



*CORPORATION TAX/INCOME TAX – Acquisition by Cayman Islands limited partnership (of which Cayman Islands limited company general partner) of 19% interest in UK limited partnership financed through borrowing – Profit allocation of UK limited partnership made to general partner of Cayman Islands limited partnership – Whether all members of Cayman Islands limited partnership members of UK limited partnership – Whether entitled to a deduction for interest on borrowing – If so, should any deduction be reduced under loan relationship provisions – Whether bank loan and loan notes classified as “trading loan relationships” or “non-trading loan relationships” – Whether discovery amendment valid – Appeal dismissed*

*CORPORATION TAX/INCOME TAX – Whether ‘Partner Incentivisation Plan’ (“PIP”) ‘profit-sharing arrangements’ under s 850 Income Tax (Trading and Other Income) Act 2005 and/or s 1262 Corporation Taxes Act 2009 – Whether Cayman Islands company liable to tax on all profit allocations from UK limited partnership – What profit sharing arrangement were relevant to the Cayman Islands limited partnership – Appeal allowed*

*CORPORATION TAX/INCOME TAX – Whether sums received pursuant to PIP capital or income – If income, whether charged to tax under s 687(1) Income Tax (Trading and Other Income) Act 2005 – If capital, whether main or one of main objects avoidance or reduction of liability to income tax – Whether transactions effected to exploit earning capacity in an occupation – Whether carrying out an ‘occupation’ of a kind undertaken in profession or vocation – Appeal dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**Appeal numbers: TC/2017/04430  
TC/2017/04431  
TC/2017/05553  
TC/2017/05704  
TC/2017/05705  
TC/2018/04690  
TC/2018/07191  
TC/2018/07196  
TC/2018/07168  
TC/2018/07172  
TC/2018/07198**

**BETWEEN**

**(1) BCM CAYMAN LP**

**(2) BLUECREST CAPITAL MANAGEMENT  
CAYMAN LIMITED**

**Appellants**

**-and-**

**THE COMMISSIONERS FOR**

**Respondents**

**HER MAJESTY'S REVENUE AND CUSTOMS**

**-and-**

**(3) BLUECREST CAPITAL MANAGEMENT LP**

**(4) BLUECREST CAPITAL MANAGEMENT LLP**

**(5) BLUECREST CAPITAL MANAGEMENT (UK)  
LLP**

**Appellants**

**-and-**

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

**Respondents**

**-and-**

**(6) ANDREW DODD**

**(7) LEDA BRAGA**

**(8) SIMON DANNATT**

**(9) MICHAEL EDWARD PLATT**

**(10) JONATHAN WARD**

**Appellants**

**-and-**

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

**Respondents**

**TRIBUNAL: JUDGE JOHN BROOKS**

**Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1 on 4 – 29 November 2019**

**Malcolm Gammie QC and Michael d'Arcy, instructed by Slaughter and May, for the Appellants**

**Rupert Baldry QC and Thomas Chacko, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

## DECISION

### TABLE OF CONTENTS

	<b>Paragraph</b>
Introduction	1 – 6
Abbreviations used	7
<b>Cayman Appeals</b>	8 – 251
Statement of Agreed Facts & Issues	8
Evidence	9 – 11
Further Findings of Fact	12 – 100
Finance	42 – 62
BCMCL	63 – 64
Facility Agreement	66 – 69
Deed of Assignment	70 – 72
Deed of Adherence	73
Subordination Deed	74 – 77
Contribution Deed	78 – 80
Subscription Deed	81 – 82
Loan Notes	83 – 89
BCM LP	90 – 96
Fyled	97 – 100
Issues	101 – 251
Issue 1 – Profit Allocation Issue	102 – 114
Issue 2 – Profit Allocation Issue	115 – 137
Issue 3 - Interest Deductibility Issue	138 – 161
Issue 4 – Interest Deductibility Issue	162 – 206
Issue 5 – Interest Deductibility Issue	207 – 211
Issue 6 – Discovery	212 – 247
Summary of Conclusions in Cayman Appeals	248 – 251
<b>PIP Appeals</b>	252 – 337
Statement of Agreed Facts and Issues	253
Evidence	254 – 255
Further Findings of Fact	256 – 307
Issue 1 – PIP Issue	308 – 335
Issues 2 and 3 Profit Allocation Issues	336
Summary of Conclusions in PIP Appeals	337
<b>IP Appeals</b>	338 -
Introduction	338 – 339
Statement of Agreed Facts and Issues	340
Evidence	341
Further Findings of Fact	342 – 400
Issue 1 – Miscellaneous Income Issue	401 – 428
Issue 2 – Sale of Occupational Income Issue	429 – 455
Summary of Conclusions in IP Appeals	456 – 457
<b>Summary of Conclusions in all Appeals</b>	458
Right to apply of permission to appeal	459

## INTRODUCTION

1. The first and second appellants, BCM Cayman LP and BlueCrest Capital Management Cayman Limited respectively (together the “Cayman Appellants” or “Cayman Appeals”) appeal against the closure notices and discovery assessment issued by HM Revenue and Customs on 31 March 2017, as set out below (see paragraph 8(42) – 8(43)) in respect of the accounting periods from that ended 30 November 2007 to that ended 31 December 2015 (inclusive).

2. The third, fourth and fifth appellants, BlueCrest Capital Management LP, BlueCrest Capital Management LLP and BlueCrest Capital Management (UK) LLP respectively (together the “PIP Appellants” or “PIP Appeals”) appeal against closure notices issued by HM Revenue and Customs, as set out below (see paragraph 253(23) – 253(25)) on 25 May 2017 for 2008-09 to 2013-14 (inclusive), on 1 March 2018 in respect of BlueCrest Capital Management LLP and 25 January 2019 in relation to BlueCrest Capital Management (UK) LLP for 2014-15.

3. The sixth, seventh, eighth, ninth and tenth appellants, Andrew Dodd, Leda Braga, Simon Dannatt, Michael Platt and Jonathan Ward respectively (together the “IP Appellants” or “IP Appeals”) appeal against closure notices, as set out below (see paragraph 340(7)), issued by HM Revenue and Customs in August 2018 for 2008-09 to 2014-15 (inclusive). Mr Dodd had also appealed against a “discovery” assessment made by HM Revenue and Customs on 1 April 2014 under s 29 of the Taxes Management Act 1970. However, having reviewed the witness statement of the officer concerned, it was accepted by him that the assessment was validly made and he no longer sought to pursue the appeal against that assessment. As such, as it is unnecessary to do so, I say nothing further in relation to that assessment.

4. In accordance with the Tribunal’s directions the Cayman Appeals, the PIP Appeals and the IP Appeals were listed to be heard together by the same Tribunal. Following a case management hearing on 9 October 2019, I directed that although each set of appeals was to be heard consecutively, the Tribunal would have notice of all the documents in the bundles for all three sets of appeals and that the witnesses could be taken to any of those documents and submissions could be made in relation to them.

5. Malcom Gammie QC and Michael d’Arcy appeared for the Cayman Appellants, PIP Appellants and IP Appellants. HMRC were represented by Rupert Baldry QC and Thomas Chacko. I am grateful for their assistance and approach to what was a long hearing dealing with complex matters. However, although carefully considered, I have not found it necessary to refer to every argument advanced or authority cited in reaching my conclusions in these appeals. Also, although throughout the decision I have referred to the respondents as HMRC, this should be read where appropriate (ie for periods before the implementation of the Commissioners for Revenue and Customs Act 2005) as a reference to the Inland Revenue.

6. As in the hearing, I consider each set of appeals in turn, first the Cayman Appeals followed by the PIP Appeals and finally the IP Appeals.

## ABBREVIATIONS

7. For the purposes of this decision I have adopted the following abbreviations:

- (1) ABM Avon Limited (“**Avon**”);
- (2) Assets under management (“**AUM**”);
- (3) BC Purpose Trust (“**BCPT**”);
- (4) BlueCrest Capital Management (UK) LLP (“**BCM UK LLP**”);
- (5) BlueCrest Capital Management Cayman Holdings Limited (“**BCMCHL**”);

- (6) BlueCrest Capital Management Cayman Limited (“**BCMCL**”);
- (7) BCM Cayman Limited Partnership (“**BCMC LP**”);
- (8) BlueCrest Capital Management Limited (“**BCML**”);
- (9) BlueCrest Capital Management Limited Partnership (“**BCM LP**”);
- (10) BlueCrest Capital Management LLP (“**BCM LLP**”);
- (11) BlueCrest Capital Management Services Limited (formerly, until 1 December 2008, BCML) (“**BCMSL**”);
- (12) Capital Allowances Act 2001 (“**CAA**”);
- (13) Corporation Tax Act 2009 (“**CTA**”);
- (14) Corporation Tax Act 2010 (“**CTA 2010**”);
- (15) Ernst & Young LLP (“**EY**”);
- (16) Finance Act 1993 (“**FA 1993**”);
- (17) Finance Act 1994 (“**FA 1994**”);
- (18) Finance Act 1996 (“**FA 1996**”);
- (19) Finance Act 1998 (“**FA 1998**”);
- (20) Fyled Energy Limited (“**Fyled**”);
- (21) HM Revenue and Customs (“**HMRC**”);
- (22) Income and Corporation Taxes Act 1997 (“**ICTA**”);
- (23) Income Tax (Trading and Other Income) Act 2005 (“**ITTOIA**”);
- (24) Income Tax Act 2007 (“**ITA**”);
- (25) Limited Partnership Act 1907 (“**LPA**”);
- (26) Michael Platt (“**MP**”);
- (27) Partnership Act 1890 (“**PA**”);
- (28) Permanent Establishment (“**PE**”);
- (29) Special Capital Limited (“**SCL**”);
- (30) Special Purpose Vehicle (“**SPV**”);
- (31) Sugarquay Limited (“**Sugarquay**”);
- (32) Taxation (International and Other Provisions) Act 2010 (“**TIOPA**”);
- (33) Taxation of Chargeable Gains Act 1992 (“**TCGA**”);
- (34) Taxes Management Act 1970 (“**TMA**”);
- (35) the “Partnership” (meaning any or all of BCM LP, BCM LLP and/or BCM (IK) LLP, as the context requires, where it is unnecessary to distinguish between them);
- (36) the Partner Incentivisation Plan (the “**PIP**”);
- (37) the Royal Bank of Scotland (“**RBS**”);
- (38) Total Return Swap (“**TRS**”); and
- (39) William Reeves (“**WR**”).

## **CAYMAN APPEALS**

### **Facts**

8. The following Statement of Agreed Facts and Issues was provided by the parties:

### **AGREED FACTS**

- (1) This is the statement of facts as agreed by the parties.

#### **Background**

##### ***Development and operation of relevant BlueCrest structure***

##### ***UK Partnership***

- (2) On 4 August 2000 a limited partnership deed establishing BCM LP (the “**BCM LP Deed**”) was entered into by BCMCL, MP and WR. BCM LP was thereafter engaged in the trade of investment fund management.

- (3) In December 2000 the fund known as BlueCrest Capital International was launched and BCM LP was appointed as investment manager. This fund was managed by the two founder partners (WR and MP) on behalf of BCM LP on a discretionary basis.

- (4) In 2003, Sugarquay, a company incorporated in England and Wales, acquired a 25 per cent interest in BCM LP from WR and MP. Sugarquay was the corporate vehicle through which Man Group plc (a third-party investor) acquired and held its investment.

##### **Transactions entered into in June and July 2007**

- (5) Over the period 2006 and 2007, three of the limited partners (Sugarquay, MP and WR) wished to sell a proportion of their interests in BCM LP, amounting to 19% of the total equity of the partnership. A structure was established in the Cayman Islands to acquire that share.

- (6) On 14 June 2007, BCMCL was incorporated as a Cayman Islands limited liability company. On 20 June 2007 BCMCHL, a Cayman Islands limited liability company, was incorporated, and on 4 July 2007 BCMCL became a wholly owned subsidiary. On 22 June 2007, BCMCL (as general partner) and Andrew Dodd (as the “initial limited partner”) established BCMC LP through a limited partnership deed which took the form of a letter agreement.

- (7) Since July 2007, BCMCHL has held 100% of the issued share capital of BCMCL. Both BCMCHL and BCMCL are resident for tax purposes in the Cayman Islands.

- (8) On 5 July 2007 BCMCHL and RBS entered into a TRS, which provided for:

- (a) BCMCHL to make an initial fixed payment of US\$20,000 to RBS;

- (b) Thereafter:

- (i) BCMCHL would make a subsequent fixed payment of US\$500,000 to its counterparty, namely RBS (provided the rights and obligations of the TRS had not been assigned, terminated or novated) on the earlier of six months from the date of the fixed payment of US\$20,000 and five business days following the date on which a net profit was first received by RBS under the BCMC LP agreement.

- (ii) Subsequently, BCMCHL would make (in summary) monthly fixed payments of US\$19,230.77 under the TRS to RBS whether or not RBS became obliged to make any payments to BCMCHL.

(c) RBS was to be a limited partner of BCMC LP and RBS's payment obligation under the TRS depended upon it being allocated profits under the relevant provisions of the BCMC LP Deed.

(d) Pursuant to the terms of the “**Subscription Deed**”, BCMCHL would use such monies as it received from RBS to subscribe for capital in BCMCL.

(9) On 6 July 2007, BCMCL, Mr Dodd and RBS entered into the BCMC LP Deed, a limited partnership deed relating to BCMC LP which replaced the letter agreement limited partnership deed dated 22 June 2007. The BCMC LP Deed included RBS as the “Corporate Limited Partner”, designated AD as “Original Limited Partner”, and, pursuant to clause 6.1, provided that the business of BCMC LP was to “*invest in an investment management business through being a limited partner in [BCM LP]*”. Letters of allocation, dated 6 July 2007, were sent by BCMCL (as general partner of BCMC LP) to RBS and AD, which noted that RBS and AD had each contributed US\$100 to the capital of BCMC LP.

(10) On 6 July 2007, the following further agreements were entered into to finance and implement the acquisition by BCMCL of the 19% interest in BCM LP (of which 13% was acquired from WR, 3% from MP and 3% from Sugarquay):

(a) the “**Facility Agreement**” pursuant to which RBS agreed to lend BCMCL US\$200 million, for an original term of 3 years but extendable to 5 years (the “**RBS Loan Facility**”); pursuant to clause 3.1(a), this sum was to be used by BCMCL to acquire a 10.3% partnership interest in BCM LP from WR, MP and Sugarquay pursuant to the Deed of Assignment (see below), such partnership interest to be promptly contributed by way of capital to BCMC LP pursuant to the Deed of Contribution (see below);

(b) a loan note instrument (the “**Loan Note Instrument**”), made by BCMCL, creating and issuing US\$165 million in Loan Notes<sup>1</sup> which were to be issued to each of WR, MP and Sugarquay as consideration for the acquisition by BCMCL of an interest of approximately 8.7% of the limited partnership interests in BCM LP from WR, MP and Sugarquay;

(c) the “**Deed of Assignment**”, by which WR, MP and Sugarquay assigned to BCMCL the 19% interest in BCM LP with effect from 1 July 2007;

(d) the “**Deed of Adherence**”, through which BCMCL became a limited partner of BCM LP;

(e) the “**Deed of Subordination**”, pursuant to which the “**Subordinated Creditors**”, namely WR, MP and Sugarquay, agreed that financial liabilities of BlueCrest entities to the “**Senior Creditors**”, namely RBS, would take priority over those BlueCrest entities’ financial liabilities to WR, MP and Sugarquay;

---

<sup>1</sup> Pursuant to clause 5 and Schedule 2 of the Loan Note Instrument, the interest rate on the Loan Notes was 15%, although the actual amount payable by BCMCL in a given Interest Period could be lower depending on the funds allocated by BCMC LP to BCMCL pursuant to clause 13.4 of the BCMC LP deed. In those circumstances, the interest due on the Loan Notes would accumulate and roll over – see paragraph 8(17).

Pursuant to clause 11.1 of the Loan Note Instrument, BCMCL (the issuer of the Loan Notes) was restricted in its ability to dispose of its interest in BCMC LP. BCMCL was not permitted to do so unless it was to be substituted as debtor under clause 9.3 of the Loan Note Instrument or otherwise in accordance with the “Security Documents” as defined in the Facility Agreement.

(f) (following BCMCL's acquisition of the 19% interest in BCM LP) the "**Deed of Contribution**", through which BCMCL made a capital contribution to BCMC LP of the interest in BCM LP which had been assigned to it pursuant to the Deed of Assignment (and consequently resigned as a limited partner in BCM LP), in consideration for BCMC LP granting it certain partnership interests as per the BCMC LP Deed; and

(g) the "**Subscription Deed**", pursuant to which BCMCHL agreed that, in the event that it received any monies from RBS (more generally, the financial trader, being the counterparty to the TRS) pursuant to the TRS, BCMCHL would apply for shares in BCMCL in an equal amount.

(11) Following the resignation of BCMCL as a limited partner of BCM LP, BCMC LP became a limited partner in BCM LP (as envisaged by clause 3.1(a) of the Facility Agreement and clause 2.2 of the Deed of Contribution), in accordance with the BCM LP Deed, which was amended accordingly on 6 July 2007. Letters of allocation, dated 6 July 2007, were sent by BCML (as general partner of BCM LP) to WR, MP, Sugarquay and BCMCL (as general partner of BCMC LP). These noted that:

(a) WR had contributed £459,525 to the capital of BCM LP, his interest in the income profits and losses of BCM LP was 7.1886%, and his interest in the capital profits and losses of BCM LP was 7.1990%.

(b) MP had contributed £463,525 to the capital of BCM LP, his interest in the income profits and losses of BCM LP was 38.8462 per cent, and his interest in the capital profits and losses of BCM LP was 39.5833%.

(c) Sugarquay had contributed £100 to the capital of BCM LP, its interest in the income profits and losses of BCM LP was 22.5437%, and its interest in the capital profits and losses of BCM LP was 22.7702%.

(d) BCMC LP had contributed £100 to the capital of BCM LP, its interest in the income profits and losses of BCM LP was 19.0000%, and its interest in the capital profits and losses of BCM LP was 19.0000%.

(12) Pursuant to the transactions described above, on 6 July 2007 the 19% interest in BCM LP was acquired from WR, MP and Sugarquay in consideration for (a) cash payments (using funds available under the RBS Loan Facility) and (b) the issuance of the Loan Notes. The payments made, which totalled US\$361 million, were as follows:

(a) To WR:

(i) US\$192 million in cash for a 10.11% interest; and

(ii) US\$55 million in Loan Notes for a 2.89% interest;

(b) To MP:

(i) US\$2 million in cash for a 0.11% interest; and

(ii) US\$55 million in Loan Notes for a 2.89% interest;

(c) To Sugarquay:

(i) US\$2 million in cash for a 0.11% interest; and

(ii) US\$55 million in Loan Notes for a 2.89% interest.

(13) The US\$361 million valuation of the 19% interest acquired in BCM LP was agreed between the parties at the time.



## **Financing of the transaction and repayment under the Facility Agreement and Loan Notes**

(14) BCMC LP would be allocated profits by BCM LP pursuant to clause 12 of the BCM LP Deed; BCMC LP would, in turn, allocate profits to BCMCL pursuant to clause 12 of the BCMC LP Deed, and it was from this profit allocation that BCMCL would meet its obligation to pay interest under the Facility Agreement and the Loan Notes and, ultimately, in the ordinary course, repay them.

### ***Interest payment obligations***

(15) BCMCL was obliged to pay interest under the Facility Agreement, calculated by reference to the aggregate of LIBOR, a margin of 2.5% and a mandatory cost formula.<sup>2</sup> Repayment of the RBS Loan Facility was to be made pursuant to clause 6. This envisaged a Termination Date between three and five years after BCMCL had utilised the facility to acquire the 19% interest in BCM LP. If the RBS Loan Facility had not been fully repaid by the Termination Date, the outstanding amount was to be repaid monthly starting on that date (the "Repayment Start Date") and ending two years later.

(16) Under the terms of the Facility Agreement there were certain "Trigger Events" which would, pursuant to clause 22, result in the loan principal becoming repayable, in instalments, earlier than would otherwise have been the case. The principal Trigger Events were: if the AUM of funds managed by BCM LP fell below US\$8.25 billion or if the AUM as at a particular month had declined by more than 30% when compared to the AUM as at the month end falling 12 months prior to that particular month<sup>3</sup>. Clause 22 also provided that repayment would cease in certain situations, principally, and respectively for the Trigger Events mentioned above, if the AUM of funds managed by BCM LP increased to above US\$11 billion or if the AUM subsequently increased by 10% above the level that existed when the Trigger Event occurred.

(17) BCMCL was also obliged to pay interest under the Loan Note Instrument at 15% and the amount of BCMCL's drawings under clause 13.4 of the BCMC LP Deed had to be applied for such a purpose. Where BCMCL's drawings were less than the interest due, calculated at 15%, the difference would be deferred until such time as the requisite amounts were available to BCMCL under the BCMC LP Deed or otherwise on redemption.

(18) The Loan Notes were redeemable on the Final Maturity Date in July 2017 if and to the extent that funds were available for that purpose, or at any time before then by BCMCL on 30 days' notice. In addition, paragraphs 3.3 to 3.6 of Schedule 2 to the Loan Note Instrument provided for earlier redemption in whole or part on various events, such as a change of control of BCM LP, the derivation of "Superprofits" from BCM LP under clause 12.1(C) of the BCMC LP Deed, a Note Trigger Event (which was the

---

<sup>2</sup> See clause 8 and Schedule 4.

<sup>3</sup> Other trigger events, as set out in clause 1.1 and clause 21 of the Facility Agreement included, in summary:

- (a) The weighted average investment performance of the "Funds" (meaning the investment funds, partnerships, unit trusts, special purpose vehicles, other entities or vehicles, segregated accounts and managed accounts managed or advised by BCM LP from time to time) was worse than -25% for the prior 12 months;
- (b) The ratio of the "Financial Indebtedness" of BCMCL to BCM LP's "Profits Before Tax" exceeded 2.5:1;
- (c) MP no longer was employed by, or acted on behalf of, BCM LP in the same capacity; and
- (d) Various events of default.

same as a Trigger Event, as defined in the Facility Agreement, requiring early repayment of the RBS Loan Facility), or if there were a default by BCMCL in paying an amount due under the Loan Notes.

(19) In particular, paragraph 3.4 of Schedule 2 to the Loan Note Instrument provided that if profits of BCM LP were ever allocated to the Corporate Limited Partner in BCMC LP (i.e. RBS, then Fyled) by way of “Superprofits” pursuant to clause 12.1(C) of the BCMC LP Deed, BCMCL was required, subject to clause 5.2 of the Deed of Subordination, to redeem the whole or any part of the outstanding Loan Notes. Clause 5.2 of the Deed of Subordination<sup>4</sup>, provided that repayments in respect of the Loan Notes were permitted where:

- (a) no Trigger Event had occurred and was continuing; and
- (b) no repayment of the RBS Loan Facility (referred to as “Loan Wind Down”) had commenced and was continuing.

If those conditions were satisfied, BCMCL was permitted to make the following payments:

- (1) interest payments under the Loan Notes at 15% per annum (provided that all interest payments under the Facility Agreement had been paid); and
- (2) principal under the Loan Notes (provided that if such payments were to be made from “Excess Benchmark Profits”, then BCMCL must first use at least 33% of the “Excess Benchmark Profits” to repay principal under the Facility Agreement).

“Excess Benchmark Profits” were defined in clause 1.1 of the Facility Agreement.

“Benchmark Profits” were defined in clause 1.1 of the BCMC LP Deed.

(20) During the period when RBS was the Corporate Limited Partner under the BCMC LP Deed, clause 7.6 of the Facility Agreement provided that if BCMCL wished to repay any amount owing under the Loan Notes from “Excess Benchmark Profits”, BCMCL was required (consistently with clause 5.2 of the Deed of Subordination) to apply at least 33% of such “Excess Benchmark Profits” in prepayment of principal under the terms of the Facility Agreement.

#### *Profit allocation provisions*

(21) The provisions in the BCM LP Deed, stipulating how the profits generated by BCM LP’s investment management business were to be allocated, were contained in clause 12 and operated, in summary, as follows:

- (a) In the absence of any Trigger Event, BCM LP profits were to be allocated amongst the partners, pursuant to clause 12.1(A), as follows:
  - (i) First, an allocation to BCML as general partner to meet working capital requirements and any contingencies;
  - (ii) Secondly, performance-related payments as determined by BCML;

---

<sup>4</sup> Subsequently clauses 7.10 and 8.3 of the Deed of Subordination as amended on 11 June 2008 when Fyled replaced RBS; see paragraphs 8(27) and 8(28) below. “Superprofits” were defined in clause 12.1(C) of the BCMC LP Deed.

(iii) Thirdly, an allocation to BCMC LP to cover any monthly drawings by BCMCL to pay the interest due under the RBS Loan Facility<sup>5</sup>;

(iv) Fourthly, the remainder, which for the purposes of the sub-clause would be increased by adding an amount equal to (iii) above, would be allocated to the partners, in the “Agreed Proportions”, ie (as defined in clause 1.1 of the BCM LP Deed) the proportions set out in the letters of allocation sent by BCMCL (as general partner of BCM LP) to the respective partners or in their Deed of Adherence on their admission as a partner of BCM LP, provided that the amount allocated to BCMC LP would be reduced by an amount equal to (iii) above.

(b) If a Trigger Event occurred and was continuing, so that early repayments of principal became due under the Facility Agreement and the Note Instrument, clause 12.1(C) of the BCM LP Deed disappplied the provision in subparagraph (a)(iv) above and instead the “Remaining Profits” (ie such of BCM LP’s as were left over after allocation in accordance with subparagraphs (a)(i)-(iii) above) were to be allocated to BCMC LP and would in turn be allocated by BCMC LP to its partners under the terms of the BCMC LP Deed, as described below.

(22) The profits of BCMC LP were agreed to be distributed among the partners of BCMC LP as follows:

(a) Clause 12.1(A) of the BCMC LP Deed provided for the following profit allocation, absent the circumstances specified in clause 12.1(B) and (C):

(i) First, an allocation to BCMCL as general partner to meet working capital requirements and any contingencies;

(ii) Secondly, an allocation to BCMCL as general partner to cover any monthly drawings by BCMCL to pay the interest due under the RBS Loan Facility<sup>6</sup>;

(iii) Thirdly, an allocation to BCMCL as general partner to fund the 15% interest on the Loan Notes, and any accrued but unpaid interest on the Loan Notes from previous financial years;

(iv) Fourthly, from any remaining profits of BCMC LP, an allocation to BCMCL as general partner of such amount of the profits as BCMCL would decide, in its absolute discretion, should be used to redeem Loan Notes; and

(v) Fifthly, the remainder would be allocated to the individual limited partners, excluding the Corporate Limited Partner, ie RBS,<sup>7</sup> in the “Agreed Proportions”, ie (as defined in clause 1.1 of the BCMC LP Deed) the proportions set out in the letters of allocation between BCMCL and each of the individual limited partners or in their Deed of Adherence on their admission as a partner of BCMC LP.

---

<sup>5</sup> “Advance Drawings” under clause 13.4(B).

<sup>6</sup> “Advance Drawings” under clause 13.4(B).

<sup>7</sup> Subsequently, from 11 June 2008, Fyled; see paragraphs 8(27) and 8(28) below. the individual limited partners or in their Deed of Adherence on their admission as a partner of BCMC LP.

(b) Clause 12.1(B) of the BCMC LP Deed disappplied the allocation provisions set out in subparagraphs (a)(iii)-(v) above in three cases:

- (i) If a “Trigger Event” occurred<sup>8</sup>; or
- (ii) From the Repayment Start Date<sup>9</sup> until after the Facility Repayment Date<sup>10</sup>; or
- (iii) During a Note Repayment Period<sup>11</sup>.

(c) In any of the cases specified in clause 12.1(B), while they continued, BCMC LP’s profits were to be allocated as follows:

- (i) First, to meet working capital requirements and any contingencies;
- (ii) Secondly, to cover any monthly drawings by BCMCL to pay the interest due under the RBS Loan Facility;
- (iii) Thirdly, to the Corporate Limited Partner, ie RBS,<sup>12</sup> or BCMCL as provided for in subclauses (1), (2) and (3) of clause 12.1(B);
- (iv) Fourthly, to fund the 15% interest on the Loan Notes, and any accrued but unpaid interest on the Loan Notes from previous financial years;
- (v) Fifthly, from any remaining profits of BCMC LP, such amount of the profits as BCMCL would decide should be used to redeem Loan Notes; and
- (vi) The remainder would be allocated to the individual limited partners, excluding the Corporate Limited Partner in the “Agreed Proportions”.

(d) Clause 12.1(C) of the BCMC LP Deed disappplied the allocation provisions set out in subparagraphs (a)(iv) and (a)(v) above in the event that BCM LP earned profits in excess of certain “Benchmark Profits” (see subparagraph (19) above) for any of the accounting periods ending 31 December 2007 through to 3 December 2011. In that event, BCMC LP’s profits were to be allocated as follows:

- (i) First, to meet working capital requirements and any contingencies;

---

<sup>8</sup> As defined in the Facility Agreement; see clause 1.1 and paragraph 8(16) above.

<sup>9</sup> As defined in clause 6.1(b) of the Facility Agreement; see clause 1.1 of the BCMC LP Deed and paragraph 8(15) above.

<sup>10</sup> The date on which all sums advanced to BCMCL under the Facility Agreement shall have been repaid and BCMCL shall have no further obligations under the Facility Agreement, see clause 1.1 of the BCMC LP Deed.

<sup>11</sup> As defined in clause 1.1 of the BCMC LP Deed to mean, in essence, either (a) the period between the occurrence of a Trigger Event and the conclusion of Loan Wind Down (in accordance with clause 22 of the Facility Agreement) or the full repayment of the Loan Notes (whichever happens first) or (b) the period from July 2017 (being the latest possible maturity date of the Loan Notes) to the complete repayment of the Loan Notes (other than any part of such period as occurred prior to full repayment of the Facility Agreement).

<sup>12</sup> Subsequently, from 11 June 2008, Fyled; see paragraphs 8(27) and 8(28) below.

- (ii) Secondly, to cover any monthly drawings by BCMCL to pay the interest due under the RBS Loan Facility;
- (iii) Thirdly, to fund the 15% coupon on the Loan Notes, and any accrued but unpaid interest on the Loan Notes from previous financial years;
- (iv) Fourthly, in paying "Superprofits" (as defined) to the Corporate Limited Partner;<sup>13</sup>
- (v) Fifthly, from any remaining profits of BCMC LP, such amount of the profits as BCMCL would decide should be used to redeem Loan Notes; and
- (vi) The remainder would be allocated to the individual limited partners, excluding the Corporate Limited Partner in the "Agreed Proportions".

(23) In the event, RBS never received any allocation in connection with BCM LP making "Superprofits" within clause 12.1(C), although subsequently Fyled did.

(24) Once BCMCL's debt to RBS had been repaid, or a trigger event was no longer in effect so that the repayments of loan principal were not due, the Corporate Limited Partner in BCMC LP would no longer be entitled to share in the income profits.

(25) Following the "Note Repayment Date" (meaning the date on which all of the Loan Notes and the interest accrued thereon had been repaid and BCMCL had no further repayment obligations in respect thereof), BCMCL would use any profits allocated to it,<sup>14</sup> and any other profits of BCMC LP not allocated to the Partners, solely for the benefit of BCMC LP and not distribute them otherwise.<sup>15</sup> This was further formalised, for consideration of £1 from each party, by an undertaking to comply with this requirement contained in a side letter dated 6 July 2007 from BCMCL to MP, WR and Sugarquay.

#### **Additional limited partners of BCMC LP**

(26) Over time several individuals were introduced as limited partners of BCMC LP and allocated interests in the income and capital profits of BCMC LP. Specifically, on 23 November 2007, further individuals were admitted as limited partners of BCMC LP and on 1 November 2008 they were allocated "Agreed Proportions". This had no effect on BCMCL's interest in BCMC LP.

#### **Replacement of RBS by Fyled in June 2008**

(27) RBS was the original Corporate Limited Partner (as defined in the BCMC LP Deed) in BCMC LP and the counterparty to the TRS. RBS was replaced by Fyled as a party to the TRS and as the Corporate Limited Partner in BCMC LP on 11 June 2008.

(28) To this end, on 11 June 2008, the following transactions took place:

---

<sup>13</sup> Payment of these "Superprofits" would trigger the Corporate Limited Partner's payment obligations to BCMCHL under the TRS. If the Corporate Limited Partner was no longer a partner, the TRS had been terminated and following the Facility Repayment Date, any Superprofits were to be allocated to BCMCL.

<sup>14</sup> Pursuant to clauses 12.1(A) and 13.4(B) of the BCMC LP Deed.

<sup>15</sup> See clause 12.3 of the BCMC LP Deed.

(a) By a deed of assignment, RBS assigned its entire interest in BCMC LP to Fyled.<sup>16</sup>

(b) The TRS was novated to replace RBS with Fyled as BCMCHL's counter-party.

(c) The "**Financial Contract**" was entered into between BCMCHL and MS Cooper, a UK incorporated limited liability company wholly owned by the Morgan Stanley Group, with an effective date of 1 August 2008 and a termination date of 5 July 2017.

(29) The Financial Contract was effectively a replacement for the TRS, and the novation confirmation for the TRS provided that the TRS was to terminate on the date of the last fixed payment to be made by BCMCHL thereunder, no later than 31 July 2008. Under the novated TRS, the second fixed payment due from BCMCHL to its counterparty was reduced from US\$500,000 to US\$300,000.

(30) The Financial Contract operated in the same way as the TRS, with MS Cooper in the position of RBS, save that:

(a) Whereas from July 2007 until June 2008 profit distributions, if any, would be made by BCMC LP to RBS, they would now be made to Fyled as the Corporate Limited Partner in BCMC LP.

(b) MS Cooper would pay BCMCHL, in summary, an amount calculated as between % and 94.4% of the amount received by Fyled by way of profit allocation from BCMC LP (higher than the 87.5% which RBS would have paid under the TRS).<sup>17</sup>

(31) The payments to be made by Fyled pursuant to the novated TRS, and by MS Cooper pursuant to the Financial Contract, were guaranteed by Morgan Stanley, which was the ultimate parent of both Fyled and MS Cooper.

