phase 3 in relation to question of participations and the distribution fees but there was insufficient evidence to make findings on what correspondence, meetings or calls had taken place in relation to any negotiations on these aspects).

218. Pausing there, HMRC are correct in my view to characterise the role of the partnership as essentially passive. Such activity as there was in film selection and the negotiation of agreements was in my judgment minimal and just as, if not more consistent with activity akin to investment.

219. Once the films were selected they slotted into a predetermined framework of transactions. The pathway to profit involved hitting the call trigger and hoping that the 6% of defined proceeds exceeded a certain level. The partnership had no activities of significance to perform. The income flows to the partnership would follow from the post release reports, which affected whether a call would be triggered, and on the actual performance of the film as regards the 6% of ongoing income. Once the agreements were in place there was no activity for the partnership to carry out. It was a matter of seeing what came out of the post-release reports and then acting accordingly. There was nothing the partnership did from then on which would influence the film's performance, the level of defined proceeds and therefore the profit to the partnership. This continuing passive role, is in my view, more consistent with the partnership acting as an investor in film rights rather than trading in them.

220. As to the appellants' argument that the partnership was trading in a kind of film rights derivative, it is correct the transactions were not about simply buying and selling films, and that any profit that could be realised depended on the metric of actual defined proceeds. But even if that could be described as a kind of derivative, what the appellant has not shown is that the partnership was *trading* in such a derivative in the sense that it was buying the chance to make a 6% income stream and then selling, dealing of exploiting it. Its activity was more typical of a person who was investing in the derivative. Also if the partnership was trading in "film performance derivatives" it might be expected that it would pay much closer attention to the inputs going into what would provide the "underlying" for the derivative and for instance that there would be more attention paid to the methodology deployed by Salter as second-guessing that would be an important part of weighing up the risk in any putative trades.

221. I therefore conclude that as far as the analysis of the partnership's activities are concerned they do not point a conclusion that it was carrying on a trade. Regarding HMRC's characterisation of what the essence of the transaction stripped bare was (with which I agree), Mr Southern draws attention to the fact 1) there was not a long term series of fixed payments 2) the performance of the films was in the "lap of the audiences". As to 1) there is no reason why income from investments would have to be fixed. As to 2) it is correct the film's success was dependent on what audiences made of it but there were additional hurdles – in all phases the need to hit the call threshold was challenging even with a successful film such as *Madea* and in phase 1 the limited screens, and smaller distributor size were also limiting variables. In any case I agree with HMRC's point that any aspect of contingency simply increased the risks related to the variable cash flow (6%) and was not inconsistent with an investment.

222.If the question of trade were to be determined purely on basis of the nature of the activities carried out then my conclusion would be that they did not amount to the carrying on of a trade but that they were more akin to an investment but given the legal test depends on an evaluation of all the facts related to the activity a number of further matters also fall to be considered.

Set-up / organisation

223.As to the factor of the physical set-up and organisation of the partnership and its resources this factor is ambiguous on whether the partnership was trading and does not assist in the circumstances of this of appeal where the fact the activities were organised through a partnership and services were outsourced to entities with full-time employees at its disposal would be just as consistent, in my view, with the set-up and organisation of sophisticated entity investing in film rights.

Likelihood and amount of profit

224.As confirmed by a number of points which came out in the expert evidence of Mr Phillips, and for various other reasons, there was a low likelihood of profit given the thresholds that had to be met for the call options to be triggered. These were, as regards Phase 1, the small size of distributors and low numbers of screens the films were shown on and in relation to Phase 3 the inclusion of significant participations, the high distribution fees agreed to, and the point in time at which Salter's post-release report was taken as final (when with only a short delay revenues could have been taken account which would trigger a call option scenario).

225.I also take into account the actual likelihood of profit being made for the film but also more crucially for the partnership and the likely amounts of profit. In that respect the calculations had be filtered through the lens of knowing that it was not merely that the film had to break even, but that the particular metrics that the Salter report would produce would have to be hit at pre-defined thresholds. A limited US release and small distributor film would be unlikely to generate high Salter post-release figures. Also while Salter's report assumed Print and Advertising figure in the pre-release was $30million, the actual figure disclosed in September 2008 was $350,000. Mr Phillips accepted there was no way with an initial release on 100 screens in July 2008 the figure of $30million would be arrived at in September. In addition Mr Phillips' evidence was that none of the directors of the three films had any track record.

226.With all the ingredients in place as they were I think it was more likely than not the figures appearing in the Salter post-release report would lead to a put option scenario thereby precipitating a loss – the film would have had to have been extremely successful in order for there to be any amount of profit and that was highly unlikely. Given the way the agreements operated even if the film was successful and the call option were triggered the amount of profit would be no more than 6% of the actual defined proceeds. There would be no certainty that the actual defined proceeds would correspond to the predicted defined proceeds. The fact that profits were so uncertain and unlikely, even if the film was very successful, is illustrated by what happened with the film *Madea.*

227.As to the Salter reports while their reliability, once the inputs provided to them was plugged in, is not in question, their function when taken by themselves, as

predictive tools for future performance is meaningless given there was not any level of probability attached to each of the high, mid, or low scenarios.

228.The low likelihood and uncertain level of profit, while not conclusive do not point towards the activity pursued by the partnership being one of trade.

Purpose of transactions:Indifference of those running partnership to making profit?

229.Even if Mr Hardy was not aware of the limited screen releases in Phase 1, HMRC draw attention to the lack of enquiries pursued on that topic, prior to the films being bought given the impact any plans for limited release would have on the likelihood of profit and the amount of any return. It revealed an indifference to executing transactions with the best chance of being profitable. Mr Phillips' evidence was that theatre release plans would at a minimum be fixed between three to six months in advance and that he would expect a film buyer who had done their research to know the details of the film release. The failure to follow up the initial enquiry made with the distributors showed a degree of nonchalance about pursuing profit. The lack of consideration given to the size of the distributor is also telling. It might be expected that persons concerned with making a profit would pause and revisit the numbers in the deal and in particular the thresholds for triggering the call option (the only scenario where a profit would be made) when they found out who the distributors were. Mr Phillips' evidence was that if the limiting factors of limited screen release and size of distributor had been taken account of the films would not have got anywhere near the high or mid case as modelled by Salter.

230.There are then a number of features which point towards an indifference to making profit on those running the partnership. As regards Phase 1, these were, as discussed above, the lack of interest / due diligence in relation to screen release numbers and size of distributors. As regards Phase 3 there was a lack of consideration given to the impact of participations, distribution fees, and the behaviour in not seeking to pursue the possibility of a call scenario by either seeking extension of the post-release report period or scrutinising or auditing the figures produced further given the figures were so marginal.

231.Mr Hardy's evidence referred to the fact some films were rejected because it was thought they would not be profitable, and also set out that investors were interested and made enquiries into the films' prospects of success. The first point to note is that, going back to the documents governing the transaction, although they contained detailed provisions on selection of successful films those provisions were not focussed on the question of ultimate profit for the partnership. The Partnership Agreement contemplated that various transaction documents including the put and call option agreements would be entered into. Clause 8.4.1 which dealt with film selection referred to the film revenues report indicating a reasonable prospect of success of the film and/or film rights and earning performance. But, the clause stopped short of enquiring into whether the film would not just be successful, but successful enough, given the options entered into, to then go on to generate a profit. Furthermore, the fact some films were rejected when viewed against the negotiation of the agreements more generally does not necessarily point towards an interest in making profit as it was not explained why, in relation to the films that were rejected, it would not have been possible to strike a deal which was profitable by flexing the numbers on the deal instead of rigidly adhering to the same percentage figures which were fixed by reference to the budget of the film. In relation to Mr Hardy's evidence

as to the interest and enquiries made into the prospects of success none of this was behaviour which was consistent with that of investors who wanted to know that partnership was on track to deliver the loss relief they wished to access to mitigate losses elsewhere.

232.The appellants' evidence was they were interested in profit. But that evidence must be considered in the light of the facts of how they, the partnership and those who it instructed behaved. In addition to the features above pointing against an interest in profit I also note the lack of enquiry / modelling into the likelihood and income/time profile of the 6% of Defined Proceeds (the amount of which, being the only cash inflow not tied to budget, effectively governed the pathway to profit as explained above). The income profile of Defined Proceeds over time and the performance of the various segments such, box office, DVD, TV etc. ought, it might be thought, to have been of great interest, but it appears no detailed enquiries were made into such issues. Also after the failure of the pre-release reports to predict the dire performance of the Phase 1 films it is curious that there was then no scrutiny of the inputs or methods used to see what might need to be adjusted to produce a better prediction in the future.

233.I therefore reject the evidence the appellants gave suggesting they were concerned with making a profit. That evidence was not borne out by the way the partnership acted, or more pertinently, omitted to act. The content and tone of the contemporaneous documentary correspondence that was before the tribunal, which I find to be a more reliable source, pointed towards the partnership and the appellants being indifferent to profit and I so conclude. That conclusion is not of course determinative on the question of whether the partnership was carrying on a trade but is a factor to be taken account of.

Conclusion on whether partnership carrying on trade

234.Disregarding the factor of set-up and organisation which I find to be ambiguous, the above factors fall to be considered in the round: namely the nature of the activities once it is stripped to its essentials, the likelihood of profit and the intentions of the partnership.

235.The activity was not about buying or selling films nor was it about trading in film rights. Rather a package of rights was bought. Stripping the transactions to their essentials, a template set of agreements were applied to a film whereby the purchaser obtained the right if certain conditions were met to an uncertain income stream depending on the amount. There were a small number of transactions with uncertain and low likelihood of reward, indifference to making profit on the part of the partnership. The partnership was not involved in any significant activity in selecting films and there was no opportunity for subsequent activities e.g. through promotion of income components or reduction of costs to maximise defined proceeds value and so as to turn a profit. The partnership was very much a passive participant. Taking the above into account, and standing back and looking at the whole picture, I conclude that the partnership was not carrying on a trade. (Given the ambivalence and indifference to a profit being made it may be inaccurate to describe the activity as something akin to an investment in view of the common understanding of that term but the point of is of no consequence; the issue before the tribunal is whether or not what the partnership did amounted to a trade. Whatever difficulties there might be in putting a label which properly captures the activities the partnership did, what is clear in my judgment, is that they did not amount to a trade).

Section 137 issue – companies exist wholly for purposes of qualifying trade?

236.Besides the question of whether the partnership carried out a trade, the trading requirement in s137 contains a further hurdle for the appellants to overcome:

> **"137 The trading requirement**
>
> (1) The trading requirement is that—
>
> (a) the company, ignoring any incidental purposes, exists wholly for the purpose of carrying on one or more qualifying trades, or…"

237.Subsection 7 sets out that "qualifying trade" has the meaning given by section 189 (extracted below at [249]).

