Appeal number: TC/2015/06868
TC/2015/06862
TC/2016/05299
TC/2016/05274

PROCEDURE – application to strike out – whether appeals have a reasonable prospect of success – no – appeals struck out

FIRST-TIER TRIBUNAL
TAX CHAMBER

THE FIRST DE SALES LIMITED PARTNERSHIP **Appellants**
TWOFOLD FIRST SERVICES LLP
TRIDENT FIRST SERVICES LLP
TRIDENT SECOND SERVICES LLP

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at Taylor House, Rosebery Avenue, London on 24 January 2018 and having considered further written submissions served by the parties on 16 February 2018

David Ewart QC, Zizhen Yang and Ben Elliott instructed by Reynolds Porter Chamberlain LLP, for the Appellants

Aparna Nathan, instructed by the General Counsel and Solicitor to HM Revenue & Customs, for the Respondents

DECISION

1. The appellants are partnerships or limited liability partnerships ("LLPs") who have entered into arrangements disclosed under the provisions of Part 7 of Finance Act 2004 that relate to the disclosure of tax avoidance schemes ("DOTAS"). Pursuant to those arrangements, the appellants all made significant payments which were contractual consideration for specific individuals granting restrictive undertakings and claimed to be entitled, in their partnership tax computations, to a tax deduction for those payments.

2. HMRC opened enquiries into all appellants' tax returns and, on conclusion of those enquiries, issued closure notices on the basis that the payments were not deductible. A number of matters are in dispute. However, it was common ground before me that the appellants' appeals cannot succeed unless they establish that the payments are, at least in part, deductible. HMRC submit that there is no reasonable prospect of the appellants establishing this and therefore have applied to strike out the appellants' appeals on the grounds that they have no reasonable prospect of success.

The background to the strike out application in more detail

3. In this section, I will not make detailed findings of fact not least since, during the hearing, I heard no live evidence and there was no opportunity for the appellants' witness evidence to be challenged. Therefore, the description below is highly abbreviated, is based on facts which I understand to be uncontroversial (at least for the purposes of the strike out application) and does not set out full details of the complicated arrangements to which all appellants were party. The focus is on the arrangements from which the disputed tax deductions are said to arise.

The First de Sales Limited Partnership

4. The First de Sales Limited Partnership ("FDS") is a limited partnership formed under the law of the Cayman Islands. Its limited partners include UK resident individuals liable to income tax.

5. In September 2009, FDS entered into an agreement with Inspire Editorial Services Ltd ("Inspire"), a company resident in the Cayman Islands, under which Inspire agreed to provide certain editorial services to FDS. For the purposes of the strike-out application, the parties proceeded on the basis that, at relevant times, FDS carried on a profession of creative writing. FDS's creative writing profession was small in scale. HMRC's Statement of Case stated that it was agreed that the income from the profession was £468 in 2010-11, £671 in 2011-12, £761 in 2012-13 and £293 in 2013-14. I have proceeded on the basis that, small though it was, the activity was nevertheless a profession for income tax purpose.

6. On 23 September 2009, FDS and Victoria Murray, a resident of Jersey, entered into an employment contract under which Ms Murray agreed to act as an administrations manager for FDS for an annual salary of £60,000. Her duties under the employment contract were essentially administrative and she was not required to produce original literary content.

7. FDS published an Information Memorandum soliciting UK resident individuals to subscribe for partnership interests in FDS. The Information Memorandum referred extensively to tax advantages that an investor in FDS could hope to obtain. The first sentence of the "Opportunity" section of the executive summary of the Information Memorandum stated:

> The First De Sales Limited Partnership has been structured to provide an expected tax advantage to UK resident and/or ordinarily resident individuals (regardless of their domicile) who join the Partnership as Limited Partners.

The Information Memorandum also described FDS's creative writing business and gave information on the UK book industry.

8. UK resident individuals subscribed for partnership interests in FDS. FDS also obtained funding by way of loan.

9. On 1 October 2009, a Deed of Restrictive Undertakings was entered into between FDS, Victoria Murray and Inspire. Pursuant to that deed, Victoria Murray gave undertakings to FDS that broadly restricted her from being involved in a business that competed with FDS, or from soliciting clients or suppliers of FDS, for a period of six months after her employment with FDS ceased. FDS agreed to pay £170,362,076 to Inspire as consideration for Victoria Murray giving the restrictive undertaking.

10. For the purposes of considering the application, I will proceed on the basis that payments were indeed made pursuant to the Deed of Restrictive Undertaking.