(32) In the event, BCMC LP made one profit allocation to Fyled arising from Superprofits which triggered a payment by Fyled under the TRS. Subsequently, there were a number of profit allocations to Fyled arising from Superprofits which triggered payments by MS Cooper under the Financial Contract.

### **Transfer from BCM LP to BCM LLP in December 2008**

(33) The business of BCM LP was transferred as a going concern to BCM LLP on 1 December 2008. Through its partnership interest in BCMC LP, BCMCL was thereafter treated as carrying on the underlying trade of BCM LLP through a PE in the UK.

### **Changes in 2009 to 2011**

(34) In April 2010 a reorganisation was effected under which BCM LLP migrated to Guernsey with effect from 1 April 2010. A new entity, BCM UK LLP, was incorporated and commenced trading in the UK, and BCMC LP also became a partner in this entity, becoming entitled under clause 10.3(A)(4) of the BCM UK LLP partnership deed to be considered for profit allocations.

---

<sup>16</sup> Since 8 July 2011, Fyled has been called Morgan Stanley Montrose Investments Limited.

<sup>17</sup> The upper and lower bounds of the amounts payable to BCMCHL were set by reference to 40 per cent and 20 per cent, respectively, of the then-applicable rate of UK corporation tax (which was 28 per cent in July 2008) and would vary if that rate varied.

(35) On 30 November 2010 Fyled ceased to be a partner of BCMC LP, and the Financial Contract was terminated.

(36) In 2011, transactions were undertaken pursuant to which BCMCL would ultimately acquire the remaining interests in the relevant BlueCrest entities ultimately held by WR and Sugarquay. As part of these transactions BCMCL's existing debt arrangements were renegotiated, including the redemption of the Loan Notes and the refinancing of the remaining balance on the RBS Loan Facility of US\$172 million as part of a new, syndicated loan of US\$610 million.

(37) Following these transactions, BCMCL continued to receive drawings from BCM UK LLP sufficient to cover the interest payable on the part of the new, syndicated loan attributable to the refinanced balance on the RBS Loan Facility (ie US\$172 million).

### **Repayment**

(38) BCMCL made repayments of the new syndicated loan during 2011 and 2012, leaving an outstanding balance of US\$197 million, which was refinanced on 9 July 2013 as part of a new loan facility. No share of BCM UK LLP profits was allocated to BCMCL after that date.

### **HMRC's tax enquiries**

(39) HMRC opened enquiries into the Appellants' tax returns under paragraph 24 of schedule 18 to the Finance Act 1998 (the "**FA 1998**") (in respect of BCMCL) and s 12AC of the Taxes Management Act 1970 (the "**TMA 1970**") on the following dates:

<b>Entity</b>	<b>Return under enquiry</b>	<b>Date of enquiry notice</b>
BCMCL	Period ended 30 November 2007	24 November 2009
BCMCL	Year ended 30 November 2008	13 October 2010
BCMCL	Year ended 30 November 2009	31 October 2011
BCMCL	Year ended 30 November 2010	27 February 2013
BCMCL	Period ended 31 December 2010	27 February 2013
BCMCL	Year ended 31 December 2011	29 August 2013
BCMCL	Year ended 31 December 2012	28 November 2014
BCMCL	Year ended 31 December 2013	10 November 2015
CMC LP	Year ended 30 November 2009 (fiscal year ended 5 April 2010)	31 October 2011
BCMCLP	Period ended 31 December 2010 (fiscal year ended 5 April 2011)	19 December 2012
BCMCLP	Year ended 31 December 2011 (fiscal year ended 5 April 2012)	29 August 2013

BCMC LP	Year ended 31 December 2012 (fiscal year ended 5 April 2013)	28 November 2014
BCMC LP	Year ended 31 December 2013 (fiscal year ended 5 April 2014)	10 November 2015

(40) By letter dated 31 March 2017, HMRC sent Closure Notices to the Appellants in respect of the above enquiries.

(41) As a result of HMRC's primary analysis in respect of what is referred to as the "Profit Allocation Issue" in the Appellants' Grounds of Appeal, HRMC's Statement of Case, and the Appellants' Reply, HMRC assessed the additional profits chargeable to tax in respect of BCMCL as follows:

<b>Accounting period</b>	<b>Increased profits in BCMCL tax return</b>
Period ended 30 November 2007	
Year ended 30 November 2008	£13,138,385
Year ended 30 November 2009	£33,988,539
Year ended 30 November 2010	-
Period ended 31 December 2010	-
Year ended 31 December 2011	-
Year ended 31 December 2012	-
Year ended 31 December 2013	-

(42) As a result of HMRC's primary analysis in respect of what is referred to as the "Interest Deductibility Issue" in the Appellants' Grounds of Appeal, HRMC's Statement of Case, and the Appellants' Reply, HMRC assessed the additional profits chargeable to tax in respect of BCMCL as follows:

<b>Accounting period</b>	<b>Increased profits in BCMCL tax return</b>
Period ended 30 November 2007	£8,085,412
Year ended 30 November 2008	£19,325,305
Year ended 30 November 2009	£16,576,629
Year ended 30 November 2010	£14,760,346
Period ended 31 December 2010	£945,990
Year ended 31 December 2011	£4,071,658



Year ended 31 December 2012	£3,528,780
Year ended 31 December 2013	£1,138,229

(43) As a result of their analysis above in respect of the Profit Allocation Issue and the Interest Deductibility Issue, HMRC contend that the following sums are chargeable by way of corporation tax in respect of the following periods. The Appellants deny that these sums are due as alleged or at all.

<b>Accounting period</b>	<b>Increased amount said by HMRC to be chargeable by way of corporation tax in respect of BCMCL</b>
Period ended 30 November 2007	£2,544,324.20
Year ended 30 November 2008	£9,687,361.06
Year ended 30 November 2009	£14,513,915.64
Year ended 30 November 2010	£3,898,001.52
Period ended 31 December 2010	£245,302.12
Year ended 31 December 2011	£833,335.96
Year ended 31 December 2012	£847,217.68
Year ended 31 December 2013	£296,333.39

(44) On the basis that HMRC have agreed to allow deductions to be taken in respect of administrative expenses incurred by BCMCL, the figures as included in the above table are required to be adjusted. The revised figures are as follows:

<b>Accounting period</b>	<b>Increased amount said by HMRC to be chargeable by way of corporation tax in respect of BCMCL</b>
Period ended 30 November 2007	£2,419,660.10
Year ended 30 November 2008	£9,428,891.79
Year ended 30 November 2009	£14,433,165.32
Year ended 30 November 2010	£3,755,792.32
Period ended 31 December 2010	£233,451.40
Year ended 31 December 2011	£833,335.96
Year ended 31 December 2012	£847,217.68
Year ended 31 December 2013	£296,333.39

#### **AGREED ISSUES**

This is the statement of issues as agreed between the parties.

The question for the Tribunal's determination is whether HMRC's amendments to the Appellants' tax returns, as detailed in the Closure Notices and Discovery Amendment, should be set aside. The parties envisage that this raises the following issues for the Tribunal's determination:

(In the terminology adopted in the Appellants' Grounds of Appeal, HMRC's Statement of Case, and the Appellants' Reply, Issues 1 and 2 below fall within the "**Profit Allocation Issue**", and Issues 3 to 5 fall within the "**Interest Deductibility Issue**".)

(1) Is BCMCL liable to corporation tax on all of the profit allocations of BCM LP in respect of the 19% interest in BCM LP sold by WR, MP and Sugarquay in July 2007? In this regard was BCMC LP a partner of BCM LP and, if not, were all the partners of BCMC LP to be treated as partners of BCM LP?

(2) Did BCMCL's entitlement to the profits of BCMC LP include those allocated to RBS/Fyled (less amounts retained by Fyled as fees for its involvement in the arrangements)? In this regard:

(a) What were the "profit-sharing arrangements", within the meaning of s.1262 of the CTA 2009, relevant to BCMC LP?

(b) In particular, were they confined to the BCMC LP Deed, or did they encompass other contractual agreements and, if so, which other agreements?

(3) Are BCMCL's interest costs on the RBS Loan Facility and the Loan Notes, entered into by BCMCL to acquire 19% partnership interest in BCM LP, allowable deductions under the CTA 2009 in calculating BCMCL's chargeable profits for corporation tax purposes? If so, to what extent are they allowable?

(4) Is the equity and debt structure of BCMCL's UK PE in any way not representative of a structure that could have been achieved if the parties were operating on an arm's length basis (i.e. is BCMCL's UK PE 'thinly capitalised') such that the deduction claimed by BCMCL in respect of interest costs on the RBS Loan Facility and the Loan Notes is to be restricted? If so, to what extent is the deduction restricted? In this regard:

(a) Are the conditions of s 147(1) TIOPA for the application of the transfer pricing provisions of Part 4 of TIOPA satisfied in relation to the RBS Loan Facility and the Loan Notes?

(b) In particular:

(i) Were the RBS Loan, the Sugarquay Loan, the MP Loan and the WR Loan arm's length provisions?

(ii) Is it necessary that MP or WR be characterised as "enterprises", for them to be within the scope of Part 4 of the TIOPA 2010 and, if so, is such characterisation merited based on the facts of the case?

(5) Are the RBS Loan Facility and the Loan Notes to be classified as "trading loan relationships" or "non-trading loan relationships" for the purposes of Part 5 of the CTA 2009? In relation to this, was BCMCL party to the RBS Loan Facility and the Loan Notes (i.e. to the Sugarquay Loan, the MP Loan and the WR Loan) for the purposes of a trade it carried on (a) at the time of the loans and (b) during each accounting period when the loan interest expense was incurred?

(6) In relation to the Discovery Amendment:

(a) Was the Discovery Amendment validly made under s.30B of the TMA 1970?

- (b) If so, were the adjustments made thereunder correct?

## **Evidence**

9. In addition to the Statement of Agreed Facts and Issues provided by the parties, I heard from the following witnesses:

(1) Andrew Dodd, a limited partner of BlueCrest Capital Management LP (“BCM LP (Guernsey)”), a Guernsey limited partnership, and a director and the Chief Financial Officer (“CFO”) of its general partner, BlueCrest Capital Management Limited (“BCML (Jersey)”), a Jersey-incorporated company, and a member of the board of directors of various other affiliated entities. He also acts as a Non-Executive Director for AgFe Group Limited, a holding company (incorporated in England and Wales in December 2007) for a group of operating entities affiliated with the BlueCrest group which provide financial advisory and asset management services and has held that appointment since December 2007. He became a limited partner of BCM LP with effect from 1 January 2006 and has subsequently worked as BlueCrest’s CFO and has held directorship roles in a number of other BlueCrest management entities (often concurrently), as well as non-executive roles on the boards of many of the funds managed by BlueCrest from time to time.

(2) Robin Aitchison, who is, since his appointment in 1999, an EY tax partner. He has advised the Cayman Appellants since the commencement of their trade in 2000 and, more specifically, from 2003, in relation to their dealings with HMRC.

(3) Carmel Coles, an Officer of HMRC who made the discovery amendment. The appeal against that assessment is Issue 6 of the agreed issues, and I consider the evidence of Mrs Coles below in relation to that issue.

(4) Marcus Stanton, who was called by the Cayman Appellants to give expert evidence on transfer pricing, having produced a Report dated 3 May 2019. Mr Stanton is a banking consultant whose main area of expertise is structured finance, particularly structures involving complex funding methodology. He has undertaken research and investigatory work for various banks, companies and governmental agencies, both in the UK and overseas and has also given expert evidence in various Court proceedings (both in the UK and abroad). Mr Stanton also acts as a chairman and non-executive director of a number of companies, quoted on the London Stock Exchange, with specific responsibility for banking and financial matters, typically as Chairman of the Audit Committee, and continues to be involved in all aspects of corporate finance, particularly those relating to the equity and debt markets. He was, from 1993 to 2001, a Director at the investment bank Robert Fleming & Co where he was Chief Operating Officer, Global Capital Markets and Head of Structured Finance. Previously (1982-1993), he was a Director, Corporate Finance, at the merchant bank Hill Samuel & Co, having qualified as a Chartered Accountant at Arthur Anderson. He is a Fellow of the Chartered Institute of Chartered Accountants of England and Wales and a Chartered Fellow of the Chartered Institute for Securities and Investments.

(5) Philip Maggs, who was called as a transfer pricing expert by HMRC, is a director of Frontier Economics Limited, a consultancy firm specialising in applied economics with a staff of about 250 professional economists. He produced a Report, dated 3 May 2019. Mr Maggs leads Frontier’s work in the area of business strategy and regularly advises clients on matters relating to competition law and other commercial disputes. He has previously advised HMRC and other tax authorities on transfer pricing cases. His work for clients in the fields of business strategy and competition policy is not confined to specific industrial sectors and he has worked with clients in a variety of

industries including retail, consumer products and financial services. As part of his role in advising on business strategy Mr Maggs has supported clients through a wide range of issues including the assessment and completion of mergers and acquisitions, investment appraisal, new market entry strategies, assessment of the cost of capital, financial risk management, contract design and negotiation, internal transfer pricing (for commercial rather than tax purposes) and assessing the drivers of credit risk. Mr Maggs is not a banker and approached his report very much from an economics perspective, which is where his expertise lies.

10. In addition to their individual Reports, Mr Stanton and Mr Maggs produced a Joint Experts Report dated 5 September 2019. The purpose of this Report was to identify points of agreement and points of disagreement between them and, where possible, explain the reasons for any disagreement. I will return to this Joint Report and the evidence of Mr Stanton and Mr Maggs in relation to the transfer pricing issue, Issue 4.

11. Because of the level of agreement between the parties it was not necessary for either party to call expert evidence in relation to Cayman Islands law. Matthew Goucke of Walkers who was instructed by the appellants produced two reports, the first dated 8 March 2019 and the second 23 March 2019. HMRC instructed Sebastian Said of Appleby who produced a report dated 26 April 2019. A meeting was held between the experts on 7 June 2019 and this was followed by telephone conferences on 9, 17, 18 and 25 July 2019. As a result limited areas of agreement and disagreement were identified and a Joint Memorandum of the Experts of Cayman Law, dated 25 July 2019 to which I refer in regard to Issue 2, below, was produced.

#### **Further findings of fact**

12. As is clear from the above Statement of Agreed Facts, there is little between the parties in relation to the factual context of this appeal. However, to assist in the understanding of the circumstances and background of the case it is necessary to expand on the Statement of Agreed Facts by reference to the evidence and contemporaneous documents.

13. As noted in the Statement of Agreed Facts, BlueCrest, an alternative asset management business, was established by WR and MP in 2000. On 4 August BCML, a company incorporated on 28 April 2000, entered into a limited partnership under the Limited Partnership Act 1907 to establish BCM LP. BCML was the general partner and WR and MP limited partners.

14. This is clear from the recitals to the original Limited Partnership Deed of 4 August 2000:

#### **“Background**

- (A) The General Partner and the Founder Limited Partners desire to form a limited partnership (the “Partnership”) to carry on the business of managing on a discretionary basis the trading and investment of assets belonging to third parties and associated activities (the “Business”)
- (B) Each of the parties hereto hereby agrees to establish and operate the Partnership from the date hereof and to carry on the Business in accordance with the terms and conditions of this Agreement.”

15. The Deed continues, defining “BlueCrest Funds” as “any investment funds (whether in corporate, partnership, trust or any other form) established or promoted by the Partnership from time to time” and “Funds” as “the BlueCrest Funds and any other investment funds in relation to which the Partnership manages part or all of the assets thereof from time to time.” It also defined “Further Limited Partners” as “any person who has entered into a Deed of Adherence with the Founder Partners pursuant to Clause 20.”

16. Clause 12 of the Deed, headed “Allocations”, states:

“12.1 The profits or losses of the Partnership arising from the Business shall be allocated to the General Partner, and the Founder Limited Partners in the Proportion 2:49:49.

12.2 Without prejudice to the generality of the foregoing, the General Partner shall have discretion to vary the proportional allocation of profits due to the Partners pursuant to Clause 12.1 provided that the proportional allocation of profits to the Further Limited Partners.”

17. In December 2000 BlueCrest Capital International was launched. This was the first BlueCrest fund for which BCM LP was appointed as investment manager. Mr Dodd explained that between 2000 and 2007 several independent offshore BlueCrest-branded funds (incorporated in the Cayman Islands or the United States and managed by BCM LP) were launched which covered a wide range of asset classes and investment strategies. BCM LP, as investment manager, was the recipient of all fee income from the services it performed in managing those funds pursuant to investment management agreements it had with each fund.

18. Over this period the BlueCrest Business grew, generating very strong returns. Its staff numbers increased from approximately 40 in 2003, to 63 in 2005 and to 294 in 2007. The number of limited partners also increased and the straightforward allocations clause became more complicated in subsequent Deeds to reflect both this and the addition of Sugarquay as a limited partner (as the Statement of Agreed Facts records (at paragraph 8(4), above) Sugarquay was the corporate vehicle through which Man Group plc (a third party investor) acquired and held its investment in BCM LP).

19. This is apparent from the allocations clause, Clause 12, of the 2003 Deed. This provided:

“12.1 Subject to Clause 12.4, in respect of each financial year of the Partnership (commencing with the financial year of the Partnership beginning on 1 December 2003) the profits of the Partnership as shown by the accounts of the Partnership prepared in accordance with Clause 17 (and after the deduction of any sums payable to an Outgoing Partner pursuant to the provisions of Clause 22 (other than such Outgoing Partner's capital contribution)) shall firstly be adjusted by adding thereto an amount equal to any sums paid by the Partnership to J.P. Morgan Alternative Asset Management Inc (or its affiliates) pursuant to the JPM Agreement in the relevant financial year of the Partnership (the “JPM Payment”) and such profits as adjusted shall then be allocated amongst the partners as follows:-

- (A) firstly, there shall be allocated to the General Partner such amount of profits as shall in the good faith opinion of the General Partner be required to be retained in the Partnership (i) as working capital to meet anticipated, current or foreseen liabilities and expenditure of the Partnership, (ii) to cover other contingencies in accordance with general principles of prudent management and (iii) to satisfy any obligation imposed on the General Partner by the Financial Services Authority to maintain a minimum level of financial resources; and
- (B) the remainder of the profits shall be allocated to the Partners in the proportions set out opposite their respective name in the third column of Schedule 3 (subject to amendment in accordance with Clause 12.5 on the admission of Further Limited Partners or otherwise) provided that the amount allocated to each of the Founder Limited Partners shall be reduced in the case of each Founder Limited Partner by an amount equal to a proportion of the JPM Payment being a proportion equal to the proportion that the interest of such Founder Limited Partner in the capital profits of the

Partnership (in accordance with Clause 12.4 and as set out from time to time in Schedule 3) bears to the interest of all the Founder Limited Partners in the capital profits of the Partnership (in accordance with Clause 12.4 and as set out from time to time in Schedule 3) provided that the foregoing reductions may be reduced in relation to any Founder Limited Partner with the prior approval of the Corporate Limited Partner [Sugarquay],

provided that the Corporate Limited Partner shall only be entitled to participate in the performance fees (if any) receivable by the Partnership in respect of the calendar year ending on 31 December 2003 (the "Performance Fees") in accordance with the following provision.

The Corporate Limited Partner shall only participate in the Performance Fees in relation to the month of December 2003 (the "Month") and provided that in relation to the performance fees which shall be earned in the Month the Corporate Limited Partners' entitlement shall be calculated as follows:

$$25\% \times (A-8)$$

where:

A = the positive change in cumulative performance fees during the Month (in each case as certified by the administrator of each relevant fund that is obliged to pay such fees); and

B = the positive change in cumulative trader bonuses during the Month (in each case as certified by the administrator of each relevant fund).

In addition, for the avoidance of doubt, in calculating Man's entitlement to be allocated profits in accordance with this clause 12, Man's share of non-trader bonuses which become payable by the Partnership in December 2003 shall be 25% of one twelfth of the non-trader bonuses payable by the Partnership in December 2003.

20. Provision was made in Clause 12.2 for allocations in the case of losses. However, this has not been applied as BCM LP did not make any losses. Clause 12.3 provided for profits allocated to the General Partner under Clause 12.1(A) and Clause 12.4 made provision for the allocation of capital profits and losses.

21. Clause 13, "Partner's Accounts and Distributions", provided:

"13.1 Each Partner shall have, inter alia, a Capital Contribution Account and a Distribution Account which shall be operated in accordance with the provisions of Clauses 13.2 to 13.4. In addition, the General Partner shall have a Retention Account which the General Partner shall operate in accordance with the provisions of Clause 12.3.

13.2 The capital contribution of each Partner shall be credited to that Partner's Capital Contribution Account.

13.3 The profits allocated to the Partners in respect of each financial year of the Partnership pursuant to Clause 12 shall be credited to the Distribution Accounts of the Partners as to 70 per cent within 30 days of the end of the relevant financial year and as to the balance within 30 days of the completion of the preparation of the accounts of the Partnership for the relevant financial year in accordance with Clause 17. Each Partner shall be permitted to withdraw amounts standing to

the credit of its Distribution Account from the date that such amounts are so credited.”

22. Other relevant clauses in the Deed provided:

**“20. New Partners**

20.1 The General Partner may at any time admit any person to the Partnership as a Further Limited Partner provided that such person executes a Deed of Adherence and the General Partner notifies the other Partners of the proposed admission of such Further Limited Partner at least 10 Business Days prior to such admission. In addition any third party purchaser that shall acquire any interest in the Partnership pursuant to Clause 19 shall execute a Deed of Adherence at the time that he completes (but as a pre-condition to) such acquisition.

**21. Removal of Limited Partners**

21.1 The General Partner shall have the absolute right to serve a Notice of Removal on any Individual Limited Partner (other than either of the Founder Limited Partners) at any time, substantially in the form set out in Schedule 2 hereto, (i) in the event that the General Partner in its absolute discretion considers the service of such notice to be in the best interests of the Partnership or (ii) in the event that such Individual Limited Partner at any time:-

- (A) is guilty of any serious misconduct or serious neglect in the discharge of his duties as an officer or employee of the General Partner; or
- (B) is convicted of any criminal offence other than a road traffic offence (including any criminal offence under any present or future statutory enactment or regulation relating to insider dealing); or
- (C) fails to comply with the rules or regulations of any appropriate regulatory organisation (including what limitation the principles and code of practice for approved persons published by the Financial Services Authority) to whose rules, regulations or equivalent the Partnership or the General Partner is for the time being subject;
- (D) ceases to be approved by the Financial Services Authority as a person who can undertake any controlled function or is censured by, or has any licence or authorisation revoked by, a regulatory body;
- (E) misuses any Confidential Information (as defined in Clause 26) relating to the General Partner or the Partnership or any customer or client thereof;
- (F) by his actions or omissions brings the name or reputation of the General Partner or the Partnership into serious disrepute or prejudices the interests of the business of the General Partner or the Partnership; or
- (G) is penalised for abusing the market under any present or future statutory enactment or regulation or otherwise acts in contravention of any enactment or regulation relating to the conduct by the General Partner or the Partnership of the Business, which has a materially adverse or prejudicial impact on

the affairs or prospects of the Business or the reputation of the Partnership.”

23. In 2004, following Man’s acquisition of its interest in BCM LP the previous year, BCM LP’s AUM rose by 50% to approximately US\$4.7 billion. However, as Mr Dodd explained, the expected benefits envisaged by Man Group at the time of its investment, of using its distribution network to help BCM LP increase its AUM did not come to fruition. As a result, in mid-2007 the senior management of Man Group plc told MP and Mr Dodd that from then on, it should no longer be considered as a “business partner” but as “financial investor”. This was understood by MP and Mr Dodd to mean that Man Group plc would be a willing seller of its interest in BCM LP if the price was right.

24. Because of the sustained growth over this period, more individuals became limited partners in BCM LP. This is clearly apparent in the subsequent versions of the BCM LP Deed. For example, that of 30 November 2006 listed 34 limited partners and this had increased to 51 by the time the 6 July 2007 version of the BCM LP Deed was executed.

25. However, in July/August 2006 WR, who at that time held a 20% interest in BCM LP, had decided to retire from the day-to-day management of the business but, as Mr Dodd explained, it was not at that time feasible for the existing partners to simply acquire WR’s interest, calculated at that time to be worth approximately US\$476 million, in its entirety. As, at that time, there was, what Mr Dodd described as, an increasingly competitive labour market, particularly in respect of the recruitment and retention of top traders with a proven track record, he saw WR’s retirement as an opportunity to continue the sustained growth achieved by BCM LP during this period and a means of incentivising the next generation of limited partners by presenting them with the prospect of a profit and capital-bearing interest in the business. He considered that sale of WR’s interest in BCM LP on retirement could be utilised as part of an “equity pool” to address the need to incentivise and retain personnel and provide selected limited partners with the opportunity to participate in, and benefit from, the future growth of the BlueCrest business.

26. Mr Dodd envisaged that some or all of the equity held by WR could be purchased by an entity within BlueCrest using financing which could then be distributed over the long term, as and when appropriate, to senior traders, members of the Systematic trading team, and senior non-trading staff to reward outstanding contribution to the business as well as to incentivise those individuals to remain with the business and also to attract future talent. He explained that it was intended that the financing required for the purchase of WR’s interest in BCM LP and the creation of the equity pool would be serviced and repaid ultimately from the profits generated by the business even though it would take some time to do so.

27. Mr Dodd described the benefits of the creation of such an equity pool as:

- (1) giving limited partners of BCM LP the prospect of greater financial reward by giving them a prospect of being allocated an income and capital interest in the business, which would act as an incentive for them to remain with the business rather than moving to a competitor (in particular, allowing top performers, particularly in the Systematic team and the senior non-investment individuals, who only held a small interest in BCM LP, to receive a greater level of financial reward linked to the overall business); and
- (2) facilitating the distribution of these interests in the equity pool without diluting MP’s or Sugarquay’s respective shares in BCM LP any further.

28. Therefore, BCM LP consulted its advisors, Colin Leaver and Mark Norris of Simmons & Simmons LLP and Mr Aitchison of EY to, as Mr Aitchison described it, consider from a tax perspective how the purchase of WR’s interest in BCM LP might be structured, with a view to



using that acquired interest to support the Partnership's growing commercial need to incentivise and retain partners in the business. Also, around December 2006 Mr Aitchison was told by Mr Dodd that in addition to WR reducing his interest in BCM LP both MP and Sugarquay had decided to sell an element of their respective interests in BCM LP too.

29. The proposed transaction was to sell 19% of the interest in BCM LP, being made up of a 13% interest by held WR, a 3% interest held by MP and a 3% interest by held Sugarquay. Mr Dodd therefore engaged with WR, MP and Sugarquay regarding the value to be attributed to this 19% interest and a market comparison method was employed which compared the BlueCrest business with comparable businesses based on information to which they had access.

30. Mr Dodd said that the effectiveness of the market comparison approach would depend on the degree of comparability between the business being valued and the businesses with which it was being compared and, as such, it was important to select the most appropriate accounting measure as a basis for the valuation, and an appropriate sample of comparable businesses. He explained that, in the valuation of asset management firms, it was appropriate to make reference to the size of the AUM and the level of profitability as a basis for calculation. Consideration was also given to expected cash flows, the risk profiles associated with different income streams, expectations of future growth, etc. to make any final adjustments to the valuation.

31. The profits of BCM LP for the year ending November 2006 were estimated to be approximately £92 million (or US\$175 million) and these were compared to equivalent asset management firms, as well as profit forecasts for 2007 (which, in February 2007, were estimated to be roughly £139 million (or US\$264 million)). Following a series of calculations, the value of BCM LP was estimated to be approximately US\$1.9 billion. The proportionate value attributable to the 19 per cent interest in BCM LP, which was to comprise the equity pool, was therefore calculated and agreed by MP, WR, Sugarquay and Mr Dodd to be US\$361 million. This valuation has not been disputed or challenged by HMRC.

32. Although various arrangements were considered as means of financing the acquisition of the 19% interest, including a public flotation of share capital in the BlueCrest business, a public listing of debt instruments, eg the listing of Eurobonds on the Luxembourg Stock Exchange and the borrowing by senior individuals of BCM LP, it became clear that due to commercial factors, including the ability to raise sufficient debt at an acceptable price, the preferred option was to explore the borrowing by a BlueCrest entity to facilitate an arrangement broadly equivalent to a management buyout.

33. It was considered that a limited partnership which would act through its general partner, a limited company, was the appropriate entity to implement these proposals and raise the necessary third-party debt to acquire the 19% interest. Under the proposed arrangement the general partner, the limited company, would enter into a deed of contribution to transfer the interest which it acquired in BCM LP to a new limited partnership, of which the borrower company would be the general partner. It was envisaged that this new limited partnership would be a partner in BCM LP, holding a 19 per cent interest.

34. However, it was not considered appropriate for BCM LP, or its general partner, BCML, to be involved in the financing transaction. This was, as Mr Aitchison explained, because Regulation 8 of the Prudential sourcebook for Banks, Buildings and Investment Firms ("BIPRU"), then in force, provided that an investment firm authorised by the Financial Services Authority (the "FSA"), and which was a member of "a UK consolidation group", would need to apply the highest capital requirement category to all of the firms in the group; and calculate its capital requirements by consolidating all the individual calculations made by the firms or by treating the whole group as one undertaking.

35. Mr Aitchison understood that under BIPRU a firm would be categorised as a “UK consolidation group” if it was a parent institution, a subsidiary of a parent institution, being a parent financial holding company or a subsidiary of a parent financial holding company in an European Economic Area (“EEA”) Member State and the FSA was required to supervise the group headed by a parent institution or parent financial holding company under the Banking Consolidation Directive No. 2006/48/EC.

36. As such, if UK-incorporated BlueCrest entities acquired the interest in BCM LP using debt financing, their debt would be consolidated with that of the other BlueCrest entities subject to the FSA’s supervision and BCM LP might need to add that amount into the group’s regulatory capital in order to meet the group’s capital requirements. The structure would also have been subject to comparable regulatory capital requirements, if based elsewhere in the EEA, owing to local implementation of the EC Banking Consolidation Directive.

37. It was therefore decided that the new limited partnership and the new corporate entity would be Cayman Islands entities. Mr Dodd said that not only did this circumvent the regulatory requirements but took advantage of BCM LP’s general familiarity with Cayman Islands entities as most BlueCrest managed funds had been established as open-ended Cayman funds.

38. In order to implement the proposed transaction a Cayman Islands limited company, BCMCL, was incorporated on 14 June 2007 by M&C Corporate Services Limited (“MCCS”) and, as noted in the minutes of its post-incorporation board meeting, its shares were transferred to BCMCHL on 4 July 2007 making BCMCL the wholly owned subsidiary of BCMCHL. BCMCHL, also a Cayman Islands limited company, was incorporated, also by MCCS, on 20 June 2007 as a special purpose vehicle for the present transactions. Its shares are held, as recorded in its 4 July 2007 post-incorporation directors board minutes, by Dominion Fiduciary Trust Limited (“Dominion”), as Trustees of the BC Cayman Charitable Trust.

39. The Declaration of Trust, dated 2 July 2007, by Dominion, as the Original Trustee, declared trusts of £100 (the “Initial Fund”) which, “is or will be beneficially owned by it and is or will be held by it or its nominees to its order.” It defines “the company” as meaning BCMCHL, “Shares” as shares in BCMCHL, “Qualified Charities” as any purpose body organisation or object in any part of the world recognised as charitable under the laws of the Cayman Islands and the “Trust Fund” as including the Initial Fund and Shares.

40. Other material terms of the Trust include:

### **“3 POWERS OF APPOINTMENT AND DISTRIBUTION**

Until the termination Date, the Trustees shall have the following powers exercisable from time to time:

- 3.1 power to appoint by deed or deeds revocable or irrevocable that whole or any part or parts of the Trust Fund and income thereof shall thenceforth be held upon trust for the benefit of such one or more Qualified Charities at such times and in such shares as the Trustees shall think fit;
- 3.2 power to pay, transfer or apply the whole or any parts of the capital of the Trust Fund to or for the benefit in any manner of such one or more Qualified Charities as the Trustees shall think fit; in particular, and without prejudice to the generality of the foregoing, the Trustees shall have power in their discretion to grant security in or over the Shares, in favour or for the benefit of any creditor of the Company;

- 3.3 power by deed or deeds to extinguish (or restrict the future exercise of) either or both of the foregoing powers or any other power or powers conferred on the Trustees by this Deed; and
- 3.4 subject to and pending any and every exercise of the powers contained in sub-clauses 3.1, 3.2 and 3.3 the Trustees may pay or apply the whole or such part or parts of the income of the Trust Fund (if any) as the Trustees shall from time to time think fit to or for the benefit of all such one or more Qualified Charities as the Trustees shall, think fit.

#### **4 CONCERNING THE SHARES OF THE COMPANY**

Subject to any and every exercise of the powers contained in sub-clauses 3.1, 3.2 and 3.3 the Trustees may:

- 4.1 not propose or pass any resolution to wind up the Company unless the Directors have confirmed that the Company intends to cease to carry on business;
- 4.2 act generally in relation to the Shares and the affairs of the Company as they may in their absolute discretion think fit, and so that the Trustees in the absence of their own actual fraud or wilful default shall not be liable for any act taken or omission made; and
- 4.3 may in their discretion without assigning any reason therefor, exercise their voting rights with respect to the Shares to remove or appoint any Director provided they may not do so without the prior written consent of a majority of the Directors.

#### **5 ULTIMATE TRUSTS**

On and from the Termination Date, the Trustees shall hold the Trust Fund as to capital and income upon trust as follows:

- 5.1 the Trustees shall have power at any time before the expiration of the period of twelve months commencing on the Termination Date in their absolute discretion to appoint, revocably or irrevocably, the whole or any part of the trust fund to or for the benefit of such Qualified Charity or Qualified Charities in such amounts and proportions as they may from time to time decide, provided that any such revocable appointment shall (to the extent not previously revoked) become irrevocable at the expiration of such period; and
- 5.2 subject thereto and in default of such appointment for such exclusively charitable purposes as the Trustees shall decide.”