238.HMRC argue there was no reason for the companies (referred to in this decision as the PartnerCos) to exist other than as a means to access the s131 loss relief and in fact all the investors in the partnership adopted the company route. Even if some attempt of seeking a possibility of profit existed, such purpose would be insufficient to deny relief as the purpose of seeking s131 relief could not be described as incidental. (As HMRC ask the tribunal to note, the issue in this part of the decision concerns the purpose of the *existence* of the company and is distinct from the issue on s16A TCGA (issue 9) below which concerns the purpose of the scheme).

239.Mr Hardy's evidence was that the possibility of generating share loss relief was certainly not the main reason for investors participating in the structure. He mentioned the following reasons for using the companies: they made the structure more flexible as it allowed investors to participate or withdraw from the structure by simply subscribing for or selling their company shares. The companies also provided investors with limited liability (a feature Mr Moxon mentioned too).

240.Mr Moxon mentioned his fears of liability but accepted he had previously been involved in partnership arrangements without the use of a company and that the borrowing liability was his not the company's. He could not articulate any particular liability he was concerned about. He mentioned ease of paperwork but as HMRC pointed out this was a concern of the partnership and not himself.

241. HMRC's written submissions referred to the FTT's analysis in *Kerrison v HMRC* [2017] UKFTT 322 (TC), a case which was decided after the hearing, submitting that the approach there supported HMRC's interpretation of s137(1)(a). The facts of that case concerned a scheme (known as the Excalibur scheme) whereby a newly incorporated Isle of Man company (Broadgate) acquired a small UK retail trade (a flower shop business). Broadgate guaranteed the borrowing of another company which subscribed for a share in Broadgate and subsequently the appellant's borrowing to repurchase shares the appellant had sold to the other company. Broadgate also capitalised a BVI subsidiary. The evidence included that from an employee (Mr Schofield – referred to by name in the extract below) of the scheme promoter. The passages HMRC refer to were in an obiter part of the decision on the question of whether Broadgate was a "qualifying trading company" under s293(2)(a) Income and Corporation Taxes Act 1988 which referred to "a company which exists wholly for the purpose of carrying on one or more qualifying trades…". After setting out the parties' competing submissions the FTT concluded:

> "124. I agree with Mr Ghosh [*who was acting for HMRC*] that a key question to consider is the purpose or purposes for which Broadgate

> existed. In order to be a qualifying trading company Broadgate must either have existed wholly for the purpose of carrying on the flower shop business, or existed for that purpose (see the reference to "so exists") together with other purposes capable of having no significant effect (other than incidentally) on the extent of its activities.
>
> 125. As explained at [62] above it was clear from Mr Schofield's evidence that Broadgate was incorporated in order to carry out the Excalibur scheme. Athough the scheme involved as a necessary initial step the acquisition of a UK trade, I do not think that it would be right to conclude from this that Broadgate existed in any meaningful sense "for the purpose of carrying on one or more qualifying trades".

242.In my view, irrespective of whether the partnership was carrying on a qualifying trade, it is clear that the PartnerCos, ignoring any incidental purpose, did not exist for the purpose of carrying on a qualifying trade. As with the company in *Kerrison* the companies existed to facilitate the use of a tax scheme, in this case one which involved the accessing of loss relief under s131 (there was no suggestion any other tax relief was to generate the 40% tax relief on loss assumed by the calculations in the presentations). As is apparent from Mr Moxon's evidence investments in similar sorts of arrangements had previously been undertaken without any need for investing through a company and I do not find the factors put forward of ease of administration or concerns over limited liability to be plausible against that background.

243.It is telling in my view that the presentations to investors were premised on the use of a company to invest (described as a "special purpose company ("SPC")) and that the illustrative tax calculations included in them which generated the most profit (i.e. the loss making scenarios) only made sense when s131 relief was accessed. Although the presentation and the investment memoranda did not in terms mandate the use of an SPC it was clearly envisaged that such an entity would be used – none of the illustrations covered what would happen if an investor chose not to use an SPC. There was no mention in the presentation of the advantages of limited liability (and while there was in the investment memoranda the presentations in my view provide a more reliable insight into how the arrangements were designed to operate in practice). If ease of administration and flexibility for the arrangements as a whole were a valid reason it might be expected that investors would be told they had to use an SPC as if some ended up not using such entities then it is difficult to see how the administration and flexibility benefits that were purportedly hoped for could sensibly be realised.

244.As HMRC allude to, a far more likely explanation is provided by the changes in tax legislation that occurred in 2007 (s103C ITA 2007 restricted sideways loss relief by individuals in partnership from March 2007 and further restrictions were put in place by para 21 of Schedule 22 Finance Act 2008 which was pre-announced in October 2007).

245.While in relation to *Kerrison* Mr Southern's submission highlighted that besides operating a flower shop the relevant company also held investments of £155,224,131 whereas all that the PartnerCos did was to act as partners of the Vanguard Partnership, I am not persuaded this is a valid ground of distinction. The FTT in that case reached its decision by reference to the purpose for which the company existed not the activities it was carrying out.

246.I also cannot accept the appellants' submission that the fact there was a fiscal purpose in using the company does not mean the company's purpose was not to carry

on the qualifying trade illustrated by the fact that many qualifying trade companies were set up following the 10% dividend tax rate change. Whether such companies exist wholly for the purpose of the qualifying trade will depend on evaluating the particular facts of and circumstances of each case.

247.In any event, even if the focus was on the activities of the company, as HMRC point out the PartnerCos were used to pay amounts that had nothing to do with the trade namely the ALCF fees and the IFA commissions and fees to Matrix for structuring all paid under the umbrella of Matrix's consultancy fee charged to Vanguard No 1.

248.For the reasons above I conclude that even if I were wrong in my conclusion above that the partnership was not trading, the trading requirement in s137 was nevertheless not satisfied. The PartnerCos did not, ignoring any incidental purposes, exist for the purpose of carrying on one or more qualifying trades.

(2) Whether, if the Vanguard 1 Partnership was carrying on a trade during either such period, such trade was conducted on a commercial basis and with a view to the realisation of profits within the meaning of s.189 of the Income Tax Act 2007.

249.Section 189 provides:

> "**189 Meaning of "qualifying trade"**
>
> (1) For the purposes of this Part, a trade is a qualifying trade if—
>
> (a) it is conducted on a commercial basis and with a view to the realisation of profits,…"

250.This issue is only relevant if I am wrong in my conclusion that the partnership was not trading. In that case the appellant submits, contrary to HMRC's position that the trade was both conducted on a commercial basis and with a view to the realisation of profits.

251. The interaction between the two tests of commerciality and profitability was considered in the Court of Appeal's decision in *Samarkand v HMRC* [2017] EWCA Civ 77. In Henderson LJ's judgment (at [88]) it was wrong to consider the tests as mutually exclusive. His view was that the tests "necessarily overlap to an extent which will vary from case to case".

252.In terms of the case-law on the "commercial basis" test both parties agree with the points made by the Upper Tribunal (Nugee J as the then was and Judge Sinfield) in *Samarkand* that:

> (1) This is a partnership level not a partner level question [246] –[248].
>
> (2) Those carrying on the activity must be seriously interested in profit and not simply concerned to cover costs or to do something interesting or engaging (a hobby art gallery, hobby farming) [251] – [256].
>
> (3) A lack of organisation or a happy-go-lucky approach, though they might not exclude trading, would not satisfy the "on a commercial basis" test [258].

253.As to (2) in the case of *Seven Individuals v HMRC* [2017] UKUT 132 (TCC) (which related to litigation between the "Icebreaker" partnerships and HMRC), Nugee J, in rejecting the argument that it was enough that a trade was sufficiently organised and that the trader hoped to make a profit explained that a trade run on commercial lines was:

> "…a trade run in the way that commercially-minded people run trades. Commercially-minded people are those with a serious interest in making a commercial success of the trade…".

254.He was of the view (at [46] to [47]) that this was in effect what the UT had said in *Samarkand* and that such view had been endorsed by Henderson LJ on appeal of that decision to the Court of Appeal. He explained "the concept of a trade carried on on commercial lines has an objective element to it…" At [54(3)] he set out that:

> "…When assessing whether a trade carried out 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".

255.Mr Southern's written submissions seek to distinguish what he depicts as an extension to the commercial basis test on the grounds the fact that the legislation in issue there (s384 ICTA 1988 / s66 ITA 2007) contained an objective element which referred to a reasonable expectation of profit in contrast to s189 ITA. I cannot accept that as a valid ground of distinction. The paragraphs he relies on ([35] and [49]) refer to the "with a view to realisation of profits" test being subjective, and in that sense presenting a lower threshold. However, the fact Nugee J viewed the likelihood of profit being central in no way stems from the legislative references to reasonable expectation of profit but because, as he set out, a person who was seriously interested in commercial success would not consider it worthwhile to carry on a trade which had a remote possibility of a small profit. To put that statement in context it should be noted that earlier on the judgment had mentioned, the UT's endorsement in *Samarkand* of the view that "the serious interest in a profit is at the root of commerciality" and had also referred to the wider relevance of the statement in *Wannell v Rothwell* [1996] STC 450 to the serious trader who was seriously interested in profit.

256.As regards the commercial basis test the issues for the tribunal to consider are 1) whether the trade was carried on in away someone seriously interested in profit or commercial success would carry it on and 2) the likelihood and amount of profit (these factors will inevitably overlap for the reason Nugee J identifies above).

Trade carried on in a way someone seriously interested in profit or commercial success would carry it on?

257.The appellants emphasise the partnership was run in a business like way – there was a selection process and some films were turned down in the process and it was entitled to use Salter and to rely on their reports. Films with good prospects were selected as per the evidence of Mr Philips and Mr Nicholas. There was a huge discrepancy between pre-release and post-release figures but that was only

appreciable with the benefit of hindsight. The obvious fiscal motives of some partners should not be confused with the question of whether the partnership was trading on a commercial basis.

258.HMRC set out numerous factors discussed below, many of which I agree are not consistent with the partnership trading on a commercial basis below but also some which in my view are ambivalent or which do not necessarily have the significance HMRC suggests. In evaluating these features I reject the appellant's generic point that these factors could only be appreciated with the benefit of hindsight. Each of them in my view were appreciably uncommercial features at the outset. Further there is nothing in the appellants' point about it not being for HMRC (or by implication anyone else to judge what is commercial behaviour) – that is precisely what the relevant case-law envisages; looking at what and how the taxpayer did run the trade and considering whether the activities undertaken were consistent with the way someone seriously interested in profit would carry it out.