FDS's arguments in support of its entitlement to a deduction

11. Section 225 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") deals with the income tax treatment of payments for restrictive undertakings from the perspective of the recipient of such payments. It provides, relevantly, as follows:

> **225 Payments for restrictive undertakings**
>
> (1) This section applies where—
>
> (a) an individual gives a restrictive undertaking in connection with the individual's current, future or past employment, and
>
> (b) a payment is made in respect of—
>
> (i) the giving of the undertaking, or
>
> (ii) the total or partial fulfilment of the undertaking.
>
> (2) It does not matter to whom the payment is made.
>
> (3) The payment is to be treated as earnings from the employment for the tax year in which it is made.
>
> …
>
> (8) In this section "restrictive undertaking" means an undertaking which restricts the individual's conduct or activities.

> For this purpose it does not matter whether or not the undertaking is legally enforceable or is qualified.

12. Both Ms Murray (the employee) and Inspire (the recipient of the payment) are resident outside the UK. Therefore, for the purposes of the strike out application, it was common ground that s225 of ITEPA could not impose a UK tax liability on either Ms Murray or Inspire. However, FDS argues that the requirements of s225 are nevertheless met and that therefore, s69 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"), which deals with the position of a person paying for restrictive undertakings, is engaged. Section 69 provides relevantly as follows:

> **69 Payments for restrictive undertakings**
>
> (1) In calculating the profits of a trade, a deduction is allowed for a payment—
>
> (a) which is treated as earnings of an employee by virtue of section 225 of ITEPA (payments for restrictive undertakings), and
>
> (b) which is made, or treated as made for the purposes of section 226 of that Act (valuable consideration given for restrictive undertakings), by the person carrying on the trade.
>
> (2) The deduction is allowed for the period of account in which the payment—
>
> (a) is made, or
>
> (b) is treated as made for the purposes of section 226 of ITEPA

13. FDS considers that, at the time it made the payment, it was carrying on the profession of creative writing. Section 56 of ITTOIA applies provisions of ITTOIA (including s69) to professions and vocations in the same way that they apply to trades. Therefore, FDS's argument is that s69 of ITTOIA applies to the payment that it made with the result that it was, in its partnership computation, entitled to a deduction for the £170,362,076 that it paid. As a result of making this significant deductible payment, FDS considers that it realised a loss in its creative writing profession that its partners could use to set off against other taxable income that they received.

14. HMRC do not seek to argue, for the purposes of the strike-out application, that FDS was not carrying on a profession or that s56 of ITTOIA does not apply in the way that FDS submits it does. Nor do HMRC argue that s225 of ITEPA does not apply on the grounds that both Ms Murray and Inspire are resident outside the UK. Rather, HMRC's case is that s225 of ITEPA (and so s69 of ITTOIA) applies only to payments "in respect of" either the giving of the undertaking or its fulfilment. They argue that, when due regard is had to the size of the payment (£170m), the administrative nature of Ms Murray's duties and the modest scale of FDS's activities, FDS has no realistic prospect of establishing that the payment was actually "in respect of" the restrictive undertaking even though it has been described as such. Rather, HMRC characterise the payment as being "in respect of" the tax avoidance arrangements.

Twofold First Services LLP

15. Twofold First Services LLP ("Twofold") is a limited liability partnership registered in England and Wales. Pursuant to s1 of the Limited Liability Partnership Act 200, an LLP is a body corporate (and therefore is a legal entity separate from its members). However, pursuant to s863 of ITTOIA, where an LLP carries on a trade, profession or business with a view to profit, it is treated for income tax purposes in a manner similar to a partnership. In the jargon of tax practitioners, an LLP that meets the requirements of s863 of ITTOIA is treated as "transparent" so that profits or losses that it makes are treated as profits or losses of the members of the LLP. In the main proceedings, HMRC are disputing that Twofold meets the requirements of s863 of ITTOIA and argue that, in consequence, Twofold is not "transparent". However, Ms Nathan confirmed at the hearing that HMRC's arguments to this effect form no part of their application to strike out Twofold's appeal.

16. The transactions that Twofold entered into were similar in nature to those effected by FDS. On 24 February 2012 Twofold acquired an agricultural estate (Hodgson Moor Farm) for around £250,000 which it financed by means of a loan. It leased that estate for an annual rent of around £3,000. It was common ground for the purposes of this application that, at material times, Twofold carried on a business of generating income from land in the United Kingdom (and so was carrying on a UK property business for the purposes of s264 of ITTOIA).

17. Twofold issued an Information Memorandum designed to attract further investors to subscribe for membership interests in the LLP. Twofold's Information Memorandum, like that of FDS, made it clear that Twofold was party to a "tax planning arrangement", but it also referred to the business that Twofold was carrying on. Twofold was successful in obtaining investors and also arranged finance in the form of loans.