41. On 22 June 2007 BCMCL wrote to Mr Dodd in the following terms:

“Dear Mr Dodd

**Re: BlueCrest Capital Management Cayman L.P.**

By this letter agreement, we hereby agree with you to form an exempted limited partnership, named as above (“the Partnership”), pursuant to the Exempted Limited Partnership Law (2003 Revision) of the Cayman Islands (“the Law”), on the following terms:

- 1. The Partnership's sole general partner is BlueCrest Capital Management Cayman Limited, of the above address (“the general partner”);
- 2. The Partnership's sole initial limited partner is Andrew Michael Dodd, of the above address (“the initial limited partner”);

3. The Partnership's registered office is at the offices of [name and address] George Town, Grand Cayman;
4. The Partnership's term shall commence on the date that it is registered as an exempted limited partnership under Section 9 of the Law and shall terminate on such date as the partners agree;
5. The general partner and the initial limited partner hereby each contributes £1.00 capital contribution to the Partnership;
6. The initial limited partner's liability for the Partnership's debts and obligations shall be limited to its capital contribution and all profits and income thereon, whether or not previously paid to it. Save to that extent, the general partner shall be liable for the Partnership's debts and obligations;
7. The Partnership's business is to undertake such investments as the general partner in its absolute discretion thinks fit;
8. The general partner shall exclusively undertake the business of the Partnership, which the limited partner is prohibited from undertaking save to the extent permitted by the Law;
9. Upon dissolution of the Partnership, the general partner will be entitled to receive from the Partnership £5 on its capital contribution;
10. No interest in the Partnership shall be assigned, nor shall any new partner, general or limited be admitted unless agreed to by both parties hereto.

This agreement may be executed in counterpart, and may be amended in whole or in part only by written agreement of the general partner and the initial limited partner.

This agreement is governed by and shall be construed in accordance with the laws of the Cayman Islands.

Please sign this letter in the space provided to establish the Partnership.”

As requested, Mr Dodd signed the letter on 22 June 2007 thus establishing BCMC LP.

#### *Finance*

42. BCMCL was to be the entity to acquire the 19% interest in BCM LP and would raise the finance required to do so. Therefore, Mr Dodd together with Andy Moss, the Head of Finance at BCM LP, commenced negotiations to obtain loan finance with various banks. Although as large a loan as possible was sought they were quite clear that this was not to be an amortising loan (ie a loan with scheduled periodic payments that consisted of both principal and interest). Rather, they were keen to agree a bullet repayment loan, requiring interest-only payments during the life of the loan with the principal of the loan being repayable at the end of the term. This was because such an arrangement provided the maximum level of cash flow flexibility and enabled BCMCL to prepay the loan at its election, if sufficient cash was available, or to repay everything at the end of the loan term if it was decided that it was preferable to distribute some cash to the partners in BCM LP.

43. To enable there to be a thorough credit analysis of the BlueCrest business and its requirements assessed against the criteria for lending, the banks were provided with some or all of the following documents:

- (1) consolidated profit and loss account figures for 2005 and 2006 (and forecasts for 2007) for BCMCL;

- (2) statutory accounts for BCM LP for 2004 and 2005;
- (3) consolidated statutory accounts for BCML for 2004 and 2005;
- (4) a management structure chart; and
- (5) a proposed structure including the new Cayman entities.

44. As is apparent from the following email, dated 22 December 2006 and addressed to Mr Moss and Mr Dodd, from a James Sackett of Barclays Capital, negotiations with Barclays Bank had commenced in December 2006. This email states:

“Andrew,

Further to our conversation I attach a revised term sheet which includes a straight line amortisation over 24 months. Profits generated in excess of the repayment schedule are free to be taken as dividends. Other terms remain unchanged.

Our ability to deliver this solution is still dependent on bringing in a couple of other banks - given the holiday season it's unlikely we will receive feedback until early in the New Year. However the change in structure will clearly help discussions.

Once we receive your feedback we will seek formal approvals internally - again this will only be possible early in the New Year.

I'm back in the office on Dec 28th although available on the mobile before then if required.

Look forward to hearing from you.

45. The term sheet attached to that email was regarding a two year straight-line amortising loan with a “Facility Amount” of \$170,000,000 and referred to the borrower being “BCM NewVehicle GP” and the lender as “Barclays Bank Plc plus other lenders tbc”. It was proposed that Barclays would hold \$70,000,000 with other lenders committing to the remaining amount.

46. Other proposed terms included:

**“REPAYMENT: Pre covenant trigger:** facility will be repaid by 24 equal monthly payments of \$7,083,333 plus due interest for the period.

**Post covenant trigger:** amortisation will 'step up' such that loan repayment ranks ahead of all dividends and distributions.

N.B. If the trigger is subsequently cured the amortisation will step down to the scheduled \$7,083,333 per month.

**PURPOSE:** To assist with the finance of the purchase of 19% income and capital entitlement in BCM LP.

**MARGIN:** LIBOR + 3% plus associated costs calculated daily on the drawn facility.

**INTEREST PERIODS:** Interest periods of 1 or 3 months will be available or such other periods as may be agreed between the Borrower and the Lender.

**UPFRONT FEE:** 1.25% of the Facility Amount.

**DROP DEAD FEE:** \$500k payable if the transaction falls away but the Lender has obtained Credit Approval/Business Case

approval broadly consistent with the Terms and Conditions detailed herein.

**LEGAL FEES:** To be paid by the Borrower. Legal Fees are to be underwritten to the level of \$[ ]k.

**SECURITY:**

- Guarantee from BCM LP.
- First ranking fixed & floating charge over all assets and undertakings of the Borrower.
- Fixed Charge over 19% interest in BCM LP held in NewCo LP.
- Inter-Creditor Agreement postponing (post trigger), in favour of the Lender, sums due to the shareholders of BCMLP through dividend distributions.

47. Conditions precedent set out in the term sheet included that the bank be satisfied with the proposed structure; the ownership of the borrower, in addition to the security arrangements; the operational and structural due diligence which was to be completed; and for the lawyers/accountants to confirm that the bank was fully protected in respect of Financial Assistance and s 151 Companies Act 1985, as well as the satisfactory completion of the bank's account opening procedures in respect of Borrower. It also required that the share purchase must be structured in a manner satisfactory to the FSA and the bank which included the repayment source and structure.

48. However, Barclays insistence on the provision of an amortising loan was not acceptable to BlueCrest and negotiations with the bank ceased. Following the termination of the negotiations with Barclays' Mr Moss and Mr Dodd approached RBS and Citibank.

49. Citibank proposed a loan of \$200,000,000 amortising over three years which required the following security:

“English law first fixed charge over all the Borrower's rights (as general partner of the Limited Partner) to receive fees and other rights and interests from the Manager under the priority profit sharing agreement between the Borrower and the Manager (the PPSA) which in turn gives to the Borrower the right to receive all payments necessary for the Borrower to meet its repayment obligations under the Facility from time to time, and a floating charge over all other assets (including a floating charge over the cash account in the name of the Borrower (as general partner of the Limited Partner) into which all income shall be paid).

In addition the Manager, the Borrower and the Lender will enter into an agreement whereby the Manager assigns, as security for the Manager's payment obligations under the PPSA, the Manager's rights to receive all fee income under the management agreements and secures its cash accounts in favour of the Borrower, as general partner of the Limited Partner, and the Borrower further assigns those rights and its security interest in those accounts to the Lender as security for the Facility.

In addition, security will be given over an agreed portion of the shares in AllBlue held by the investors in the Limited Partner provided that the Lender shall have recourse to those shares only where both (a) an Event of Default has occurred and (b) the AUM has declined below 50% of the AUM as at the date of the Facility.”

In addition Citibank required the following security covenants:

“Each Managed Fund will enter into a side letter with the Lender, the Manager and the Borrower confirming and acknowledging (a) the assignment to the Borrower, by way of security, of the Manager’s rights under the management agreements and the further assignment of those rights by the Borrower to the Lender (b) that the Manager is not entitled to terminate or agree to amend the management agreements except with the Lender’s consent and that any purported termination without the Lender’s consent shall be ineffective (c) that the Manager is not entitled to waive its rights to receive fees or rebate any such fees without the prior consent of the Lender and (d) that any payment due to the Manager under the management agreements will be paid only into an account secured in favour of the Borrower (which is further secured in favour of the Lender).

The Manager will enter into a side letter with the Lender and the Borrower confirming that the PPSA will not be amended or terminated without the prior written consent of Citigroup and that all amounts due under the PPSA will be paid into an account secured in favour of the Lender.”

50. However, this was a significantly more extensive security package than that proposed by RBS. Moreover, the loan offered by Citibank was to have been on an amortising basis which was not acceptable to BlueCrest. Therefore, an agreement with RBS, which had offered a \$200,000,000 bullet repayment loan for a period of three years (with the possibility to extend for a further two years) with a requirement of security of a first charge over BCMC LP’s and BCMCL’s interest in BCM LP.

51. During the course of negotiations with RBS various forms of security had been requested including a guarantee from BCM LP and fixed and floating charges. Additionally, the concept of a “downside trigger” was introduced whereby the borrower’s repayment obligations would be accelerated if the AUM of the funds managed by BCM LP fell below an agreed amount.

52. This is clear from an email sent to Mr Dodd and Mr Moss by Liam Peek of RBS on 20 March 2007 which states:

“As I mentioned the other day we are able to use the AUM trigger in the same way as the Debt:PBT [profits before tax] metric. However the reality of the maths is that this would need to be set as close to \$11bn as possible to achieve a similar level of protection as the proposed 1.5 x Debt: PBT measure. We perhaps need to talk to you further about how you would manage your cost base in such a scenario before settling on a number but intuitively it is not going to be below \$10bn.”

53. Even though BCM LP’s AUM had grown by approximately \$300 million since December 2006, because such growth could not be guaranteed and as BCM LP’s AUM had been \$11.67 billion, as at 1 March 2007, Mr Dodd was concerned that a downside trigger of US\$11 billion would produce an unacceptably high risk of a trigger event. If this occurred the repayment of loan capital would be accelerated which would have had an adverse effect on BCM LP’s ability to continue allocating profits to its partners. Mindful of this, on 21 March 2007 Mr Dodd responded to Mr Peek’s email:

“... obviously the difference between \$10bn and \$11bn is very significant - one is a 5 per cent fall in assets from current levels and one is a 15 per cent fall; we would definitely not be comfortable with the former and the latter would be very much at the upper end of what we would find acceptable based on our current asset level. It would be very helpful to understand whether you could see a way to drop this to, say \$9bn or \$9.5bn.”

Later that same day Mr Peek replied, by email, stating that:

“...we have of course run some numbers on this ourselves which suggests going below \$10bn is going to be quite difficult.”

54. RBS produced the first draft of its “Term Sheet” on 26 March 2007. This included a downside trigger of AUM falling below US\$10 billion. However, as Mr Peek noted in an email, also on 21 March 2007, RBS was keen to work with BCM LP to bring the AUM downside trigger to a level with which both parties were “comfortable”.

55. It was around this time that Mr Dodd requested advice from Mr Aitchison of EY in relation to the possibility of an alternative or complementary funding arrangement which could avoid such an AUM-related downside trigger at the level proposed by RBS. The solution proposed by Mr Aitchison, around April 2007, was the use of a structure involving a TRS arrangement which Mr Aitchison in his evidence described as a “well known tax planning technique”.

56. He said that a TRS was a commonly used instrument in structured financing at the time. This, he said, could most easily be described as a bilateral financial transaction in which the counterparties swap the returns realised from an asset (or assets) in exchange for periodic cash flows. To put it in simpler terms, one party (in this scenario, the relevant BlueCrest entity) makes payments based on a set rate, while the other party (in this scenario, the third-party bank which provided the loan, RBS) makes payments based on the return of an underlying asset, including both the income it generates and any capital gains (in this scenario, the profits generated ultimately by BCM LP).

57. Mr Aitchison explained to Mr Dodd that the introduction of a TRS into the financing structure would reduce the corporation tax payable by the BlueCrest entity which borrowed from RBS thereby increasing the cash available to service and repay the debt. He said that this could potentially enable RBS to agree to a lower AUM threshold for the downside trigger that was more commercially acceptable to BCM LP. Mr Aitchison, on Mr Dodd’s request, confirmed that such arrangements could also be used in the event of “abnormally high” profits, ie if BCM LP’s profits exceeded its forecasts, to allow the debt to be settled more quickly. Mr Dodd labelled such profits as “Superprofits”.

58. Mr Moss, Mr Dodd and Mr Aitchison attended meetings with RBS, which, as they confirmed, was familiar with TRS arrangements. On 1 May 2007 RBS produced a “Term Sheet” which essentially set out the ‘Heads of Terms’ between RBS and the general partner of the new limited partnership, referred to in the Heads of Terms as NewLP (which subsequently became BCMC LP), and BCM LP.

59. The Heads of Terms included the following “Wind-down Arrangements”:

“The Facility will be repaid in instalments equal to the amount received by NewLP and/or the Borrower under the Secondary Profit Share (as defined below)

Where the Wind-down Arrangements apply, the Facility shall be repayable in full at the earlier of (i) the date on which distributions under the Secondary Profit Share reach an amount equal to outstanding principal and interest amounts under the Facility, and (ii) 2 years from the date on which the Wind-down Arrangements became applicable.”

Under paragraph 5(e) of the section on Pre-payment and Cancellation, it stated that:

“The Borrower must use any monies received from NewLP or the Fund Manager (after the deduction of any tax payable, as a result of the Secondary Profit share (as defined below) to prepay the Loan.”



The “General Undertakings”, in the Heads of Terms in respect of the Borrower, New LP and the Fund Manager as applicable (subject to agreed exceptions and carve-outs) included:

“The Fund Manager shall pay to the NewLP and/or the Borrower as a secondary profit share (to be documented in the Fund Manager's Limited Partnership Agreement and NewLP’s Limited Partnership Agreement as required) (the “**Secondary Profit Share**”), as soon as they are available, its full earnings ahead of any other partner distributions (other than certain permitted payments [*to be defined*] if either:

- (i) the Extension Option is not exercised with respect to either the third or the fourth anniversaries of the Agreement Date; or
- (ii) the Facility has not been repaid in full on or before the fifth anniversary of the Agreement Date; or
- (iii) Total Assets Under Management of the Fund Manager reported in the Monthly Report is less than US\$9,500,000,000 (If a binding tax opinion confirming that application of the Wind-down Arrangements will not lead to a deduction of tax is not in place at any time), or US\$8,250,000,000 (if a binding tax opinion confirming that application of the Wind-down Arrangements will not lead to a deduction of tax is in place), provided, however, that such Secondary Profit Share shall cease to apply in respect of any subsequent periods for which Total Assets Under Management is reported to be greater than US\$11,000,000,000;

...

60. Mr Aitchison confirmed that an opinion was obtained by RBS from Freshfields Bruckhaus Deringer LLP which advised that there would not be a deduction of tax and the agreement proceeded on the basis of US\$8,250,000,000 AUM.

61. On 5 July 2007 RBS wrote to BCMCHL in the following terms:

“Dear Sirs,

**Re: Total Return Swap Transaction**

The purpose of this letter agreement is to confirm the terms and conditions of the Swap Transaction entered into between us on the Trade Date specified below (the “Transaction”). This letter agreement constitutes a “Confirmation” as referred to in the Agreement (as defined below).

The definitions and provisions contained in Annexes 1 to 18 and Section 6 of the 2002 Master Agreement Protocol published by the International Swaps and Derivatives Association, Inc (“ISDA”) on 15 July 2003, the 2002 Equity Derivatives Definitions and the 2006 ISDA Definitions (the “Definitions”) are incorporated into this Confirmation. For these purposes, all references in the Definitions to a “Swap Transaction” shall be deemed to apply to the Transaction referred to herein. Terms used herein and not defined shall have the meanings given to them by the limited partnership agreement by which New LP [ie BCMC LP] was established, dated on or about 5 July 2007, as amended from time to time (the “New LP Limited Partnership Agreement”). In the event of any inconsistency between this Confirmation and either the Definitions or the New LP Limited Partnership Agreement, this Confirmation will govern.

This Confirmation supplements, forms part of, and is subject to, the ISDA Master Agreement dated on or about 5 July 2007, as amended and supplemented from time to time (the “Agreement”), between us. All

provisions contained in the Agreement govern this Confirmation except as expressly modified below.

**The terms of the particular Transaction to which this Confirmation relates are as follows:**

**GENERAL TERMS**

<b>Trade Date:</b>	5 July 2007
<b>Effective Date:</b>	5 July 2007
<b>Termination Date:</b>	5 July 2017
<b>Party A:</b>	The Royal Bank of Scotland plc
<b>Party B:</b>	BlueCrest Capital Management Holdings Limited, a limited liability company incorporated in the Cayman Islands ...
<b>Calculation Agent:</b>	The Royal Bank of Scotland plc
<b>Business Day:</b>	London, Cayman Islands, New York
<b>Business Day Convention:</b>	Following Business Day Convention

**FIXED AMOUNT (I):**

<b>Fixed Rate (I) Payer:</b>	Party A
<b>Fixed Amount (I):</b>	Amounts 1n USD equal to the net profit received under the New LP Limited Partnership Agreement by Party A, less an amount (the "Retention Amount") set out in the fee letter between Party A and Party B dated on or about the date of this confirmation (the "TRS Fee Letter")

<b>Fixed Rate (I) Payment Dates:</b>	2 Business Days following receipt of each amount received by Party A under and in accordance with the New LP Limited Partnership Agreement
--------------------------------------	--

**FIXED AMOUNTS (II)**

<b>Fixed Rate (II) Payer:</b>	Party B
<b>Fixed Amounts (II):</b>	In USD, as set out in the TRS Fee Letter
<b>Fixed Rate (III) Payment Date:</b>	In USD, as set out in the TRS Fee Letter

...

62. The TRS Fee Letter which, like that letter, is dated 5 July 2007. It is from BCMCHL to RBS and states:

**“Fee Letter**

We refer to the swap confirmation dated on or about 5 July 2007 between Party A [RBS] and Party B [BCMCHL] (the "Swap Confirmation"). Terms defined in the Swap Confirmation (including by incorporation) shall have the same meaning in this letter, unless the contrary intention appears.

This letter is the TRS Fee Letter referred to in the Swap Confirmation and shall be read together with and comprise part of same.

We agree and confirm that, for the purposes of the Swap Confirmation:

1. The Retention Amount In relation to each Fixed Amount (I) shall be equal to the product of 0.125 and the net profit received under the New LP Limited Partnership Agreement by Party A in relation to such Fixed Amount (I);
2. The following Fixed Amounts (II) shall be payable by Party B:
  - (A) US\$20,000;
  - (B) US\$500,000;
  - (C) US\$19,230.77.
3. The following Fixed Rate (II) Payment Dates shall apply to Party B:
  - (A) in respect of paragraph 2(A) above, the Effective Date;
  - (B) in respect of paragraph 2(8) above, and provided that the rights and obligations of Party A under the Total Return Swap have not been assigned, terminated or novated to another party in accordance therewith, on the earlier of (i) 6 months from and including the Effective Date and (ii) 5 Business Days following the date on which a net profit is first received under the New LP Limited Partnership Agreement by Party A;
  - (C) in respect of paragraph 2(C) above, commencing on the earlier of (i) 6 months from and including the Effective Date and (ii) the date on which a net profit is first received under the New LP Limited Partnership Agreement by Party A, and thereafter on each monthly anniversary thereof (such Fixed Amount (II) having accrued on a daily basis), until assignment, termination or novation of the Total Return Swap in accordance with the terms thereof.

Please countersign and return the enclosed copy of this letter of acknowledgement and acceptance of your agreement to pay the fees detailed above."

#### *BCMCL LP*

63. On 6 July 2007 Mr Dodd, BCMCL and RBS (the "Corporate Limited Partner") entered into a limited partnership deed, the BCMC LP Deed. This replaced the original agreement between Mr Dodd and BCMCL.

64. Material clauses of the BCMC LP Deed provide:

#### **"6. Business**

- 6.1 The Partnership's [ie BCMC LP's] business shall be to invest in an investment management business through being a limited partner In BCMCLP and "the Business" shall be construed accordingly.
- 6.2 The Partnership may execute, deliver and perform all contracts and other undertakings and engage in all activities and transactions as may in the sole and absolute discretion of the General Partner be necessary

or advisable in order to carry on the Business (including, in particular but without prejudice to the generality of the foregoing, the provision of security over any of the assets of the Partnership).

- 6.3 For the avoidance of doubt, the Business shall not extend to the management of the investment or trading of the contributions made by the Partners to the Partnership pursuant to Clause 9 below.

## **7. Name**

- 7.1 The Business shall be carried on under the name and style or firm name of BlueCrest Capital Management Cayman LP or such other name as the General Partner shall from time to time determine.
- 7.2 Each of the Partners acknowledges that all proprietary and other rights in the Partnership name are vested exclusively in the General Partner.

## **8. Term**

- 8.1 Each of the Partners acknowledges and agrees that the Partnership commenced on 22 June 2007 and shall continue unless and until terminated in accordance with the provisions set out in Clause 23.

## **9. Capital and Loan Contributions**

...

## **12. Allocations**

### **12.1**

- (A) Subject to the further provisions of this Clause 12.1 and to Clause 12.4, in respect of each financial year of the Partnership the profits (before tax) of the Partnership as shown by the accounts of the Partnership prepared in accordance with Clause 17 (and after the deduction of any sums payable to an Outgoing Partner pursuant to the provisions of Clause 22 (other than such Outgoing Partner's capital contribution)) shall be allocated amongst the Partners as follows:-
- (1) firstly, there shall be allocated to the General Partner such amount of profits as shall in the good faith opinion of the General Partner be required to be retained in the Partnership (i) as working capital to meet anticipated, current or foreseen liabilities and expenditure of the Partnership and (ii) to cover other contingencies in accordance with general principles of prudent management;
  - (2) secondly, there shall be allocated to the General Partner such amount of profits as is equal to the aggregate Advance Drawings during such financial year of the Partnership;
  - (3) thirdly, there shall be allocated to the General Partner such amount of profits as is equal to the aggregate of the interest payable by the General Partner on the Notes during such financial year and any accrued but unpaid interest on the Notes in respect of any previous financial year;
  - (4) fourthly, there shall be allocated to the General Partner (or as the General Partner may in its absolute discretion direct) such amount of the remaining profits as the General

Partner shall decide which amount shall be utilised by the General Partner in redeeming the Notes, and

- (5) the remainder of the profits (if any) shall be allocated to the Limited Partners (other than the Corporate Limited Partner) in accordance with the Agreed Proportions.
- (B) The provisions of Clauses 12.1(A)(3), 12.1(A)(4) and 12.1(A)(5) shall cease to apply
  - (1) if a Trigger Event occurs, in which case during the related Facility Trigger Period the Remaining Profits shall be allocated to the Corporate Limited Partner provided that in the event that the Corporate Limited Partner shall no longer be a Partner or if the TRS shall have been terminated then the Remaining Profits shall be allocated to the General Partner, or
  - (2) following the Repayment Start Date until after the Facility Repayment Date (a "Facility Repayment Period") when in such period the Remaining Profits shall be allocated to the General Partner; and
  - (3) during any Note Repayment Period, when in such period the Remaining Profits shall be allocated (a) if a Note Trigger Event has occurred such that a Note Repayment Period within paragraph (a) of the definition of such term is ongoing, to (at the discretion of the General Partner) either the General Partner or the Corporate Limited Partner or (b) otherwise to the General Partner.

To determine the allocation pursuant to this Clause 12.1(B) in any relevant financial year of the Partnership, the General Partner shall prepare Management Accounts (i) for each Facility Trigger Period, (ii) for each Note Repayment Period and (iii) for each period that is neither a Facility Trigger Period nor a Note Repayment Period (each one a "Remaining Period"). Following the preparation of such Management Accounts (which shall be prepared within 30 days of the end of the relevant financial year) the General Partner shall deduct from the profits shown by such Management Accounts an amount equal to the allocation of profits pursuant to Clauses 12.1(A)(1) and (A)(2) for the relevant financial year (such deduction to be applied as between each Facility Trigger Period, Note Repayment Period and Remaining Period pro rata to their respective durations) and will calculate the Remaining Profits for each Facility Trigger Period, Note Repayment Period and each Remaining Period. The General Partner will, on request, provide copies of such Management Accounts and such calculations to the other parties to this Agreement and without prejudice to the foregoing will provide copies of such Management Accounts and calculations to the Corporate Limited Partner as soon as is reasonably practicable after the same have been prepared.

Following the completion of such calculations.

- (a) a sum equal to the Remaining Profits for any Facility Trigger Period and any Note Repayment Period shall be allocated to the Corporate Limited Partner or, as the case may be, the General Partner in accordance with sub-clauses (1), (2) and (3) of this Clause 12.1 (B), and

- (b) a sum equal to the Remaining Profits for any Remaining Period shall be allocated amongst the Partners in accordance with the provisions of Clauses 12.1(A)(3), 12.1(A)(4) and 12.1(A)(5).
- (C) If the profits of BCM LP in respect of the six months ending 31 December 2007 or in respect of any of the calendar years ending on 31 December 2008, 2009, 2010 or 2011 (as shown in each case by management accounts of BCM LP in respect of such six month period or calendar years prepared (in US\$) applying the Accounting Principles (as defined in the BCM LP Deed) and after the deduction of the amounts, based on practices previously adopted by BCM LP, that are to be allocated from such profits pursuant to Clauses 12.1(A)(1) and 12.1(A)(2) of the BCM LP Deed) exceed the Benchmark Profits for such six month period or relevant calendar year then no profit shall be allocated in accordance with Clauses 12.1(A)(4) or 12.1(A)(5) until an amount of profit of the Partnership for the financial year of the Partnership in which the relevant calendar year ended equal to 19 per cent of the profits of BCM LP in such six month period or calendar year (as shown by the relevant management accounts of BCM LP) in excess of the Benchmark Profit for that six month period or calendar year ("Superprofits") has been allocated to the Corporate Limited Partner (provided that in the event that the Corporate Limited Partner shall no longer be a Partner or if the TRS shall have been terminated then such amount shall be allocated to the General Partner) save that following the Facility Repayment Date any Superprofits shall be allocated to the General Partner.

(D) ...

...

### **13. Partner's Accounts and Distributions**

...

#### **13.4**

- (A) Subject in all respects to the General Partner being satisfied as to the level of profits anticipated in respect of any financial year, the General Partner shall have the discretion to allow Partners to make drawings ("Discretionary Drawings") in advance of the end of a financial year in anticipation of their profit entitlement for such financial year provided that (i) in the case of any drawings in anticipation of profit entitlements under Clause 12.1(A)(5), all Limited Partners shall be entitled to participate in such drawings and the aggregate amount that the General Partner shall decide may be drawn in anticipation of such profit entitlements shall be drawn as between the Limited Partners in the Agreed Proportions, and (ii) no Discretionary Drawings shall be allowed during a Facility Trigger Period or a Note Repayment Period.
- (B) Notwithstanding the discretion referred to in Clause 13.4(A), in each financial year of the Partnership distributions ("Advance Drawings") shall be made at the end of each month to the General Partner in an amount equal to an amount (if any) sufficient for the General Partner to pay or payable under the Facility Agreement during the following month provided that, pursuant to Clauses 12.1 (D), no distributions shall be made pursuant to this Clause 13.4(B) after the Facility Repayment Date.

(C) Notwithstanding the discretion referred to in Clause 13.4(A) but subject to clauses 13.4(D) and (E), distributions (“Sweep Drawings”) shall be made at the end of each month in each financial year of the Partnership by the General Partner in the amounts calculated in accordance with the following provisions of this Clause 13.4(C). The General Partner will prepare Management Accounts for each month during such financial year of the Partnership within 30 days of the end of such month. Following the preparation of such Management Accounts, in respect of each month the General Partner shall deduct from the profits (if any) shown by such Management Accounts an amount equal to any Discretionary Drawings made during that month and an amount equal to the aggregate of the Advance Drawings and the Further Drawings for that month and the balance of the profits (if any) shown by such Management Accounts shall be distributed to the General Partner and shall firstly be applied by the General Partner in paying interest (including deferred interest as described in Condition 2.4 of the Note Instrument) on the Notes, such distribution to take place as soon as reasonably practicable following the completion by the General Partner of the preparation of such Management Accounts provided that no Sweep Drawings shall be made during a Facility Trigger Period or a Note Repayment Period.

(D) ...

...

### **29. Miscellaneous**

29.1 This Deed (together with the letters of allocation) constitutes the entire agreement between the Partners and there are no other written or verbal agreements or representations with respect to the subject matter hereof.

...

### **30. Governing Law**

This Agreement and the rights of the Partners shall be governed by and construed in accordance with Cayman Islands law and the Partners hereby submit to the non-exclusive Jurisdiction of the Cayman Islands Courts.”

65. The following deeds were also executed on 6 July 2007:

- (1) the Facility Agreement;
- (2) the Deed of Assignment;
- (3) the Deed of Adherence;
- (4) the Deed of Subordination;
- (5) the Deed of Contribution; and
- (6) the Subscription Deed.

Each of these deeds references the others which, as Mr Gammie put it in opening, was because “all of the pieces of the jigsaw have to fit together, otherwise something will clearly have gone wrong in implementing the transaction agreed with all the parties.”

### *Facility Agreement*

66. The parties to the Facility Agreement were BCMCL (the “Borrower”), BCMCHL (the “Parent”), and RBS (as the “Arranger”, the “Agent” of the other Finance Parties and as “Security Agent” for the Finance Parties and the Financial Institutions listed in Schedule 1, the “Original Lenders” which includes RBS).

67. Under clause 2.1, “the Lenders make available to the Borrower a US dollar term loan facility in an aggregate amount equal to the Total Commitments” ie US\$200,000,000.

68. The purpose of the loan is set out in clause 3:

#### **“3.1 Purpose**

The proceeds of the Loan shall be applied:

- (a) in and towards the acquisition by the Borrower of a partnership interest in BCM LP pursuant to the Deed of Assignment, such partnership interest to be promptly contributed by way of capital to New LP [ie BCMC LP] pursuant to the Deed of Contribution;
- (b) in and towards the intra Group loan to be made by the Borrower to Parent as set out in the Funds Flow Statement and pursuant to the Upstream Intercompany Loan Agreement, which loan shall not exceed US\$ 2,000,000 in principal amount (excluding any capitalised interest from time to time); and
- (c) in and towards the payment of related transaction costs as set out in the Funds Flow Statement.”

69. Other material clauses provide:

#### **“1. DEFINITIONS AND INTERPRETATION**

##### **1.1 Definitions**

...

*Loan Extension Conditions* means

- (a) the aggregate AUM (as reported in the information most recently delivered to the Agent pursuant to Clause 7.4 (Reports of BCM LP) of the Subordination Deed) shall not be less than US\$ 11,000,000,000; and
- (b) the aggregate outstanding Financial Indebtedness of the Group (excluding any such Financial Indebtedness of the Borrower arising under the Seller Notes and the Parent arising under the Upstream Intercompany Loan Agreement) as determined by reference to the latest audited consolidated financial statements delivered pursuant to Clause 7.1 (Financial statements) of the Subordination Deed does not exceed BCM LP Profit Before Tax.

*Mandatory Cost* means the percentage rate per annum calculated by the Agent in accordance with Schedule 4 (*Mandatory Cost formula*).

*Margin* means 2.50 (two and one half) per cent. per annum.

...

*Termination Date* means subject to Clause 6.1 (*Repayment of Loan*) the third anniversary of Utilisation.

...

*Trigger Event* means any of the following events or occurrences:



- (a) subject to Clause 10 (*Reset of Trigger Event AUM Threshold*) of the Subordination Deed, the aggregate AUM for any month as reported pursuant to Clause 7.4 (Reports of BCM LP) of the Subordination Deed is less than US\$ 8,250,000,000;
- (b) the ratio of the aggregate Financial Indebtedness of the Borrower (excluding any such Financial Indebtedness arising under the Seller Notes) as determined by reference to the last audited consolidated financial statements of the Borrower, to the BCM LP Profit Before Tax exceeds 2.5: 1;
- (c) where the aggregate AUM in any month as reported pursuant to Clause 7.4 (Reports of BCM LP) of the Subordination Deed (the Reference Month) is:
  - (i) less than US\$16,000,000,000, the AUM as at that Reference Month has declined by more than thirty percent (30%) when compared to the AUM as at the month end falling 12 months prior to that Reference Month; or
  - (ii) greater than US \$16,000,000,000, the AUM as at that Reference Month has declined by the greater of:
    - (A) thirty percent (30%) when compared to the AUM as at the month end falling 12 months prior to that Reference Month, and
    - (B) the figure produced by taking whichever is the lesser of. (i) the maximum AUM as at any month end in the 12 month period prior to that Reference Month and subtracting from that figure US \$16,000,000,000; or (ii) fifty percent (50%) of the maximum AUM as at any month end in the 12 month period prior to that Reference Month,

(as depicted in the worked example contained in Schedule 8), and in each case, the Agent (acting with the consent of each Lender, and after consultation with the Borrower for a period of twenty (20) Business Days) does not, acting reasonably, agree to waive such trigger and the application of the Loan Wind Down procedure that would otherwise commence pursuant to Clause 22 (Occurrence of Trigger Event);
- (d) WAIP [weighted average investment performance] in any 12 month period is worse than minus 25% (that is, a negative percentage the modulus of which is greater than 25);
- (e) Michael Platt dies, is declared incompetent by a court or authority (howsoever described) of competent jurisdiction, or otherwise ceases to be employed by or act on behalf of BCM LP in broadly the same capacity as he acts as at the date of this Agreement, and is not replaced in his role (whether on a temporary or permanent basis) within 30 days by another person approved by the Agent (such approval not to be unreasonably withheld or delayed); or
- (f) an Event of Default occurs and is continuing.

...

## **6. REPAYMENT**

### **6.1 Repayment of Loan**

- (a) Provided that each of the Loan Extension Conditions are satisfied (and an authorised signatory of the Borrower certifies to the Agent not more

than 60 days and not less than 30 days prior to the Termination Date that such conditions have been satisfied), the Termination Date shall be automatically extended for one calendar year (which revised date shall be the fourth anniversary of Utilisation (the First Revised Termination Date)). If the Termination Date has been extended in accordance with the foregoing sentence, provided that each of the Loan Extension Conditions are satisfied (and an authorised signatory of the Borrower certifies to the Agent not more than 60 days and not less than 30 days prior to the First Revised Termination Date that such conditions have been satisfied), the First Revised Termination Date shall be automatically extended by one further calendar year (which second revised date shall be the fifth anniversary of Utilisation (the Second Revised Termination Date)).