259.The following factors pointed out by HMRC appeared to me, as they submitted, inconsistent with the carrying on of business in way that someone seriously interested in profit would carry it out. As will be seen many of the factors are common to those underpinning the tribunal's earlier view that the partnership was indifferent to the making of profit:

> (1) The Partnership always paid an 8% premium over the film's production cost without considering whether it was an appropriate price to pay. The 108% was always to be used. Salter pre-release reports if they were thought of as relevant to film prospects had no effect on pricing (*Elegy* had high budget / highest price but Salter gave it lowest prospects on itsHigh case).
>
> (2) The put and call options thresholds did not vary according to films realistic prospects. The call and put option thresholds, and consideration were payable all fixed by production cost as opposed to being considered in the context of the film's realistic prospects. (Mr Phillips, in his expert evidence, had thought this odd.) There was no enquiry into the *likelihood* of any of the low medium or high (highest) scenarios.
>
> (3) The lack of due diligence and enquiry into matters relevant to prospects of film e.g. advertising and release plans. The partnership failed to follow up on requested information. Even if they did not know about the limited release the appellants ought to have known about it. I also note that although the appellants' case dismissed various pieces of information as "internet tittle-tattle" and say it would have been of little weight what is more telling is that there was no evidence that Matrix had made any attempt to establish through, what they at least might have viewed as more credible channels, what the screen release proposals were going to be.
>
> There was also a failure to check information being given to Salter and their methodology. On *Madea* there was no follow up on re-introduction of the participations.
>
> (4) The distribution agreements were uncommercial. They gave Lakeshore / Lionsgate complete control over what happened to the film, there was no recourse to Lakeshore, the fees were high at 40% (Mr Phillips said the usual range was 20-35%), the reducing fees inexplicably only applied if

the call option was exercised. Mr Hardy thought there was a failure to update the distribution agreement which in itself would reveal uncommerciality in failing to keep on top of central transaction document For the reasons discussed above the retrospective 10% distribution fee arrangement does not have quite the significance HMRC put on it, but I agree with the submission that the distribution fees were high (35% in the case of *Madea* and 40% for the three Phase 1 films).

(5) There was no attempt to model in the event of the call option being exercised as to the amount of defined proceeds and when such proceeds would be payable.

(6) In relation to *Madea*, there was no attempt to verify production cost. Even if there was not a deliberate attempt to exaggerate the budget there was at least "deeply uncommercial indifference" to the accuracy of the figures given. As I have indicated above I do not agree that the budget was in fact lower but I agree it was strange there was not more scrutiny over it given the press report. Also even though the results came close to the threshold for exercising the call option there was no audit of the figures or attempt to delay the post-release reports.

(7) It was also uncommercial not to check Salter's methodology after films were failures. Following Phase 1 it is notable that given how crucial the Salter figures were to whether an option leading to profit was triggered there was no analysis unpick what had given rise to the mismatch between pre and post-release figures. Someone seeking profit in a structure which was dependent on the Salter outputs and their predictive accuracy would want to ensure the process by which the outputs were derived was as robust as possible.

(8) The ALCF loan was uncommercial. I consider this point in more detail below at [303] onwards. It is submitted ALCF were being paid a fee for the "loan" money which had no commercial effect and that this was not commercial behaviour. Mr Southern pointed to various commercial reasons for the loan. HMRC argue that despite all the documentation referring to a loan it concerned an arrangement where no money moved to anyone. The loans were there to maximise the tax loss and they had no commercial relevance or reality. For the reasons explained in more detail below I agree; as evidenced by the use of deferred consideration in Phase 3 the loan was not a commercial part of the transaction.

260. However some of the other factors HMRC rely on are not significant in my view or are ambiguous. It was submitted the fee paid to Matrix was uncommercially high at 7% that it was what MSF had charged as standard and was and same as had been charged by them in other schemes that had been litigated before the FTT, but in the absence of any evidence as to what would be a commercial fee it is difficult for the tribunal to make a judgment on whether the rate was commercial. Whether or not the investment memoranda properly described the proposals also does not assist – a firm could be unwittingly deficient in its disclosure obligations to investors but still be acting on a commercial basis when carrying on the trade. HMRC also point to the fact the US dollar/ sterling exchange rate fixed, cost the partnership more than it needed to pay and submit it was really done to facilitate modelling so the scheme could proceed smoothly. Again this factor is ambiguous because I can see that there might be some benefit to commercial parties of certainty as compared with taking the

risk of currency fluctuations. Similarly the point that Salter's work was used in an entirely novel manner as a trigger for put and call options does not assist because in this section of the decision it must be assumed the composite transactions using put options and call options dependent on Salter's outputs, were despite their novelty, considered to amount to a trade.

261.The appellants' case places much store by the reliability and professionalism of Salter but in doing so they seek to meet an argument that HMRC does not make. HMRC's case does not at any point suggest that the Salter reports did anything but apply their expertise to the information that was provided to them. In relation to the appellants' arguments that it was not the case that the films were doomed from the outset, HMRC's case was not that the films were destined to be flops because of their genre, script or cast but because of predictive attributes such as screen release. As well illustrated by *Madea*, where the screen release figure was not an issue, the concern was the arrangements were inherently uncommercial not because of the film itself because of the structure into which the film was plugged. That structure was not one someone seriously in profit would have deployed.

Likelihood and amount of profit

262.The appellant submits the possibility of profit was sufficiently realistic to constitute a trade carried on a commercial basis.

263.The appellants highlight that the Salter reports indicated significant amounts of profit that might be achieved in the high scenario. While the parties differ in their views on the precise level of profit that could be achieved (as can be seen from the annex this depends on what particular elements are taken account of in the ROE calculation (see [33] and Annex)). Crucially these reports do not assist at all on the question of prospects of success for the simple reason that they do not say or even purport to say anything about the likelihood of such a scenario being reached. Viewing the evidence in the round the probability of the films achieving the high scenario was unrealistic. The fact a significant amount of profit is possible is irrelevant if the probability of that possibility occurring is unrealistic. The actual likelihood of achieving any kind of significant profit (so as to justify the high risks involved) was low.

264. For all the reasons discussed earlier (the small number of screens, the small distributors (phase 1), the high distribution fees and inclusion of participations, the failure to audit, or to flex the post-release report dates (phase 3)) the likelihood of the call option being exercised and therefore of any profit being achieved was low. If a call option was triggered it was still uncertain as to whether the 6% amount of defined proceeds would actually exceed the other costs so as to result in a profit. While it is self-evidently true that because the 6% of defined proceeds was uncapped the income that could be achieved from a profitable film could potentially be worth a lot of money, the possibility of a large profit is meaningless in the absence of a realistic assessment of the likelihood of profit.

265.In his written submissions Mr Southern argues it should also be taken account of that Parliament has recognised that creative industries are special and a general lack of profitability must be weighed against the outside chance of substantial profits in a minority of projects. He also submits that the investors' risk reduction through tax relief cannot be ignored. There was however insufficient evidence before the tribunal

to make findings of fact that there was in fact an even outside chance of substantial profits. There is nothing in the statutory provisions which indicates that Parliament wished the commercial basis test to be interpreted more liberally to take account of tax reliefs in certain areas. Even if it were correct for the test in s189 ITA 2007 to vary to take account of tax reliefs so as to encourage investing in the creative industries it is not clear why this would necessarily extend to the trading in derivative products based on film performance which the appellants maintain they were carrying on.

Conclusion on commercial basis test

266.For the reasons above I conclude that even if the partnership was trading it was not trading on a commercial basis (1) because it was not carried out in a way which someone seriously interested in profit would carry it out and (2) because of the low likelihood of profit and the uncertainty, if any profit were achieved, that such profit, would be of sufficient amount to justify the low likelihood of it materialising in the first place.

With a view to realisation of profit?

267.It follows from the analysis above (at [229] onwards) that the partnership and the appellants were indifferent to making a profit that the test of "with a view to realisation of profit" is not satisfied. Although there might in principle be cases where the purpose of the relevant person is to realise profit despite the fact that the activities which are carried on in a way that someone seriously interested in profit would carry them on, the current case is not one of those. In addition the low likelihood of profit and the uncertainty that those would be significant even if achieved, features which would put off someone who was seriously interested in profit, suggest that the activity was undertaken for reasons other than realisation of profit.

268.I therefore conclude that even if I were wrong on the issue of trading, any trade would, in any event, not meet either the commercial basis or the "with a view to the realisation of profits" tests in s189.

(3) Whether the PartnerCos (Richmond Palace Limited and Daivat 2 Limited) satisfied the trading requirement in s137 of the Income Tax Act 2007 on the date and for the period required under s134.

269.Insofar as the partnership is held to be trading for the relevant period of ownership of the PartnerCos by Mr Hardy and Mr Moxon, HMRC do not dispute that the PartnerCos would also be treated as so trading.

(4) Whether the PartnerCos satisfied the control and independence requirements in s139 of the Income Tax Act 2007 on the date and for the period required under s134.

270.The relevant section (with the particular subsection in issue emphasised) provides as follows:

> **"139 The control and independence requirement**
>
> (1)The control element of the requirement is that—

(a) the company must not control (whether on its own or together with any person connected with it) any company which is not a qualifying subsidiary of the company, and

(b) no arrangements must be in existence by virtue of which the company could fail to meet paragraph (a) (whether at a time during the continuous period that is relevant for the purposes of section 134(3) or otherwise).

(2)The independence element of the requirement is that—

(a) **the company must not**—

(i) be a 51% subsidiary of another company, or

(ii) **be under the control of another company (or of another company and any other person connected with that other company), without being a 51% subsidiary of that other company**, and

(b) no arrangements must be in existence by virtue of which the company could fail to meet paragraph (a) (whether at a time during the continuous period that is relevant for the purposes of section 134(3) or otherwise).

(3)This section is subject to section 145(3).

(4)In this section—

"arrangements" includes any scheme, agreement or understanding, whether or not legally enforceable,

"control", in subsection (1)(a), is to be read in accordance with sections 450 and 451 of CTA 2010,

"qualifying subsidiary" is to be read in accordance with section 191."

271. The issue here is whether the PartnerCos were under the control of Matrix. For the purposes of subsection 2 "control" had the meaning contained in s995 of ITA 2007. The concept of control over the affairs of a company, as the parties agree, is to be understood in the light of the Court of Appeal's judgment in *Steele (Inspector of Taxes) v EVC* [1996] STC 785; it entails control over the general meetings of shareholders. HMRC acknowledge by reference to *UBS & Anor v HMRC [2016] UKSC 13* that close coordination is not enough. HMRC acknowledge that formally, Mr Hardy and Mr Moxon as sole shareholders had respective control of the PartnerCos; they argue however that the documents of the scheme taken together reveal that such control lay elsewhere with the Executive Partner (MSF Vanguard No 1 IC –(an incorporated cell of MSF Partnership Services ICC, an incorporated cell company incorporated in Jersey) and a Matrix owned entity) which was, under the terms of the Partnership Agreement granted unfettered powers in relation to all matters concerning the "Business" of the partnership and the "Transaction Documents".

272.HMRC submit the interlocking agreements essentially strangled the ability on anyone apart from Matrix to realistically exercise control over the companies. The Nominee Agreement further confirmed the unfettered powers of the Executive Partner. HMRC say the PartnerCo's only activities entailed being passive members of a partnership subject to the direction and control of the Executive Partner; there was no realistic possibility that the PartnerCos would do anything other than "follow the script" set out by Matrix and the Executive Partner who shared common directors

with the PartnerCos as well. Unless Matrix said so, the partnership could not do anything other than enter into the transaction documents. There were not going to be any general meetings, everything was going to be conducted in accordance with the Executive Partner's wishes. In relation to Mr Moxon, the Power of Attorney he gave to a Matrix employee authorised the employee to take out a Partner Loan in his name and to exercise all the rights exerciseable as a shareholder. The 120 day non-revocation period was, HMRC suggest, anticipated to cover all of the scheme transactions. It gave power of control over shareholders' meetings to another company.