18. On or around 27 February 2012, Twofold employed Jason Rose, a resident of Jersey, as an estate manager for an annual salary of £40,000. His duties were essentially to manage the portfolio of property that Twofold held and perform the customary duties of an estate manager such as ensuring that rent was paid, dealing with planning issues and liaising with other professionals on matters regarding the estate.

19. On 27 February 2012, Twofold entered into a Deed of Restrictive Undertakings with 3P Limited ("3P"), a company incorporated in the Cayman Islands, and Jason Rose. Pursuant to that Deed, Mr Rose gave a restrictive undertaking that restricted him from being involved in a business that competed with that of Twofold, or from soliciting clients or customers of Twofold, for six months after his employment ceased. Twofold agreed to pay 3P £200m as consideration for Mr Rose entering into that deed.

20. On 1 March 2012, Twofold, 3P and Mr Rose entered into a further Deed of Restrictive Undertakings which provided for Twofold to pay £300m to 3P as consideration for Mr Rose giving restrictive undertakings. Those restrictive undertakings went further than those set out in the deed of 27 February 2012: for example they restricted Mr Rose's ability to solicit prospective counterparties of Twofold, and not just counterparties with whom Twofold had actually done business.

21. The means by which Twofold obtained the £500m necessary to discharge its obligations under both Deeds of Restrictive Undertakings were complicated. However, at least for the purposes of the strike out application, the parties proceeded on the basis that the aggregate £500m consideration was paid in a number of instalments.

22. At the time Mr Rose started his employment, and gave both restrictive undertakings, Twofold held just a single property, Hodgson Moor Farm. Subsequently, on 5 April 2012, it acquired some additional land at Manor Farm that was let on an annual rent of £8,880.

23. For Twofold, it is argued as follows:

(1) Section 863 of ITTOIA applies so that Twofold is treated like a partnership for income tax purposes.

(2) Twofold was carrying on a property business under s264 of ITTOIA. Under s272 of ITTOIA, the profits of that property business have to be the have to be computed in the same way as profits of a trade with the result that, in particular, s69 of ITTOIA affords a deduction for payments made in respect of restrictive undertakings.

(3) The £500m that it paid in return for the grant of the restrictive undertakings was deductible applying s69 of ITTOIA. Having made such a large deductible payment, Twofold realised a loss in its property business which, because Twofold was "transparent" for income tax purposes, was treated as a loss of its members. Twofold's members were therefore entitled to set their share of the loss against other taxable income that they had received so as to reduce their tax liabilities.

24. As I have noted, in the main proceedings, HMRC are disputing that Twofold is transparent for tax purposes, but that is not relevant to the strike out application. For the purpose of the strike out application, HMRC's central argument is that Twofold has no reasonable prospect of demonstrating that the £500m that it paid was a deductible payment "in respect of" restrictive undertakings.

Trident First Services LLP and Trident Second Services LLP

25. Trident First Services LLP ("Trident First") and Trident Second Services LLP ("Trident Second" and, together with Trident First, the "Trident LLPs") are both limited liability partnerships formed under the law of England and Wales. The Trident LLPs both entered into arrangements disclosed under DOTAS that were very similar to those entered into by Twofold. In summary:

(1) Both Trident LLPs acquired real estate. Trident First acquired a property for around £165,000. Trident Second acquired property for £135,000. The properties were initially let out for an annual rent of between £5,000 and £8,000.

(2) Both Trident LLPs engaged Jason Rose to act as estate manager for a salary of £20,000 per annum[1].

(3) The Trident LLPs made an Information Memorandum available to solicit investments from third parties. Like the other information memoranda, this document referred in detail to the tax advantages that could be expected from investing in the Trident LLPs (for example, the front cover of the Information described the Trident LLPs as "a potential shelter for profits chargeable to corporation tax". Unlike Twofold, the Trident LLPs sought investments from UK resident companies (who were subject to corporation tax) rather than from UK resident individuals (who were subject to income tax).

(4) Both Trident LLPs entered into Deeds of Restrictive Undertaking with Jason Rose and 3P. Mr Rose gave materially similar undertakings to those outlined at [21]. Trident First agreed to pay 3P £100 million as consideration for that undertaking and Trident Second agreed to pay 3P £200 million as consideration. I will proceed on the basis that both amounts were paid, in one or more instalments.

26. The Trident LLPs' arguments in are in material respects identical to those of Twofold. However, since the members of the Trident LLPs consist of companies subject to corporation tax (rather than individuals subject to income tax), the Trident LLPs rely on some provisions of the Corporation Tax Act 2009 ("CTA 2009") and the Corporation Tax Act 2010 ("CTA 2010"), which are materially similar to their counterparts in ITTOIA. More specifically, the Trident LLPs argue:

(1) That they are transparent, and treated as partnerships for corporation tax purposes, by virtue of s1273 of CTA 2010 (the corporation tax counterpart of s863 of ITTOIA).