- (b) If the Borrower has not repaid the Loan in full on the Termination Date, or (if the Termination Date is extended pursuant to Clause 6.1(a)) the First Revised Termination Date or the Second Revised Termination Date, as the case may be, then the Borrower shall commence repayment of the Loan and all other amounts payable under the Finance Documents monthly from all amounts received by the Borrower under the Transaction Documents (Loan Wind Down) from such date (Repayment Start Date). All amounts received by the Borrower under the Transaction Documents from the Repayment Start Date until the Loan and all other amounts payable under the Finance Documents have been repaid in full shall (after the deduction of reasonable operating costs of the Borrower as set out in the budget provided pursuant to Clause 10.3 of the New LP Limited Partnership Agreement) be applied by the Borrower in repayment of the Loan including interest due under clause 8 (Interest) (and all other amounts payable under the Finance Documents). Any amounts which remain outstanding on the second anniversary of the Repayment Start Date shall become immediately due and payable by the Borrower to the Finance Parties without further demand on such second anniversary of the Repayment Start Date.

62. ...

## **7. PREPAYMENT AND CANCELLATION**

...

### **7.6 Mandatory prepayment**

If the Borrower wishes to repay any principal amount under the Seller Note Instrument from Excess Benchmark Profits, the Borrower must use at least 33% of the Excess Benchmark Profits to prepay principal under the Loan.

...

## **8. INTEREST**

### **8.1 Calculation of interest**

The rate of interest on the Loan for the Interest Period is the percentage rate per annum which is the aggregate of the applicable:

- (a) Margin;
- (b) LIBOR; and
- (c) Mandatory Cost, if any.

...

## 22. OCCURRENCE OF TRIGGER EVENT

### 22.1 Trigger Event

If a Trigger Event occurs, the Loan Wind Down as described in Clause 6.l(b) will commence such that the Borrower shall repay the Loan (and all amounts payable under the Finance Documents) from all amounts received by the Borrower under the Transaction Documents (less an amount equal to the reasonable operating costs of the Borrower as set out in the budget provided pursuant to Clause 10.3 of the New LP Limited Partnership [ie BCMC LP] Agreement) in monthly instalments within two calendar years of the date on which that Loan Wind Down commences, provided that:

- (i) If the Loan Wind Down commences solely as a result of the occurrence of an event specified in paragraph (a) of the definition of Trigger Event, repayment in accordance with the Loan Wind Down shall cease if the AUM subsequently increases to above US\$11,000,000,000,
- (ii) If the Loan Wind Down commences solely as a result of the occurrence of an event specified in paragraph (c) of the definition of Trigger Event, repayment in accordance with the Loan Wind Down shall cease if (and for so long as) the AUM subsequently increases by 10% above the level that existed when the Loan Wind Down commenced; and
- (iii) if the Loan Wind Down commences solely as a result of the occurrence of an Event of Default, repayment in accordance with the Loan Wind Down shall cease if (and so long as) the Event of Default is remedied (if capable of remedy) or waived (with the consent of the Majority Lenders)."

### *Deed of Assignment*

70. The Deed of Assignment, at clause 1.1 contains the following definitions:

"Deed of Adherence" means a deed of adherence to be entered into on the date hereof whereby BCMCL adheres to the terms of the Limited Partnership;

...

"Facility Agreement" means the facility agreement entered into between BCMCL, RBS and others on or around the date hereof, pursuant to which a facility of US\$200,000,000 will be made available to BCMCL;

...

"Instrument" means the loan note instrument to be executed by BCMCL on or around the date hereof in the form set out in schedule 2;

71. Under clause 2 of the Deed of Assignment, WR, MP and Sugarquay assigned to BCML:

"... with full title guarantee, free from all Encumbrances and together with all rights attaching thereto, such part of their current interests In the Partnership carrying the right to participate after the Effective Date in the future income and capital profits and income and capital losses of the Partnership as is set out opposite each of the Assignor's respective names in schedule 1 to this Deed (excluding for the avoidance of doubt any amounts standing to the credit of any of the Assignor's respective Capital Contribution Accounts and Distribution Accounts (as defined in the Limited Partnership Deed) immediately prior to the Effective Date) (the "Partnership Interests")."

The interests set out in schedule 1 are the 13% interest of WR and the 3% interests of MP and Sugarquay.

72. Clause 3 of the Deed of Assignment dealt with consideration and payment. It provided:

“3.1 The consideration for the assignment in clause 2 shall be satisfied within one calendar month from the date hereof (or as the parties may otherwise agree in writing) as follows:

(A) In respect of WR:

- (1) BCMCL shall pay to WR the sum of US\$192,000,000, such payment to be made by electronic transfer of funds for same day value to WR's bank account [account details], and
- (2) BCMCL shall issue at par to WR a Note for the aggregate principal amount of US\$55,000,000,

(B) In respect of MP

- (1) BCMCL shall pay to MP the sum of US\$2,000,000, such payment to be made by electronic transfer of funds for same day value to MP's bank account [account details], and
- (2) BCMCL shall issue at par to MP a Note for the aggregate principal amount of US\$55,000,000; and

(C) In respect of Sugarquay

- (1) BCMCL shall pay to Sugarquay the sum of US\$2,000,000, such payment to be made by electronic transfer of funds for same day value to Sugarquay's bank account [account details], and
- (2) BCMCL shall issue at par to Sugarquay a Note for the aggregate principal amount of US\$55,000,000”

#### *Deed of Adherence*

73. The Deed of Adherence between BCML (as General Partner) and BCMCL (as Further Limited Partner), having referred to the 31 December 2003 BCM LP Deed and supplemental Deeds increasing the number of limited partners which are defined as the “Agreement”, provides, at clause 2:

#### **2. Adherence to the Partnership**

- 2.1 The Further Limited Partner covenants with the Partners for the time being to observe and perform the terms and conditions of the Agreement on terms that the Further Limited Partner becomes a Further Limited Partner under the Agreement with effect from the date hereof.
- 2.2 At the request of the Assignors (as defined in a Deed of Assignment entered into between the Further Limited Partner, [WR], [MP] and Sugarquay on the date hereof (the "Deed of Assignment"), £100, being part of the capital contributed in aggregate by the Assignors to the Partnership, is to be credited to the Further Limited Partner's Capital Contribution Account on execution of this Deed which amount shall be deemed to have been contributed by the Further Limited Partner in accordance with clause 9.2 of the Agreement.
- 2.3 This Deed shall be supplemental to and read together with the Agreement.”

The reduction of WR's, MP's and Sugarquay's respective interests is shown in Schedule 1 to the Deed as is the 19% interest of BCMCL.

#### *Subordination Deed*

74. Clause 2 of the Deed of Subordination and Covenant sets out the terms of the subordination:

#### **“2. SUBORDINATION**

2.1 In consideration of the Senior Creditors acting under or in connection with the Finance Documents and making the Facility available to the Company pursuant to the Credit Agreement and the other Finance Documents, and acting otherwise pursuant to the Transaction Documents, the Subordinated Creditors each agree that until all moneys and liabilities whatsoever which now are or at any time hereafter may become due, owing or payable to the Senior Creditors in respect of the Senior Liabilities have been irrevocably repaid in full and the Senior Creditors shall be owed no further liability (actual or contingent) in respect of the Senior Liabilities:

- (a) the Subordinated Liabilities are subordinated to the Senior Liabilities;
- (b) any payment of principal or interest or any other amount that would otherwise be due in respect of the Subordinated Liabilities shall be postponed and shall not become due and payable; and
- (c) the Company's or, as the case may be, the Parent's, obligation to make any payment of principal or interest or any other amount that would otherwise be due in respect of the Subordinated Liabilities shall be conditional upon the irrevocable payment in full of all amounts owing (including the satisfaction of contingent liabilities) to the Senior Creditors in respect of the Senior Liabilities.

2.2 Clause 2.1 does not apply to any Permitted Payment.

...

A “Permitted Payment” is defined in Clause 5, as follows:

#### **5 PERMITTED PAYMENTS**

##### **5.1 Upstream Intercompany Loan Agreement**

- (a) The Company may advance \$2,000,000 under the Upstream Intercompany Loan Agreement to the Parent on the date of Utilisation under the Facility Agreement, or a later date, such amount to be paid, upon advance, into the TRS Fee Account or otherwise in accordance with the Funds Flow Statement.
- (b) The Parent may repay to the Company principal and/or interest outstanding under the Upstream Intercompany Loan Agreement from surplus amounts standing to the credit of the TRS Fee Account once the TRS Fee has been paid in full.

##### **5.2 Seller Notes/Credit Agreement**

Notwithstanding any other Clause of this Deed, provided that:

- (a) no Trigger Event has occurred and is continuing, and
- (b) no Loan Wind Down has commenced and is continuing,

the Company may make the following payments in respect of the Seller Notes, and the Seller Note Holders may receive in respect of the Seller Notes and retain such payments, namely:

- (i) interest at the rate of 15% per annum, but only after and to the extent that the Company has paid all amounts of interest then due and payable under the Finance Documents; and
- (ii) principal owing under the Seller Notes, PROVIDED ALWAYS THAT if a Permitted Payment is a repayment of any amount of principal owing under the Seller Notes and is to be made from Excess Benchmark Profits, then the Company must first use at least 33% of the Excess Benchmark Profits to prepay principal under the Credit Agreement.

### **5.3 Distributions to Parent shareholder**

- (a) The Parent may use interest accruing on amounts standing to the credit of the TRS Fee Account to pay US\$5,000 per annum in respect of distributions to its shareholder pursuant to Clause 8 14(f) hereof.”

75. I was also referred to Clause 8, “General Undertakings” which provided:

“Each Obligor agrees with each other party to this Agreement to be bound by the covenants set out in this clause relating to it. The undertakings in this Clause 8 remain in force from the date of this Agreement for so long as any amount is outstanding under the Finance Documents or the Seller Note Instrument or any Commitment is in force.

...

### **8.12 The Company**

Notwithstanding any other provision of this Deed, the Company will not carry on any business other than being a general partner of New LP or incur or permit to subsist any indebtedness or other liability, make any loan or guarantee, own any asset (including, without limitation, any bank account), make or receive any payment or enter into any other transaction, in each case except to the extent arising solely from:

- (a) entering into and exercising its rights and performing its obligations under the Transaction Document to which it is party,
- (b) the ownership of partnership interests in New LP and the ownership of cash balances in the Borrower Bank Account;
- (c) the ownership of the Borrower Bank Account;
- (d) the receipt of any payment, allocation, subscription amount or any other amount under the Transaction Documents (provided such payment, allocation or subscription is permitted by this Deed and/or the Transaction Documents and paid into the Borrower Bank Account) and the making of a payment to:
  - (i) the Finance Parties pursuant to the Finance Documents; and
  - (ii) the Parent under the Upstream Intercompany Loan Agreement and, subject to the terms of this Deed. the Seller Note Holders pursuant to the Seller Note
- (e) liabilities in respect of its share capital and reasonable professional fees, employee costs, administration costs and taxes in each case incurred in the ordinary course of its business...

### **8.13 New LP [BCMC LP] as limited partner**

Notwithstanding any other provision of this Deed, New LP will not carry on any business other than being a limited partner in BCM LP or incur or permit to subsist any indebtedness or other liability, make any loan or guarantee, own any asset (including, without limitation, any bank account), make or receive any payment or enter into any other transaction, in each case except to the extent arising solely from:

- (a) entering into and exercising its rights and performing its obligations under the Transaction Documents to which it is party;
- (b) the ownership of partnership interests in BCM LP and the ownership of cash balances in the New LP Bank Account,
- (c) the ownership of the New LP Bank Account;
- (d) the receipt of any payment, allocation or any other amount from BCM LP pursuant to the BCM LP Limited Partnership Agreement (provided such payment or allocation is paid into the New LP Bank Account) and the making of a payment to its partners in accordance with the terms of the New LP Limited Partnership Agreement (provided that in the case of any payment to the Company, such payments are made to the Borrower Bank Account), or
- (e) liabilities in respect of reasonable professional fees, employee costs, administration costs and taxes in each case incurred in the ordinary course of its business as a limited partner.

### **8.14 Parent**

Notwithstanding any other provision of this Deed, Parent will not carry on any business other than being the holding company of the Company or incur or permit to subsist any indebtedness or other liability, make any loan or guarantee, own any asset (including, without limitation, any bank account), make or receive any payment or enter into any other transaction, in each case except to the extent arising solely from.

- (a) entering into and exercising its rights and performing its obligations under the Transaction Documents to which it is party;
- (b) the ownership of shares in the Company and the ownership of cash balances in the Parent Bank Account and the TRS Fee Account;
- (c) the ownership of the Parent Bank Account and the TRS Fee Account; or
- (d) the receipt of any payment, allocation or any other amount under the Transaction Documents (provided such payment is made into the Parent Bank Account (except for the Upstream Intercompany Loan Agreement, the proceeds of which will be paid directly by the Company (as lender) into the TRS Fee Account or otherwise in accordance with the Funds Flow Statement) and the making of any payment, subscription or allocation to any party under the Transaction Documents, and further provided such payments or subscriptions amounts paid to the Company are paid into the Borrower Bank Account,
- (e) liabilities in respect of its share capital and reasonable professional fees, employee costs, administration costs and taxes in each case incurred in the ordinary course of its business as a holding company; and

- (f) distributions to its shareholder in an amount not exceeding \$5,000 per annum.”

76. The position of RBS was protected from the risk of an unexpected tax charge by clause 10.1 of the Subordination Deed which provided:

**“10. RESET OF TRIGGER EVENT AUM THRESHOLD**

10.1 Upon the occurrence of Reset Event:

- (a) the Agent, BCM LP, and the [borrowing] Company shall enter into good faith negotiation for 20 Business Days to determine an appropriate level for the AUM threshold in paragraph (a) of the definition of Trigger Event, which currently stands at US\$ 8,250,000,000, to be reset upward to a more appropriate level. If good faith negotiations fail to reach a result within 20 Business Days, the AUM threshold level in paragraph (a) of the definition of Trigger Event shall automatically be reset to US\$ 9,500,000,000; and
- (b) each obligor agrees that all reasonably necessary consequential amendments will be made to the Transaction Documents.”

A “Reset Event” is defined in the Deed (clause 1.1) as being, where RBS is a limited partner in the new LP (ie BCMC LP), an “Initial Corporate Limited Partner Resignation Event”.

77. This, and paragraph (a) of the definition of Trigger Event”, is defined at clause 1.1 of the Cayman Limited Partnership (BCMC LP) Deed as meaning:

“... any change, after the accession of the Corporate Limited Partner [RBS] to the Partnership, in (or in the interpretation, administration or application of) any law or treaty (including the publication of any decision in any case), in each case relating to tax, or any published practice or concession of any relevant tax authority (other than a change in tax rates) (each, a “**Change of Law**”) or any communication from any relevant tax authority (a “**Communication**”), which gives rise to, creates a material probability of, or materially increases the probability of, a material adverse impact on the after-tax economic return to the Corporate Limited Partner from the interest which it holds in the Partnership and any transactions undertaken by it relating or by reference to its share in the profits of the Partnership (including, without limitation, the TRS) (as compared with the after-tax economic return expected by the Corporate Limited Partner at the date of the accession of the Corporate Limited Partner to the Partnership) as against the position if the Change of Law or Communication had not occurred, but for the avoidance of doubt the resignation or removal of the Corporate Limited Partner not in connection with a Change of Law or Communication but in connection with the assignment, novation or other transfer of the TRS shall not be an Initial Corporate Limited Partner Resignation Event. ...”

*Contribution Deed*

78. The Deed of Contribution between BCMCL and BCMC LP provides for the contribution from BCMCL to BCMC LP of the interests in BCM LP assigned to it by WR, MP and Sugarquay under the Deed of Assignment (see above) referred to in the Deed as the “BCM LP Interests”, ie the 19% interest in BCM LP.

79. Clause 2 of the Deed provides:

**“2. Contribution of the BCM LP Interests**

- 2.1 BCMCL (on its own account) hereby makes a capital contribution to the Partnership [ie BCMC LP] of the BCM LP Interests (the



“Contribution”) in consideration of the Partnership, acting through its general partner, granting to BCMCL certain partnership interests in the Partnership, as set out in the revised limited partnership agreement relating to the Partnership to be entered into on or around the date hereof.

- 2.2 On receiving the Contribution, the Partnership, acting through BCMCL as its general partner, will become a limited partner of BCM LP and its capital contribution account with BCM LP will be credited to the value set out in clause 2.2 of the Deed of Adherence.
- 2.3 The value of the Contribution is equivalent to US\$361,000,000 (the “Contribution Value”) and BCMCL's capital account with the Partnership will be credited with an amount equal to the Contribution Value.”

80. The Deed of Contribution continues:

**“3. Assignment of BCM LP Interests**

- 3.1 The Partnership agrees that, following the irrecoverable satisfaction in full of all amounts owing by BCMCL under the Facility Agreement or by any Obligor under the Finance Documents to which it is party, in the event that the Partnership receives a Loan Note Conversion Request from the Issuer the Partnership will, acting through BCMCL as its general partner, assign to the Noteholders such proportion of the BCM LP Interests set out in the Loan Note Conversion Request to satisfy the obligation of the Issuer under the Loan Notes.
- 3.2 The consideration in respect of any assignment pursuant to clause 3.1 shall be an amount equal to the value of the BCM LP Interests so assigned, as determined in accordance with the definition of “Value” in the Instrument. Where BCMCL remains a partner in the Partnership at such times, such consideration shall be satisfied by way of a reduction of the amount standing to the credit of the capital contribution account of BCMCL in the Partnership.”

*Subscription Deed*

81. Finally, the Subscription Deed between BCMCHL (the “Subscriber”) and BCMCL (the Company”) the Recitals of which provided:

**“RECITALS**

- (A) The Subscriber entered into a total return swap agreement with Financial Trader [RBS] on or around the date hereof (the “TRS”).
- (B) The effect of the TRS is that an amount equal to any profits in BlueCrest Capital Management Cayman LP allocated to Financial Trader shall, less a margin, be paid to the Subscriber, in consideration for which swap fees will be due from the Subscriber to RBS in accordance with the terms of the TRS
- (C) The Subscriber and the Company wish to enter into an agreement whereby the Subscriber agrees to subscribe, and the Company agrees to allot, shares in the Company on the terms set out herein.”

82. Material clauses of the Subscription Deed provided:

**“2. Subscription**

- 2.1 The Subscriber agrees that in the event it receives any monies from Financial Trader pursuant to the TRS (“Swap Proceeds”), the

Subscriber will apply an amount equal to all such Swap Proceeds to subscribe for Shares without due delay.

- 2.2 The Company agrees that upon any application by the Subscriber to the Company to subscribe for Shares pursuant to the Subscriber's obligation in clause 2.1, the Company shall, subject to any legal or regulatory prohibition, accept such subscription and allot the requisite number of Shares to the Subscriber upon receipt of payment from the Subscriber without undue delay.

...

## **5. Governing Law**

- 5.1 The governing law of this agreement shall be that of the Cayman Islands. ...”

### *Loan Notes*

83. Notwithstanding the TRS arrangements and funding from RBS, Mr Dodd explained that it had always been clear to BCMCL that a bank loan in itself was not sufficient to finance the transaction as it was never likely that a bank would be prepared to fund the entire value of the transaction. Also, as security had already been granted to RBS, no other bank would be prepared to lend to BCMCL as effective first-ranking security would not be available. Therefore, it was for a different type of debt instrument and different type of lender to secure the balance to be considered.

84. In the circumstances Mr Dodd suggested that, in addition to the RBS loan, BCMCL should issue loan notes to WR, MP and Sugarquay to the aggregate value of US\$165 million. Under this approach, WR, MP and Sugarquay would effectively be taking on the role of a mezzanine finance provider where they would be compensated with market-rate interest payments for the risk associated with the lending. It was intended that interest payments under the loan notes would rank behind those to RBS under the loan facility and, if for any interest, payment period, BCMC LP did not distribute sufficient profits to enable the interest under the loan notes to be paid, that interest payment would be deferred and would be capitalised. This feature was and is known as a “Payment in Kind” or “PIK” facility.

85. Mr Dodd participated in the negotiations regarding the level of interest which would be payable to WR, MP and Sugarquay under the terms of the loan notes. He explained that although there was a general desire to complete this deal there were nevertheless competing interests.

86. BCML and the limited partners, such as Mr Dodd, and any potential future recipients of equity from the equity pool would wish to ensure that the rate of interest payable on the loan notes was as low as possible and, in particular, one which did not exceed the anticipated growth in the value of the equity pool. However, WR, MP and Sugarquay would seek to achieve the highest possible interest rate even though their interests were not completely aligned with each other as, under the proposed transaction, each would be left with a different-sized interest in BCM LP: WR 7.2%, Sugarquay 22.77% and MP 39.58%. Additionally, WR, Sugarquay and MP bore the risk of receiving no profit distributions if the downside trigger was engaged as all cashflows generated by BCM LP (and not just those generated by BCMC LP) would then be used to repay the loan from RBS. As such, the residual equity value that they held could be eroded to repay a loan designed to benefit BCMC LP in which they did not have any interest.

87. In the light of these competing interests it was agreed that that a 15% rate of interest was appropriate for the loan notes and that this was equivalent to the “market standard”. Although Mr Dodd considered that there could have been a market for the loan notes he accepted, in evidence, that it “was never really contemplated that they would sell them.”

88. The Loan Note Instrument, dated 6 July 2007, issued by BCMCL acting “in its personal capacity and not as general partner of BCMC LP” constituted US\$165,000,000 unsecured loan notes due in 2017. Clause 5 of the instrument provided for BCMCL to pay interest until such time as the Loan Notes are redeemed or repaid.

89. Other material terms of the Loan Note Instrument include:

### **9. Substitution of another debtor for the Company**

#### **9.1 Right to substitute**

The Company may with the consent of the Noteholders (such consent not to be unreasonably withheld or delayed), substitute any member or members of the Group (the “Substituted Debtor”) in place of the Company (or of any previous Substituted Debtor under this clause 9.1) as the principal debtor or debtors under this Instrument and the Loan Notes by means of an instrument (the “Supplemental Instrument”) executed by the Company (or any previous Substituted Debtor under this clause 9.1), and the Substituted Debtor in such form as they may agree, a copy of which shall be made available for inspection by Noteholders.

#### **9.2 Release**

Compliance with the provisions of clause 9.1 shall operate to release the Company (or any such previous Substituted Debtor) from all of its obligations under this Instrument and the Loan Notes. Not later than 14 days after the execution of the Supplemental Instrument, and after compliance with all such requirements as are set out in clause 9.1, notice of the substitution will be given to the Noteholders. Such notice shall also give details of where copies of the Supplemental Instrument may be inspected. The non-receipt of notice by, or the accidental omission to give notice to, any Noteholder shall not invalidate any substitution and release pursuant to this clause 9.

#### **9.3 Substitution of new debtor**

Upon the execution of the Supplemental Instrument and compliance with the other provisions of clause 9.1, the Substituted Debtor will be deemed to be named in this Instrument and on the Loan Notes as the principal debtor in place of the Company (or any previous Substituted Debtor) as provided in the Supplemental Instrument and shall be liable to the Noteholders accordingly. The existing Loan Note certificates held by the Noteholders (including the Conditions endorsed upon them) shall not be cancelled but shall remain valid in relation to the Substituted Debtor as aforesaid. Every reference in this Instrument to the Company shall henceforth have effect as if it were a reference to the Substituted Debtor.

...

### **11. Covenants**

The Company covenants and undertakes to each of the Noteholders to procure that save as otherwise authorised by an Extraordinary Resolution of the Noteholders:

#### **11.1 Restrictions on disposals of assets**

The Company shall not sell, lease, transfer or otherwise dispose of any of its partnership interest in New LP [BCMC LP], unless it is to be substituted as debtor under clause 9.3 or otherwise in accordance with the Security Documents (as defined in the Facility Agreement).

...

#### **11.4 Payments to Corporate Limited Partner**

The Company shall use reasonable endeavours to procure that any payment to the Corporate Limited Partner pursuant to Clause 12.1 (8)(3) or Clause 13.4(E) of the New LP [BCMC LP] Limited Partnership Agreement shall be made only after the Company is satisfied that after the Parent receives the corresponding payment from the Corporate Limited Partner under the TRS, shares in the Company may be issued to the Parent in accordance with the Deed of Subscription.

...

### **SCHEDULE 2: THE CONDITIONS**

...

## **2. Interest**

### **2.1 Interest calculation and payment dates**

Interest on the Loan Notes will accrue on a daily basis, be calculated by the Company on the basis of the number of days elapsed and a 360 day year and will be payable (subject to any requirement of law to deduct tax therefrom) monthly in arrear, on the last day of each month (the "Interest Payment Date"), to the holders of the Loan Notes ("Noteholders") whose names appear on the Register on the fifth day before the relevant Interest Payment Date in respect of the Interest Period (as defined below) ending on the day immediately before such dates at the rate specified in Condition 2.2, except that the first payment of interest on the Loan Notes, which will be made on 31 July 2007, will be in respect of the period from and including the first date of issue of any of the Loan Notes to (but excluding) 31 July 2007. The period from and including the first date of issue of any of the Loan Notes to (but excluding) 31 July 2007, and the period from (and including) 31 July 2007, or any subsequent interest Payment Date to (but excluding) the next following interest Payment Date is referred to as an "Interest Period".

### **2.2 Interest Amount payable for each Interest Period**

The amount of interest payable on each Loan Note for each Interest Period shall be the lower of

- (A) the product of 15 per cent. per annum and the principal amount outstanding of the relevant Loan Note in the relevant Interest Period (calculated as the weighted average of the principal amount outstanding of such Loan Note during such Interest Period); and
- (B) the product of the funds distributed under clause 13.4 of the New LP Limited [ie BCMC LP] Partnership Agreement to be applied by the Company for such purpose and a fraction, the denominator of which is the aggregate principal amount outstanding of all Loan Notes and the numerator of which is the principal amount outstanding of such Loan Note.

### **2.3 Interest Amount payable on Redemption**

The amount of interest payable on each Loan Note in respect of a redemption of such Loan Note on a Business Day under these Conditions shall be the lower of:

- (A) the sum of (i) the product of 15 per cent per annum for the period from and including the immediately preceding Interest Payment Date to and excluding the date of redemption and the principal amount outstanding of the relevant Loan Note in the relevant Interest Period (calculated as

the weighted average of the principal amount outstanding of such Loan Note during such Interest Period) and (ii) any interest deferred in respect of such Loan Note in accordance with Condition 2.4,

- (B) the product of the funds distributed under clause 13.4 of the New LP [BCMC LP] Limited Partnership Agreement to be applied by the Company for such purpose and a fraction, the denominator of which is the aggregate principal amount outstanding of all Loan Notes and the numerator of which is the principal amount outstanding of such Loan Note.

...

### **3. Redemption**

#### **3.1 Redemption by the Company**

- (A) The Company shall, without the need for consent from any Noteholder or other person, be entitled to require all Noteholders to redeem the whole (whatever the amount) or a specified percentage of their respective holdings of Loan Notes at par, together with accrued interest and any deferred interest payable under Condition 2.4 (subject to any requirement to deduct tax therefrom) up to (but excluding) the date of payment, on any Business Day by giving not less than 30 days' notice in writing. Every such notice of redemption shall be irrevocable.
- (B) The Company shall, with the consent of each Noteholder and the New LP [BCMC LP], be entitled to require one or more (but not all) Noteholders to redeem the whole (whatever the amount) or any part of their holding of Loan Notes at par, together with accrued interest and any deferred interest payable under Condition 2.4 (subject to any requirement to deduct tax therefrom) up to (but excluding) the date of payment, on any Business Day by giving not less than 30 days' notice in writing. Every such notice of redemption shall be irrevocable.

#### **3.2 Redemption on Final Maturity Date**

Any Loan Notes not previously redeemed or purchased will be redeemed in full on the Final Maturity Date together with accrued interest and any deferred interest payable under Condition 2.4 (subject to any requirement to deduct tax therefrom). Such redemption will be effected

- (A) if and to the extent that funds are available for this purpose, at par, and/or
- (B) by issuing a Loan Note Conversion Request to New LP and transferring or procuring the transfer of a portion of New LP's partnership interests in BCM LP in accordance with clause 3.1 of the Deed of Contribution, the percentage of all of the outstanding partnership interests in BCM LP at that time transferred in respect of each relevant Loan Note being determined as follows:
  - (1) If the Value at the Final Maturity Date is less than US\$1,900,000,000, a percentage equal to the product of  $165/1,900 \times 100$  and a fraction, the numerator of which is the principal amount outstanding of the relevant Loan Note and the denominator of which is the aggregate principal amount of all of the loan Notes outstanding as at the Final Maturity Date, and
  - (2) if the Value at the Final Maturity Date is greater than US\$1,900,000,000, a percentage equal to:

$1,900,000,000/N \times 165/1,900 \times 100 \times A/B$

where

N is the Value as at the Final Maturity Date.

A is the principal amount outstanding of the relevant Loan Note as at the Final Maturity Date, and

B is the aggregate principal amount outstanding of all of the Loan Notes outstanding as at the Final Maturity Date.

### **3.3 Redemption on change of control**

If the events set out in clause 7.2 of the Facility Agreement occur, each Loan Note shall be redeemed at par (together with accrued interest and any deferred interest payable under Condition 2.4 (subject to any requirement to deduct tax therefrom) by the Company on any Business Day by giving not less than 30 days notice in writing to the Noteholders.

### **3.4 Redemption on increase of profit**

If at any time the profits of BCM LP are paid in accordance with clause 12.1(C) of the New LP Limited Partnership [BCMC LP] Agreement, then the Company shall, subject to clause 5(11) of the Subordination Deed, on 30 days notice, redeem at par the whole or any part of the Loan Notes on any Business Day together with accrued interest and any deferred interest payable under Condition 2.4 (subject to any requirement to deduct tax therefrom), for the time being outstanding and on the expiry of the notice the Loan Notes in respect of which it has been given shall be so redeemed.

If the Company redeems part only of the Loan Notes, there shall be redeemed out of the holding of each Noteholder that proportion (as near as may be without involving any fraction of £1) of his holding of Notes which the total amount of the Notes then being redeemed bears to the total amount of Notes then in issue.

### **3.5 Redemption on Note Trigger Event**

...

### **3.6 Redemption on default**

If any principal or interest due and payable on any of the Loan Notes is not paid in full within 7 Business Days following the due date for payment of the same, each Noteholder shall be entitled to serve written notice on the Company declaring all Loan Notes held by such Noteholder to be immediately repayable, and upon actual or deemed receipt pursuant to Clause 11.3 of such notice by the Company, all Loan Notes held by such Noteholder then outstanding shall become immediately repayable together with accrued interest and any deferred interest payable under Condition 2.4 (subject to Clause 7.1)."

#### ***BCM LP***

90. On 6 July 2007, having executed the above deeds, BCMC LP became a partner in BCM LP. This had been recognised in the deeds (eg in clause 3.1(a) of the Facility Agreement and clause 2.2 of the Contribution Deed). The parties to the Limited Partnership (BCM LP) Deed of 6 July 2007 included BCML (as General Partner), BCMC LP (as Special Limited Partner), MP, WR, Sugarquay, and over 45 additional limited partners with letters, dated 6 July 2007 being sent by BCML, the general partner of BCM LP, to Sugarquay, WR and MP confirming the proportions of their remaining interests in its income and capital as a result of the transactions under the deeds.

91. Recital (G) of the 6 July 2006 BCM LP Deed explains:

“With effect from the date hereof the General Partner wishes to admit the Special Limited Partner to the Partnership as a Further Limited Partner and the General Partner and the Limited Partners wish to restate the Prior Deed and replace it in its entirety by this Agreement.”

92. By clause 1.1 the BCM LP Deed adopted the Facility Agreement definition of “Trigger Event”. Clause 2 of the Deed states:

**“2. Original Agreements**

- 2.1 This Deed shall take effect from the Effective Date in substitution for the Prior Deed which shall, without prejudice to any accrued rights of any of the parties, from such date, be of no further force and effect.
- 2.2 By way of reaffirmation, each of the General Partner, MP and WR acknowledges and agrees that by executing the Original Deed they agreed to form and to enter into the Partnership established and constituted under English Law and to register it under the Act [ie the Limited Partnerships Act 1907].
- 2.3 Each of the General Partner and the Limited Partners at the date hereof acknowledges and agrees that from the date hereof, and each Further Limited Partner agrees that from the date of its admission to the Partnership as determined under Clause 3, the Partnership shall continue to be established and constituted under English law and to be registered under the Act.”

93. The “business” of BCM LP is dealt with under clause 6:

**“6. Business**

- 6.1 The Partnership's business shall be to carry on the business of (1) managing on a discretionary basis the investment or trading of assets belonging to other persons, (2) marketing shares or interests in such other persons, (3) activities associated therewith and (4) such other activities as may in the opinion of the General Partner be desirable (subject to prior notice of such other activities having been given to each of the limited Partners) and “the Business” shall be construed accordingly.
- 6.2 The Partnership may execute, deliver and perform all contracts and other undertakings and engage in all activities and transactions as may in the opinion of the General Partner be necessary or advisable in order to carry on the Business.
- 6.3 For the avoidance of doubt, the Business shall not extend to the management of the investment or trading of the contributions made by the Partners to the Partnership pursuant to Clause 9 below.”

Clause 9 concerned capital and loan contributions and provides:

**“9. Capital and Loan Contributions**

- 9.1 Each of the Partners acknowledges and agrees that the General Partner and each of the Limited Partners at the date hereof have contributed to the capital of the Partnership in the amounts set out in the letters of allocation between the General Partner and each of the Partners entered into on the date hereof.
- 9.2 Each Further Limited Partner shall contribute upon admission to the Partnership such sum not being less than £100 to the capital of the

Partnership as shall be determined in the absolute discretion of the General Partner and specified in the Deed of Adherence executed by such Further Limited Partner.

- 9.3 The capital of the Partnership may be increased from time to time by such amount and in such proportions as between the Partners as may be agreed between the General Partner and the Partners proposing to make further capital contributions and the letter of allocation between the General Partner and each relevant Partner shall be amended to reflect any such further contribution (or in the case of a Further Limited Partner a letter of allocation shall be entered into between such Further Limited Partner and the General Partner by way of an amendment to this Deed of Adherence executed by such Further Limited Partner to reflect any such further contribution).
- 9.4 No Partner shall be entitled to interest on the amount of its capital contribution made pursuant to this Clause 9.
- 9.5 Loan contributions may also be made to the Partnership by any or all of the Partners from time to time on such terms as to repayment, interest and otherwise as may be agreed between the General Partner and the Partners so contributing or, if a loan contribution is to be made by a Further Limited Partner, between the General Partner and that Further Limited Partner.”