273.The appellants' case is that as regards Richmond Palace Ltd. the company was under the control of Mr Hardy either as shareholder or through his involvement with Matrix. No-one other than Mr Hardy had the power over the company at the general meeting. As regards Daivat 2 Ltd, it is submitted that Mr Moxon was an active, knowledgeable and interested investor. He authorised the way in which the Partnership was organised and run, and the role of the Partnership Company within it, thereby retaining and exercising control. While there was a power of attorney this was for a limited period. The fact employees had power did not mean the *company* (as referred to in the legislation) had control.

Discussion

274.As Mr Southern's skeleton argument reminds the tribunal, the statutory question is not whether the Vanguard Partnership was under the control of Matrix because of the role played by the Executive Partner but whether the PartnerCos, Richmond Palace Ltd and Daivat 2 Limited, were under its control.

275.I note that while it is correct that the provisions of the Partnership agreement and the Nominee agreement which HMRC highlighted give the Executive Partner a starring role in the activities of the Partnership and regulate the PartnerCos relationship between it and the Partnership and others in relation to the activities of the partnership, there is nothing I have identified which specifically regulates the affairs of the PartnerCos. Neither the partnership agreement nor the nominee agreement curtailed what the PartnerCo could do in relation to anything it wished to pursue outside of the partnership (the fact it did not decide to, and there was no suggestion that it would pursue other activities strike me as irrelevant). At least in relation to Richmond Palace Ltd therefore, there was nothing in the documentary provisions I was referred to, which ceded control of its affairs generally to another company. To the extent the PartnerCo was following a script, then that was something it was choosing to do in relation to its role as a partner in the Vanguard partnership.

276.I therefore conclude that in relation to Richmond Palace Limited the independence requirement was satisfied.

277.As regards Daivat 2 Limited the question arises as to what, if any, difference it makes that Mr Moxon gave a power of attorney which was irrevocable for 120 days. While it is submitted on the appellant's behalf that he authorised the way in which the partnership was organised and run and thereby retained control I do not there is anything in this argument. The provisions of the statute clearly envisage control being derived through mechanisms other than through formal ownership and that being the case, by definition control that would otherwise have lain with the company under consideration would have had to have been ceded with the company's authorisation.

In any case the power of attorney here was irrevocable at least for period of time. I also do not think there is anything in the fact the power was given to employees of a Matrix company rather than to a company (the attorney appointed was Robert Charlton and failing him Mr Hardy). It is clear from the drafting of the power, its title ("Power of Attorney in respect of the Vanguard No. 1 Partnership") and its recitals that it was given to the individuals not personally but as agents of a Matrix corporate entity involved in structuring the partnership arrangements and activities. However a more promising argument for the appellants rests in the scope of the power. Although for instance it contains a provision (paragraph 2) which is drafted in wide terms (providing the attorney with full power and authority to exercise any rights exercisable by Mr Moxon as a shareholder) the title, recitals and list of specific matters which follow the general power all point towards the power being intended for the specific purposes of participating in the Vanguard partnership and its activities. The power of attorney regulated the affairs of the company vis à vis the partnership but it did not regulate its affairs for all purposes. For similar reasons therefore as in respect of Richmond Palace Ltd. I therefore conclude that Daivat 2 Ltd was, despite the power of attorney, not controlled by another company and that the independence requirement of the statute was satisfied.

(5) Whether the Appellants' disposals of their shares in Richmond Palace Limited and Daivat 2 Limited were bargains at arm's length for purposes of s131(3) of the Income Tax Act 2007.

278. Section 131(3) provides:

> **"131 Share loss relief**
>
> (1) An individual is eligible for relief under this Chapter ("share loss relief") if—
>
> (a) the individual incurs an allowable loss for capital gains tax purposes on the disposal of any shares in any tax year ("the year of the loss"), and
>
> (b) the shares are qualifying shares.
>
> This is subject to subsections (3) and (4) and section 136(2).
>
> …
>
> (3) Subsection (1) applies only if the disposal of the shares is—
>
> (a) by way of a bargain made at arm's length,"

279. Both parties agree the relevant definition is as set out in *Mansworth v Jelley* [2002] STC 1013 (which dealt with the 1979 Act predecessor to the TCGA1992 but with the same wording) but they disagree as to its application. The appellants maintain that both sides were acting in their own interests and with benefits on both sides.

280. Construing the words "by way of bargain made at arm's length" Lightman J stated:

> "…the phrase "bargain at arm's length" stipulates a particular type of transaction. The formula of words connotes more than a transaction: it connotes a transaction between two parties with separate and distinct

> interests who have agreed terms (actually or inferentially) with a mind solely to his own respective interests."

281.The appellants submit that, given the disposals were transactions for consideration between unconnected parties, it may be inferred that they were bargains at arm's length. Mr Hardy's witness statement says the shares were sold for the best price available because that was the sum to which the PartnerCo was entitled under the Partnership Agreement following the exercise of the Put Options and the share sale price was determined on that basis. Mr Southern emphasised the TCGA section was very much designed to operate in the area of gifts. He maintained the transaction was a perfectly commercial one – the acquisition by Lakeshore and Matrix, of outstanding shares. It was the means by which the studio reacquired full control of the films at the same time as getting rid of all the security interests attached to the shares.

282.Mr Yates argues the parties were following a pre-ordained script whereby it was inevitable or at least very likely that the appellants were to invest and then lose money on the eventual sale rather than entering into a bargain at arm's length. The investor knew that they would also have their loan written off. Further the price made no sense; they were buying it for an equivalent amount of cash without taking account of the cost of incurring stamp duty.

283.HMRC also argue that the way in which the agreements worked (as set out previously at [129]), no genuine third party purchaser would acquire a PartnerCo.

Discussion

284.In Phase 1, the purchase was by MPSL and Lakeshore FilmCo LLC. In Phase 3 the purchase was by Bailigay Ltd, a subsidiary of Lionsgate. Although Mr Hardy's evidence maintained that each shareholder assessed the commercial merits of the disposal of the shares at that time, as HMRC point out, this was not correct as Mr Moxon accepted that he did not negotiate the sale of the shares at all but asked Matrix what everyone else was doing.

285.There was no evidence of a negotiation happening between the buyer(s) and seller of the shares. It was known from the outset that the shares would be bought. The share purchase by entities linked to the producer was clearly pre-ordained. A sale was crucial to the working of the scheme and getting share loss relief – it could not be left to chance as to whether there would be a purchaser and what terms they would pay. It was inconceivable investors would be left holding shares in a private limited company. Each of the scenarios set out in the investor presentation envisaged a purchaser and stated the amount, which in the put option scenarios corresponded to the exercise price of the relevant partnership put option. There were for instance no disclaimers indicating that the purchase amount might depend on what was negotiated.

286.I agree therefore that the parties were following a pre-ordained script. One way or the other the shares in the PartnerCos were going to be sold, most likely at a loss. Where, as in this case the parties operate according to a script any separate or distinct interests they might have had were overtaken by their common interest in following the script. A "deal" had to be reached and there was no room for a bargain in any meaningful sense to be struck. The "offending" feature is not so much that there was a plan (as a plan could have built into it a step which contemplated arm's length negotiations), but that the plan assumed a sale and purchase for a particular sum. It

did not leave room for two parties with separate and distinct interests to negotiate. The stamp duty difficulties ([117] and [129] above) militate against a conclusion that a bargain had been struck after each party had considered its respective interests.

287.The appellants refers to the FTT's decision in *Kerrison* (which was issued 19 April 2017) noting that there the tribunal had found that the disposal of shares had been by way of bargain made at arm's length because the vendor and purchaser were unconnected and each was acting in its own interest (at [131]- [135] of its decision).

288.The position in *Kerrison* can readily be distinguished however in my view (it should also be noted its discussion on that point was not necessary for its decision). In contrast to the facts of *Kerrison* there is no evidence here as to what the purchaser's interests were. In *Kerrison* the purchasing company (Brae) required a formal valuation and knew it would get a premium on value because of the put. By contrast there was no valuation here and for the reasons HMRC explain (see [129] above) there was could be no premium in a purchaser acquiring a PartnerCo. Against this backdrop there was no meaningful negotiation that could take place or room to strike a bargain by a person acting in his or her own interest. Even if the particular circumstances of the purchaser's links to the studio (the sub-participator) are considered (i.e. that they had an interest in reducing a debt owed), the debt reduction meant the shares in the company were worth correspondingly less and there would still be the matter of stamp duty to fund.

289.Although Mr Southern argued the share sale transaction made perfect sense commercially, maintaining that it was the means by which the studio regained full control over the film, that submission does not reflect what happened. The studio regained the film when the partnership exercised the put option as it would inevitably do in circumstances where the threshold was met.

290.While the purchasers were not connected with the vendors in the legal sense of being under common ownership, they were however participants of the same set of pre-planned transactions. In such circumstances, even if there was a bargain there is no reason that to accept that it must be inferred by dint of lack of common ownership that the bargain was at arm's length. I note in passing that such a conclusion is not out of keeping with the Upper Tribunal's view in *Brain Disorders* (in a decision issued on 8 May 2017 after *Kerrison* which was issued on 19 April 2017) (at [41]) that the suggestion that a transaction was one at arm's length and which occurred as a device within a tax avoidance scheme was "fanciful".

291.I therefore conclude that the appellants' disposals of shares in the PartnerCos were not at arm's length for the purposes of s131(3).

(6) Whether section 17 of the Taxation of Chargeable Gains Act 1992 applied to the Appellants' subscription for shares in Richmond Palace Limited and Daivat 2 Limited such that their acquisition cost was lower than the amount of any subscription.

Law

292.Section 17 provides:

17 Disposals and acquisitions treated as made at market value

> (1) Subject to the provisions of this Act, a person's acquisition or disposal of an asset shall for the purposes of this Act be deemed to be for a consideration equal to the market value of the asset—
>
> (a) where he acquires or, as the case may be, disposes of the asset otherwise than by way of a bargain made at arm's length, and in particular where he acquires or disposes of it by way of gift or on a transfer into settlement by a settlor or by way of distribution from a company in respect of shares in the company, or
>
> (b) where he acquires or, as the case may be, disposes of the asset wholly or partly for a consideration that cannot be valued, or in connection with his own or another's loss of office or employment or diminution of emoluments, or otherwise in consideration for or recognition of his or another's services or past services in any office or employment or of any other service rendered or to be rendered by him or another.
>
> (2) Subsection (1) shall not apply to the acquisition of an asset if—
>
> (a) there is no corresponding disposal of it, and
>
> (b) there is no consideration in money or money's worth or the consideration is of an amount or value lower than the market value of the asset."