(2) That, for corporation tax purposes, they carrying on a UK property business by virtue of s64 of CTA 2010 (the corporation tax counterpart of s264 of ITTOIA) and that profits of that business must, under s210 of CTA 2009 be calculated in the same way as profits of a trade.

(3) That the payments that they made to Jason Rose fell within s225 of ITEPA since they were in respect of the grant of restrictive undertakings given by an employee.

(4) It follows that s69 of CTA 2009 (the counterpart of s69 of ITTOIA) provides that the Trident LLPs are entitled to a deduction in computing the profits of their UK property business for the £300m paid for the restrictive undertakings. Since the property business made a loss as result of the payment, the members of the Trident LLPs are entitled to use that loss to set off against other taxable income.

[1] Both parties proceeded on the basis that Jason Rose was the estate manager for both Trident LLPs. The hearing bundle contained some employment contracts between the Trident LLPs and Victoria Murray. I assume that they were superseded by contracts with Jason Rose.

27. HMRC's arguments as to why the Trident LLPs' appeals should be struck out are in all material respects the same as those raised in connection with Twofold.

The Tribunal's Rules applicable to strike-outs

28. The parties were broadly agreed on the approach that I should follow when considering the application to strike out the appeal and therefore I will summarise the applicable principles briefly.

29. The Tribunal has a power to strike out the appeal. That follows from Rule 8(3) of the Tribunal Rules that provides, relevantly, as follows:

> (3) The Tribunal may strike out the whole or a part of the proceedings if-
>
> …
>
> (c) the Tribunal considers there is no reasonable prospect of the appellant's case, or part of it, succeeding .

That is a discretionary power. If satisfied that there is no reasonable prospect of an appellant's case succeeding, I am not obliged to strike the appeal out.

30. The Upper Tribunal have, in *HMRC v Fairford Group* [2015] STC 156 given guidance as to how the Tribunal should assess whether a case has no reasonable prospect of success which requires the Tribunal to apply certain principles that have been developed in the courts. At [41] of their decision, the Upper Tribunal said:

> [41] In our judgment an application to strike out in the FTT under r 8(3)(c) should be considered in a similar way to an application under CPR 3.4 in civil proceedings (whilst recognising that there is no equivalent jurisdiction in the FTT Rules to summary judgment under Pt 24). The tribunal must consider whether there is a realistic, as opposed to a fanciful (in the sense of it being entirely without substance), prospect of succeeding on the issue at a full hearing, see *Swain v Hillman* [2001] 1 All ER 91 and *Three Rivers* [2000] 3 All ER 1 at [95], [2003] 2 AC 1 per Lord Hope of Craighead. A 'realistic' prospect of success is one that carries some degree of conviction and not one that is merely arguable, see *ED & F Man Liquid Products Ltd v Patel* [2003] EWCA Civ 472, [2003] 24 LS Gaz R 37. The tribunal must avoid conducting a 'mini-trial'. As Lord Hope observed in *Three Rivers*, the strike-out procedure is to deal with cases that are not fit for a full hearing at all.

Both parties took me briefly to the underlying authorities that apply in the courts but I will not quote from those authorities since the Upper Tribunal's decision quoted above captures the essence of them.

Discussion

31. The core issue in this application is whether the appellants have a reasonable prospect of establishing that at least part of the sums paid pursuant to the Deeds of Restrictive Undertaking were deductible for tax purposes. If the appellants have a reasonable prospect of establishing that, then I must not strike out the appeals. If the

appellants have no reasonable prospect of establishing this, then I have a discretion to strike out the appeals.

32. The appellants are all putting their case on the basis that s69 of ITTOIA or s69 of CTA 2009 confers a deduction. Mr Ewart confirmed that they are not seeking to argue that, even if their case under these provisions fails, they nevertheless incurred the expenditure wholly and exclusively for the purposes of their respective professions or property businesses so that they are entitled to a deduction on general principles. Therefore, the question for me is essentially whether the appellants have a reasonable prospect of establishing that, by virtue of s69 of ITTOIA or s69 of CTA 2009, they are entitled to a deduction for all or part of the payments that they made.