94. However, of greater significance in the present case is Clause 12. This provided how the profits generated were to be allocated and states:

**“12. Allocations**

**12.1**

- (A) Subject to the further provisions of this Clause 12.1 and to Clause 12.4, in respect of each financial year of the Partnership the profits of the Partnership (before tax) as shown by the accounts of the Partnership prepared in accordance with Clause 17 (and after the deduction of any sums payable to an Outgoing Partner pursuant to the provisions of Clause 22 (other than such Outgoing Partner's capital contribution)) shall, subject as provided In this Clause, be allocated amongst the Partners as follows:-
  - (1) firstly, there shall be allocated to the General Partner such amount of profits as shall in the good faith opinion of the General Partner be required to be retained in the Partnership (i) as working capital to meet anticipated, current or foreseen liabilities and expenditure of the Partnership, (ii) to cover other contingencies in accordance with general principles of prudent management and (iii) to satisfy any obligation imposed on the General Partner by the Financial Services Authority to maintain a minimum level of financial resources;
  - (2) secondly, there should be allocated to such of the Partners (if any) as the General Partner shall in its absolute discretion determine (i) such amount of profits, in aggregate not exceeding the performance fees received by the Partnership in the relevant financial year (“Performance Fees”), as the General Partner shall in its absolute discretion by resolution of its board of directors determine, in order to recognise investment performance



attributable to such Partners during the relevant financial year; and (ii) such amount of profits (in aggregate not exceeding 15 per cent. of the amount of the Performance Fees less any allocations to recognise investment performance (as set out in (i) above) as the General Partner shall in its absolute discretion by resolution of its board of directors determine, in order to recognise management performance during the relevant financial year;

- (3) thirdly, there shall be allocated to the Special Limited Partner such amount of profits ("SLP Profits") as is equal to the aggregate Advance Drawings during such financial year;
  - (4) the remainder of the profits, which for the purposes of the operation of this sub-clause shall be increased by adding thereto an amount equal to any SLP Profits in respect of the relevant financial year, shall then be allocated to the Partners in the Agreed Proportions provided that the amount allocated to the Special Limited Partner under this Clause 12.1 (A)(4) shall be reduced by an amount equal to any SLP Profits in respect of the relevant financial year.
- (B) The parties agree and acknowledge that in respect of the current financial year of the Partnership (being the period of 12 months ending on 30 November 2007, the "Current Financial Year"), the Special Limited Partner is entitled to participate in the profits and losses of the Partnership only for the Future Period and accordingly the parties have agreed that the profits and losses of the Partnership for the Current Financial Year shall be allocated between the parties in the following manner.

The General Partner will prepare Management Accounts (i) for the Prior Period and (ii) for the Future Period and will calculate the profits or losses of the Partnership for the Prior Period and for the Future Period based on such Management Accounts. The General Partner will prepare such Management Accounts and calculations within 30 days of the completion of the audit of the accounts of the Partnership for the relevant financial year pursuant to Clause 17 and will, on request, provide copies of such Management Accounts and such calculations to the other parties to this Agreement and without prejudice to the foregoing will provide copies of such Management Accounts and such calculations to the New GP as soon as is reasonably practicable after the same have been prepared.

Following the completion of such calculations:

- (1) a sum equal to the profits or losses for the Prior Period (as shown by the calculation for such period) shall be allocated as if the Prior Deed were still in full force and effect and without regard to Clause 12.1 (A) hereof; and
- (2) a sum equal to the profits or losses for the Future Period (as shown by the calculation for such period) shall be allocated amongst the Partners (including the Special Limited Partner) in accordance with the provisions of Clause 12.1(A).

- (C) The provisions of Clause 12.1(A)(4) shall cease to apply and the Remaining Profits shall be allocated to the Special Limited Partner during:

- (1) any Facility Trigger Period; or
- (2) any Note Repayment Period

To determine the allocations payable pursuant to this Clause 12.1(C) in any relevant financial year, the General Partner shall prepare Management Accounts (i) for each Facility Trigger Period, (ii) for each Note Repayment Period and (iii) for each period that is neither a Facility Trigger Period nor a Note Repayment Period (each one a "Remaining Period") during the relevant financial year.

Following the preparation of these Management Accounts (which shall be prepared within 30 days of the end of the relevant financial year) the General Partner shall deduct from the profits shown by such Management Accounts an amount equal to the allocation of profits pursuant to Clauses 12.1(A)(1), (A)(2) and (A)(3) for the relevant financial year (such deduction to be applied as between each Facility Trigger Period, Note Repayment Period and Remaining Period pro rata to their respective durations) and shall calculate the Remaining Profits for each Facility Trigger Period, each Note Repayment Period and each Remaining Period. The General Partner will, on request, provide copies of such Management Accounts and such calculations to the other parties to this Agreement and without prejudice to the foregoing will provide copies of such Management Accounts and such calculations to the New GP as soon as is reasonably practicable after the same have been prepared.

Following the completion of such calculations:

- (a) a sum equal to the Remaining Profits for any Facility Trigger Period and any Note Repayment Period shall be allocated to the Special Limited Partner in accordance with sub-clauses (1) and (2) of this Clause 12.1 (C); and
- (b) a sum equal to the Remaining Profits for any Remaining Period shall be allocated amongst the Partners in accordance with the provisions of Clause 12.1 (A)(4). ..."

95. Provision for drawings was made in Clause 13, this states:

**"13. Partners' Accounts and Distributions**

- 13.1 Each Partner shall have, inter alia, a Capital Contribution Account and a Distribution Account which shall be operated in accordance with the provisions of Clauses 13.2 to 13.4. In addition, the General Partner shall have a Retention Account which the General Partner shall operate in accordance with the provisions of Clause 12.3.
- 13.2 The capital contribution of each Partner shall be credited to that Partner's Capital Contribution Account.
- 13.3 The profits (or losses) allocated to the Partners in respect of each financial year of the Partnership pursuant to Clause 12 shall be credited (or debited, as the case may be) to the Distribution Accounts of the Partners as to 70 per cent of the General Partner's good faith estimate

of the profits (or losses) of the financial year within 30 days of the end of the relevant financial year and as to the balance within 30 days of the completion of the preparation of the accounts of the Partnership for the relevant financial year in accordance with Clause 17. Save as otherwise agreed with the General Partner, each Partner shall be permitted to withdraw amounts standing to the credit of its Distribution Account from the date that such amounts are so credited provided that in the case of the Special Limited Partner any such withdrawal shall only be made by way of a payment to the NewLP Bank Account (as defined in the Facility Agreement).

14.4

- (A) Subject in all respects to the General Partner being satisfied as to the level of profits anticipated in respect of any financial year, the General Partner shall have the discretion to allow Partners to make drawings (“Discretionary Drawings”) in advance of the end of a financial year in anticipation of their profit entitlement for such financial year provided that (i) in the case of any drawings in anticipation of profit entitlements under Clause 12.1(A)(4), all Partners shall be entitled to participate in such drawings and the aggregate amount that the General Partner shall decide may be drawn in anticipation of such profit entitlements shall be drawn as between the Partners in the Agreed Proportions, and (ii) no Discretionary Drawings shall be allowed during a Facility Trigger Period or a Note Repayment Period other than Discretionary Drawings on account of an allocation that the General Partner anticipates will be made pursuant to Clauses 12.(A)(1) or 12.1 (A)(2).
- (B) Notwithstanding the discretion referred to in Clause 13.4(A), in each financial year of the Partnership distributions shall be made at the end of each month to the Special Limited Partner in an amount equal to an amount (if any) sufficient for the New GP to pay interest payable under the Facility Agreement during the following month, such amount to be notified in writing by the Special Limited Partner to the General Partner not less than two Business Days prior to the end of the relevant month provided that no Advance Drawings shall be made pursuant to this Clause after the Facility Repayment Date.
- (C) ...”

96. As noted in the Statement of Agreed Facts (at paragraph 8(34)) on 1 December 2008 the business of BCM LP was transferred as a going concern to BCM LLP.

*Fyled*

97. Notwithstanding the “protection” provided to it under the TRS and other agreements, RBS became cautious and appeared to Mr Aitchison to become reluctant to provide the funds and be a counterparty to the TRS. He explained that this was due, in part, to many banks, including RBS, changing their general approach to tax risk in the summer of 2007. However, although RBS did agree to enter into the TRS arrangement it nevertheless set the terms and pricing of the TRS at a level designed to encourage BlueCrest to seek a replacement counterparty (eg RBS were charging a higher fee for participation than might have been expected from another financial institution).

98. Mr Aitchison was therefore asked by Mr Dodd and Ms Catherine Kerridge, then Head of Tax at BCM LP, for the contact details of teams at other financial institutions that might be

familiar with the TRS arrangement and who might be willing to replace RBS in its role as counterparty to the TRS. As noted in the Statement of Agreed Facts (see paragraph 8(28) – (33), above), RBS was replaced on 11 June 2008 as the Corporate Limited Partner in BCMC LP by Fyled, part of the Morgan Stanley Group.

99. The Deed of Assignment, dated 11 June 2008, between RBS, as assignor and Fyled, as assignee, provides:

**“Background:**

The Assignor wishes to assign to Fyled, and Fyled wishes to take an assignment from RBS of RBS’s Partnership Interest (as defined in clause 2 below) on the terms of this Deed with effect from the date hereof and in conjunction with the accession to the Limited Partnership Deed by Fyled (the “Effective Date”).

100. It is clear from clause 2 of that Deed that RBS assigned the interest it held in BCMC LP to Fyled.

**ISSUES**

101. Having set out the factual background (although further details in relation to the discovery assessment are set out below in relation to that issue, Issue 6), I now turn to the issues.

**Issues 1 – Profit Allocation Issue**

*Is BCMCL liable to corporation tax on all of the profit allocations of BCM LP in respect of the 19% interest in BCM LP sold by WR, MP and Sugarquay in July 2007? In this regard was BCMC LP a partner of BCM LP and, if not, were all the partners of BCMC LP to be treated as partners of BCM LP?*

102. It is clear from the various relevant documents above, eg clause 8.13 of the Deed of Subordination and Covenant (see paragraph 75, above) which specifically refer to BCMC LP not undertaking any business other than “being a limited partner in BCM LP”, that these refer to BCMC LP being a partner, albeit a limited partner, in BCM LP.

103. However, it is agreed by the experts on Cayman Islands law, whose evidence I shall come to in due course (see paragraph 135, below) that (as in English law) a Cayman Islands partnership does not have separate legal personality and, as a matter of Cayman Islands law, a Cayman Islands partnership is not an entity in its own right. The only entities are the partners. It is therefore necessary to consider which of the partners in BCMC LP (the Cayman Islands exempted limited partnership) is, as a matter of partnership law, a partner of the UK limited partnership BCM LP.

104. In relation to this issue, *Lindley & Banks on Partnership* (20<sup>th</sup> edition, 2017) at 4-27 states:

“Since under English law a firm does not have separate legal personality, it cannot, as such, be a member of another firm.

Thus, where a firm purports to become a partner, this will, as a matter of law, constitute each of the members of that firm as a partner in his own right, and the correctness of this analysis is indirectly confirmed by the provisions of the Partnerships (Accounts) Regulations 2008.

However, there is no reason in principle why, internally, the firm should not be treated as if it were a single partner.

The position is otherwise in Scotland, where the firm is a separate legal person and its ability to enter into the partnership relation is well recognised.”

105. A footnote to this passage from *Lindley & Banks* refers to a decision of the High Court, *Major v Brodie* [1998] STC 491. In that case Park J referred to the facts as stated in the decision of the Special Commissioner and, having observed that Mr and Mrs Brodie owned the Skeldon Estate in Ayrshire on which they carried on business activities including the grant of grazing licences, furnished lettings, selling timber from woodlands, and exploiting shooting and fishing rights, at 507, continued:

“3. On 13 June 1986 Mr and Mrs Brodie formed a partnership between themselves to carry on the business of proprietors of the estate. The partnership name was Skeldon Estates. For the most part in this judgment I shall refer to it as Skeldon Estates partnership in order to minimise the risk of confusion between the partnership and the landed property. In fact the document recording the partnership and its terms was not executed until the following year, but it was not doubted before Mr Shirley [the Special Commissioner] or before me that the partnership existed. The documentation of it was a contract of co-partnery under Scottish law, entered into on 16 May 1987 and stating in cl 1 that the partnership commenced on 13 June 1986.

4. By a number of documents entered into in June and July 1987 another partnership was formed. This partnership involved an additional person, Mr Henry Murdoch, who (or whose family) I surmise to have been concerned in another farm in the locality, called Torr farm. It also involved a third farm (as well as the Skeldon Estate farm and Torr farm). This third farm was called Balgreen farm. There were several documents. Plainly they were all entered into in contemplation of each other. The following summary is not necessarily in the sequence in which they were executed, but sets them out in the order in which, as it seems to me, they can most clearly be understood.

(a) Each of Mr and Mrs Brodie borrowed £225,000 from Coutts Finance Co. (In fact each drew down the borrowing in two instalments of £150,000 and £75,000 a few days apart.) So the total loans were £450,000. It was not a single loan of that sum to Skeldon Estates partnership. There were two loans of £225,000 to two separate borrowers.

(b) Each of Mr and Mrs Brodie contributed or advanced to Skeldon Estates partnership the £225,000 which he or she had borrowed from Coutts. So Skeldon Estates partnership had £450,000.

(c) Skeldon Estates partnership bought from the Murdoch family for a total of £300,000 Balgreen farm and the milk quota which went with it.

(d) A second partnership was formed. It was called W Murdoch & Son. The critical aspects of it were as follows. (i) There were stated to be two partners. 'The Second Party' was straightforward: it was Mr Henry Murdoch. 'The First Party' was a little more complex. It was stated to be Mr Brodie and Mrs Brodie 'trading as "Skeldon Estates"'. So W Murdoch & Son was a partnership between (1) Skeldon Estates partnership, which was itself a partnership between Mr and Mrs Brodie, and (2) Mr Henry Murdoch. (ii) W Murdoch & Son was to carry on the business of farmers. (iii) It was to carry on that business at three farms: Balgreen, Torr, and the farmland at Skeldon estate. (iv) None of those farms was to be a partnership asset. (v) The partners were to contribute partnership capital of £220,161, doing so equally. This meant that Skeldon Estates partnership had to contribute £110,080. (Skeldon Estates partnership, though itself a partnership of two persons, was one partner in W Murdoch & Son, not two.) (vi) The Partnership Act 1890 and the law of Scotland applied. [1998] STC 491 at 508

(e) The effect of sub-para (d)(iii) and (iv) was that Skeldon Estates partnership, which owned Balgreen farm and the Skeldon estate farmland, would continue to own them to the exclusion of Mr Henry Murdoch, but would make them available to be farmed by W Murdoch & Son. Conversely, Mr Henry Murdoch, who owned Torr farm, would continue to own it to the exclusion of Skeldon Estates partnership and Mr and Mrs Brodie, but would make it available to be farmed by W Murdoch & Son.

106. Park J continued, at 510-511:

“Before me a rather different Scottish law point emerged. The separate legal personality of Skeldon Estates partnership made it very easy to see that the farming trade was indeed carried on by the partnership to which Mr and Mrs Brodie contributed the money which they had borrowed from Coutts. That partnership was Skeldon Estates partnership. Since it was a legal person it could itself be a partner in W Murdoch & Son. Mr Henderson said that it would have been different in England, and that Mr and Mrs Brodie could not have qualified for interest relief if Skeldon Estates partnership had been an English partnership. So in order to achieve uniformity of application of the tax code north and south of the border I should hold that they did not qualify for relief in the actual case where Skeldon Estates partnership was a Scottish partnership.

I do not agree with this argument. In the first place I tend to the view that the tax result would be the same with an English partnership. Suppose that A and B were the partners in partnership X, an English partnership. Suppose further that an agreement was entered into between (1) partnership X and (2) C to form another partnership, partnership Y. It was submitted that the analysis under English law would be that partnership Y had three members, A, B and C, not two. I am willing to assume that that is right. However, A and B would be partners in partnership Y in their capacity as members of partnership X. In my judgment that would satisfy s 362(1)(b). When the paragraph refers to 'the trade ... carried on by the partnership' its strict meaning in relation to an English partnership is 'the trade carried on by the partners in their capacities as members of the partnership'—because under English law a partnership is not a legal person. I consider that, despite the complicated sound of the proposition, it is perfectly possible for A and B, who have capacities as partners in partnership X, to possess [1998] STC 491 at 511 those capacities in the further capacities which they have of being partners in partnership Y.

107. Relying on *Major v Brodie*, Mr Gammie contends that all of the partners in BCMC LP are also partners in BCM LP whereas Mr Baldry, who also seeks support from *Major v Brodie* says that only BCMCL and not the other members of BCMC LP (ie Mr Dodd, RBS and ultimately Fyled) was a partner in BCM LP.

108. Mr Baldry contends that Park J, in *Major v Brodie*, was contemplating a “relatively straightforward situation” of an English partnership between A and B, which agrees to go into a partnership with C. He accepts that in such a case A, B and C may have agreed to be partners but, he says, that this is “quite a long way” from the present case, especially in relation to Fyled, as on day one, under clause 2 of the Deed of Contribution (see paragraphs 80 - 81, above), BCMCL contributed the share it had acquired by becoming a member of BCM LP to effectively hold in its capacity as a general partner of BCMC LP.

109. The relationship arising as a result was described by Mr Baldry, relying on the following passage at 5-70 of *Lindley & Banks*, as a sub-partnership:

“Lord Lindley defined a sub-partnership as follows:

“A sub-partnership is as it were a partnership within a partnership; it presupposes the existence of a partnership to which it is itself subordinate. An agreement to share profits only constitutes a partnership between the parties to the agreement. If, therefore, several persons are partners and one of them agrees to share the profits derived by him with a stranger, this agreement does not make the stranger a partner in the original firm. The result of such an agreement is to constitute what is called a *sub-partnership*, that is to say, it makes the parties to it partners inter se; but it in no way affects the other members of the principal firm.”

110. It is therefore necessary to consider whether, as a result of the arrangements between the parties (the material provisions of which are set out above), BCMC LP can be best described as a sub-partnership of BCM LP or, if in accordance with the agreements, all of the partners in BCMC LP became partners in BCM LP.

111. As stated above, the first step under the arrangements was for BCMCL became a partner in BCM LP. It, BCMCL, then contributed that interest to BCMC LP in accordance with Clause 2 of the Deed of Contribution under which BCMCL “on its own account” made a capital contribution to BCMC LP of its interests in BCM LP (see paragraphs 80 – 81, above) which, in my view, makes it clear that BCMCL was acting in its own capacity when it made that contribution.

112. Accordingly, the interest BCM LP held by BCMCL, which was in its own right as a partner in BCM LP is now held by BCMCL in its capacity as the general partner of BCMC LP. However, it does not necessarily follow from this that the partners of BCMC LP also became partners of BCM LP. There is no evidence from RBS that it intended to become a member of BCM LP and certainly no evidence that Fyled to which RBS transferred its interest in BCMC LP intended to become a member of BCM LP.

113. In my judgment, having regard to the various deeds and/or agreements, the arrangements between the parties can best be described as a sub-partnership with BCMCL becoming a partner of BCM LP. Although BCMCL subsequently distributed its profit allocation in respect of the 19% interest in BCM LP in accordance with the BCMC LP agreements, this can be compared to the partner described in *Lindley and Banks* that agrees to share the profits derived by him with someone other than a partner (a stranger). Clearly this has no effect on the other partners of the firm (in this case BCM LP) and does not make the person who received profits from the partner (ie the other BCMC LP members) a partner in the original firm (ie BCM LP).

114. Therefore, to answer Issue 1, as I consider that only BCMCL was a partner in BCM LP (rather than all the partners in BCMC LP) it, and it alone, is liable for corporation tax on its profit allocations in respect of the 19% interest it acquired from WR, MP and Sugarquay in BCM LP.

## **Issue 2 - Alternative Profit Allocation Issue**

*Did BCMCL’s entitlement to the profits of BCMC LP include those allocated to RBS/Fyled (less amounts retained by Fyled as fees for its involvement in the arrangements)? In this regard:*

(1) *What were the “profit-sharing arrangements”, within the meaning of s.1262 of the CTA 2009, relevant to BCMC LP?*

(2) *In particular, were they confined to the BCMC LP Deed, or did they encompass other contractual agreements and, if so, which other agreements?*

115. Although, given my conclusion that only BCMCL (and not all the members of BCMC LP) was a partner of BCM LP it is not strictly necessary to consider HMRC's alternative argument that BCMCL was entitled to all of the profits allocated to BCMC LP including that allocated to RBS/Fyled. However, I have done so as the issue was fully argued and in case of any further appeal.

116. Mr Gammie contends that it is necessary to look to Cayman Islands law to determine the rights of the partners of BCMC LP to the profits of BCM LP that are allocated to BCMCL as the general partner BCMC LP. He relies for support on the decision of the Court of Appeal in *Dreyfus v Inland Revenue Commissioners* (1929) 14 TC 560 ("*Dreyfus*"), *Memec plc v Inland Revenue Commissioners* [1998] STC 754 ("*Memec*") and *HMRC v Anson* [2015 STC 1777 ("*Anson*").

117. *Dreyfus* concerned two Frenchmen carrying on business through French entity, a Société en nom collectif, in the UK and raised the issue of whether the two individuals could be assessed to supertax in the UK. At 573, of the decision Lord Hanworth MR said:

"We have to take the facts as they are found for us in the Case. We know that Louis Dreyfus et Compagnie is a "Société en nom collectif." What that is in French law is a matter of fact. Foreign law has to be proved as a matter of fact over here ... Now here we are told that this "société" owes its existence not to the combination of the parties but to a written document and it is there and there only that you will find what is the nature of the embodiment of these persons"

118. After noting, at 574, that the "execution and registration of this document has brought into being a legal person as distinct from the individuals of which it is composed", Lord Hanworth continued, at 575-576:

"Now it is to be remembered that no company which is registered or incorporated in a foreign country can bring over its law and be for all purposes a company over here. By the comity of nations we do recognise the incorporation of other legal entities in other countries but a company registered in a foreign country is of course a foreign company. It is only by that comity that we accept the conditions which are imposed by foreign law, and to take a simple illustration of that, it is well found in the case to which Sir Boyd Merriman [the Solicitor-General who appeared for the Revenue] called our attention this morning, that you may have a body to which recognition is given in the English Courts by reason of the status which it has reached in the foreign courts. You may, on the other hand, have some indicia from a foreign country which are not recognised over here, because they are merely matters of the *lex fori*, and in our law matters of procedure are governed by our own *lex fori*."

Having referred to the case of the *General Steam Navigation Company v Guillo* 11 M&W 877, Lord Hanworth continued, at 576-577:

"Now that case is very interesting because it shows this, that all that is established is something which deals with the *lex fori*, and this Court being governed by its own *lex fori* will not be hampered by any restrictions of the *lex fori* of another country. On the other hand, if there has been a body established by foreign law, the courts will recognise the juristic status of that body, and thus the Court says that the principle of the liability of members of a foreign corporation to third parties is to be referred to the law under which that corporation was established, and if the law shows that it was established as a separate entity, then effect should be given to it, and it is otherwise with matters which are merely matters of the *lex fori*."



Now we have got here upon the facts, which I do not repeat, a clear finding that there was an entity apart from these partners constituted by French law and we have to recognise that entity so established and treat the body so set up as having had attributed to it the status which ought to be recognised over here. It does not avail to say that we have no such entity or means of establishing a separate entity over here and as we have not, therefore we must tear down the status of the foreign entity. Not so, we must respect the foreign entity properly established because it is not a mere matter of the *lex fori*, it is a matter of the status which the entity brings over here with it. Now, this being the case, how can we it be said in respect of this trade, which I repeat again for the third time has been properly taxed to income tax, it can be dealt with as the individual profits or the individual trade of the tax partners when we are told in plain and clear words that the “société” does not owe its existence to the combination of the parties and that it is a legal person distinct from the individuals of which it is composed? Mr Stamp said: Are those profits being earned for these men, or for the “société”? It seems to me quite plain upon what has been found that they are being earned for the “société” or the French entity, and not for these men, and that these men (I am quoting, I think, verbatim) “are not “entitled to”, and would not know what was their interest in the “business” over here unless and until that declaration had been “made”, according to the resolutions of which we have a translation in the case. I think it is upon the facts impossible to say that these two persons, Charles Dreyfus and Louis Dreyfus, are mere partners, and only clothed with an imaginary personality. Whether we could do this or not in England does not seem to me to matter. We have to recognise that it is not the business of these persons, they are not the persons who are carrying on the trade, and there is not merely an imaginary, but a legally constituted entity which is carrying on the business. Mr Justice Rowlatt has put the matter quite plainly, I think, in his judgment, in which he puts it forward as part of the argument of Mr Latter. He says: “He argued further that it also follows that the Appellants incomes as individuals were not from a source in the United Kingdom but from one in Paris where the Society is situated”; and where, I would say, the distribution is made after the totality of the profits of the ‘société’ have been taken into consideration; and he adds this: ‘It appears to me that section 20, proviso (ii), can only be applied to partnership profits as understood in this country and, at any rate, to this extent, that they must be profits of individual aggregated together by partnership agreement and trading in earning profits in such aggregate, the partnership name, if any, meaning merely all the individuals and so trading together.”

119. Mr Gammie says of *Dreyfus* that this was not only the Court of Appeal recognising the distinct legal personality of the société by reference to French law but also that the profits were the profits of the société and not the profits of the appellants in that case.

120. *Memec* concerned a UK incorporated company (referred to in the decision as “Plc”) which entered into a German “silent partnership” agreement with its German subsidiary holding company (referred to in the decision as “GmbH”). An issue before the Court of Appeal was whether the 87% share of the profits of the silent partnership that were paid to GmbH were equivalent to a partner’s share of profits. This turned on the nature of Plc’s interest in the silent partnership the answer to which depended on the position under German law. Both counsel accepted that there was no direct authority on how a silent partnership should be treated for corporation tax purposes, which, as Peter Gibson observed at 763, was “hardly surprising given that it is not a form of partnership known in English or Scottish law.”

121. Peter Gibson LJ, who considered the nature of the interest in and profits derived from a silent partnership according to German law, said, at 765-766:

“A silent partnership, whilst being similar to an English partnership in not being a separate legal entity, differs from both English and Scottish partnerships in a number of respects. The judge considered the decisive point to be the absence of any proprietary right, legal or equitable, enjoyed by Plc in the shares of the subsidiaries or in the dividends accruing on those shares. That is certainly a strong point of distinction from an English partnership, though it is less obviously so in the case of a Scottish partnership. But even a Scottish partner has an (indirect) interest in the profits of the partnership as they accrue as well as in the assets of the partnership. In a real sense the profits and assets are the profits and assets of the partners, the firm, their collective alter ego, merely receiving those profits and holding those assets for the partners who are the firm. They are jointly and severally liable for the firm’s debts. In contrast, though a silent partner is indirectly interested in those profits, in that his entitlement to a share of the profits (or his obligation in respect of the losses) will be computed by reference to the profits of the owner at the end of the year, his interest is purely contractual. A clearer distinction is the point advanced by Mr Henderson [counsel for the Revenue] that, unlike in an English or Scottish partnership, in the silent partnership no business is carried on by Plc and GmbH in common with a view to profit. The business is that of GmbH as sole owner. Plc is not jointly liable with GmbH to creditors of GmbH for the debts and obligations of GmbH. The liabilities of the business are those of GmbH alone, though Plc can be called on by GmbH to bear its share of losses computed at the end of the year to the extent of its capital contribution. To a third party, Plc’s role in the silent partnership is irrelevant and may not be known.

The position of Plc seems to me to be that of a purchaser who, for a consideration consisting of the contribution of a capital sum and an undertaking to contribute to losses of the owner of a business up to the amount of the contribution, purchases a right to income of a fluctuating amount calculated as a share of the annual profits of the business. Neither in English or Scottish law would that leave Plc a partner with GmbH. That in itself is not determinative of transparency, and I of course accept Mr Venables’ submission that technical differences in the nature of rights should not cause cases which are in substance identical to receive different United Kingdom tax treatment. But I see insufficient justification present in the circumstances of the silent partnership for treating the share of the profits of the GmbH business received by Plc as the same as the profits of the subsidiaries or the dividends which were paid to GmbH alone as shareholder and not to Plc.”

122. *Memec* was considered by the Supreme Court in *Anson* which concerned an individual who was a member of a United States limited liability company (“LLC”) who derived a share of the profits in the business carried on by the LLC and claimed double tax relief on the United States tax that had been paid in respect of those profits. The issue in that case being did he have an entitlement to the profits of the LLC as they arose, ie was the LLC effectively equivalent to a transparent partnership. If so his share of the profits was his partner’s share but if the profits were derived entirely by the LLC and taxed in the United States the share he received was effectively his dividend from the LLC which fell to be taxed separately and for which he would not qualify for relief.

123. Lord Reed SCJ (with whom Lord Neuberger P, Lord Clarke, Lord Sumption and Lord Carnwath SCJJ agreed) said:

“101. Further arguments were advanced by both parties on the basis of the case of *Memec*. ...

...

103. The first point on which issue was joined (and the only one relevant to the present case) was whether the dividends paid by the trading subsidiaries to GmbH should be treated as having been paid by them to Plc. It was conceded by the Commissioners that, if that premise were established, relief would then be due.

104. The basis of the concession is not recorded in the judgments, but must have been the provision in the UK/German treaty corresponding to article 23(2)(b) of the 1975 Convention (as was submitted on behalf of Mr Anson, and not disputed, in the present appeal). What was being sought was relief in respect of underlying tax on the profits out of which dividends were paid. Such relief was only available under the equivalent of article 23(2)(b), and was only available under that provision “in the case of a dividend paid by a company which is a resident of the Federal Republic to a company which is a resident of the United Kingdom”. It could hardly have been argued that relief was available under the provision in the treaty corresponding to article 23(2)(a) of the 1975 Convention, since (apart from any other consideration) article 23(2)(a) does not provide relief in respect of the underlying tax on profits out of which dividends are paid. The question under the treaty, therefore, was the one arising under the provision corresponding to article 23(2)(b): were the dividends paid by GmbH's subsidiaries “paid by a company which is a resident of the Federal Republic to a company which is a resident of the United Kingdom”? The critical issue was whether the dividends were paid by the subsidiaries to Plc, for the purposes of the treaty, notwithstanding that the payments were made to GmbH.

105. The arguments on that issue focused on the question whether the source of the relevant income of Plc was the dividends from the trading subsidiaries, or its contractual right under the agreement to payment of its share of the partnership profits. Another way the argument was expressed was in terms of whether the partnership was transparent, so that its existence could be disregarded in determining whether the dividends were paid by the subsidiaries to Plc.

106. In deciding that relief was not available on this basis, Robert Walker J considered that the decisive point was the absence of any proprietary right enjoyed by Plc in the shares of the trading subsidiaries, or in the dividends accruing on those shares. The shares and the dividends belonged to GmbH. Plc did not therefore receive, or become entitled to, the dividends paid by the trading subsidiaries. Its contractual right to a share of the profits of the partnership must be regarded as a separate source of income.

107. In the Court of Appeal, the approach adopted by Peter Gibson LJ was to consider the characteristics of an English or Scottish partnership which made it transparent, and then to see to what extent those characteristics were shared or not by the silent partnership, in order to determine whether it should be treated for corporation tax purposes in the same way. In that regard, it was observed that the absence of a proprietary right in the shares of the subsidiaries, or in the dividends accruing on those shares, was less obviously a point of distinction from a Scottish partnership than an English one. A clearer distinction was that, unlike an English or Scottish partnership, Plc and GmbH did not carry on business in common: the business was carried on solely by GmbH. Peter Gibson LJ acknowledged that the absence of what English or Scots law would regard as a partnership was not in itself determinative of transparency, but concluded that he saw “insufficient justification present in the circumstances of the silent partnership for treating the share of the profits of the GmbH business received by Plc as the same as

the profits of the subsidiaries or the dividends which were paid to GmbH alone as shareholder and not to Plc” (p 766). Henry LJ agreed, and Sir Christopher Staughton gave a concurring judgment on this issue.

108. The present case is not concerned with a claim to relief under article 23(2)(b). If it were – if, for example, the taxpayer were Anson plc, a UK resident company holding at least 10% of the voting power in the LLC, and the question was whether it was entitled to relief from corporation tax in respect of underlying tax paid in the US by subsidiaries of the LLC – then it would be necessary, as in *Memec*, to consider whether Anson plc could be treated as having been paid the dividends received by the LLC from its subsidiaries. But that is not this case.

109. The issue in this case is not whether the receipts of the LLC from third parties are to be regarded as having been paid to the members of the LLC, but whether the income on which Mr Anson paid tax in the US is the same as the income on which he is liable to tax in the UK. As I shall explain, answering that question involves considering whether income arises to Mr Anson, for the purposes of UK income tax, when his share of profits is allocated to his account, or when he receives distributions of profits. That issue is different from the issue considered in *Memec*. The answer to the question whether the receipts and expenditure of an entity are paid to and by its members does not necessarily determine whether, when a profit arises in a given accounting period, that profit constitutes the income of the members. The answer to the latter question depends on the respective rights of the entity and its members in relation to the profit, and therefore on the legal regime governing those rights.

After considering the correct approach to the issue under the double tax treaty Lord Reed continued:

“115. Mr Anson is liable to UK income tax under Case V of Schedule D “in respect of income arising from possessions out of the United Kingdom”. There is no dispute that he had a possession out of the UK for this purpose, although the parties differ as to how it should be described. More importantly, the parties differ as to the stage at which Mr Anson's income, and therefore a liability to tax, arises. Mr Anson maintains that income arises as profits are earned by the LLC, regardless of whether they are distributed. The income which is liable to tax is therefore Mr Anson's share of the profits. The Commissioners argue that income arises only as and when profits are distributed. If no distributions are made, then on the Commissioners' argument no tax liability arises. The income liable to tax is therefore the distributions.