293. HMRC argue that if the investors (Mr Hardy and Mr Moxon) acquired their shares in circumstances where it was always part of the arrangement that the shares would, in a very short time, be sold at a loss it follows that their acquisition was not 1) a bargain or 2) one which was at arm's length, and in those circumstances the true market value of the shares needs to be imposed – this was the value the shares were ultimately disposed of. (HMRC explained this was a technically discrete point from the s131 relief point – that was relevant to income tax whereas this point was relevant to whether there was a capital loss.)

294. It was not clear what positive arguments the appellants made by way of response. No specific oral submissions were made on the point. While their skeleton noted the market value rule was disapplied where a) there was no corresponding disposal of the asset and b) where there was no consideration in money or money's worth or the consideration was lower than the value of the asset and furthermore that on a subscription for shares an asset is acquired with no corresponding disposal within 17(2)(a) the appellants also accepted that the acquisition cost was not lower than the market value of the asset acquired. That meant the s17(2) disapplication of the market value rule did not apply.

295.In any case for similar reasons as apply to the preceding issue, it appears clear that the acquisition was not a bargain let alone a bargain at arm's length. The subscription for shares was part of a scheme to facilitate the access to the loss relief provisions of s131. That the partnership would make losses, although not guaranteed was highly likely. The PartnerCos were following a script, and had the same interest in following through the steps of the scheme which involved subscription for shares for a pre-determined amount– in such circumstances it was not so much the fact that the shares would shortly be sold for a loss but the fact that because both parties were following through a scheme, there were no separate or distinct interests at play. To the extent the appellants' response seeks to makes the point that it was not pre-ordained that there would be a loss then this is irrelevant to the fact that the PartnerCos were not acting as parties with separate and distinct interests.

296.I therefore agree s17 means the acquisition cost was lower than what was paid at subscription.

(7) In the event that Issue (6) is answered in the negative whether, when considering the expenditure of the Appellants on subscribing for their shares in Richmond Palace Limited and Daivat 2 Limited, for the purposes of s38 of the Taxation of Chargeable Gains Act 1992, one can ignore any expenditure attributable to any "loan" from ALCF.

297.Given the conclusion I have reached above it is not necessary to address the full level of detail of the submissions made but I will set out my findings of fact and conclusions on this issue in case they become relevant following any appeal.

298.Section 38 provides:

> **"38 Acquisition and disposal costs etc.**
>
> (1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of an asset shall be restricted to—
>
> (a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition… or,
>
> …"

299.Mr Southern referred to various House of Lords / Supreme Court decisions in which the issue of circular loans arose noting there were two where the loans were considered to work, *MacNiven (Inspector of Taxes) v Westmoreland Investment Ltd* [2001] STC 237 concerning the question of whether a subsidiary had made a payment of interest and *Barclays Mercantile Finance Ltd v Mawson* [2005] STC 1 concerning the question of the amount of expenditure incurred for the purposes of capital allowances and two (*Ensign Tankers (Leasing) Ltd. v Stokes* [1992] STC 226 and *TowerMCashback LLP v R&C Commissioners* [2011] STC 1143 where such loans were not considered to work. The appellants' point in essence is that circular loans do not matter if the transaction which is thereby effected comes within the terms of the taxing statute; the substitution of the studio (Lakeshore in Phase 1 and Lionsgate in Phase 3) for ALCF as creditor did not alter the nature of the loans as regards the debtor.

300.Mr Yates, for HMRC, points out that none of the authorities the appellant refers to relate to the statutory construction of the capital gains tax provisions in issue here. Their purpose is the computation of gains and losses and it is clear from the authorities in particular *Ramsay*[1] that the provision is concerned with is economic reality, real losses incurred to set against disposal of the shares. He referred to Lord Wilberforce's judgment at [326]:

> "The capital gains tax was created to operate in the real world, not that of make believe…. it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. To say that a loss (or

[1] WT Ramsay Ltd v IRC [1982] AC 300 [1981] STC 174

> gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function."

301. The loan element was not a real loss; it reduced according to the share proceeds amount when looking at the transaction as a whole and never had to be repaid. It was unreal for appellant to say having expended £170k he had actually lost £1.15 million. He knew from the outset he did not have to repay the loan.

302.HMRC say the tribunal should ignore the circular "loan". They say the relevant question is what the amount or value of the appellant's expenditure was for the purposes of s38 TCGA 1992 – namely what the amount or value was given by the appellants "wholly and exclusively" for the acquisition of the shares in the PartnerCos. The amounts said to be borrowed from ALCF were never, viewed realistically, given for the acquisition of the shares. All Mr Hardy had to "repay" was the proceeds of sale, the rest was effectively waived and was always going to be waived.

Discussion

303.As identified by HMRC the issue is not an abstract one of whether the loan was a real loan but of what the amount or value of the consideration was which was given by the appellants wholly and exclusively for the acquisition of the shares in the PartnerCos.

304.Noting that the provision is concerned with economic reality, it is clear that the amount of consideration for the purposes of the statutory provision captures amounts of real economic value in money or money's worth such that when it has been expended in acquiring the asset the person is, (putting aside the value of the asset they have acquired) economically worse off. Something of value in money or money's worth which the person had, has been given wholly and exclusively in return for the asset.

305. I find the following points which HMRC highlighted to be relevant in considering the reality of what the appellant was claiming to put forward as consideration:

> (1) ALCF had no real commercial involvement and was not commercially at risk – they simply received a fee and held rights on trust for Lakeshore / Lionsgate.
>
> (2) ALCF, the investors, the PartnerCos and the partnership never transferred money – the studio as sub-participator merely paid itself.
>
> (3) Under the put option Lakeshore / Lionsgate paid itself the exercise prices and waived the balance of loan (which was non-recourse).
>
> (4) Under the call option scenario the studios paid the exercise price up to the amount of loan and outstanding interest. Either way there was no transfer of cash regarding the loan, or possibility that investor would have to repay the loan: Lakeshore would pay itself and waive balance.

306.Contrary to the appellants' submission the loans did not fulfil a function of placing risk where it lay. (As described by Mr Southern the non-recourse nature of the the loan sub-participated by the producer worked to convert the credit risk of the loan into equity risk (i.e. the risk of how well the film would perform). That the loan was not required is well illustrated, as HMRC point out, by the facts of the transaction for *Madea* where a shortfall in funds was made up by allowing for deferred consideration. The consideration only became payable depending on the performance of the film. The consideration paid to the partnership on exercise of the put and call options was not maintained but reduced proportionately to reflect the proportion the actual consideration bore to the total amount. More generally as regards both phases 1 and 3 the insignificance of the loan is reflected by the fact there was no real discussion of the loan by Mr Nicholas to prospective buyers.

307.At the time the global sums were paid for subscription of the shares it was known that the partnership had agreed to buy the films at budget plus 8% (£24,966,000). But it was also known the film was subject to various puts and a call option, that the put and call option would be exercised such that the film would go back to Lakeshore, that the shares would be sold to a purchaser, and that the proceeds of the share sale would be applied to pay off the loan. On 24 July 2008 there was also a side letter that 24 months after the enforcement of security following the date the loan fell due ALCF would write to the borrower saying that they had written off the loan. It was known that ALCF was not to have any recourse against the investor (Mr Hardy) personally.

308.Where, as in this case, an amount of £1,136,337 which was ostensibly put forward as consideration but had in fact never been paid to the person, and where the obligation to repay did not exist in any real sense because it was always known the obligation to repay would be met by funds from the sub-participator (the put option exercise price ultimately being applied against the obligation with the remainder being waived) that amount cannot, in my view, come within the definition of consideration contemplated by the statute.

309.Although Mr Southern put forward various reasons for why the loan arrangement made sense commercially none of these assist for the reasons HMRC suggest. There was no question as suggested of the financial risk being placed where it lay as the risk always lay with Lakeshore who was always going to retain the film. Nor was there any function as suggested in ensuring the film company had first charge on film revenues as this presupposed that what the parties were buying was a film and then independently entering into a distribution agreement whereas the two steps were meant to operate together. The loan did not, as suggested, ramp up the profit share. Lakeshore received 8% of budget and if the call option was triggered the amounts paid to the partnership would be netted off whatever the loans were.

310.As Mr Yates for HMRC highlights, the illusory nature of the loan element of consideration from an economic capital gains point of view is apparent from the perspective of each party: the appellant never received the amount and never had to pay the amount back, ALCF never parted with any funds and took no commercial or credit risk on the transaction, and Lakeshore never parted with funds it simply paid itself.

311.If I were wrong in my conclusion on issue 6 above then I would therefore hold that any expenditure attributable to the amounts said to be loaned from ALCF should be ignored for the purposes of s38 TCGA.

(8) Whether any alleged capital loss falls to be reduced on a just and reasonable basis as a result of the operation of ss 30 and 125A(2) of the Taxation of Chargeable Gains Act 1992.

312.This issue involves the application of s125A (read with s30). Section 125A at the relevant time provided as follows:

> "(1) If loss relief under section 573 of the Taxes Act or Chapter 6 of Part 4 of ITA 2007 ("share loss relief") is obtained in respect of a loss or any part of a loss, no deduction is to be made in respect of the loss or (as the case may be) the part under this Act.
>
> (2) If a claim is made for share loss relief in respect of a loss accruing on the disposal of shares, section 30 has effect in relation to the disposal as if for the references in subsections (1)(b) and (5) to a tax-free benefit there were substituted references to any benefit whether tax-free or not.
>
> (3) All such adjustments of corporation tax on chargeable gains or capital gains tax are to be made, whether by way of assessment or by way of discharge or repayment of tax, as may be required in consequence of–
>
> (a) share loss relief being obtained in respect of an allowable loss, or
>
> (b) such relief not being obtained in respect of the whole or part of such a loss in respect of which a claim is made."

313.The operative part of s125A for the purposes of these appeals is therefore s125A(2) which requires s30 to be read as follows:

> "(1) This section has effect as respects the disposal of an asset if a scheme has been effected or arrangements have been made (whether before or after the disposal) whereby—
>
> (a) the value of the asset or a relevant asset has been materially reduced, and
>
> (b) any benefit has been or will be conferred—
>
> (i) on the person making the disposal or a person with whom he is connected, or
>
> (ii) subject to subsection (4) below, on any other person.
>
> …
>
> (3) For the purposes of subsection (1)(b) above a benefit is conferred on a person if he becomes entitled to any money or money's worth or the value of any asset in which he has an interest is increased or he is wholly or partly relieved from any liability to which he is subject;
>
> …
>
> (5) Where this section has effect in relation to any disposal, any allowable loss or chargeable gain accruing on the disposal shall be calculated as if the consideration for the disposal were

increased by such amount as is just and reasonable having regard to the scheme or arrangements and the benefit in question."