33. Ms Nathan's primary criticism of the case that the appellants are putting forward is that it contains little, if any, evidence to explain why such large payments, in respect of restrictive undertakings given by employees who performed largely administrative duties for relatively modest salaries, in connection with small business ventures, were commercially justified. Essentially, she put this point in two distinct, but related, ways. First she argued that, as a matter of statutory construction, applying the principle set out in *UBS v HMRC* and *DB Group Services v HMRC* [2016] UKSC 13, s225 of ITEPA, s69 of ITTOIA and s69 of CTA 2009 are only concerned with payments having a genuine business or commercial purpose. In the absence of any satisfactory evidence of such a business or commercial purpose, those provisions were not engaged and it followed that, as a matter of law, the appellants were not entitled to the deductions claimed.

34. Ms Nathan's second argument was that, in any event, the words of the statute required that the payments the appellants made were "in respect of" the restrictive undertakings. Following the decision in *Vaughan-Neil v Inland Revenue Commissioners* [1979] WLR 1283, she argued that this required a broad factual examination of what the payments were made for. Without any evidence as to the commercial rationale for making such significant payments, the Tribunal could only realistically conclude, as a matter of fact, that the payments were "in respect of" an attempt to obtain a tax advantage rather than the undertakings themselves.

35. Mr Ewart did not expressly concede that the payments had no business or commercial purpose but he did accept that the appellants are not seeking to establish that the payments were commercially justified in the sense that the appellants obtained a benefit to their businesses from the restrictive undertakings that were commensurate with the large sums paid for them. However, he submitted that, even without such evidence, the appellants had a case with a reasonable prospect of success.

36. He emphasised that the construction of s225 of ITEPA is central to this appeal as s225 is a "gateway" into s69 of ITTOIA and s69 of CTA 2009 in the sense that, once a payment is identified as being within s225 of ITEPA it is automatically deductible under s69 of ITTOIA and s69 of CTA 2009. Therefore, the focus should be on the construction of the charging provision (in s225 of ITEPA) and not the relieving provisions (in s69 of ITTOIA and CTA 2009). Mr Ewart submitted that s225 is a charging provision whose purpose was to cast the net wide and so tax a wide range of

payments. Since the purpose of s225 is to tax, rather than relieve, he submitted that there is a reasonable prospect of establishing that Parliament did not intend the provision to apply only to payments made with a commercial justification. Rather, as a matter of construction, he submitted that Parliament intended a wide meaning to be given to the phrase "in respect of" so that the payments that the appellants made were "in respect of" the restrictive undertakings by virtue only of the fact that they were contractual consideration for the restrictive undertakings. Therefore, he submitted that the appellants need only establish by evidence that the payments were contractual consideration for the undertakings which they had clearly done by producing the Deeds of Restrictive Undertakings as evidence.

37. Ms Nathan did not really dispute that the task is to construe and apply s225 of ITEPA (as distinct from s69 of ITTOIA or s69 of CTA 2009) and I will therefore focus attention on how that provision should be construed and then applied to the undisputed facts.

38. In *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51, the House of Lords gave guidance on the approach to the construction of tax statutes. In the single decision of the Appellate Committee, it was said:

> The essence of the new approach [to the construction of tax statutes] was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. As Lord Nicholls of Birkenhead said in *MacNiven v Westmoreland Investments* Ltd [2003] 1 AC 311 … 'The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case'.

In addition, the House of Lords emphasised that:

> Tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said [in *W T Ramsay v IRC* [1981] STC 174] 'in the real world'.

39. In *UBS* and *Deutsche Bank*, the Supreme Court emphasised the importance of a "real-world" application of taxing statutes saying:

> [T]ax avoidance schemes commonly include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from charge. In other words, as Carnwarth LJ said in the Court of Appeal in *Barclays Mercantile* … taxing statutes generally 'draw their life-blood from real-world transactions with real world economic effects. Where an enactment is of that character, and a transaction or an element of a composite transaction, has no purpose other than tax avoidance, it can be usually said, as Carnwarth LJ stated, that 'to allow tax treatment to be governed by transactions which have no real-world purpose of any kind is inconsistent with that fundamental characteristic'.

While the Supreme Court also performed a detailed analysis of the statutory purpose behind the provisions of ITEPA dealing with "restricted securities", I do not consider that the above reasoning is limited to the construction of those provisions. Rather, in the above passage, the Supreme Court give guidance on the approach to be taken to the construction of tax statutes generally which they then apply (in paragraphs 72 to 85 of their decision) to the specific statutory provisions under consideration.

40. Finally, it is worth noting that "purposive" approach to the construction of tax statutes has two aspects. First it is an approach to the construction of the statute; second it is an approach to the ascertainment of the facts. As Lewison J (as he then was) said in *Andrew Berry v HMRC* [2011] STC 1057

> The principle is two-fold; and it applies to the interpretation of *any* statutory provision:
>
> (a) To decide on a purposive construction exactly what transaction will answer to the statutory description; and
>
> (b) To decide whether the transaction in question does so.