116. There is no doubt that taxpayers can be liable to tax in respect of income to which they are entitled without receiving payment of that income. Examples include the income of an interest-in-possession trust (*Baker v Archer-Shee*) or of a partnership (*Reed v Young* [1986] 1 WLR 653-654; [1986] STC 285, 289-290; *Padmore v Inland Revenue Commissioners* [1987] STC 36, 51).

117. The Commissioners distinguish partnerships from the present case on the basis that the business of a partnership is carried on by the partners themselves, who are therefore automatically entitled to the profits. There is a dispute between the parties whether that is a correct analysis of a Scottish partnership, but it is unnecessary to resolve that question in the present appeal. The Commissioners distinguish the case of an interest-in-possession trust on the basis that the business (or other profit-generating activity) is carried on by one person on behalf of another, who is automatically entitled to the profits. The present case is different, it is said, because there is no similar entitlement.

Expressing the same idea in a different way, in the case of a partnership or an interest-in-possession trust, the source of the taxpayer's income is the business carried on by the firm or the trustees respectively, whereas in the present case, it is said, the source of Mr Anson's income is his rights under the LLC agreement.

118. The premise of the Commissioners' submissions is that, because the business of the LLC is carried on by the LLC, it necessarily follows that the profits generated by the business belong to the LLC. On that premise, the effect of the LLC agreement must be to require the LLC to transfer its profits to the members. As the Commissioners state in their printed case:

“If a trader carries on a trade beneficially, the profits belong to him and any instrument which obligates the trader to pay on those profits creates a source for the payee which is a distinct source from that of the trading entity's trade. ... A trader who agrees contractually to pay all, or a part of, his profits to a third party remains taxable on all of his profits. The profits do not belong to the third party and he is not taxable on them.”

119. The difficulty with this argument is that it is contradicted by the findings made by the FTT. It is relevant to note, in the first place, that the rights of a member of the LLC were found to arise from the LLC Act, combined with the LLC agreement. Secondly, that agreement was not a contract between the LLC and its members: the LLC was not a party to it, but was brought into being by it, on the terms set out in it and in the provisions of the LLC Act. It was thus the constitutive document of the LLC. It was against that background that the FTT made findings which contradict the premise that the profits belong to the LLC in the first instance and are then transferred by it to the members. Their conclusion, on the contrary, was that, under the law of Delaware, the members automatically became entitled to their share of the profits generated by the business carried on by the LLC as they arose: prior to, and independently of, any subsequent distribution. As the FTT stated:

“The profits do not belong to the LLC in the first instance and then become the property of the members. ... Accordingly, our finding of fact in the light of the terms of the LLC operating agreement and the views of the experts is that the members of [the LLC] have an interest in the profits of [the LLC] as they arise.”

120. As I have explained, the evidence as to Delaware law entitled the FTT to make that finding. The Commissioners challenged it in this court, as they did below, on two bases. The first was that the FTT was describing a proprietary right, as the Upper Tribunal had held. Since there was no basis in the evidence for such a finding, the FTT had erred in law. I reject that criticism for the reasons explained at paras 38-40. Secondly, it was argued that the FTT's finding constituted a holding on domestic law, not a finding of fact on foreign law. I reject that criticism for the reasons explained in para 51.

121. If, then, Mr Anson was entitled to the share of the profits allocated to him, rather than receiving a transfer of profits previously vested (in some sense) in the LLC, it follows that his "income arising" in the US was his share of the profits. That is therefore the income liable to tax under UK law, to the extent that it is remitted to the UK. There is no dispute as to the income which was taxed in the US: that was Mr Anson's share of the profits of the LLC. Mr Anson's liability to UK tax is therefore computed by reference to the same

income as was taxed in the US. He accordingly qualifies for relief under article 23(2)(a).

### *Conclusion*

122. For these reasons, I agree with the conclusion reached by the FTT, and would therefore allow the appeal.”

124. As in *Anson*, Mr Gammie invites me to make a finding of fact in this case on the basis of Cayman Island law.

125. However, Mr Baldry does not accept that it is necessary to consider Cayman Islands law as, he says, that the issue before the Tribunal is very different particularly in a case such as the present where it is necessary to consider a flow of funds through a structure put in place to achieve a particular aim. He contends that foreign law does not operate as “some kind of insulating cover” for arrangements precluding the *Ramsay* approach of looking at the matters realistically and says that there is nothing in the *Dreyfus*, *Memec* and *Anson* line of cases for suggesting otherwise.

126. He therefore advocates that such an approach should be adopted under which, although foreign law may explain how the income arose within the structures concerned, it is necessary to look at the end result. This is consistent, he says, with the way the Supreme Court in *RFC 2012 plc (in liquidation) (formerly The Rangers Football Club plc) v Advocate General for Scotland* [2017] 1 WLR 2767 (“*Rangers*”) approached the tax avoidance scheme involving an employee remuneration or employee benefit trust (“EBT”).

127. Under the sub-heading ‘Applying the legislation to the facts’ Lord Hodge JSC (with whom the other Justices in *Rangers* agreed) observed that:

“64. The relevant provisions for the taxation of emoluments or earnings were and are drafted in deliberately wide terms to bring within the tax charge money paid as a reward for an employee’s work. The scheme was designed to give each footballer access without delay to the money paid into the Principal Trust, if he so wished, and to provide that the money, if then extant, would ultimately pass to the member or members of his family whom he nominated. Having regard to the purpose of the relevant provisions, I consider the sums paid to the trustee of the Principal Trust for a footballer constituted the footballer’s emoluments or earnings.

65. There was a chance that the trust company as trustee of the Principal Trust might not agree to set up a sub-trust and there was a chance that as trustee of a sub-trust it might not give a loan of the funds of the sub-trust to the footballer. But that chance does not alter the nature of the payments to the trustee of the Principal Trust. In applying a purposive interpretation of a taxing provision in the context of a tax avoidance scheme it is legitimate to look to the composite effect of the scheme as it was intended to operate. In *Inland Revenue Comrs v Scottish Provident Institution* [2004] 1 WLR 3172 Lord Nicholls stated (para 23): “The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned.” The footballers, when accepting the offer of higher net remuneration through the trust scheme which the side letters envisaged, were prepared to take the risk that the scheme might not operate as planned. The fact that the risk existed does not alter the nature of the payment to the trustee of the Principal Trust.”

128. Mr Baldry advocating a *Ramsay* approach in the present case makes the point that EBTs have always served an underlying commercial purpose and were established by employers to

incentivise their workforce through payments – the greater the amount of payment the greater the reward and greater the incentive. But the fact they served that ultimate commercial purpose did not make them immune from the *Ramsay* approach in *Rangers*.

129. However, Mr Gammie contends that the application of such an approach is misconceived. In support, he cited the observation of Patten LJ in *Brain Disorders Research Limited v HMRC* [2018] STC 2382 who said, at [32]:

“... Although the *Ramsay* approach to construction has undoubtedly involved the courts in looking at the commercial realities of the transaction and ignoring financial components of a scheme which are circular or have no purpose other than to produce a tax loss in order to identify whether and, if so, which parts of the transaction engage the relevant tax provisions, it does not enable the courts to fix the taxpayer with a contract which under the scheme it does not have. The actual transactions remain the same.”

130. It is clear from this, as Mr Gammie says, that various agreements between the various parties such as the TRS and including those listed at paragraph 65, above, cannot be just set aside or treated as though they do not exist. Indeed a similar point was made by the Chancellor in *HMRC v Lansdowne Partners Limited Partnership* [2012] STC 544 (“*Lansdowne*”) who at [19] rejected submissions by the appellant which involved:

“... disregarding the plain effect of a number of commercial documents and legal relationships which are not alleged to be shams.”

131. In *Ingenious Games LLP v HMRC* [2019] STC 1851 (“*Ingenious*”) the Upper Tribunal (Falk J and Judge Herrington) having referred to the decision of the House of Lords in *AG Securities v Vaughan, Antoniadis v Villiers* [1990] 1 AC 417 observed, at [98], that:

“... this case does not offer support for an approach to contractual construction which permits a number of agreements entered into together in relation to a single transaction to be construed as a single composite agreement.”

After saying it was “important” to note that noting that *Antoniades* was not decided on the basis that the contractual arrangements were a sham, the Upper Tribunal continued:

“100. Although all the opinions in *Antoniades* conclude that clause 16 was unrealistic (or a pretence) that was never intended to be acted on, and there is therefore clearly an analogy with the concept of sham, the distinction is that there was no ‘common intention’ of the parties in relation to cl 16, because the young couple simply did not understand the provisions in the documents they were signing. Rather, the case is an illustration of the principle that the court is not bound by labels the parties have chosen to apply if those labels do not reflect the true nature of the legal rights and obligations, or by provisions in documents that the parties never intended to be acted upon and which are inconsistent with the true nature of the transaction.

...

102. Similarly, in *Agnew v IRC* [2001] UKPC 28, [2001] 2 BCLC 188, [2001] 2 AC 710 (PC), another case relied on by the FTT, the question was whether a charge was fixed or floating. Lord Millett said at [32] that the question was not merely one of construction but one of ascertaining the nature of the rights and obligations which the parties intended to grant to each other in respect of the charged assets, and then moving on to consider how to categorise the transaction as a matter of law. The second step did not depend on the intention of the parties.

103. Neither do we agree with HMRC that the approach taken by Lord Templeman in *Ensign Tankers* [1992] STC 226 at 232, [1992] 1 AC 655 at

665 ([86] above) was the right approach as a matter of pure contractual construction. In our view, the approach taken by Lord Templeman was an early example of the application of the principle derived from the *Ramsay* line of cases, namely (as expressed at the time) that the fiscal consequences of a preordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole, and not by dissecting the scheme and considering each individual transaction separately. Indeed, Lord Templeman started his speech ([1992] STC 226 at 229, [1992] 1 AC 655 at 661) by describing the appeal as being concerned with a tax avoidance scheme, 'a single composite transaction whereunder the tax advantage claimed by the taxpayer is inconsistent with the true effect in law of the transaction'. Lord Templeman's remarks ([1992] STC 226 at 232, [1992] 1 AC 655 at 665) must be read in the light of that opening statement. He also referred to *Ramsay* and the later authorities applying it in support of his approach: see [1992] STC 226 at 241, [1992] 1 AC 655 at 676 where he remarks that no difficulties will arise in applying the *Ramsay* principle to a single composite transaction provided that the results of the transaction read as a whole are correctly identified.

104. That the House of Lords was seeking to apply the *Ramsay* principle rather than engaging in an exercise of contractual construction is supported by the speech of Lord Goff. He said this ([1992] STC 226 at 245, [1992] 1 AC 655 at 681):

'Now, if one takes certain individual features of the transaction, and considers them in isolation, it is possible to give some colour to Victory Partnership's argument. For example, it is no doubt correct that the mere fact that the taxpayer borrows money in order to incur capital expenditure does not prevent him from qualifying for a capital allowance under the section; likewise the mere fact that such a loan is a non-recourse loan in the sense that the taxpayer is not personally liable for its repayment, the loan being repayable out of property or proceeds in the hands of the taxpayer, will not of itself prevent the transaction from constituting what is in truth a loan, or the expenditure so financed qualifying for a capital allowance. But it is well established in the cases that we should not, for present purposes, have regard to such features in isolation. Indeed the authorities require us to look at related transactions such as those which were entered into on 14 July 1980 as one composite transaction. It is that composite transaction which we have to analyse, as a whole, in order to ascertain its true nature and effect, and to decide whether the transaction so analysed results, on a true construction of the relevant statutory provision, in the taxation consequences for which the taxpayer contends.'

105. These remarks need to be read in the context of the authorities to which he was referring, which can only be *Ramsay* and the cases following it referred to by Lord Templeman. The final sentence is also very close to the way in which the *Ramsay* approach is now authoritatively expressed, namely whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.

106. That similarity was recognised by Lord Walker in his judgment in *Tower MCashback LLP v Revenue and Customs Comrs* [2011] UKSC 19, [2011] STC 1143, [2011] 2 AC 457. When referring to similar remarks of Lord Goff at *Ensign Tankers* [1992] STC 226 at 245–246, [1992] 1 AC 655 at 682, Lord



Walker said at [47] that Lord Goff had emphasised that the *Ramsay* principle was a principle of statutory construction, now to be applied in the manner described above.

107. We are therefore not persuaded that, as a matter of contractual construction, the FTT was correct in adopting a ‘composite agreement’ approach without reference to *Ramsay*. In our view, the starting position for the FTT in construing the contracts should have been to consider them separately in accordance with the basic principles set out at [79] and [80] above.

108. However, where a number of contracts are entered into together, at the very least the existence of the other contracts is part of the factual background known to the parties at or before the date of the contract, as referred to by Lord Neuberger at [10] of *Wood v Capita* (quoted at [79] above) and commonly referred to as the ‘factual matrix’. The existence of the other contracts is therefore a relevant part of the factual matrix when construing any one of them. Furthermore, where the contracts specifically cross-refer or there are other indications that they are intended to operate only as a package, then that fact will be relevant.

...

110. Therefore, where there is in truth one transaction, the tribunal is entitled to read the contracts together for the purpose of determining their legal effect. That is not the same as saying that where there is a series of contracts to implement a transaction there is a single composite agreement. As we have said, the ‘composite agreement’ approach is not correct as a matter of contractual construction. However, what must not be done is to adopt blinkers in looking at each agreement. In determining the legal rights and obligations acquired by the LLPs pursuant to the contractual arrangements, the FTT was entitled and correct to look at the entirety of each set of transaction documents, which it found at [91] were entered into at the same time and as a single package. That set of documents, which we have referred to at [82] above, reflected what was undeniably a single, albeit multi-party, transaction as a commercial matter. Even though it was common ground that none of the documents in question could be regarded as a sham, the absence of any allegation of sham does not prevent the tribunal following the approach outlined above or, for example, examining critically whether the written provisions of the documents had the effect when read together that the LLPs maintained that they did. This is consistent with the principle, illustrated in *Antoniades v Villiers* as discussed above, that the tribunal is not bound by labels that the parties have chosen to apply if those labels do not reflect the true nature of the legal rights and obligations created pursuant to the contractual arrangements.”

132. The adoption of a “composite approach” to the agreements between the parties in this case may initially appear attractive – I have already alluded to Mr Gammie’s observation of the necessity for “all of the pieces of the jigsaw” fitting together to implement the transaction agreed with all the parties (see paragraph 65, above). However, given what was said in *Lansdowne* and *Ingenious* in relation to construing the agreements/deeds as though they were a single document, although in the present case there is clearly a link between them, it is necessary to consider each separately in accordance with the following basic principles set out at [79] and [80] of *Ingenious*:

“79. The basic principles to be applied to the construction of written contracts have been set out in a number of relatively recent Supreme Court judgments, namely *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900, *Arnold v Britton*

[2015] AC 1619, and *Wood v Capita Insurance Services Limited* [2017] AC 1173 where Lord Neuberger PSC summarised the approach to be taken at [10] to [15]:

“10. The court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. It has long been accepted that this is not a literalist exercise focused solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning. In *Prenn v Simmonds* [1971] 1 WLR 1381 (1383H-1385D) and in *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 (997), Lord Wilberforce affirmed the potential relevance to the task of interpreting the parties' contract of the factual background known to the parties at or before the date of the contract, excluding evidence of the prior negotiations. When in his celebrated judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 Lord Hoffmann (pp 912-913) reformulated the principles of contractual interpretation, some saw his second principle, which allowed consideration of the whole relevant factual background available to the parties at the time of the contract, as signalling a break with the past. But Lord Bingham in an extra-judicial writing, *A new thing under the sun? The interpretation of contracts and the ICS decision* Edin LR Vol 12, 374-390, persuasively demonstrated that the idea of the court putting itself in the shoes of the contracting parties had a long pedigree.

11. Lord Clarke elegantly summarised the approach to construction in *Rainy Sky* at para 21f. In *Arnold* all of the judgments confirmed the approach in *Rainy Sky* (Lord Neuberger paras 13-14; Lord Hodge para 76; and Lord Carnwath para 108). Interpretation is, as Lord Clarke stated in *Rainy Sky* (para 21), a unitary exercise; where there are rival meanings, the court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense. But, in striking a balance between the indications given by the language and the implications of the competing constructions the court must consider the quality of drafting of the clause (*Rainy Sky* para 26, citing Mance LJ in *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2)* [2001] 2 All ER (Comm) 299 paras 13 and 16); and it must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest: *Arnold* (paras 20 and 77). Similarly, the court must not lose sight of the possibility that a provision may be a negotiated compromise or that the negotiators were not able to agree more precise terms.

12. This unitary exercise involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated: *Arnold* para 77 citing *In re Sigma Finance Corp*n [2010] 1 All ER 571, para 10 per Lord Mance. To my mind once one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed

analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each.

13. Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type. The iterative process, of which Lord Mance spoke in *Sigma Finance Corp'n* (above), assists the lawyer or judge to ascertain the objective meaning of disputed provisions.

14. On the approach to contractual interpretation, *Rainy Sky* and *Arnold* were saying the same thing.

15. The recent history of the common law of contractual interpretation is one of continuity rather than change. One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation.”

80. In *Arnold v Britton* at [15] Lord Neuberger said that when interpreting a written contract, the court is concerned to “identify the intention of the parties by reference to what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean” (citing Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Limited* [2009] AC 1101 at [14]), by focusing on the meaning of the relevant words, in the documentary, factual and commercial context.”

133. In taking such an approach above it is necessary to consider the actual arrangements between the parties and not, by regarding these as a composite agreement, substitute something different.

134. The starting point is to note that BCMCL’s rights and obligations, including its entitlement to profits of BCMC LP, are derived from the BCMC LP Deed, the material

provisions of which are set out above (at paragraph 64). Clause 29.1 of that Deed provides that it constitutes the “entire agreement between the Partners and there are no other written or verbal agreements or representations with respect to the subject matter hereof.” Therefore, it is not necessary to consider any additional or other agreements. Also, as clause 30 provides that the Deed and the rights of partners “shall be construed in accordance with Cayman Islands law” it is necessary, as in *Dreyfus*, *Memec* and *Anson*, to consider the law applicable to the Deed.

135. As is clear from that Joint Report, dated 25 July 2019, the Cayman Island Law experts, Mr Goucke for the Cayman Appellants and Mr Said for HMRC, agree that under Cayman Islands law:

- (1) Exempted Limited Partnerships (“ELPs”) such as BCMC LP do not have their own separate legal personality;
- (2) a partnership can be a limited partner of a Cayman Islands ELP as a matter of Cayman Islands law, pursuant to section 4(4) of the 2007 ELP Law;
- (3) BCMC LP cannot own assets because an ELP has no separate legal personality;
- (4) BCMCL, as General Partner of BCMC LP, holds the assets on trust for the partnership, BCMC LP, in accordance with the terms of the applicable partnership agreement of the ELP, pursuant to s 6(2) of the 2007 ELP Law and later amended to be s 7(8) of the 2007 ELP Law;
- (5) BCMCL as General Partner carries on BCMC LP’s business;
- (6) section 7(1) of the 2007 ELP Law prohibits limited partners from taking part in the conduct of the business of an ELP;
- (7) it is the Cayman Partnership Deeds which set out the contractual rights of BCMCL and the limited partners in BCMC LP to share in the profits of BCMC LP;
- (8) Profits of BCMC LP fall to be allocated according to the terms of Clause 12 of the BCMC LP Deed;
- (9) the BCMC LP Deed governs the allocation of BCMC LP’s profit amongst its partners, but reference is required to the TRS, Financial Contract, Facility Agreement and Loan Notes (as the case may be) to properly understand a number of defined terms used in the profit allocation provisions in Clause 12;
- (10) other than for the limited purpose explained above (ie to properly understand defined terms from other agreements), reference is not required to further agreements beyond the BCMC LP Deed to ascertain the rights of the partners of BCMC LP to share in profits; and
- (11) if and to the extent BCMC LP became entitled to a profit allocation from BCM LP if those profits were available for allocation and distribution as before tax profits for a particular financial year, BCMCL and the other partners in BCMC LP would share in that profit, according to the allocation and distribution processes set out in Clauses 12 and 13 of the BCMC LP Deed.

136. Accordingly, as the experts agree, as a matter of Cayman Islands law, the profit sharing agreements were confined to the BCMC LP Deed under which BCMCL’s entitlement to profits of BCMC LP did not include those allocated to RBS and subsequently Fyled. Therefore, had I reached a different conclusion and found in favour of the Cayman Appellants in relation to Issue 1, for the reasons above, I would have rejected HMRC’s argument in relation to Issue 2.

137. I now turn to Issue 3.

### Issue 3 – Interest Deductibility Issue

*Are BCMCL's interest costs on the RBS Loan Facility and the Loan Notes, entered into by BCMCL to acquire 19% partnership interest in BCM LP, allowable deductions under the CTA 2009 in calculating BCMCL's chargeable profits for corporation tax purposes? If so, to what extent are they allowable?*

138. In essence, Mr Gammie contends that BCMCL is entitled to a deduction for the interest it incurred on the loan it received from RBS and the Loan Notes issued to the three vendors of the 19% interest it acquired in BCM LP (WR, MP and Sugarquay) under the provisions of the CTA 2009. HMRC disagree.

139. Mr Gammie argues that although most of the cases concern how expenditure is or is not allowed in the partnership computation and whether it is incurred wholly and exclusively for the purposes of the trade, this “is not and has never been” the position in relation to financing expenses which are largely borne outside the context of a trade by the partners themselves borrowing to finance their investments in the trade.

140. To illustrate the point Mr Gammie referred back to the system introduced by Addington in 1803 and replicated by Peel in 1842, when he reintroduced income tax which included, as one of the main charges on income, the payment of yearly interest. Mr Gammie says that the cost of finance was not seen as a deduction to be made in calculating the taxable profit – both Addington's Act of 1803 and the 1806 Act, which was effectively the Act Peel reintroduced in 1842 denied, subject to some exceptions, the deduction of interest in effect to prevent a double deduction given that a recipient of interest on the loan was able to claim the benefit of the tax that was borne on the fund out of which the interest was paid.

141. The history of such a position, ie the ability by a company to obtain relief for interest against total profits on borrowings to invest in a partnership by way of a charge in income, is described in some detail by Richard Thomas in his paper *Retention of Tax at Source and Business Financing* (in Peter Harris and Dominic De Cogan (eds) *Studies in the History of Tax Law*, Volume 7, Hart Publishing 2015) who observed that:

“The Inland Revenue had gone to court to establish that annual interest, even some short interest, and all associated debt costs were capital and they continued to do so after 1965. And since most annual interest was, even though capital, effectively relieved against total income before 1965, the best way of maintaining the prohibition of capital rule while allowing relief was the way they did it.

In 1969, however, the prohibition of capital rule was abolished, but only for interest. It remained in place for other types of debt cost, including exchange losses, until the major financial transactions reforms of Finance Acts 1993 (exchange gains and losses), 1994 (‘new’ financial instruments, ie certain derivatives) and 1996 (so-called loan relationships, ie debt transactions). These finally put an end to the complex systems of relief and denial of relief that had applied both before and after the introduction of Corporation Tax.

And the world did not fall in.”

142. Mr Gammie contends that until the present case HMRC have always accepted such an approach and by advancing its argument to deny BCMCL its interest deduction HMRC is prepared to “tear up the history of the last 150 years” and “forget where everything came from” and emphasises the importance of taking account of the history in this regard and refers to *Walker v Centaur Clothes Group Limited* [2000] 1 WLR 799 as an example in which the House of Lords noted the reason for the introduction of a particular provision by reference to the history of corporation tax.

143. Turning to the present case, although BCMCL is a Cayman Islands company (and non-UK resident) it is carrying on trade through a UK PE and has borrowed money to acquire and become a partner in UK partnership business, BCM LP. In the circumstances, Mr Gammie says that the argument advanced by HMRC must apply equally to any UK resident company and I did not understand Mr Baldry to argue otherwise. Rather he accepted that BCMCL, like any other company, can deduct administrative costs in computing its corporation tax liability but is only entitled to deduct interest if, and only if, it falls within statutory provisions in the self-contained code of the loan relationship provisions, as introduced by FA 1996. As such, he says, that the historical position, although possibly interesting, cannot be relevant.

144. As I shall come to in due course Mr Baldry contends that BCMCL does not come within the loan relationship provisions but, he says relying on *Major v Brodie*, that even if it did it would not be entitled to a deduction of interest.

145. *Major v Brodie* concerned a claim for relief under s 362 ICTA which provided:

**362 Loan to buy into partnership**

(1) Subject to sections 363 to 365, interest is eligible for relief under section 353 if it is interest on a loan to an individual to defray money applied—

- (a) in purchasing a share in a partnership; or
  - (b) in contributing money to a partnership by way of capital or premium, or in advancing money to a partnership, where the money contributed or advanced is used wholly for the purposes of the trade, profession or vocation carried on by the partnership
- ...

(2) The conditions referred to in subsection (1) above are—

- (a) that, throughout the period from the application of the proceeds of the loan until the interest was paid, the individual has been a member of the partnership otherwise than—
  - (i) as a limited partner in a limited partnership registered under the Limited Partnerships Act 1907, or
  - (ii) as a member of an investment LLP; and
- (b) that he shows that in that period he has not recovered any capital from the partnership, apart from any amount taken into account under section 363(1).

146. In relation to this provision, at 506 of *Major v Brodie*, Park J said :

“Our present tax law does not confer a general right to tax relief for interest paid. Rather the position is that interest qualifies for relief if and only if it meets certain detailed statutory conditions, of which the most important is that the money borrowed must have been used for one of the particular purposes which are specified in the applicable sections of the Income and Corporation Taxes Act 1988 (the 1988 Act). The Crown submitted to Mr Shirley [the Special Commissioner], and repeat the submission to me, that the way in which Mr and Mrs Brodie used the money which they borrowed did not satisfy the statute. Mr Shirley disagreed, and so do I.

Before I quote the relevant sections I should mention in order to avoid any risk of misunderstanding that neither this case nor what I have said in the previous paragraph are concerned with the common situation where a person who carries on a trade, profession or vocation, taxable under Case I or II of Sch D, borrows money for the purposes of the trade etc and pays interest on

the borrowing in the course of it. In that case the interest will normally be deducted as an ordinary expense of the trade etc in the computation of the Sch D profits or losses.”

147. After setting out the facts Park J continued, at 508:

“5. The transactions described in para 4 [of the Special Commissioner’s decision, see paragraph 105, above] involved each of Mr and Mrs Brodie borrowing £225,000 from Coutts. In the case of each of them £150,000 of it was used to pay for Balgreen farm and £55,040 of it was used to contribute capital to W Murdoch & Son, which no doubt used the capital in its farming trade. The remaining £19,960 out of each borrowing was retained in Skeldon Estates partnership and used as working capital of the other aspects of the business of Skeldon Estates partnership—the aspects of its business which were not concerned with its interest as a partner in the farming trade carried on by W Murdoch & Son.”

Park J then went on to consider HMRC’s argument that the money was contributed to the Skeldon partnership but it was used for the purposes of the trade of the Murdoch partnership saying, at 509:

“The Crown’s principal argument, both before the Special Commissioner and before me, was that, because two partnerships are involved rather than the more normal case of one, s 362(1)(b) is not satisfied. The paragraph requires that the money which has been borrowed shall be contributed to a partnership. It also requires the money so contributed to be used wholly for the purposes of ‘the trade ... carried on by the partnership’. Plainly the two references to a partnership are references to the same partnership. On behalf of the Crown Mr Henderson QC says that the money was contributed to Skeldon Estates partnership but it has been used wholly for the purposes of the trade carried on by W Murdoch & Son. He says that this is a ‘mismatch’, and therefore Mr and Mrs Brodie do not qualify for relief.

In my judgment, however, this ignores the true legal nature of a partnership, and the relationship of a partnership and its members. Leaving aside for a moment the special feature that a Scottish partnership has a legal personality of its own (see s 4(2) of the Partnership Act 1890), a trade carried on by a partnership is a trade carried on by its members and by each of them. As Mr Shirley correctly and pertinently points out, s 1(1) of the 1890 Act provides: ‘Partnership is the relation which subsists between persons carrying on business in common with a view of profit’. He also quotes s 4(1), which provides that ‘persons who have entered into partnership with one another are for the purposes of the Act called collectively a firm’.

So when Mr Henderson says that the money has been used wholly for the purposes of the trade carried on by W Murdoch & Son, he is correct as far as he goes, but what his statement does not go on to add is that the money is thereby used wholly for the purposes of the trade carried on by the partners in W Murdoch & Son. Those persons are (1) Skeldon Estates partnership, and (2) Mr Henry Murdoch.

So the money which was contributed by Mr and Mrs Brodie to Skeldon Estates partnership is used wholly for the purposes of the trade of farmers carried on by Skeldon Estates partnership in common with Mr Henry Murdoch under the firm name of W Murdoch & Son. The following two statements are not inconsistent with each other; on the contrary, they are two separate ways, each correct, of saying the same thing. (1) Skeldon Estates partnership carries on the trade of farming as a member of a firm called W Murdoch & Son. (2) W

Murdoch & Son, a firm of which a member is Skeldon Estates partnership, carries on the trade of farming.

In my judgment the conditions of s 362(1)(b) are thereby satisfied.”

148. It is clear from *Major v Brodie* that there is no right for an individual to deduct interest in buying a share in a limited partnership other than in accordance with the legislation and, as such, it is necessary to distinguish such a case from that where a deduction is claimed for interest incurred wholly and exclusively for the purpose of the trade. However, it is clear from the legislation that such interest relief is not available for simply buying a share in a partnership.

149. Turning to the relevant legislation under which BCMCL was subject to UK tax and seeks relief on its interest costs, the following provisions of ICTA were in force in 2008-09:

**6.— The charge to corporation tax and exclusion of income tax and capital gains tax.**

(1) Corporation tax shall be charged on profits of companies, and the Corporation Tax Acts shall apply, for any financial year for which Parliament so determines, and where an Act charges corporation tax for any financial year the Corporation Tax Acts apply, without any express provision, for that year accordingly.

(2) The provisions of the Income Tax Acts relating to the charge of income tax shall not apply to income of a company (not arising to it in a fiduciary or representative capacity) if—

- (a) the company is resident in the United Kingdom, or
- (b) the income is, in the case of a company not so resident, within the chargeable profits of the company as defined for the purposes of corporation tax by section 11(2).

(3) A company shall not be chargeable to capital gains tax in respect of gains accruing to it so that it is chargeable in respect of them to corporation tax or would be so chargeable but for an exemption from corporation tax.

(4) In this section, sections 7 to 12, 114, 115 (but subject to subsection (7)) and 248, Part VIII, Chapter IV of Part X and Part XI, except in so far as the context otherwise requires—

- (a) “*profits*” means income and chargeable gains; and
- (b) “*trade*” includes “*vocation*”, and also includes an office or employment ...

(5) Part VIII contains provisions relating to the taxation of profits of companies.

**7.— Treatment of certain payments and repayment of income tax.**

...

(2) Subject to the provisions of the Corporation Tax Acts, where a company resident in the United Kingdom receives any payment on which it bears income tax by deduction, the income tax thereon shall be set off against any corporation tax assessable on the company for the accounting period in which that payment falls to be taken into account for corporation tax (or would fall to be taken into account but for any exemption from corporation tax);

(3) Subsection (2) above does not apply to a payment of relevant loan interest to which section 369 applies.



## **8.— General scheme of corporation tax.**

(1) Subject to any exceptions provided for by the Corporation Tax Acts, a company shall be chargeable to corporation tax on all its profits wherever arising.

(2) A company shall be chargeable to corporation tax on profits accruing for its benefit under any trust, or arising under any partnership, in any case in which it would be so chargeable if the profits accrued to it directly; and a company shall be chargeable to corporation tax on profits arising in the winding up of the company, but shall not otherwise be chargeable to corporation tax on profits accruing to it in a fiduciary or representative capacity except as respects its own beneficial interest (if any) in those profits.

...

## **9.— Computation of income : application of income tax principles.**

(1) Except as otherwise provided by the Tax Acts, the amount of any income shall for purposes of corporation tax be computed in accordance with income tax principles, all questions as to the amounts which are or are not to be taken into account as income, or in computing income, or charged to tax as a person's income, or as to the time when any such amount is to be treated as arising, being determined in accordance with income tax law and practice as if accounting periods were years of assessment.

(2) For the purposes of this section “income tax law” means, in relation to any accounting period, the law applying, for the year of assessment in which the period ends, to the charge on individuals of income tax, except that it does not include

(a) such of the enactments of the Income Tax Acts as make special provision for individuals in relation to matters referred to in subsection (1) above

(b) ITA 2007.

(2A) But no income shall be computed, and no assessment shall be made, for purposes of corporation tax under ITTOIA 2005.

(2B) Instead, income shall continue to be computed, and the assessment shall continue to be made, for purposes of corporation tax under Schedules A and D and the Cases of Schedule D.

(2C) For (but only for) the purpose of continuing to apply for purposes of corporation tax, those Schedules and Cases are treated as if they were still part of income tax law (and therefore applied in accordance with subsection (1) above for purposes of corporation tax).

(3) Accordingly, for purposes of corporation tax, income shall be computed, and the assessment shall be made, under ...

(a) Schedules A[and D] and the Cases of Schedule D ... and

(b) the following provisions of ITEPA 2003 (which impose charges to income tax)—

(i) Part 2 (employment income),

(ii) Part 9 (pension income), and

(iii) Part 10 (social security income),

and in accordance with the provisions applicable to those Schedules and Cases and those Parts, but (subject to the provisions of the Corporation Tax Acts) the amounts so computed for the several sources of income, if more than one, together with any amount to be included in respect of chargeable gains, shall be aggregated to arrive at the total profits.

...

#### **11.— Companies not resident in United Kingdom.**

(1) A company not resident in the United Kingdom is within the charge to corporation tax if, and only if, it carries on a trade in the United Kingdom through a permanent establishment in the United Kingdom.

(2) If it does so, it is chargeable to corporation tax, subject to any exceptions provided for by the Corporation Tax Acts, on all profits, wherever arising, that are attributable to its permanent establishment in the United Kingdom. These profits, and these only, are the company's "chargeable profits" for the purposes of corporation tax.

(2A) The profits attributable to a permanent establishment for the purposes of corporation tax are—

- (a) trading income arising directly or indirectly through or from the establishment,
- (b) income from property or rights used by, or held by or for, the establishment, and
- (c) chargeable gains falling within section 10B of the 1992 Act—
  - (i) by virtue of assets being used in or for the purposes of the trade carried on by the company through the establishment, or
  - (ii) by virtue of assets being used or held for the purposes of the establishment or being acquired for use by or for the purposes of the establishment.