314.HMRC argue that to the extent the ALCF loans had any substance, the release from the loans was a benefit under the above provisions. The scheme or arrangement was that the burden of the ALCF "loan" was waived as part of the arrangements involving the sale of the shares in the PartnerCos. Mr Hardy and Mr Moxon were relieved from their liability to the ALCF loan (clause 2 of the Deed of Release entered into on 22 November 2008 (Mr Hardy) and 2 April 2009 (Mr Moxon) and the side letters of 21 November 2008 and 19 February 2009. A benefit was therefore conferred within the meaning of s30(1) and consequently the disposal consideration ought to be increased by an amount equivalent to this. HMRC run this argument in the alternative to Issue 7 (they do not propose to deny a deduction under s38 but then also increase any disposal consideration).

315.Given our conclusion above on issue 7 (s38) it is not therefore necessary to reach a conclusion on this issue. If I were wrong however in my conclusion on Issue 7 (which itself only becomes relevant if I were wrong on issue 6) then there is nothing in my view to suggest HMRC's argument above would not succeed or that there is anything in the appellant's argument to the contrary. It is important to note the issue is only relevant in the event it is accepted the loan was one which created a real liability on the part of the borrower. The question then is not whether, as Mr Southern's argument suggests, being released from a non-recourse obligation to pay is a benefit but whether the scheme that had been effected or the arrangements that were made (which must be taken to include such a real liability) had conferred, or would confer any benefit. The answer to that question is that waiver of such a real liability on the borrower clearly would confer a benefit.

(9) Whether any alleged capital losses of the Appellants in respect of their disposals of shares in Richmond Palace Limited and Daivat 2 Limited were outside the definition of "allowable loss" as a result of s.16A of the Taxation of Chargeable Gains Act 1992.

316.The relevant statutory provisions are as follows:

"(1) For the purposes of this Act, "allowable loss" does not include a loss accruing to a person if–

(a) it accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements, and

(b) the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.

(2) For the purposes of subsection (1)–

"arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and

"tax advantage" means–

(a) relief or increased relief from tax,

(b) repayment or increased repayment of tax,

> (c) the avoidance or reduction of a charge to tax or an assessment to tax, or
>
> (d) the avoidance of a possible assessment to tax,
>
> and for the purposes of this definition "tax" means capital gains tax, corporation tax or income tax.
>
> (3) For the purposes of subsection (1) it does not matter–
>
> (a) whether the loss accrues at a time when there are no chargeable gains from which it could otherwise have been deducted, or
>
> (b) whether the tax advantage is secured for the person to whom the loss accrues or for any other person."

317.The test is therefore whether there was a main purpose of the arrangements to secure a tax advantage.

318.As to how that test is to be approached, Mr Yates' submission on behalf of HMRC was that a finding of the intention of the individual investors is not a pre-requisite to the tribunal being able to reach a conclusion as to whether the arrangements themselves had a main purpose of securing a tax advantage if the tribunal were otherwise able to reach such a conclusion from the objective facts of the arrangement (i.e. the manner it was structured and marketed). He refers to the guidance the Chancellor gave in in *Snell v HMRC* [2007] STC 1279 in relation to the similar wording of another anti-avoidance provision in TCGA 1992, s137 TCGA 1992 (emphasis added):

> "[27] These submissions are challenged by counsel for the Revenue. He points out that there are the two issues of fact I have summarised in para [13] above. He observes that the purpose of Mr Snell is relevant to the identification of the elements of the scheme or arrangements. Once the scheme or arrangements have been identified then it must be ascertained whether their main purpose is the avoidance of a liability to capital gains tax. <u>The purpose of Mr Snell may be relevant to the latter question if it is not self-evident from the nature of the scheme or arrangements themselves.</u> In neither case, so he submits, is it necessary that the purpose of Mr Snell should be final and unalterable.
>
> [28] I prefer the submissions for the Revenue. The ordinary meaning of the word 'scheme' is 'a plan of action devised in order to attain some end'. Similarly an arrangement is 'a structure or combination of things for a purpose', see for both meanings the Shorter Oxford English Dictionary…"

319.Relying on *Addy v IRC* [1975] STC 601 at 610 Mr Yates submitted it was sufficient if those who designed the arrangement had a purpose of securing a tax advantage. (*Addy* dealt with the test in transactions in securities legislation which was concerned with whether transactions "were carried out" for a main object to enable tax advantages to be obtained.)

320.Mr Southern submitted it was important to acknowledge that business is always shaped for the form best suited to keep down taxes. He emphasised that a transaction was no less a transaction with a commercial purpose even if there was another transaction the taxpayer could have entered into (but did not) which would have resulted in more tax being payable.

321.As to what was meant by a main object he referred to Lightman J's observation in *IRC v Trustees of the Sema Group Pension Scheme* [2002] STC 276 at [53]:

> 'Obviously if the tax advantage is mere "icing on the cake" it will not constitute a main object. Nor will it necessarily do so merely because it is a feature of the transaction or a relevant factor in the decision to buy or sell. The statutory criterion is that the tax advantage shall be more than relevant or indeed an object; it must be a main object. The question whether it is so is a question of fact for the commissioners [fact-finding appeal tribunal] in every case.'

322. This depiction of objects which did not meet the test was echoed in the Special Commissioner's decision in *Snell* which having considered the House of Lords judgment in *CIR v Brebner* 43 TC 705 (and the proposition there that a tax advantage that was ancillary to a main object was not a main object), at [22] paraphrased something which was ancillary as being "purely incidental and of little importance compared with the other object or objects".

323.As to the relevance of a commercial reason being present, while the appellants argue that s16A cannot apply if the scheme was entered into both to make a commercial return and in the large allowable tax loss, as HMRC point out this submission was rejected the Court of Appeal's decision in *Revenue and Customs Commrs v Lloyds TSB* [2014] EWCA Civ 1062. That case concerned capital allowance anti-avoidance provision. The court was of the view that it was not enough for the appellant to say that there was a commercial reason; it had to be shown there was no main purpose of tax avoidance.

Discussion

324. It follows from the case-law discussed above that the appellant must show that obtaining a tax advantage was not one of the main objects of the arrangements and that the tribunal should assess this by reference to the objective facts. An alternative way of approaching the issue is that if the appellants can show that tax was an incidental purpose or was "icing on the cake" then that will show the obtaining of a tax advantage was not a main object.

325.Mr Southern's essential argument is that there was no pre-planned scheme to make a loss –the partnership planned for success. If the film transactions were unsuccessful then certainly the investors hoped to obtain tax relief on their losses but this was a fall-back and not a main purpose of the transaction. If the plan was to make profits then the consequences of a loss were not relevant in deciding what the main purpose of the transaction was. The appellants submit that if the arrangements were essentially commercial then it would not be correct to characterise them as a tax-driven scheme. They also suggest that the issue is largely the same question of whether the partnership was trading.

326.HMRC highlight that the insertion of contingency and alternative of being able to sell shares at a gain does not stop there being a main tax purpose. They argue that even if, contrary to their case on trading, there was still some realistic "hope" of a commercial profit, the main purpose was of securing a tax advantage. Further if what would actually happen could not be predicted, how could it not then be said that obtaining a tax advantage was not just as much a main a purpose as that of commercial gain? Even if there was no scheme to make a loss, making a profit was less likely as illustrated by *Madea* which was a successful film but one where the partnership still made a loss. HMRC also refer to the analysis above that the loan served no commercial function but was only there to ramp up losses.

327.In my judgment Mr Southern's characterisation of the partnership being one which planned for profits is simply not borne out by the arrangements that were in place, and the purpose indicated by them. Many of the factors which relevant to my conclusion that, if there was a trade, it was not one that was carried on on a commercial basis or with a view to realisation of profit are equally relevant to explaining why the arrangements were not for a commercial reason but motivated by tax reasons.

328.As regards both Phases 1 and 3, the effective application of a template set of put and call option percentage thresholds, which did not vary according to the prospects of the particular film that was picked, signalled an indifference to making a profit.

329. As HMRC point out given the probabilities, and relative uncertainty of rewards it was unreal to depict the tax loss scenario as ancillary or incidental. This was not a situation where even if the chances of making a profit were small they would necessarily be worth it because of the size of the profits. The level of profit in the only profit making scenario –in the event a call option was triggered – was uncertain both in amount and timing.

330.It is also correct that far more attention was given to tax considerations e.g. going to specialist tax counsel, e-mails referencing underlying tax concerns (for instance that at [84]) than looking at the commercial prospects of the films. As regards the presentation materials to investors these are telling in two respects. First in that the loss-making scenarios were more numerous and were depicted as profit-making from the investors' point of view rather than as a mitigant or fall-back as suggested. Second, the materials appear designed to appeal exclusively to investors who it was assumed would have income against which to set losses off against. Furthermore, for the reasons already discussed the loan arrangements, which involved a lot of thought and effort in devising, given they needed a complex set of agreements and persuading a bank to put its name to them, served no other purpose other than to ramp up losses. As illustrated in *Madea* there was no reason why any shortfall in funds could not have been addressed by the kind of deferred consideration arrangement that was used for that phase. The inclusion of the loan was woven into the actual arrangements (see the analysis of the documents at [124] onwards) but served no commercial function other than to secure a tax advantage. The facts in relation to the transactions are inconsistent with tax being an incidental purpose.

331.As to the appellants' argument that losses were not guaranteed there is no merit in this. It only needs to be considered that profits do not need to be guaranteed in order for profit to be a main object – similarly losses do not need to be guaranteed for a loss

to be a main object. The fact losses were not guaranteed is not therefore inconsistent with a main objective being the tax advantage of loss relief.

332.I therefore conclude s16A is satisfied. Obtaining a tax advantage was one of the main objects of the arrangements.

333.The above is sufficient to dispose of this issue but were it necessary to consider Mr Hardy's and Mr Moxon's subjective purposes it was not credible, that either entered into the scheme with the object of making a profit (ignoring the effect of loss relief) for all the factors which led me to conclude that the partnership was indifferent to profit and that it was not trading with a view to realisation of profit. Mr Hardy and Mr Moxon were both sophisticated and financially savvy business persons. The low probability of success and uncertain return, the structuring of the put and call arrangements and fees such that profit was unlikely even if a film achieved box office success all point towards profit not being their objective. Rather, as is clear from the presentation materials, their object was securing a tax advantage in the shape of obtaining loss relief.

(10) Whether HMRC is entitled to challenge the Appellants' claims to share loss relief pursuant to an enquiry under section 9A of the Taxes Management Act 1970 or whether HMRC was only entitled to challenge the Appellants' claims to share loss relief pursuant to an enquiry under Schedule 1A to the Taxes Management Act 1970?

334.This issue arises out of the fact that HMRC opened their enquiry into Mr Hardy's 2008-9 return. The appellants' case is that if they wanted to challenge his claim under s131 ITA 2007 for loss relief HMRC should have opened an enquiry under Schedule 1A. They did not do this and are now out of time to do so. HMRC disagree, they submit that a s9A enquiry into the 2008-9 return was a permissible means of challenging Mr Hardy's claim.