41. Mr Ewart submitted that properly understood, the principles of statutory construction referred to above relate only to statutory provisions affording relief, and not to taxing provisions such as s225 of ITEPA. For obvious reasons, I accept that the principle is most often quoted in cases of alleged tax avoidance where HMRC are arguing that a taxpayer is not entitled to a relief that is claimed. Indeed in *Berry* Lewison J said:

> A provision granting relief from tax is generally (though not universally) to be taken to refer to transactions undertaken for a commercial purpose and not solely for the purposes of complying with the statutory requirements of tax relief.

However, in saying that, I do not consider that Lewison J was seeking to circumscribe the effect of the general presumption that tax statutes are concerned with "real-world transactions with real-world economic effects". Rather, in this passage, Lewison J was applying the approach outlined in *Mawson* in the context of relieving provisions.

42. Mr Ewart did not show me any authority suggesting that the principles outlined above apply only to relieving provisions. I do not consider that a submission that different principles apply to taxing provisions, as distinct from relieving provisions, would have any reasonable prospect of success at a full hearing not least because the principles set out are not whether expressly or by implication, limited to the construction of relieving provisions. Indeed, the quotation from *UBS* and *Deutsche Bank* set out above sets out a principle to be applied to the construction of "taxing statutes" generally and in *Barclays Mercantile*, the reference is to tax being imposed (and not merely to tax being relieved) by reference to transactions existing in the "real world".

43. Therefore, I consider that there is no reasonable room for doubt that the twofold approach outlined in *Barclays Mercantile* set out above applies to s225 of ITEPA. Nor do I consider that there is reasonable room for doubt that, when the twofold approach

is followed, it should be presumed (although that presumption is rebuttable) that the statutory provisions in question are concerned with "real-world transactions with real-word economic effects".

44. Of course, the House of Lords and Supreme Court emphasise that the principle is ultimately of statutory construction. Therefore, as is recognised in paragraph 68 of the Supreme Court's decision in *UBS* and *Deutsche Bank*, it is at least possible that, by way of exception to the general rule, when enacting s225 of ITEPA, Parliament intended that a payment could be "in respect of" a restrictive undertaking even if there was no "real-world" connection between the payment and that undertaking. Mr Ewart submitted that there is an indication, in s225 of ITEPA itself, that Parliament was not concerned with there being a general "real-world" connection between payments and restrictive undertakings. Rather, in his submission, Parliament intended a payment to be "in respect of" a restrictive undertaking simply if it was contractual consideration for the undertaking. In support of that argument, he submitted:

> (1) Section 225 of ITEPA ultimately derived from s26 of Finance Act 1950 which had been introduced to reverse the effect of the decision of the House of Lords in *Beak v Robson* [1943] AC 352. Parliament cannot, therefore, have intended the ambit of a charging provision such as this to be narrowed by questions of whether the payments had a "real-world" commercial justification.
>
> (2) Section 225 of ITEPA is not expressly limited to payments made with a commercial justification or object.
>
> (3) Section 225 of ITEPA contains indications that it is to apply broadly. For example, s225(2) emphasises that it does not matter to whom the payment is made. Moreover s225(8) makes it clear that a payment can be within the scope of s225 even if the underlying restrictive undertaking is not legally enforceable. Paying money in return for an unenforceable obligation would be inherently uncommercial which demonstrates that Parliament cannot have had only payments with a commercial rationale in mind.

45. I have considered those submissions carefully. However, while I have concluded that they are arguable, I do not consider that they carry the measure of conviction necessary for me to conclude that they have a reasonable prospect of success. I accept Mr Ewart's general point that, in s225 of ITEPA, Parliament has cast the net wide. However, wide though the net has been cast, Parliament is still seeking to tax only payments made "in respect of" restrictive undertakings. The decisions of the House of Lords and Supreme Court I have referred to make it clear that the usual position is that Parliament intends taxing statutes to operate in the "real world". I see no reason why, in s225, Parliament chose not to follow its usual approach so as to cover a connection between a payment and a restrictive undertaking that did not exist in the "real world". That is particularly true given that restrictive undertakings generally are the province of "real-world" businesses which are requested, and paid for, precisely so a business can protect itself from the risk of commercial damage caused by employees after they leave. I do not believe that conclusion is altered by the fact that Parliament seeks to tax payments in respect of non-binding restrictive undertakings since Parliament would

have been aware that some restrictive undertakings can be found void, after they have been given, as an unlawful restraint of trade.