(3) ..., where a company not resident in the United Kingdom receives any payment on which it bears income tax by deduction, and the payment forms part of, or is to be taken into account in computing, the company's income chargeable to corporation tax, the income tax thereon shall be set off against any corporation tax assessable on that income ... for the accounting period in which the payment falls to be taken into account for corporation tax; ...

(4) Subsection (3) above does not apply to a payment of relevant loan interest to which section 369 applies.

#### **11AA.— Determination of profits attributable to permanent establishment**

[see below]

#### **18.— Schedule D.**

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

SCHEDULE D

Tax under this Schedule shall be charged in respect of—

- (a) the annual profits or gains arising or accruing—
  - (i) to any person residing in the United Kingdom from any kind of property whatever, whether situated in the United Kingdom or elsewhere, and
  - (ii) to any person residing in the United Kingdom from any trade, profession or vocation, whether carried on in the United Kingdom or elsewhere, and
  - (iii) to any person, whether a Commonwealth citizen or not, although not resident in the United Kingdom from any property whatever in the United Kingdom or from any trade, profession or vocation exercised within the United Kingdom, and
- (b) all interest of money, annuities and other annual profits or gains not charged under [not charged under [Schedule A or under ITEPA 2003 as employment income, pension income or social security income], and not specially exempted from tax.

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

(3) The Cases are—

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

Case II: tax in respect of any profession or vocation not contained in any other Schedule;

Case III: tax in respect of—

- (a) any interest of money, whether yearly or otherwise, or any annuity or other annual payment, whether such payment is payable within or out of the United Kingdom, either as a charge on any property of the person paying the same by virtue of any deed or will or otherwise, or as a reservation out of it, or as a personal debt or obligation by virtue of any contract, or whether the same is received and payable half-yearly or at any shorter or more distant periods, but not including any payment chargeable under Schedule A, and
- (b) all discounts, and
- (c) income from securities which is payable out of the public revenue of the United Kingdom or Northern Ireland;

Case IV: tax in respect of income arising from securities out of the United Kingdom ...;

Case V: tax in respect of income arising from possessions out of the United Kingdom not being employment income, pension income or social security income on which tax is charged under ITEPA 2003;

Case VI: tax in respect of any annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of Schedule A or by virtue of ITEPA 2003 as employment income, pension income or social security income.

(3A) For the purposes of corporation tax subsection (3) above shall have effect as if the following Case were substituted for Cases III and IV, that is to say—

Case III: tax in respect of—

- (a) profits and gains which, as profits and gains arising from loan relationships, are to be treated as chargeable under this Case by virtue of Chapter II of Part IV of the Finance Act 1996;
- (b) any annuity or other annual payment which—
  - (i) is payable (whether inside or outside the United Kingdom and whether annually or at shorter or longer intervals) in respect of anything other than a loan relationship; and
  - (ii) is not a payment chargeable under Schedule A;

and as if Case V did not include tax in respect of any income falling within paragraph (a) of the substituted Case III.

(3B) ...

#### **70.— Basis of assessment etc.**

(1) In accordance with sections 6 to 12 and 337 to 344, for the purposes of corporation tax for any accounting period income shall be computed under Cases I to VI of Schedule D on the full amount of the profits or gains or income arising in the period (whether or not received in or transmitted to the United Kingdom), without any other deduction than is authorised by the Corporation Tax Acts.

(2) Where a company is chargeable to corporation tax in respect of a trade or vocation under Case V of Schedule D, the income from the trade or vocation shall be computed in accordance with the rules applicable to Case I of Schedule D.

(3) Cases III and V of Schedule D shall for the purposes of corporation tax extend to companies not resident in the United Kingdom, so far as those companies are chargeable to tax on income of descriptions which, in the case of companies any resident in the United Kingdom, fall within those Cases (but without prejudice to any provision of the Tax Acts specially exempting non-residents from tax on any particular description of income).

#### **72.— Apportionments etc. for purposes of Cases I, II and VI.**

(1) Where in the case of any profits or gains chargeable to corporation tax under Case I, II or VI of Schedule D it is necessary in order to arrive for the purposes of ... corporation tax at the profits or gains or losses of any ... accounting period or other period, to divide and apportion to specific periods the profits or gains or losses for any period for which the accounts have been made up, or to aggregate any such profits, gains or losses or any apportioned parts thereof, it shall be lawful to make such a division and apportionment or aggregation.

(2) Any apportionment under this section shall be made in proportion to the number of days in the respective periods.

#### **74.— General rules as to deductions not allowable.**

(1) Subject to the provisions of the Corporation Tax Acts, in computing the amount of the profits to be charged to corporation tax under Case I or Case II of Schedule D, no sum shall be deducted in respect of—

- (a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade or profession;
- ...
- (e) any loss not connected with or arising out of the trade or profession;
- (f) any capital withdrawn from, or any sum employed or intended to be employed as capital in, the trade or profession, but so that this paragraph shall not be treated as disallowing the deduction of any interest.

#### **111.— Treatment of partnerships.**

(1) Where a trade or profession is carried on by persons in partnership, the partnership shall not, unless the contrary intention appears, be treated for corporation tax purposes as an entity which is separate and distinct from those persons.

#### **114.— Special rules for computing profits and losses.**

(1) So long as a trade, profession or business is carried on by persons in partnership, and any of those persons is a company, the profits and losses (including terminal losses) of the trade, profession or business shall be computed for the purposes of corporation tax in like manner, and by reference to the like accounting periods, as if the partnership were a company and, subject to section 115(4), as if that company were resident in the United Kingdom, and without regard to any change in the persons carrying on the trade, profession or business, except that—

- (a) references to distributions shall not apply; and
- (b) subject to section 116(5), no deduction or addition shall be made for charges on income, or for capital allowances and charges, nor in any accounting period for losses incurred in any other period nor for any expenditure to which section 401(1) applies; and
- (c) a change in the persons engaged in carrying on the trade, profession or business shall be treated as the transfer of the trade, profession or business to a different company if there continues to be a company so engaged after the change, but not a company that was so engaged before the change.

(2) A company's share in the profits or loss of any accounting period of the partnership, or in any matter excluded from the computation by subsection (1)(b) above, shall be determined according to the interests of the partners during that period, and corporation tax shall be chargeable as if that share derived from a trade, profession or business carried on by the company alone in its corresponding accounting period or periods; and the company shall be assessed and charged to tax for its corresponding accounting period or periods accordingly. In this subsection "*corresponding accounting period or periods*" means the accounting period or periods of the company comprising or together comprising the accounting period of the partnership, and any necessary

apportionment shall be made between corresponding accounting periods if more than one.

#### **115.— Provisions supplementary to section 114.**

...

(4) So long as a trade, profession or business is carried on by persons in partnership and any of those persons is a company which is not resident in the United Kingdom, section 114 shall have effect in relation to that company as if—

- (a) the reference in subsection (1) to a company resident in the United Kingdom were a reference to a company that is not so resident; and
- (b) in subsection (2), after ‘carried on’ there were inserted ‘in the United Kingdom through a permanent establishment’.

(5) Subsections (5A) and (5B) apply if—

- (a) a company resident in the United Kingdom (“the resident partner”) is a member of a partnership which resides outside the United Kingdom or which carries on any trade, profession or business the control and management of which is situated outside the United Kingdom, and
- (b) by virtue of any arrangements falling within section 788 (“the arrangements”) any of the income or capital gains of the partnership is relieved from corporation tax in the United Kingdom.

...

150. From 2000 through to 2010 the above provisions of ICTA under which BCMCL had been taxed in its first year of trading were replaced by those of CTA 2009. Those material to the present case provided:

#### **19 Chargeable profits**

(1) This section applies if a non-UK resident company carries on a trade in the United Kingdom through a permanent establishment in the United Kingdom.

(2) The company’s chargeable profits are its profits that are—

- (a) of a type mentioned in subsection (3), and
- (b) attributable to the permanent establishment in accordance with sections 20 to 32.

(3) The types of profits referred to in subsection (2)(a) are—

- (a) trading income arising directly or indirectly through or from the establishment,
- (b) income from property or rights used by, or held by or for, the establishment, and
- (c) chargeable gains falling within section 10B of TCGA 1992 (non-resident company with United Kingdom permanent establishment)—

...

## **20 Profits attributable to permanent establishment: introduction**

(1) Sections 21 to 32 apply for the purpose of determining the amount of profits of a non-UK resident company that are attributable to a permanent establishment of the company in the United Kingdom.

...

## **21 The separate enterprise principle**

(1) The profits of the non-UK resident company that are attributable to the permanent establishment are those that the establishment would have made if it were a distinct and separate enterprise which—

- (a) engaged in the same or similar activities under the same or similar conditions, and
- (b) dealt wholly independently with the non-UK resident company.

151. It is common ground that BCMCL was trading through a UK PE, ie as a partner of BCM LP (and subsequently BCM LLP) which carried on its trade through a fixed place of business in the UK and that it had no separate or other trading activity in the UK. As a result BCMCL was chargeable to UK tax only on those profits specified in s 19(3) CTA 2009 and it is therefore necessary to identify those trading profits in accordance with the partnership rules contained in Part 17 CTA 2009, in particular s 1259 CTA 2009 which provides:

### **1259 Calculation of firm's profits and losses**

- (1) This section applies if a firm carries on a trade and any partner in the firm ("the partner") is a company within the charge to corporation tax.
- (2) For any accounting period of the firm, the amount of the profits of the trade ("the amount of the firm's profits") is taken to be the amount determined, in relation to the partner, in accordance with subsection (3) or (4).
- (3) If the partner is UK resident— ...
- (4) If the partner is non-UK resident—
  - (a) determine what would be the amount of the profits of the trade chargeable to corporation tax for that period if a non-UK resident company carried on the trade, and
  - (b) take that to be the amount of the firm's profits. ...

152. Where a company is a member of a partnership s 380 CTA 2009 provides:

### **380 Partnerships involving companies**

- (1) This section applies if—
  - (a) a trade or business is carried on by a firm,
  - (b) any of the partners in the firm is a company (a "company partner"), and
  - (c) a money debt is owed by or to the firm.
- (2) In calculating the profits and losses of the trade or business for corporation tax purposes under section 1259 (calculation of firm's profits or losses), no credits or debits may be brought into account under this Part—
  - (a) in relation to the money debt, or

- (b) in relation to any loan relationship that would fall to be treated for the purposes of the calculation as arising from the money debt.

(3) Instead, each company partner must bring credits and debits into account under this Part in relation to the debt or relationship for each of its accounting periods in which the conditions in subsection (1) are met.

...

153. Additionally, the statutory question in relation to the rules for computing partnership profit and losses which was contained in s 114(2) ICTA was replaced by s 1262 CTA 2009 which provided:

(1) For any accounting period of a firm a partner's share of a profit or loss of a trade carried on by the firm is determined for corporation tax purposes in accordance with the firm's profit-sharing arrangements during that period. This is subject to sections 1263 and 1264.

(2) If a firm pays charges on income, a partner's share of the charges is determined for corporation tax purposes in accordance with the firm's profit-sharing arrangements during the accounting period of the firm in which the charges are paid.

(3) For the purposes of subsection (2) a charge on income which arises from a disposal such as is mentioned in section 587B(1) of ICTA (gifts of shares, securities and real property to charities etc) is taken to be paid when the disposal is made.

(4) In this section and sections 1263 and 1264 "*profit-sharing arrangements*" means the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade.

154. The proper approach to be adopted in relation to statutory construction was set out "with great clarity", to use Mr Baldry's words, by House of Lords in *Barclays Mercantile Business Finance Limited v Mawson (Inspector of Taxes)* [2005] STC 1 ("*BMBF*"). Having referred to the "new approach", first enunciated in *W T Ramsay Ltd v IRC* [1981] STC 174, it was observed that:

"32. The essence of the new approach 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. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 at [8], [2001] STC 237 at [8], [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.'

...



34. Unfortunately, the novelty for tax lawyers of this exposure to ordinary principles of statutory construction produced a tendency to regard *Ramsay* as establishing a new jurisprudence governed by special rules of its own. This tendency has been encouraged by two features characteristic of tax law, although by no means exclusively so. The first is that tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said, 'in the real world'. The second is that a good deal of intellectual effort is devoted to structuring transactions in a form which will have the same or nearly the same economic effect as a taxable transaction but which it is hoped will fall outside the terms of the taxing statute. It is characteristic of these composite transactions that they will include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge.

...

36. Cases such as these gave rise to a view that, in the application of *any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far. It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, to decide whether the transaction in question does so. As Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 at [35], (2004) 6 ITLR 454 at [35]:

'[T]he driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.'

37. The need to avoid sweeping generalisations about disregarding transactions undertaken for the purpose of tax avoidance was shown by *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] STC 237, [2003] 1 AC 311 in which the question was whether a payment of interest by a debtor who had borrowed the money for that purpose from the creditor himself and which had been made solely to reduce liability to tax, was a 'payment' of interest within the meaning of the statute which entitled him to a deduction or repayment of tax. The House decided that the purpose of requiring the interest to have been 'paid' was to produce symmetry by giving a right of deduction in respect of any payment which gave rise to a liability to tax in the hands of the recipient (or would have given rise to such a liability if the recipient had been a taxable entity). As the payment was accepted to have had this effect, it answered the statutory description notwithstanding the circular nature of the payment and its tax avoidance purpose.

38. *MacNiven* shows the need to focus carefully upon the particular statutory provision and to identify its requirements before one can decide whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute. In the speech of Lord Hoffmann in *MacNiven* it was said that if a statute laid down requirements by reference to some commercial concept such as gain or loss, it would usually follow that elements inserted into a composite transaction without any commercial purpose could be disregarded, whereas if the requirements of the statute were purely by reference to its legal nature (in *MacNiven*, the discharge of a debt) then an act having that legal effect would

suffice, whatever its commercial purpose may have been. This is not an unreasonable generalisation, indeed perhaps something of a truism, but we do not think that it was intended to provide a substitute for a close analysis of what the statute means. It certainly does not justify the assumption that an answer can be obtained by classifying all concepts *a priori* as either 'commercial' or 'legal'. That would be the very negation of purposive construction: see Ribeiro PJ in *Arrowtown* at paras 37 and 39 and the perceptive judgment of the Special Commissioners (Theodore Wallace and Julian Ghosh) in *Campbell v IRC* [2004] STC (SCD) 396.”

155. In *MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co* [1989] STC 898, at 900-901, Lord Oliver of Aylmerton, giving the only speech in the case, said:

“Before turning to the facts of the instant case, I ought, perhaps, to say a word about the position, both generally and in relation to income tax of partners in a firm. A partner working in the business or undertaking of the partnership is in a very different position from an employee. He has no contract of employment for he is, with his partners, an owner of the undertaking in which he is engaged and he is entitled, with his partners, to an undivided share in all the assets of the undertaking. In receiving any money or property out of the partnership funds or assets, he is to an extent receiving not only his own property but also the property of his co-partners. Every such receipt must, therefore, be brought into account in computing his share of the profits or assets. Equally, of course, any expenditure which he incurs out of his own pocket on behalf of the partnership in the proper performance of his duties as a partner will be brought into account against his co-partners in such computation. If, with the agreement of his partners, he pays himself a 'salary', this merely means that he receives an additional part of the profits before they fall to be divided between the partners in the appropriate proportions. But the 'salary' remains part of the profits.

So far as concerns the assessment of partnership profits to tax, I do not think that I can improve on the analysis in the instant case of Vinelott J (see [1986] STC 491 at 504–505) which I will both quote and adopt:

"There are, in effect, three stages. First, the profits of the firm for an appropriate basis period must be ascertained. What has to be ascertained is the profits of the firm and not of the individual partners. That is not, I think, stated anywhere in the Income Tax Acts, but it follows necessarily from the fact that there is only one business and not a number of different businesses carried on by each of the partners. The income of the firm for the year is then treated as divided between the partners who were partners during the year to which the claim relates—the year of assessment in one of the many senses of that word: see the proviso to s 26 of the Income and Corporation Taxes Act 1970. That is the second stage. The tax payable is then calculated according to the circumstances of each partner—that is, after taking into account on the one hand any personal allowances, reliefs or deductions to which he is entitled and any higher rate of tax for which he is liable. The Acts do not provide for the way in which personal allowances, reliefs and deductions are to be apportioned between the partnership income and other income. I understand that in practice they are deducted from the share of the partnership income if that was the partner's main source of income. When the tax exigible in respect of each share of the partnership income has been ascertained the total tax payable is

calculated. Section 152 (formerly rule 10 of the Rules applicable to Cases I and II of Sch D) provides that the total sum so calculated is to be treated as “one sum ... separate and distinct from any other tax chargeable on those persons ... and a joint assessment shall be made in the partnership name”. That is the third stage.’

The question in the instant case is whether, at the first stage, moneys paid out of the partnership assets to a partner in order to indemnify him against expenses incurred by him out of his own pocket otherwise than on behalf of the partnership or in the course of acting in the partnership business can be deducted at the first stage as being a payment any personal benefit from which is purely incidental or ancillary to the purposes of the firm considered as an entity separate from the recipient.

Having considered the facts of the case, he continued, at 902:

“Now it is plain that in so holding the commissioners were regarding the firm as being, as it were, an entity quite separate from the two individual partners whose initial personal expenditure was being reimbursed and looking not at all at the immediate purpose which that expenditure served — namely, the establishment of personal residences for themselves and their families — but solely at the advantages which the firm would derive from having these partners residing in their new locations. The real, indeed the only question, in this appeal is whether that was a permissible way in which to test whether the expenditure was laid out not merely as something from which the partnership was intended to and did derive a benefit but exclusively for the purposes of the partnership practice.

...

Now there is, if I may say so respectfully, a confusion here. It is perfectly true that in *Heastie (Inspector of Taxes) v Veitch & Co* [1934] 1 KB 535 at 547, 18 TC 305 at 319, Romer LJ remarked that by r 10 of the Rules applicable to Cases I and II (now contained in s 152 of the 1970 Act) a partnership is treated for the purposes of Sch D taxation as a separate entity from the individual partners composing the firm—that is at stage three of Vinelott J’s analysis—but there is nothing in that decision nor in the other cases cited by Slade LJ to justify a conclusion that it can permissibly be so treated at stage one of the analysis in relation to sums which have been received by a partner from the partnership funds in his capacity as a partner. All that *Heastie*’s case established was that sums received by a partner in a quite different capacity, for instance, as the landlord of premises let to the partnership or for goods supplied from an independent trade carried on by a partner, are not to be regarded as non-deductible expenses simply because they are received by a person who is also a partner in the firm. But we are not concerned here with sums coming to the hands of Mr Wilson and Mr Cooper as a result of some wholly collateral bargain between them and the firm of Arthur Young and Co. What they received, they received as partners in the firm. The fact that they were partners and were going to continue to act as such was indeed the very justification for the receipt.

My Lords, for my part I am unable to accept that the purpose of ‘the partnership’, considered as if it has a separate legal identity, and the purpose of the individual partners for whose benefit the payment enured can be segregated in this way. I cannot, with respect to the Court of Appeal, resist the conclusion that they allowed themselves to be confused and led astray by a

number of extraneous factors which do not, as a matter of analysis have any legal significance.

...

It can make not the slightest difference whether a partner incurs an expenditure out of his own pocket and recovers it from the partnership funds or whether he draws the money required directly from the partnership funds in the first instance — for example, where he is enabled to draw cheques on the partnership bank account — and his partners, either expressly or by implication, agree that he need not bring the money drawn into account in ascertaining his share of the profits. There is in either case only one relevant expenditure and it is the purpose of that outlay which has to be regarded.

...

Finally, I think that a good deal of the confusion was caused in the Court of Appeal, as indeed it was before your Lordships, by an appeal to the position of an employee as providing a useful analogy. Superficially, the analogy is attractive, as indeed is the suggestion that ‘the reality’ of the situation renders absurd any distinction between, for instance, a senior employee and a junior partner. But, with respect, the distinction is not only legal but real. An employee has no interest in the property or profits of the firm and anything paid to him by way of additional remuneration for acting as an employee and to secure his continued loyalty to the firm cannot easily fail to be deductible as an expenditure exclusively for the purpose of the firm's business. ... A partner, on the other hand, whether he be senior or junior is in a quite different position. What he receives out of the partnership funds falls to be brought into account in ascertaining his share of the profits of the firm except in so far as he can demonstrate that it represents a payment to him in reimbursement of sums expended by him on partnership purposes in the carrying on of the partnership business or practice — the example was given in the course of argument of the partner travelling to and staying in Edinburgh on the business of the firm — or a payment entirely collateral made to him otherwise than in his capacity as a partner (as in *Heastie*).”

156. In *Lansdowne*, the second issue before the Court of Appeal was whether sums paid by Lansdowne Partners Limited Partnership (“LPLP”) were deductible for tax purposes. In relation to this issue Sir Andrew Morritt C said:

“21. ... In the case of amounts repaid to investors who are not limited partners it is accepted by HMRC that such expenditure is ‘money wholly and exclusively laid out or expended for the purposes of the trade’ within s 74(1)(a), ICTA. Why, counsel for LPLP ask rhetorically, should it be different in the case of limited partners?”

22. The General Commissioners considered that they were not different. In para 10.2 of the case stated they said:

‘10.2.1 We are prepared to accept that the rebates paid to [Mr Heinz] and other partners are deductible expenses.

10.2.2 We consider that *Mallalieu* and *Arthur Young* are distinguishable as the non deductible items in those cases relate to a claim for tax allowances on personal expenses or reimbursement of personal expenses for employees. Here the fee rebates are of the same nature as those to non partners which were accepted by HMRC as deductible expenses of the business. Does it matter that there was no express contract by which the fees were rebated to partners? From the evidence put forward on

behalf of LPLP, especially that of Suzanna Nutton we accept that fee rebates were the strong norm in the business and partners expected fee rebates. Furthermore we believe that if the fee rebates had not been given it would have been a significant sign that partners were not valued (especially but not merely if given to some but not others) and there was a significant danger that non rebated partners would have left. As such the rebates were part of partner care and we find that they were paid wholly and exclusively for the purposes of a trade.’

23. Lewison J disagreed. In his judgment he said (at [28]):

‘[28] I agree with [counsel for HMRC] that the commissioners asked themselves the wrong question. They concentrated on the reason why the rebates to partners were made; and treated that as the relevant purpose. But as *Arthur Young* shows the relevant purpose is the purpose of the individual partner in making the expenditure in the first place. The commissioners appear to have distinguished *Arthur Young* on the ground that it concerned reimbursement of personal expenses for employees. It did not. The House of Lords was at pains to stress that the reimbursement of expenditure incurred by a partner was quite different from the reimbursement of expenditure incurred by an employee. In my judgment the distinction drawn by the commissioners did not exist ...’

He concluded (at [32]) that the purpose of the original outlay was a question of fact. As the General Commissioners had not asked themselves that question, if it arose, the matter would have to be remitted to the General Commissioners for them to make the relevant finding.

...

25. *Arthur Young* concerned the reimbursement to partners of relocation expenses incurred by them personally in moving house to another part of the country where they were required to work. Two partners were so reimbursed but the Inspector of Taxes refused to allow a claim to deduct those sums in computing the profits of the partnership on the ground that they had not been laid out wholly and exclusively in the business of the partnership. The appeal of the partnership was allowed by the Special Commissioners and the Court of Appeal (see [1988] STC 116, [1989] Ch 454) but not by Vinelott J (see [1986] STC 491, [1986] 1 WLR 1468) and the House of Lords (see [1989] STC 898, [2012] STC 544 at 559[1990] 2 AC 239). The other members of the Appellate Committee agreed with the speech of Lord Oliver of Aylmerton.

...

28. In this appeal counsel for LPLP seek to distinguish the decision of the House of Lords in *Arthur Young* on two grounds. They contend, first, that the payments of the fees to the investor/limited partners was in their capacity as investors, not as limited partners and, second that the initial payment by them was to the partnership, not to a third party. I will consider each of those contentions in turn.

29. The first contention arises from the qualification in the speech of Lord Oliver, which I have quoted already, namely “a payment entirely collateral made to him otherwise than in his capacity as a partner”. That exception recognised the decision of the Court of Appeal in *Heastie v Veitch & Co* [1934] 1 KB 535. In that case one partner permitted the partnership to occupy premises separately owned by him in return for what the Special

Commissioners found to be a fair and proper rent. The Court of Appeal concluded that such rent was properly allowed as a deduction in computing the profits of the partnership for tax purposes because it was paid to that partner as landlord, not as partner.

30. Counsel for HMRC suggests that the collateral payment principle cannot apply to payments out of partnership funds to a partner to reimburse him for expenses he incurred. In addition, he submits, it cannot apply on the facts of this case even if the initial expenditure by the partner was a payment to the partnership itself not to a third party. For my part I would accept both of those contentions.

31. In relation to the first, a payment to a partner in reimbursement of expenses incurred by him in relation to the partnership business cannot, by definition, be entirely collateral to his status or capacity of partner; nor is there anything in the decision of the Court of Appeal in *Heastie v Veitch & Co* to suggest otherwise. So, in my view, the distinction is not a proper one as a matter of law. In addition the facts do not fit the suggested distinction. The repayments are made to individuals because they are (1) investors and (2) limited partners. None of the relevant repayments were or would have been made to individuals who did not satisfy both those qualifications. It follows that no such repayment can be entirely collateral to the recipient's position as a partner.

32. In relation to the second, it is true that the principle was expounded by Lord Oliver in the context of a payment to a partner in reimbursement of expenses paid by him in relation to the partnership business. If it be assumed that the initial payment was made by the partner to the partnership its repayment cannot give rise to expenditure entirely collateral to his position as a partner. It may or may not satisfy the conditions specified in s.74(1)(a) ICTA but that will depend on the purpose of his initial payment. As Lord Oliver observed in the passage in his speech I have quoted already:

“What he [the partner] receives out of the partnership funds falls to be brought into account in ascertaining his share of the profits of the firm except in so far he can demonstrate that it represents a payment to him in reimbursement of sums expended by him on partnership purposes in the carrying on of the partnership business or practice...”

33. But even if the suggested distinction gave rise to a different legal result it could not apply in the circumstances of this case. What the limited partner paid as an investor was paid to LEEF in subscription for A or B shares. He did not pay the performance or management fees to either LPIL or LPLP. They were paid respectively by LEEF and LPIL. What he receives is not entirely collateral to his position as a partner and is not applied wholly and exclusively for the purposes of the trade of the partnership.

...

35. I turn then to consider the contentions of HMRC that it would be pointless to remit to the General Commissioners the question of the purpose of the repayments made by LPLP to the investor/limited partners. HMRC point out that the purpose of remission would be to ascertain the object of the limited partners in subscribing for shares in LEEF, see, for example, *Mallalieu v Drummond* [1983] 2 AC 861, 870D-871A. HMRC contend that expenditure on personal investments must, by definition, be made in the personal interests of the partners. Further, the General Commissioners had, contrary to what Lewison J thought, found the relevant facts in the Case Stated. They rely on paragraph 7A.10 where the General Commissioners said:

‘7A.10 Investments by partners in LPLP were partly for creating confidence in clients, partly for personal financial gain and partly for convenience. Investment managers spend the whole day considering investments. It is convenient to have personal wealth in the fund as managed by the job. Partners could choose to have personal portfolios that mirror the fund but the arrangement avoids peer trading. Partner investment gives a strong message to investors and makes investment managers risk averse.’

Although that statement was made in connection with the evidence of Ms Nutton there is no suggestion that it was undermined in cross-examination or by the evidence of others. Accordingly, it is to be regarded as accepted by the General Commissioners and to be part of their factual findings.

36. I did not understand counsel for LPLP to challenge that submission. I see no reason not to accept it. Lewison J did not order any remission because of his conclusion on the third issue. Similarly in this court all now depends on our conclusion on the third point. ...”

157. *HMRC v Vaines* [2018] STC 297 concerned a claim by Mr Vaines to be entitled to deduct £215,455 from a share of the profits of his then profession as a solicitor in 2007-08. As Henderson LJ (with whom Newey and Sharp LJJs agreed) observed:

“2. At the material time, Mr Vaines was a partner in the law firm of Squire Sanders & Dempsey LLP (“SSD”). His share of profits from the firm was his only source of professional income for the year 2007/08. But the deduction which he sought to make had no direct connection with the business of SSD. It related, instead, to the previous period of Mr Vaines’ professional career when he had worked (until 31<sup>st</sup> December 2005) in the London offices of a German law firm, Haarmann Hemmelrath & Partner GbR (“HH GbR”). HH GbR was a partnership under German law, and Mr Vaines had been a member of that partnership until it was dissolved, and ceased trading, on 31<sup>st</sup> December 2005.

3. At the time when it ceased trading, HH GbR owed a total of approximately €17 million (including accrued interest) to Bayerische Landesbank and two other German banks. In 2007, Bayerische Landesbank sought repayment of this sum from Mr Vaines, claiming that he was personally liable for the debts of HH GbR, either in his capacity as a former partner in that firm or in his capacity as a partner in SSD (which had apparently succeeded to part of the business of HH GbR). Similar claims were made against a number of Mr Vaines’ former colleagues in HH GbR.

4. As Mr Vaines explained, in his witness statement for the hearing before the FTT:

"I did not consider that I was liable for any part of the amount claimed by the Bank but the risk of challenging the Bank through the German Courts was unacceptable to me. The Bank made it clear that they would sue me for the full amount which I understood was €17,000,000 on the basis of joint and several liability. I would have been involved in expensive and lengthy litigation in a foreign country and even a comparatively modest success on their part would have bankrupted me. Even a very low risk of bankruptcy was too great a risk to contemplate as it would have effectively deprived me of my livelihood."

A brief statement of agreed facts prepared for the same hearing confirmed that, if he were made bankrupt, Mr Vaines would lose his position as a partner in SSD.”

Under the heading ‘What was the trade carried on by Mr Vaines in 2007-08?’ and having set out the relevant legislative provisions, Henderson LJ continued:

“17. In 2007-08, Mr Vaines was resident in the UK. It therefore follows from section 849 (1) and (2) that the profits of the (deemed) partnership trade are to be calculated “as if the firm were a UK resident individual”, the “firm” for this purpose being a collective description of Mr Vaines and his fellow partners in the (deemed) partnership of SSD. The trade in question is the actual trade of SSD, which section 863(1) treats as carried on in partnership by its members. It is not a separate trade carried on by Mr Vaines alone, but the trade of SSD carried on collectively by himself and his fellow partners.

18. Once the profits of that collective trade have been ascertained, section 850 then provides (as one would expect) that Mr Vaines’ share of the profit for the relevant period of account is to be determined “in accordance with the firm’s profit-sharing arrangements during that period.” Under section 5 of ITTOIA, Mr Vaines is charged to income tax on his share of the profits. By virtue of section 7, the tax is charged on the full amount of the profits of the tax year, which means the profits of the “basis” period for the tax year. As the Upper Tribunal explained in paragraph 9 of the UT Decision, the basis period rules are found in Chapter 15 of Part 2 of ITTOIA. The normal rules operate by reference to the date in the tax year by reference to which 12 month accounts are drawn up, with specific rules to cover the situation in which a person has started or ceased (or is treated as starting or ceasing) to carry on a trade.

19. At this point, it is necessary to introduce a further complication – but, I stress, a complication which relates only to the basis period rules in Chapter 15 of Part 2 of ITTOIA. For those purposes, but no other, section 852 (1) states that:

‘For each tax year in which a firm carries on a trade (the “actual trade”), each partner’s share of the firm’s trading profits or losses is treated, for the purposes of Chapter 15 of Part 2 (basis periods), as profits or losses of a trade carried on by the partner alone (the “notional trade”).’

The remainder of section 852 lays down rules as to when a partner starts, or permanently ceases, to carry on this notional trade, and related matters. Section 853 then further provides that the basis period of a partner’s notional trade is determined by applying the rules in Chapter 15 of Part 2 as if:

- (a) the trade were carried on by an individual, and
- (b) its accounts were drawn up to the same dates as the accounts of the actual trade.”

Henderson LJ, having considered these provisions, then turned to the question of whether the payment made by Mr Vaines, that had arisen from his carrying on trade in a previous firm, was deductible in computing the partnership’s (ie SSD’s) trade. He then considered arguments advanced by Mr Vaines placing reliance on an HMRC ‘help sheet’ in relation to doctors’ practices and doctors’ expenses that might be allowable even if incurred by the doctor alone even though part of a partnership practice and concluded, at [35]:

“In my view, Mr Vaines can derive no assistance from this help sheet. In the first place, it correctly emphasises the general rule that the only legal basis for giving relief for expenditure by an individual partner is as a deduction in the



calculation of the profits of the partnership business. Thus, for example, if a doctor incurs expenditure relating to his individual specialisation, but the expenditure nevertheless satisfies the “wholly and exclusively” test, it may properly be deducted in calculating the partnership profits. Secondly, however – and here there may be a small element of concessionary treatment – HMRC do not insist on the inclusion of all such expenditure in the partnership accounts. Provided that the expense in question “would be allowable if met from partnership funds”, HMRC will accept entries made in the relevant sections of the partnership tax return, by way of adjustment to the partnership accounts. Once the adjustments have been made, the expenditure will then be treated as if it had been included in the partnership accounts. There is no suggestion, however, that any expenditure by an individual doctor could be allowed as a deduction even if it failed to satisfy the “wholly and exclusively” test. Nor is there any indication that a doctor could make such adjustments in his personal tax return, which is what Mr Vaines purported to do. At most, therefore, the help sheet provides a limited measure of practical assistance for medical partnerships. Even if similar assistance were to be provided, by analogy, for solicitors’ partnerships, it could not help Mr Vaines, for two reasons. First, the payment which he made could not satisfy the “wholly and exclusively” test, and could never have been an allowable deduction in computing the profits of SSD’s trade. Secondly, Mr Vaines sought to make the deduction, without reference to SSD, in his personal tax return.”

158. It is apparent from these cases, particularly *Vaines*, that it is the profits of the actual trade of the partnership, as computed at the partnership level, are then allocated to the various partners according to their profit-sharing arrangements. It also makes clear that the position has not changed with the advent of self-assessment.