Facts

335.Mr Hardy's 2007-8 return referred to the following, which Mr Southern argued was a stand-alone carry back claim:

> "Unquoted Shares or Securities
>
> Description: Richmond Palace Ltd.
>
> I disposed of my shareholding in Richmond Palace Ltd on 5 August 2008. I realised a loss on my shares in this unquoted trading company of £1,153,717. I hereby claim this loss against my other income from the year of 2007/08."

336. Mr Hardy's tax return for 2008-9 in box 4 stated the figure of 1,153,717 which was the loss he sought to carry back to the previous year.

337. In relation to Mr Moxon such evidence as there was (an HMRC letter dated 10 January 2013) referred to a repayment claim in box 14 relating to a loss in 2007-8 but there was no evidence that Mr Moxon made any claim on the face of his 2007-8 return in relation to his 2008-9 losses.

Statutory provisions

338.Under section 8 TMA 1970 a person may be required by a notice given to him by HMRC to make and deliver a return. Section 9 requires a return under s8 to include a self-assessment and s9A empowers HMRC to enquire into returns as follows:

> "9A. Power to enquire into returns
>
> (1) An officer of the Board may enquire into –
>
> (a) the return on the basis of which a person's self-assessment was made under section 9 of this Act, or
>
> (b) any amendment of that return on the basis of which that assessment has been amended by that person, or
>
> (c) any claim or election included in the return (by amendment or otherwise)
>
> if, before the end of the period mentioned in subsection (2) below, he gives notice in writing to that person of his intention to do so."

339.Schedule 1A deals with claims not included in returns, with provisions defining claims (paragraph 1), who the claim should be made to and the form (paragraph 2), amendments to claims (paragraph 3), the giving effect to claims and amendments (paragraph 4) and at paragraph 5 provides for a power to enquire into a claim within certain time limits.

340.Schedule 1B to TMA deals with claims for relief involving two or more years. Paragraph 2 provides:

> "2(1) This paragraph applies where a person makes a claim requiring relief for a loss incurred or treated as incurred, or a payment made, in one year of assessment ("the later year") to be given in an earlier year of assessment ("the earlier year").
>
> (2) Section 42(2) of this Act shall not apply in relation to the claim.
>
> (3) The claim shall relate to the later year.
>
> ...
>
> (6) Effect shall be given to the claim in relation to the later year, whether by repayment or set off, or by an increase in the aggregate amount given by section 59B(1)(b) of this Act, or otherwise. ...".

341.Section 42 which is referred to in 2(2) above deals with the procedure for making claims and at subsection 2 provide where relevant that where notice has been given to file returns under specified sections of the TMA (which include s8):

> "a claim shall not at any time be made otherwise then by being included in a return under that section if it could, at that or any subsequent time, be made by being so included".

342.Section 42(11) provides:

> "Schedule 1A to this Act shall apply as respects any claim or election which --
>
> (a) is made otherwise than by being included in a return under section 8, 8A or 12AA of this Act,

...

(11A) Schedule 1B to this Act shall have effect as respects certain claims for relief involving two or more years of assessment ..."

Case law and parties' arguments:

343. Mr Southern submits TMA 1970 makes a binary distinction between claims "included" in a return (s9A) and stand-alone claims (Sch 1A) which are not so included and that each has its own distinct enquiry procedure. He highlights s8(1) TMA, s8(1AA) and s9 contain the crucial words "included in the return" which suggests there are certain claims which are not included in a return. Further S42(2) and (11) TMA – again envisages that not all claims can be included in a return. Under s42(11) where claims are made "otherwise than being included in a return under…" then Schedule 1A applies. Under Section 11A Schedule 1B applies in respect of "claims for relief involving two or more years of assessment". There are separate but parallel enquiry procedures: enquiries under s9A are enquiries into a return and enquiries under Schedule 1A para 5(1) are enquiries into a claim and are not specific for any year of assessment. Schedule 1B para 2.1 clearly refers to carry back claims. (Paragraph 2.2 says s42(2) shall not apply in relation to the claim. Para 2.3 says the claim shall relate to the later year).

344.He relies on the Supreme Court's decision in *R&C Comrs v Cotter* [2013] STC 2480 for the proposition that even if a claim appears on the face of a return it is only "included" in a return if it is i) entered on the return and ii) if it alters the tax charged on the return for the year of assessment to which the claim relates. A carry back claim is therefore a stand-alone claim, not a claim included in a return.

345.HMRC disagree *Cotter* means the only correct mode of enquiry into stand-alone claims is Schedule 1A. They say that following *R (De Silva) v HMRC* [2016] STC 1333 an enquiry into the return is a permissible way of challenging Mr Hardy's claim and that the recent High Court case of *Wickersham* (which, they say, is binding on the FTT) confirms that contrary to the appellant's argument *De Silva* is not to be restricted to its facts which concerned partnership taxation and in particular partnership losses (rather than losses on company shares). Mr Southern submits that *Wickersham* is obiter on its consideration of *De Silva.*

346.Each of the cases concern a loss in a later year and a claim relating to the loss in an earlier year. For the purposes of the issue before me nothing turns on the particular years of assessment so in the interests of simplicity and as an aid to comparability I shall summarise the facts by reference to the shorthand used in the discussions in those cases which refer to an earlier year (Year 1) and the later year (Year 2).

Cotter

347.The facts concerned employment loss relief on an amount sought to be collected in Year 1. The taxpayer had filed his return but had not done his self-assessment leaving it to HMRC to do the calculation. The taxpayer wanted the amount reduced to a lower amount and HMRC was seeking to collect the unadjusted amount. HMRC had opened a Schedule 1A enquiry into Year 2. The issue was whether the Revenue were required to make a s9A enquiry for Year 1.

348.The Supreme Court, in a judgment given by Lord Hodge with which the other JSCs agreed, held the carryback claim could not, and did not, purport to affect the tax due for Year 1 and that HMRC were therefore entitled to bring the county court action for Year 1 without giving effect to the carryback claim.

349. Noting on the one hand the taxpayer's argument that a claim had been made in a return, that therefore Schedule 1A could not apply, only s9A, and on the other HMRC's argument to the effect that not everything on a return could be regarded as a "return" for the purposes of the relevant TMA provisions including s9A, Lord Hodge explained why a Schedule 1A enquiry was in point rather than s9A:

> "25. The tax return form contains other requests, such as information about student loan repayments (page TR2), the transfer of the unused part of a taxpayer's blind person's allowance (page TR3) or claims for losses in the following tax year (box 3 on page Ai3) which do not affect the income tax chargeable in the tax year which the return form addresses. The word "return" may have a wider meaning in other contexts within TMA. But, in my view, in the context of sections 8(1), 9, 9A and 42(11)(a) of the TMA, a "return" refers to the information in the tax return form which is submitted for "the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax" for the relevant year of assessment and "the amount payable by him by way of income tax for that year" (section 8(1) TMA).
>
> 26.In this case, the figures in box 14 on page CG1 and in box 3 on page Ai3 were supplemented by the explanations which Mr Cotter gave of his claim in the boxes requesting "any other information" and "additional information" in the tax return. Those explanations alerted the Revenue to the nature of the claim for relief. It concluded, correctly, that the claim under section 128 of ITA in respect of losses incurred in 2008/09 did not alter the tax chargeable or payable in relation to 2007/08. The Revenue was accordingly entitled and indeed obliged to use Schedule 1A of TMA as the vehicle for its enquiry into the claim (section 42(11)(a)).
>
> 27. Matters would have been different if the taxpayer had calculated his liability to income and capital gains tax by requesting and completing the tax calculation summary pages of the tax return. In such circumstances the Revenue would have his assessment that, as a result of the claim, specific sums or no sums were due as the tax chargeable and payable for 2007/08. Such information and self assessment would in my view fall within a "return" under section 9A of TMA as it would be the taxpayer's assessment of his liability in respect of the relevant tax year. The Revenue could not go behind the taxpayer's self assessment without either amending the tax return (section 9ZB of TMA) or instituting an enquiry under section 9A of TMA."

De Silva

350.The facts concerned appellants who were limited partners in a limited film partnership and statutory provisions which enabled a limited partner to set off his allocated share of film partnership losses against general income in previous years. The relevant film partnerships lodged partnership tax returns completed by the general partner pursuant to s12AA TMA claiming tax losses in a number of years. HMRC initiated an enquiry into the partnership returns under s12AC(1) TMA which

gave rise (under ss6) to a deemed giving of notice under s9A(1) TMA to each partner who had made or subsequently made a s8 TMA return. The taxpayers were arguing that carry back claims could only be made by stand-alone claims and that the claim they had made was a stand-alone claim made in Year 1 which could only be challenged by an enquiry under Schedule 1A (which HMRC were out of time to make).

351.In a judgment given by Gloster LJ (with which Simon LJ and Arden LJ agreed), the Court of Appeal rejected, for a number of reasons, the taxpayers' arguments that HMRC were not entitled to enquire into the appellants' tax returns for Year 2 pursuant to the combined effect of s9A and s12AC(3) TMA.

352.First as set out at [48] it was not correct that a carry back claim could only be made by means of a stand-alone claim. The disapplication of s42(2) TMA 1970 meant that by dint of it being possible to make the claim in return it was not required to be made in a return. The claim could therefore be made in a standalone claim or outside a return.

353.Second, as set out at [49] to [51] however the claim was made, it was required to be included in the return of the taxpayer for the year in which the losses were actually made (Year 2) because if valid the claim would affect the tax chargeable and payable in Year 2 (per 2(3) of Schedule 1B). The judgment explained:

> "Thus, the correct procedure for making a Schedule 1B claim is either to make it in the return for the loss-making year in question (the Year 2 return), or to make an earlier (or indeed later) Schedule 1A standalone claim, which is then, subsequently, nonetheless required to be included in the return for the later year."

354.Gloster LJ agreed with the characterisation of Sales J in the High Court that the claims in the appellants' Year 1 returns to use partnership losses in later periods were "inchoate". Those claims could not be viewed as simple stand-alone claims for relief made outside a return. The claims for relief:

> "…could, as matter of substance, only ultimately be made good if the Appellants also eventually included their shares of the partnership trading losses in their own individual returns for the periods in which those losses actually arose."

355.Third even if the claims were stand-alone claims HMRC were not obliged to use Schedule 1A, and if they did not they were not precluded from bringing a further enquiry under s9A. Gloster LJ explained at [52]:

> "Apart from the fact that there is nothing, in my judgment, in the relevant statutory provisions that prevents the Revenue from waiting for the submission of the required partnership and individual returns for Year 02 (by which time the relevant losses have purportedly been incurred and a claim for relief is required to be included in the return) before deciding to initiate an enquiry under section 9A, or specifically in this case, an enquiry under the combined effect of that section and section 12AC(6) of the TMA, commercially there would be little, or no, sense in the Revenue initiating its enquiry before the full facts were known. Contrary to the judge's doubts (see paragraph 42 of the judgment), I consider that the Revenue would have had a choice as to which enquiry route it took, if indeed there had been a separate stand-

> alone claim made prior to the Year 02 self-assessment returns. But I agree with him that, normally, the appropriate point of challenge for the carry back claim in respect of partnership losses incurred in Year 02 has to be at the time when such losses are included in the partnership return and the individual partner's return for that year."