46. A further indication that s225 of ITEPA is postulating a "real-world" connection between the payment and the restrictive undertaking comes from the decision of *Vaughan Neil v IRC*. In that case, the Inland Revenue Commissioners were seeking to argue that a payment made was "in respect of" a restrictive undertaking since the obligation to make the payment and the obligation to give the undertaking formed part of the same contractual clause. By contrast, the taxpayer was arguing for a broader examination that asked whether, in the light of all relevant facts, the payment was made for the restrictive undertaking. Oliver J held that an examination of all the facts of the case was required saying:

> I return, therefore to what I conceive to be the principal point. Was the payment made "in respect of" or "for" the giving of the undertaking in clause 1? I do not think it can be enough simply to look at the face of the deed and to treat the only reality of the transaction as that which emerges from the juxtaposition of the covenant for payment and the taxpayer's covenant to cease practice. *Pritchard v Arundale* [1972] Ch. 229 was concerned with the not dissimilar question of whether a transfer of shares pursuant to a deed which provided for such a transfer "in consideration of the taxpayer undertaking to serve the company" was an emolument from his employment… That question … is a question to be answered in the light of the particular facts of every case.

Oliver J emphasised the need for a broad factual enquiry, not limited to the terms of the contract in question in his final paragraph:

> I agree with the special commissioners that the point is a narrow one, but I do not agree that it is simply a point of construction of the deed. The question is: does the Crown, in all the circumstances of the case, including the terms of the deed, demonstrate that the payment was one "in respect of" a relevant undertaking by the taxpayer? In my judgment is does not, and the appeal must be allowed.

47. Mr Ewart rightly pointed out that no finding was made to the effect that the payments in *Vaughan Neil* were contractual consideration for the grant of the undertaking. However, I do not accept his submission that the conclusion in *Vaughan Neil* depends on this issue since Oliver J made it clear that the question cannot be determined simply by reference to the terms of the contract. In any event, having read the extensive quotes from the contract in Vaughan Neil, it seems most likely to me that the payments referred to were contractual consideration for the restrictive undertaking even if the recipient also had other reasons for requiring the payment.

48. Mr Ewart also noted that s31 of ITTOIA means that, if s69 of ITTOIA applies to a payment in respect of a restrictive undertaking, then a deduction is available for the payment even if payment does not satisfy the requirement of s34 of ITTOIA (that it be

made wholly and exclusively for the purposes of a trade).[2] He submitted that this provides a clear indication that Parliament did not intend a deduction for payments under in respect of a restrictive undertaking to be available only where the payment had a commercial justification. I do not, however, consider that argument has a reasonable prospect of success. Section 31 of ITTOIA certainly provides that a payment in respect of a restrictive undertaking is automatically deductible, without any need to examine the taxpayer's objects in making the payment. However, s31 does not answer the question of what Parliament meant, in s225 of ITEPA, for a payment to be "in respect of… a restrictive undertaking". General principles of statutory construction to which I have referred indicate that Parliament would normally be referring to a "real-world" connection between the payment and the undertaking. Section 31 of ITEPA does not demonstrate that Parliament intended payments lacking any "real-world" connection with the restrictive undertaking to be both taxable under s225 of ITEPA and deductible under s69 of ITTOIA. Similar reasoning applies to the corporation tax counterparts of s31 of ITTOIA.

49. In support of his argument that Parliament intended to tax any payments made "in respect of" restrictive undertakings and not merely payments that had a "real-world" connection with those undertakings, Mr Ewart submitted that Parliament and HMRC would be highly sceptical if taxpayers sought to argue that receipts should escape tax because of the absence of a "real-world" connection with the undertaking. I can quite accept that there would be a degree of scepticism about such arguments. In *Vaughan Neil* the revenue authorities were sceptical just as Mr Ewart suggested they would be. However, I do not consider that the existence of such healthy scepticism sheds any light on the construction of s225 of ITEPA. Nor does it explain why, if Parliament generally intends taxing statutes to operate in the "real world", they intended s225 of ITEPA, by way of exception, to be interpreted differently.

50. Therefore, my overall conclusion on the question of construction of s225 is that there is no reasonable prospect of the appellants establishing that the payments were "in respect of" restrictive undertakings unless they can establish that there was a "real-world" connection between the payments and the undertakings.

51. That leads to the second question of whether on the basis of the evidence before the Tribunal, the appellants have a reasonable prospect of establishing that a real-world connection exists. As a preliminary point, I do not consider that there is a reasonable prospect of establishing that the requisite "real-world" connection is established solely by the fact that the payments were contractual consideration for the large payments made. Such an interpretation would convert the question into a pure question of legal drafting which would be completely at odds with a "real-world" connection.

52. The payments of several hundred million pounds were made in relation to employees on modest salaries whose duties were primarily administrative. The businesses of the appellants were conducted on a modest scale. Even if the employees had the unfettered right to compete with the appellants' businesses after they left, the

[2] Section 51 of CTA 2009 has a similar effect in relation to the Trident LLPs whose profits are calculated under corporation tax principles.

loss to the appellants could only ever be modest. The restrictive undertakings endured for just 6 months after the employment ceased. Those factors alone strongly suggest that the payments were not "in respect of" the restrictive undertakings and were, instead, "in respect of" a tax avoidance arrangement.

53. The evidence put forward does nothing to dispel that impression. In Trident's appeals, Mr Ewart referred me to the following extract from Mr Turner's witness statement in support of a commercial justification for the payments or a "real-world" connection:

> The undertakings given by Mr Rose were drawn on similar terms to undertakings given by employees everywhere, particularly those engaged in professional positions. For example, it is common place to require employees to acknowledge that the business of their employer is to be kept confidential. Similarly, employees are very often required not to encourage clients (tenants in the case of Trident), or other staff, away from the employer, or to join a competitor business (usually the employee's new employer after his current employment has ceased), as to do so would damage the current employer's business and could cause a financial cost. For example, Trident could ill afford to have had its tenants encouraged to rent different properties that Trident did not own.

For the purposes of this application, I have assumed that Mr Turner's evidence is unchallenged. At most that evidence demonstrates that (i) Trident would not want its tenants to be encouraged to move to different premises; (ii) employees generally are often required to sign restrictive undertakings and (iii) the terms of Mr Rose's undertaking were similar to those signed by employees generally. However, that evidence has not satisfied me that an argument that there was a "real-world" connection between the payment of some £300m and the restrictive undertakings that Mr Rose gave. The evidence of a "real-world" connection in relation to Twofold and FDS was even scantier.

54. It follows that there is no reasonable prospect of the appellants establishing that they are entitled to the entirety of the deduction they have claimed in relation to the restrictive undertakings. Nevertheless, if I thought that the appellants had a reasonable prospect of establishing that they were entitled to some deduction, I do not consider I should strike out the appeal since the act of striking out the appeal would deprive the appellants of the ability to argue for any deduction at all.

55. At the substantive hearing, the appellants bear the burden of proving whether they are entitled to a deduction and, if so, how much that deduction should be. The evidence that the appellants have served does not make out a case for even a much reduced deduction. For example, they have not put forward any evidence as to how much (if any) damage would be caused to their respective businesses if Ms Murray or Mr Rose were free to act as they saw fit after leaving the appellants' employment. They have not put forward evidence to establish whether a payment would be made, and if so how much, in return for restrictive undertakings granted by employees performing the kind of duties that Mr Murray and Mr Rose performed. In short, the evidence does not explain what specific amount businesses like those of the appellants might expect to

pay for restrictive undertakings granted by employees like those of Mr Murray and Ms Rose. At the hearing, while Mr Ewart alluded to the possibility that the appellants might obtain some deduction for the payments, he did not refer me to any evidence that they relied upon in support of such an assertion. He submitted, generally, that there is always the prospect of further evidence emerging at the hearing (for example in response to questions asked in cross-examination) that might have a bearing on this issue. However, I attach little significance to this. As matters stand, the appellants' evidence fails to satisfy me that there is any reasonable prospect of establishing that the payments are deductible in whole or in part. I do not consider that there is any reasonable prospect of this shortcoming in the evidence being overcome at the hearing.

56. Neither party suggested that, if I thought there was no prospect of the appeals succeeding, I should still decline to exercise my discretion to strike out the appeals. By striking out the appeals, I will save the parties the costs of dealing with an appeal that has no reasonable prospect of success. I will also ensure that the Tribunal's resources can be deployed to deal with other, more meritorious, appeals. I paused somewhat in relation to the appeal of Twofold since that is now listed for a five-day hearing at the end of May. The parties will, therefore, already have incurred the costs of getting the proceedings this far. Moreover, there is a risk that striking out the appeal now may create "satellite litigation" (if my decision is the subject of an appeal to the Upper Tribunal) which could be avoided if Twofold's appeal was dealt with at a full hearing. However, a five-day hearing where both sides are represented by counsel would be expensive both in terms of the parties' costs and the Tribunal's resources. I have concluded, on balance, that these costs should be avoided even if by striking out the appeal I am creating the risk of further satellite litigation.

57. For all of those reasons, my overall conclusion is that the appeals have no reasonable prospect of success and that I will, therefore, exercise my discretion to strike them out.

58. 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.

JONATHAN RICHARDS
TRIBUNAL JUDGE

RELEASE DATE: 28 FEBRUARY 2018