356. As regards the taxpayers' reliance on the Supreme Court's decision in *Cotter* it was highlighted at [53] that *Cotter* was a different case of a stand-alone claim for carry back relief where no claim for carry-back relief had been made or intimated either in the tax return for Year 1 or Year 2 in which the losses had been incurred.

Wickersham v CIR [2016] EWHC 2956

357. The facts concerned tax losses incurred in Year 2 carried back to Year 1 so as to extinguish income with the loss in the taxpayer's return of Year 1. Absent relief the taxpayer's income tax liability would have been approximately £63,000 higher and the taxpayer sought repayment of that amount in his claim before the High Court. HMRC had opened a s9A enquiry into Year 2 which was still open. The taxpayer argued that HMRC failed to serve notice of intention to open Sch1A enquiry and therefore the claim was final and should be given effect to. HMRC defended the claim on various grounds each of which it was accepted would be determinative: 1) the relief not quantified therefore not a claim 2) the notice was served in time 3) the taxpayer's claim for relief in Year 1 was premature or inchoate because there was a Year 2 enquiry into the same loss which was ongoing ("the prematurity argument") 4) if the claim for credit, could not succeed there was a defence under Schedule 1A 4(4) (in essence it was argued the subparagraph 4(4) excluded free-standing credits to tax as distinct from "repayment" of tax). At [13] the judge noted that if any of the defences was established that the claim had to fail but that he explained that he was dealing with each one in turn as if the preceding defence had not been established. Judge Saffman rejected HMRC's defences on 1) and 4).

358. In relation to the prematurity argument the taxpayer sought to distinguish *De Silva,* contrary to HMRC's position, on the same basis as Mr Southern does (that the case concerned the peculiarities of partnership taxation) and as with Mr Southern relied on *Cotter* to say the claim was a stand alone claim (and as a stand alone claim was not impacted by the outcome of an enquiry into a subsequent year). HMRC relying on *De Silva* argued that was irrelevant; until this asserted loss was allowed it could not form the basis for relief in the earlier year.

359. The High Court rejected, at [81] to [82] of the judge's decision, the taxpayer's argument that *De Silva* was distinguishable merely because it concerned partners and at [90] the judge explained he was bound by the basic principle in *De Silva* that losses arising in Year 2 invoked for relief for Year 1 were inchoate until validated by being included in the tax return for Year 2 and accepted by HMRC.

Discussion

360. I consider first the issue of whether the analysis in *Wickersham* that *De Silva* was not confined to partnership taxation is binding. As indicated above the appellant argues that aspect of the decision was obiter. Once the judge had decided there was a valid Schedule 1A enquiry it was not necessary to consider whether a s9A enquiry was also possible (as had been necessary in *De Silva* because of the absence of Schedule 1A enquiry).

361. HMRC disagree; merely because a judge gives two reasons for dismissing a claim does not render the second obiter. This was made clear by Lord Simmonds in *Jacobs v London County Council* [1950] AC 361 at 369.

> 'there is in my opinion no justification for regarding as obiter dictum a reason given by a judge for his decision, because he has given another reason also.'

362. Mr Southern's response is that the principle speaks to the situation where there are two independent reasons (as was the case in relation to the Court of Appeal's conclusions in *Jacobs*) whereas here the two reasons are closely connected with each other. The second reason is premised of a hypothetical fact, namely, that no notice of enquiry into the Year 1 claim had been given. As the judge said at [55]: 'Even if no notice has been given, nonetheless HMRC argue that the claim cannot be sustained because it is premature ...'. Referring to A.L Goodhart, 'Determining the Ratio Decidendi of a Case' (1931) 40 YLJ 161 Mr Southern submits that reasoning based on a hypothetical fact is a dictum.

363. I do not agree the question of notice of the Schedule 1A enquiry is a matter of hypothetical fact; rather it was a hypothetical conclusion on a legal issue. (I have not found it necessary to refer to the Goodhart article and therefore to prolong further rounds of post-hearing submissions by inviting HMRC to address it).

364.It is also not clear to me that the judge's reasoning, that the appellant's claim did not succeed because a s9A enquiry was open, was dependent on a conclusion being reached as to the validity of the Schedule 1A notice. Rather it appears to me that even if the conclusion was that there was *not* a valid Schedule 1A notice the point would still stand that the taxpayer would not have been entitled to the repayment because the loss in Year 2 upon which the claim had been based was still under enquiry.

365.Taking account of what the judge said at [13] which indicated that each conclusion was not intended to be obiter, it is apparent that if the question were to be asked what were the reasons for the judge's decision, there would be no doubt that the claim had failed for the two reasons relating to ground 2 and 3. Read as a whole the decision was not, as Mr Southern would have it, that the claim failed because the defence to ground 2 was made out but even if that were wrong then it failed on ground 3. The decision could equally have been approached dealing with the prematurity argument first (that so long as the enquiry into Year 2 remained open it did not matter whether a claim had or had not been validly filed) and then secondly, the arguments on the validity of the Schedule 1A notice. In those circumstance it would seem arbitrary that the binding principle from the case was dependent on which was taken first.

366.The High Court's analysis in *Wickersham* that *De Silva* is not restricted to taxation of partnerships is therefore binding on this tribunal. Even if I were wrong in this conclusion and *Wickersham* is only of persuasive value then I would have no hesitation in agreeing with the proposition that *De Silva* is not restricted to a partnership context. Nothing in the reasons or the statutes referred to suggest the analysis is so restricted. Further, in addition to the reasons of Judge Saffman, it is clear as pointed out by HMRC, that the passage of the judgment setting out the Court of Appeal's third reason at [52] (extracted above at [355] and the reference to "…before deciding to initiate an enquiry under section 9A, or specifically in this case, an enquiry under the combined effect of that section and section 12AC(6) of the

TMA…", confirm the Court of Appeal was laying down a principle that went beyond the particular relationship between individual partner and partnership level returns and applied more generally to s9A actual enquiries as opposed to deemed enquiries. Although as HMRC accept the facts of this case concern an actual s9A enquiry rather than a deemed enquiry there is nothing in the reasoning of the Court of Appeal which turns on that particular distinction. The Court of Appeal's decision establishes a number of clear propositions which firmly shut the door on the appellant's arguments and do so in a way which cannot be read as restricted to the particular situation of partnership taxation.

367. In Mr Southern's further written submissions he suggests the Court of Appeal in *De Silva* distinguished *Cotter* because of a particular feature of the tax return namely that no provision was made on the return for the unusual situation of losses from employment (in contrast to the situation for trading losses / losses from a partnership trade) and that distinguishing on the basis of the design of a tax return does not align the substantive position with the procedural position. Mr Southern also argues that as regards the argument that carry back claims as regards Year 1 are inchoate /premature until an entry is made in Year 2 (at which point a 9A enquiry into Year 2 can be opened (and by extension according to the judge in *Wickersham* could displace an actual Sch 1A enquiry) then this was inconsistent with the Supreme Court's narrow view in *Cotter* of the phrase "included in the return" and also meant that Parliament had legislated in vain as regards Schedule 1A enquiries.

368.It follows from what I say about *Wickersham* that *De Silva* is not to be distinguished. The principle that both enquiry routes are open to HMRC in *De Silva* is binding. Given that it is not open, certainly at the level of this tribunal, to question the correctness of the principle I do not deal in any detail with Mr Southern's submissions above which in essence seek to unpick the Court of Appeal's decision in *De Silva* that *Cotter* was not on point and which maintain the principle to be derived from *De Silva* is inconsistent with *Cotter*.

369.I would observe that, in any event, it is not correct to say Schedule 1A is superfluous. I note Mr Southern, who appeared for the taxpayer in *De Silva* made a similar argument before the Court of Appeal (see [32](iv)). As illustrated by paragraph [52] of *De Silva* there are however consequences attached to HMRC's decision to which sort of inquiry they open and the point at which they do that. The facts of *Cotter* also demonstrate factual circumstances where Schedule 1A may serve a function.

370.As regards the statement in [26] of Lord Hodge's decision suggesting that Schedule 1A was the only route, this was addressed comprehensively in Sales J's analysis in *De Silva* at [58] onwards of his decision (extracted at [30] of the Court of Appeal's decision) a passage which was endorsed and adopted by the Court of Appeal at [53]. It was highlighted that *Cotter* was a different case of a stand-alone claim for carry back relief where no claim for carry-back relief had been made or intimated either in the tax return for Year 1 or Year 2 in which the losses had been incurred.

371.In relation to Mr Southern's submission that the *De Silva* is of lesser import given it is on appeal to the Supreme Court, there having been no application for a stay pending the Supreme Court's decision it is irrelevant to the question of what the law

as it currently stands which the tribunal must apply in making its substantive decision on the issue before it.

372.In view of the above it is not necessary to make any determination on whether in fact the taxpayers had stand-alone claims because whether or not that is the case, valid s9A enquiries were opened into the "Year 2"s when the loss upon which the loss relief claim is based happened. The appellants' case on this issue fails.

Conclusion

373.The appellants' appeals are dismissed.

374.This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

SWAMI RAGHAVAN

TRIBUNAL JUDGE

RELEASE DATE: 16 OCTOBER 2017

ANNEX

High Case analysis	**MMT**	**Henry Poole**	**Elegy**	**Madea**
Budget	13,360,215	12,231,309	18,009,923	34,049,000
Budget + 8%	14,720,632	13,209,814	19,450,717	36,772,920
Equity	150,000	150,000	150,000	160,000
Defined Proceeds (High Case)	32,038,140	31,525,997	28,506,357	69,849,700
6% of DP	1,922,228	1,891,560	1,710,381	4,190,982
6% per 1m of investment	130,584.64	143,193.53	87,934.11	113,969.25
ROE at partnership level	*87%*	*95%*	*59%*	*75%*
Additional Return on call option (113.5% - 108%)	*749,662*	*672,722*	*990,546*	*1,872,695*
Additional Return per $/£ 1million	*50,926*	*50,926*	*50,926*	*50,926*
Total Return ROE	*121%*	*129%*	*93%*	*107%*
Share sale proceeds retained	116,000	116,000	116,000	118,000
Equity less share sale proceeds	(34,000)	(34,000)	(34,000)	(42,000)
CGT on share sale	(4,800)	(4,800)	(4,800)	(4,800)
Interest relief	24,000	24,000	24,000	24,000
18% CGT on disposal 6% interest	(23,505)	(25,775)	(15,828)	(20,514)
Net adjustment	(38,305)	(40,575)	(30,628)	(43,314)
6% per 1mill less net adjustment	92,279	102,619	57,306	70,655
Adjusted RoE	61.52%	68.41%	38.20%	44.16%