159. Therefore, in the case of BCMCL, a non-UK resident company carrying on a trading partnership through a UK PE, to compute its profits under s 1259(3) CTA 2009 it is necessary to determine what the trading profit of the partnership would be if a non-UK resident company carried it on and, as Mr Baldry said, this must be applied by reference to the activities carried out and the expenses incurred at the level of the partnership.

160. As such it is necessary to consider s 380 CTA 2009. This concerns the deduction of interest in calculating the profits and losses of the trade or business for corporation tax purposes, under s 1259 CTA 2009, if a trade or business is carried on by a firm and any of the partners in the firm is a company. However, s 380 CTA 2009 is only applicable where “a money debt is owed by or to the firm”. In the present case interest is not due on a debt owed by a “firm”, ie the partnership BCM LP, but by an individual partner, BCMCL, in its own right.

161. Accordingly s 380 CTA 2009 cannot apply and there is no mechanism by which BCMCL can claim a deduction for interest on either the RBS loan or Loan Notes. As such, BCMCL is not entitled to claim a deduction for interest.

#### **Issue 4 – Interest Deductibility Issue**

*Is the equity and debt structure of BCMCL’s UK PE in any way not representative of a structure that could have been achieved if the parties were operating on an arm’s length basis (ie is BCMCL’s UK PE ‘thinly capitalised’) such that the deduction claimed by BCMCL in respect of interest costs on the RBS Loan Facility and the Loan Notes is to be restricted? If so, to what extent is the deduction restricted? In this regard:*

*(1) Are the conditions of s.147(1) of the TIOPA 2010 for the application of the transfer pricing provisions of Part 4 of TIOPA satisfied in relation to the RBS Loan Facility and the Loan Notes?*

(2) *In particular:*

(a) *Were the RBS Loan, the Sugarquay Loan, the MP Loan and the WR Loan arm's length provisions?*

(b) *Is it necessary that MP or WR be characterised as "enterprises", for them to be within the scope of Part 4 of the TIOPA 2010 and, if so, is such characterisation merited based on the facts of the case?*

162. Although, having concluded that BCMCL is not entitled to a deduction for interest on its borrowing this issue is somewhat academic, I have nevertheless addressed it as the issue was fully argued and in case of any further appeal. In doing so it is convenient to first set out the applicable legislation.

163. Although the Agreed Issues refer to the provisions of TIOPA, the legislation applicable in 2007, to which both Mr Gammie and Mr Baldrey referred, was schedule 28AA to ICTA (rather than TIOPA which applied from 2010).

164. The material parts of schedule 28AA provided:

1.—

(1) This Schedule applies where—

- (a) provision ('the actual provision') has been made or imposed as between any two persons ('the affected persons') by means of a transaction or series of transactions, and
- (b) at the time of the making or imposition of the actual provision—
  - (i) one of the affected persons was directly or indirectly participating in the management, control or capital of the other; or
  - (ii) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the affected persons.

(2) Subject to paragraphs 5A, 5B, 8, 10 and 13 below, if the actual provision—

- (a) differs from the provision ('the arm's length provision') which would have been made as between independent enterprises, and
- (b) confers a potential advantage in relation to United Kingdom taxation on one of the affected persons, or (whether or not the same advantage) on each of them,

the profits and losses of the potentially advantaged person or, as the case may be, of each of the potentially advantaged persons shall be computed for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision.

(3) For the purposes of this Schedule the cases in which provision made or imposed as between any two persons is to be taken to differ from the provision that would have been made as between independent enterprises shall include the case in which provision is made or imposed as between any two persons but no provision would have been made as between independent enterprises; and references in this Schedule to the arm's length provision shall be construed accordingly.

2.—

(1) This Schedule shall be construed (subject to paragraphs 8 to 11 below) in such manner as best secures consistency between—

- (a) the effect given to paragraph 1 above; and
- (b) the effect which, in accordance with the transfer pricing guidelines, is to be given, in cases where double taxation arrangements incorporate the whole or any part of the OECD model, to so much of the arrangements as does so.

(2) In this paragraph ‘*the OECD model*’ means—

- (a) the rules which, at the passing of this Act, were contained in Article 9 of the Model Tax Convention on Income and on Capital published by the Organisation for Economic Co-operation and Development; or
- (b) any rules in the same or equivalent terms.

(3) In this paragraph ‘the transfer pricing guidelines’ means —

- (a) all the documents published by the Organisation for Economic Co-operation and Development, at any time before 1st May 1998, as part of their Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations; and
- (b) such documents published by that Organisation on or after that date as may for the purposes of this Schedule be designated, by an order made by the Treasury, as comprised in the transfer pricing guidelines.

...

4A.—

(1) A person (“P”) shall be treated for the purposes of paragraph 1(1)(b)(i) above (but subject to sub-paragraph (7) below) as indirectly participating in the management, control or capital of another (“A”) at the time of the making or imposition of the actual provision if—

- (a) the actual provision relates, to any extent, to financing arrangements for A;
- (b) A is a body corporate or partnership;
- (c) P and other persons acted together in relation to the financing arrangements; and
- (d) P would be taken to have control of A if, at any relevant time, there were attributed to P the rights and powers of each of the other persons mentioned in paragraph (c) above.

4B.—

(1) To the extent that it applies to provision relating to financing arrangements, this Schedule has effect as if in paragraph 1(1)(b) above the words “or within the period of six months beginning with the day on which the actual provision was made or imposed” were inserted immediately before sub-paragraph (i).

(2) In this paragraph “*financing arrangements*” has the same meaning as in paragraph 4A above.

...

165. In 2007, when the transactions with which this appeal is concerned took place, no Treasury Order had been made under paragraph 2(3)(b) of schedule 28AA and therefore the relevant OECD transfer pricing guidelines, as published before 1 May 1998, were the 1995 Transfer Pricing Guidelines.

166. In relation to the arm's length principle these guidelines provide:

**‘B. Statement of the arm's length principle**

***i) Article 9 of the OECD Model Tax Convention***

1.6 The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD Member countries and an increasing number of non-Member countries. Article 9 provides:

[Where] conditions are made or imposed between ... two [associated] enterprises in the commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxes accordingly.

...

**C. Guidance for applying the arm's length principle**

***i) Comparability analysis***

***a) Reason for examining comparability***

1.15 Application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent enterprises. In order for such comparisons to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (eg price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. In determining the degree of comparability, including what adjustments are necessary to establish it, an understanding of how unrelated companies evaluate potential transactions is required. Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter into the transaction if they see no alternative that is clearly more attractive. For example, one enterprise is unlikely to accept a price offered for its product by an independent enterprise if it knows that other potential customers are willing to pay more under similar conditions. This point is relevant to the question of comparability, since independent enterprises would generally take into account any economically relevant differences between the options realistically available to them (such as differences in the level of risk or other comparability factors discussed below) when valuing those options. Therefore, when making the comparisons entailed by application of the arm's length principle, tax administrations should also take these differences into account when establishing whether there is comparability between the situations being compared and what adjustments may be necessary to achieve comparability.

1.16 All methods that apply the arm's length principle can be tied to the concept that independent enterprises consider the options available to them and in comparing one option to another they consider any differences between the options that would significantly affect their value. For instance, before purchasing a product at a given price, independent enterprises normally would be expected to consider whether they could buy the same product at a lower

price from another party. Therefore, as discussed in Chapter II, the comparable uncontrolled price method compares a controlled transaction to similar uncontrolled transactions to provide a direct estimate of the price the parties would have agreed to had they resorted directly to a market alternative to the controlled transaction. However, the method becomes a less reliable substitute for arm's length dealings if not all the characteristics of these uncontrolled transactions that significantly affect the price charged between independent enterprises are comparable. Similarly, the resale price and cost plus methods compare the gross profit margin earned in the controlled transaction to gross profit margins earned in similar uncontrolled transactions. The comparison provides an estimate of the gross profit margin one of the parties could have earned had it performed the same functions for independent enterprises and therefore provides an estimate of the payment that party would have demanded, and the other party would have been willing to pay, at arm's length for performing those functions. Other methods as discussed in Chapter III are based on comparisons of profit rates or margins between independent and associated enterprises as a means to estimate the profits that one or both of the associated enterprises could have earned had they dealt solely with independent enterprises, and therefore the payment those enterprises would have demanded at arm's length to compensate them for using their resources in the controlled transaction. In all cases adjustments must be made to account for differences between the controlled and uncontrolled situations that would significantly affect the price charged or return required by independent enterprises. Therefore, in no event can unadjusted industry average returns themselves establish arm's length conditions.

1.17 As noted above, in making these comparisons, material differences between the compared transactions or enterprises should be taken into account. In order to establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof), it is necessary to compare attributes of the transactions or enterprises that would affect conditions in arm's length dealings. Attributes that may be important include the characteristics of the property or services transferred, the functions performed by the parties (taking into account assets used and risks assumed), the contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties. These factors are discussed in more detail below."

167. The OECD Guidelines were considered by the Special Commissioners (Dr Avery Jones and Mr Hellier) in *DSG Retail Limited and other v HMRC* [2009] STC (SCD) 397 ("*DSG*"). As the Special Commissioners observed, at [4], there were two separate periods to consider in relation to the law:

"... During the first, comprising 1996-97 (the Cornhill Period and relevant only to scheme year 1996-97) to 1998-99 (part of the ASL period), the law was contained in s 770 of the Taxes Act 1988. In the second, affecting periods 1999-00 to 2003-04 (part of the ASL period), the law is contained in Sch 28AA of the Taxes Act 1988, introduced by the Finance Act 1999. Briefly, the parties are agreed that the main difference between them is that under s 770 one takes the facts of the transaction as they are and asks whether a price would have been charged for entering into the transaction if the parties had been at arm's length, whereas under Sch 28AA one asks whether the terms of the transaction would have been different if the parties had been at arm's length."

At [62] the Special Commissioners noted:

“It is clear to us that “giving business facilities of whatever kind” is intended to encompass a wide variety of things. As the Special Commissioners said in *Ametalco* [1996] STC SCD 399, these words are a wide description, and this approach was adopted in *Waterloo v IRC* [2002] STC SCD 95. It is not in our view limited to a contract between the described persons. But one must be able to identify a “facility”, something which confers some form of benefit or advantage. That benefit or advantage need not be an immediate pecuniary advantage but could be the hope or expectation of profit or other advantage.”

168. Referring to schedule 28AA the Special Commissioners said:

“65. Paragraph 1(1) speaks of provision between two persons. For the schedule to apply those two persons must be identified. Whilst the transaction or series of transactions by which the relevant provision is made or imposed may encompass transactions between persons other than those two persons, the identified provision must be between two persons only. There is, in our view, no scope for reading “two” as “two or more”.

66. There is no further definition of “provision” in the schedule. But we note that transaction includes informal arrangements and understandings and series of the same. That suggests that “provision” is not limited to formal or enforceable arrangements but may be of a similar nature, since it may be made by means of such informal arrangements or understandings. Article 9 of the OECD Model Tax Convention contains the phrase “conditions made or imposed between the two enterprises in their commercial or financial relations”, and the Appellants note that para 42 of the Explanatory Notes to clause 106 of the Finance Bill 1998 stated that the term provision is analogous to that phrase. The obligation to construe para 1 in such manner as best secures consistency with the OECD model indicates that “provision” should be given a similar meaning to that which should be given to “condition” in the model. There seems to us however, to be nothing in the model which indicates that “condition” should be restricted to formal or enforceable arrangements.

...

70. Para 2(1)(b) speaks of giving effect “in cases where double taxation arrangements incorporate the whole or any part of the OECD model, to so much of the arrangements as does so”. (Para 14 defines “double taxation arrangements” as meaning “arrangements having effect by virtue of section 788”). There are two possible readings of this provision: under the first it applies only where the parties to the provision are resident in jurisdictions between which there is a double tax treaty which incorporates the model or any part of it; under the second it applies generally and independently of whether or not there is a relevant double tax treaty between those jurisdictions because its effect is to apply the meaning that would apply if there were such a treaty in force to interpreting Sch 28AA. The question is whether “in cases” refers to cases of particular provision or to any cases where there are double tax treaties.

...

72. Like s 770’s reference to “the” arm’s length price, Sch 28AA uses the definite article, referring to “the” provision which would be made as between independent parties. Clearly there will be circumstances where independent parties could have made one of a number of different provisions, but the legislation requires one to be fixed upon.

73. In summary in relation to Sch 28AA: (a) we have to identify whether in relation to any Appellant there was any provision made or imposed between

it and DISL, (b) if so, we have to determine whether the same provision would have been made had that Appellant and DISL been independent, (c) if not, then we must determine the provision which would have been made, and (d) we must then determine for each relevant year after 1 July 1999 what effect the making of the different provision would have had on the taxable profits of that Appellant.”

169. The Special Commissioners then went on to discuss the differences between s 770 ICTA and schedule 28AA saying:

“76. We should comment on three differences between the s 770 and sch 28AA provisions. First, the s 770 regime requires the arm's length price to be determined for the facilities actually provided. By contrast para 1 of Sch 28AA requires the identification of a provision between relevantly connected persons and the determination of what provision would have been made between independent persons. That notional provision could be different, not only in price, but in its terms from the actual provision made.

77. Second, the Sch 28AA regime, by virtue of para 2 requires effect to be given to the Transfer Pricing Guidelines as they apply to treaties following the OECD model. The incorporation is not wholesale: it merely requires the schedule as a whole to be interpreted in such a way as secures consistency between para 1 of the schedule and the OECD model in accordance with the Transfer Pricing Guidelines. There is no incorporation of the OECD model in s 770. But it seems to us that in determining the arm's length price, the approach of the OECD model is a useful aid which we should apply in the absence of any other guidance as they are the best evidence of international thinking on the topic.

78. Third, s 770 requires one to determine the price which would have been paid if the parties “had been independent parties dealing at arm's length”. It seems clear to us that those words do not require any adjustment to be made in setting the price to the actual characteristics of the parties other than their independence. The actual assets, business and attributes of each party remain constant and may be relevant to the determination of the arm's length price. The language of para 1(2)(a) is different: “differs from the provision which would have been made between independent enterprises”. It is at first sight possible that those “independent enterprises” may not be enterprises which do not share the same attributes as the actual parties to the provision. But it is clear to us that that interpretation is not consistent with the OECD model (see in particular the emphasis on comparability in the extracts below which presupposes looking at the actual characteristics of the enterprises between which provision has been made) and therefore that para 1(2)(a) should be interpreted as requiring consideration of what provision independent enterprises sharing the characteristics of the actual enterprises would have made.”

170. Before considering the OECD guidelines the Special Commissioners observed that:

“90. Where a taxpayer is a party to two or more non-arm's length provisions with different counterparties but which have the same effect and which are given that effect by the same series of transactions, then it is possible to read sch 28AA to require each such provision to be separately adjusted for without regard to the other or others because the only assumption required in determining the taxpayer's profits is that it is independent of the particular counterparty, and there is little room for applying para 1(2) to provisions in the plural deriving from separate bilateral provisions found under para 1(1). However, not only would such an approach result in double taxation, but it is

plainly contrary to the whole spirit of the OECD Guidelines with regard to which para 1 must be construed. It seems to us therefore that at the very least in a case where the other bilateral provisions consist of procuring the taxpayer to enter into a provision between that taxpayer and another, no separate or fractional adjustment falls to be made for each provision, but instead a single adjustment in respect of the provision between the taxpayer and that other should be made which reflects the full effect of the non-arm's length nature of that provision. For this reason the existence or otherwise of provision between Dixons Finance or Dixons Group and DISL which consisted of procuring the arrangements between DSG and DISL in circumstances where such other provisions did not involve the conferring of payment or benefit on DSG by such other party neither deters us from our conclusion that there was an arrangement between DSG and DISL nor persuades us that any adjustment to our determination should be made to reflect such provisions.

...

93. For an adjustment to be made under Sch 28AA the provision must be different from that which would have been made as between arm's length parties. We accept Mr Goy's contention that if the 1997 provision had been at arm's length, then other provisions between these parties made in subsequent years would have been at arm's length. Thus there is no need to consider whether such other provisions give rise to other adjustments. We now proceed to consider what that provision would be. In the discussion which follows as in the argument before us our focus is on the profits which each party to an arrangement under which extended warranty business was insured or reinsured could be expected to make if they were independent. That discussion is a necessary precursor to the determination of the terms on which an arrangement between an independent DSG and DISL relating to that business would take place. The discussion of comparables thus looks not specifically at a comparable arrangement to that identified above, but to entities conducting comparable business."

171. The Special Commissioners, at [94], noted that there was an express reference to the OECD guidelines in schedule 28AA which, "stress the importance of looking for comparable transactions so long as they are comparable, the need to strive to make adjustments to create comparability if at all possible, and that more than one method may be considered."

172. Returning to the OECD guidelines, under the sub-heading 'Recognition of the actual transactions undertaken', these state:

"1.37 However, there are two particular circumstances in which it may, exceptionally, be both appropriate and legitimate for a tax administration to consider disregarding the structure adopted by a taxpayer in entering into a controlled transaction. The first circumstance arises where the economic substance of a transaction differs from its form. In such a case the tax administration may disregard the parties' characterisation of the transaction and re-characterise it in accordance with its substance. An example of this circumstance would be an investment in an associated enterprise in the form of interest-bearing debt when, at arm's length, having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way. In this case it might be appropriate for a tax administration to characterise the investment in accordance with its economic substance with the result that the loan may be treated as a subscription of capital. The second circumstance arises where, while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which



would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price. An example of this circumstance would be a sale under a long-term contract, for a lump sum payment, of unlimited entitlement to the intellectual property rights arising as a result of future research for the term of the contract (as previously indicated in paragraph 1.10). While in this case it may be proper to respect the transaction as a transfer of commercial property, it would nevertheless be appropriate for a tax administration to conform the terms of that transfer in their entirety (and not simply by reference to pricing) to those that might reasonably have been expected had the transfer of property been the subject of a transaction involving independent enterprises. Thus, in the case described above it might be appropriate for the tax administration, for example, to adjust the conditions of the agreement in a commercially rational manner as a continuing research agreement.

1.38 In both sets of circumstances described above, the character of the transaction may derive from the relationship between the parties rather than be determined by normal commercial conditions and may have been structured by the taxpayer to avoid or minimise tax. In such cases, the totality of its terms would be the result of a condition that would not have been made if the parties had been engaged in arm's length dealings. Article 9 would thus allow an adjustment of conditions to reflect those which the parties would have attained had the transaction been structured in accordance with the economic and commercial reality of parties dealing at arm's length."

173. Both the Cayman Appellants and HMRC rely on expert evidence in relation to the arm's length issue. The Cayman Appellants called Marcus Stanton and HMRC Mr Philip Maggs. As noted above (at paragraph 9) Mr Stanton and Mr Maggs each produced a report in which they were instructed to respond to the following questions that had been agreed between the parties:

- (1) In relation to whether or not the provision in question was at arm's length:
  - (a) Would the Loan Note holders (or any of them) lend to BCMCL?
  - (b) If so, would they (or any of them) lend to BCMCL in the amount and on the terms set out in the Loan Note documentation?
  - (c) If not, in what amounts and on what terms would they (or any of them) lend to BCMCL?
  - (d) Would BCMCL borrow at all from the Loan Note Holders or any of them?
  - (e) If so, would BCMCL borrow in the amounts and on the terms set out in the Loan Note documentation?
  - (f) If not in what amount and on what terms would BCMCL borrow from the Loan Note holders?
- (2) On the basis that the UK PE is a PE of BCMCL and, as such, is required to be treated as if it was a distinct and separate enterprise which:
  - (a) was engaged in the same or similar activities under the same or similar conditions, dealing wholly independently with BCMCL; and
  - (b) had the same credit rating as BCMCL;

what equity and loan capital structure (or range of equity and loan capital structure) could the UK PE reasonably be expected to have in those circumstances specified at (a) and (b)?

(3) On the basis of the assumptions in (2)(a) and (b) and an equity and loan capital structure that the UK PE could reasonably be expected to have, and assuming that the transactions between the UK PE and BCMCL take place on such terms as would have been agreed between parties dealing at arm's length:

(a) would the answers to questions (a) to (f) in paragraph (1) above differ in the case of the Loan Note holders (or any of them) and, if so, in what way and why?

(b) what are the answers to questions (1) to (6) in paragraph (1) above in the case of RBS and its loan facility?

174. The fundamental difference between the experts relates to their different approaches to the independence of BCMC LP and BCMCL. In essence Mr Maggs believed, because the case raised transfer pricing issues, that it was necessary to delineate the relevant transaction in a way consistent with the OECD guidelines. He considered that the actual transaction involved multiple steps and several economic relationships with a high degree of interdependency between the sellers (MP, WR and Sugarquay) and the Cayman businesses (BMC LP, BCMCL, BCMCHL and the BC Cayman Charitable Trust) the UK businesses (BCML and BCM LP) and RBS. Mr Maggs also believed that MP, WR and Sugarquay collectively had control over both the UK businesses and the Cayman businesses and that the Cayman businesses are not independent of the UK businesses.

175. In order to answer the questions Mr Maggs considered it was necessary to hypothesise an arm's length transaction in which BCMCL is considered as an independent entity, without connection to the sellers, the UK businesses or RBS. He proposed two hypotheses, both of which consider BCMCL as an independent entity without such connections. In the first he considered the Cayman businesses as independent from the UK businesses, Loan Note issuers, the sellers and RBS. For the second of the hypotheses Mr Maggs also considered the Cayman businesses as independent from the UK businesses, the Loan Note issuers, the sellers and RBS but, in addition, he considered the issuance of the Loan Notes made in conjunction with the sale of stakes in BCM LP and recognised that the sellers "sellers have control over BCM LP through their ownership of BCML."

176. Mr Maggs, who HMRC provided with an additional document, "Note for experts on transfer pricing assumptions", which was not made available to Mr Stanton or the appellant's representatives prior to the filing of the reports, concluded that RBS would not have lent to BCMCL in either of these hypothetical arm's length transactions because the UK businesses would not accept the covenants and undertakings required by RBS to lend to BCMCL. He also concluded that the Loan Note Holders (WR, MP and Sugarquay) would not have lent to BCMCL. This was because in the first hypothesis the covenants and undertakings from the UK businesses would not have been available and in the second hypothesis, that the covenants and undertakings would not be available and that there would have been more efficient ways to structure the arrangements assuming the sellers recognised the value of the "lock-in" properties of the loan.

177. Mr Stanton, however, took a different approach. Having analysed the RBS Loan Facility and the Loan Notes, including the preparation of a quantitative analysis of how these would be repaid out of the available profits of BCM LP and as supported by the various agreements entered into by BCMCL, he concluded that terms of both the RBS facility and the Loan Notes would have been acceptable to independent providers of finance and that RBS was such an

independent provider of finance. Mr Stanton did not accept that the hypotheses on which Mr Maggs relied were appropriate. Rather he considered that these were “very far removed” from the actual transactions of BCMCL.

178. An example of this in the Joint Report concerns the consequences of the delineation of Mr Maggs who had considered that the transaction involved a number of economic relationships between parties that were not independent and that, in order to assess whether or not it was consistent with the arm's length principle, it was necessary to consider the extent to which these relationships would have been available at arm's length which had Mr Maggs to conclude that that RBS would not have lent to BCMCL. However, in Mr Stanton's view:

“... RBS was an independent party to these arrangements and it did lend to BCMCL. As a consequence, in the view of [Mr Stanton], any comparative, or hypothesised, transaction should be of a nature that includes RBS lending into BCMCL (and receiving the covenants that it did).”

The Joint Report also sets out the implications of the fundamental difference between the experts.

179. However, notwithstanding these different approaches the experts agreed on the following related points:

(1) that the provision of various covenants (including those provided by the UK businesses), as included in the Deed of Subordination and Covenant, and reflected in the partnership deeds for BCM LP and BCMC LP, was essential in order for both RBS and the Loan Note Holders to lend to BCMCL on the basis (eg as to amount and terms) that they did;

(2) That, in the actual transaction, with the provision of various covenants, as included in the Deed of Subordination and Covenant, the terms and conditions of the RBS Loan Facility were such that the risks being borne by RBS, together with the arrangement fees and interest returns being received by RBS (US\$ LIBOR plus 2.5%), were fully consistent with the risks and rewards that would be sought by a major bank; and

(3) that the source of repayment of the Loan Notes was the same as the source of repayment of the RBS Loan Facility and that “one of the key attractions” to both RBS and the Loan Note holders was that they were not just lending on the basis of the cash flows generated from the 19% of BCM LP 's remaining profits (after working capital, contingencies and performance payments), but both debt providers had access to the entirety of BCM LP 's remaining profits when the repayment of these debt facilities became due.

180. The specific points of disagreement between the experts concerned the issues of incentivising existing and future staff of BCM LP, consideration of alternative agreements in which there was no link between UK and Cayman businesses (which Mr Maggs considered to be consistent with the arm's length principle), the relevance of the RBS loan as a benchmark for assessing the terms of the Loan Notes and whether the Cayman businesses had taken on significant liabilities.

181. In regard to the incentivising of existing and future staff of BCM LP at arm's length, Mr Maggs considered that his hypothesised transaction failed the ultimate purpose which was to sell a partnership stake in BCM LP in a way that could incentivise both its existing and future staff and that “this alone” may have been “sufficient” for him to conclude that the transaction described in such a hypothesis can “never be an arm's length transaction”. However, to Mr Stanton this is another indicator that the hypothesised transaction of Mr Maggs is not a valid

comparator to the transactions that actually took place, as incentivising existing partners and senior management was one of the primary objectives of the arrangements.

182. Mr Maggs, having rejected the possibility of the loans satisfying the arm's length principle under the assumption of independence between the UK and Cayman businesses, considered that it was helpful to delineate an alternative arrangement which would satisfy the arm's length principle. Such a transaction would need to satisfy the same purpose as the actual transaction but without the Cayman structures that were put in place. In his suggested alternative transaction RBS would lend US\$200 million at arm's length to BCMCL, allowing it to buy back the collective 19% partnership interests held by WR, MP and Sugarquay, who would receive a similar up-front payment, with further payments made in stages over the life of the RBS loan, but with a substantial final payment and stronger performance incentives.

183. Mr Stanton, however, did not consider such an alternative scenario to be necessary as in his view the loans provided by way of both the RBS Facility and under the Loan Notes were made at arm's length. He is also of the view that the alternative transaction, based on the analysis of Mr Maggs of a mechanism to "lock-in" WR, MP and Sugarquay, and a mechanism to pay them amounts depending on the performance of BCM LP (an "earn-out"), "does not sit well with the context, structure and purpose of the actual transaction". This was because:

"A. The main vendor of the partnership interests to BCMCL was WR, and one of the primary reasons for WR selling his 13% partnership interest was that he "intended to retire from active participation in the business of BCM LP". To this extent, MJS [Mr Stanton] does not see that a lock-in sits well with what WR or BCM LP would be seeking to achieve from these arrangements, in that, going forward, WR would make far less of a contribution to the ongoing success of BCM LP. Additionally, the Loan Notes did not function as a form of lock-in since they were freely transferable (subject to acceding to the terms of the Loan Notes).

B. MJS also does not see that an earn-out sits particularly well with WR, in that:

a. to the extent an earn-out structure is designed to reflect WR's ongoing contribution or involvement in the business, the reality was that WR was to have a much reduced involvement going forward, and

b. to the extent an earn-out mechanism is simply designed to reflect that a fixed price was not able to be agreed at the time of the sale, then again, the reality was that a fixed price was agreed at the time of the sale.

C. WR's reducing involvement in BCM LP was also recognised in the RBS Loan Agreement, where a "Trigger Event" was defined to include the event of MP ceasing to be the chief executive officer of BCM LP, and not being replaced by an individual approved by the loan facility Agent. By contrast, there was no such requirement as regards WR ceasing to be employed by BCM LP, presumably because he was to have a much-reduced role going forward.

D. As regards MP, he had a 41.8% profit allocation interest in BCM LP prior to these arrangements being entered into, and a 38.8% profit allocation post the sale of 3% of his interests. In the view of MJS, MP's involvement in BCM LP did not, therefore, significantly alter as a result of these arrangements, and there would be no need to add in further earn-out or lock-in mechanisms for MP.

E. As regards Sugarquay, by mid-2007 it had informed MP and Andrew Dodd that they "should consider" ... [Sugarquay]. .. a "financial investor" rather

than a “business partner”. In the view of MJS, this too does not appear to sit well with a lock-in or earn-out mechanism.

F. It is also not clear to MJS whether PM’s [Mr Magg’s] alternate structure would serve the purpose of being able “... to mitigate the potential adverse regulatory consequences of using a UK Entity ...”, which was one of the objectives of the arrangements, nor is MJS clear as to the taxation consequences of PM’s alternate structure.”

184. The experts also disagreed on the relevance of the RBS loan as a benchmark for assessing the terms of the Loan Notes. Mr Stanton, who was of the view that the RBS loan was “clearly at arm’s length”, considered that the RBS loan could be used as a benchmark for assessing the arm’s length nature of the Loan Notes. This was because the source of the repayment of the Loan Notes was the same as the source of the repayment of the RBS Loan Facility, the profits allocated by BCM LP. Mr Stanton considered that the main difference between the two loans was the additional risk being taken on by the Loan Note Holders by virtue of the Loan Notes ranking behind the RBS funding, even with the Loan Notes having a higher interest rate than the RBS loan. Mr Stanton was of the view that, in banking terms, such differences indicate that the Loan Note structure would appeal to a high-yield investor base who, by their nature, would be looking to earn higher returns than conventional lending, by taking on higher risk.

185. Mr Maggs, however, considered that there was a further difference between the RBS Loan and the Loan Notes in that:

“...the Loan Notes serve to reduce the risk taken on by RBS in two ways. First, they act as a buffer in that they are subordinate to RBS’s claim on the profits that accrue to the 19% stake in BCM LP held by BCMCL (through BCMC LP), albeit the value of this may be limited since RBS also has a preferential claim over the other limited partners (representing 81 per cent of the BCM LP partnership interests). Second, and more importantly, the Loan Notes incentivise the sellers to continue to act in the interests of BCM LP.”

He was also of the view that the Loan Note structure had the economic effect of a lock-in term for the sellers, linking the repayment to the sellers to the performance of BCM LP which they control. Mr Stanton did not accept that this was the case. He disagreed that the Loan Notes functioned as a lock-in mechanism. He considered the Loan Notes to be transferable and had no “upside payments” attached to them.

186. As to whether the liabilities taken on by the Cayman businesses Mr Maggs, in his Report, observed that:

“... BCMCL appears to receive an asset over which it does not have control. It has no say over where the income generated by the partnership interests will flow, cannot sell the asset, and a condition is that BCM LP will be able to appoint limited partners to BCMC LP (who will have claim over the income it generates). Accordingly, it is not clear from the perspective of the Cayman business that an economic transaction has actually occurred.”

As a result Mr Maggs considered that the relationships between the UK and Cayman businesses means that ultimately the liability to RBS rests with the UK businesses, and that RBS has therefore entered into a transaction with the UK businesses.

187. Mr Stanton took a different view. He considered that BCMCL had taken on significant liabilities, ie the US\$200 million loan from RBS and the US\$165 million of Loan Note funding from the Loan Note Holders. He also considered that BCMCL had significant assets, the right to receive income from BCM LP and additional share capital from BCMCHL and that BCMC LP in its 19% interest in BCM had a significant asset which was valued at US\$361 million.

Additionally, Mr Stanton was of the view that, from the perspective of RBS, it had entered into a lending transaction with BCMCL.

188. Perhaps not surprisingly, Mr Gammie emphasised Mr Stanton's banking credentials and urged me to adopt the approach he had taken and conclude that RBS and the Loan Note holders were acting commercially, whereas Mr Baldry took the opposite view. He contends that I should accept the approach of Mr Maggs which, Mr Baldry says, was "much more rooted in the arm's length principle in accordance with the OECD guidelines" and who had concluded that had the parties been acting on arm's length terms they would not have entered into the transactions at all.

189. However, the arm's length issue in this case concerns how the transaction was financed rather than its price. As noted above (at paragraph 31) the US\$361 million paid for the 19% interest in BCM LP has not been challenged by HMRC.

190. Mr Baldry contends that RBS and all Loan Note holders acted together in relation to financing arrangements and are therefore "indirectly participating in the management, control or capital of the other" within the meaning of paragraph 1(1)(b) of schedule 28AA ICTA and that this is apparent from the financing arrangements, which are to be considered by virtue of paragraph 4B of schedule 28AA ICTA, as these include steps taken six months before the loans were made. All of the parties concerned were signatories to the Subordination Deed and were, Mr Baldry contends, all acting together in fulfilment of the overall common purpose of establishing the equity pool for the incentivisation of BlueCrest junior partners and potential junior partners.

191. However, Mr Gammie contends that this case differs from a "normal" transfer pricing scenario in that there has been no other transaction or terms suggested by reference to which the commercial objectives of WR retiring from the business of BCM LP and providing equity pool for future partners could be achieved. He says that the only question to ask when considering a transfer pricing issue in such circumstances is whether the funding differs from the provision that would have been made between independent enterprises and in the present case there is an independent third party, RBS.

192. As Mr Baldry said during the hearing, given the evidence of Mr Stanton and Mr Maggs, it is not possible to come to "judgment of Solomon" on this issue, the transaction was either at arm's length or it was not, there is no halfway house.

193. Having carefully considered the reports of Mr Stanton and Mr Maggs and their joint report, on balance I prefer the conclusion reached by Mr Stanton that the transactions were at arm's length. I agree with Mr Gammie that it is clear from the evidence that each of the parties had their own interests in the transactions. RBS as a commercial bank wanted to protect its own interests as can be seen by from the negotiations and its insistence on the downside trigger in the event of a reduction in AUM below US\$8,250,000,000. WR, who was retiring from the business, clearly would wish to maximise the sale price of his interest whereas Mr Dodd, on behalf of himself and future partners, would want to minimise it. Additionally, MP and Man Group through Sugarquay would have had their own divergent and differing interests in the transaction. In the circumstances I consider that, because of their conflicting interests, the transactions concerned were arm's length transactions, ie that wholly independent parties would have come to the same arrangements.

194. Therefore, even if one of the parties was either directly or indirectly "participating in the management control or capital of the other" for the purposes of paragraph 1 of schedule 28AA, as is clear from paragraphs 1.15 – 1.17 of the OECD Guidelines, the essential starting point is the provision that would have been made between independent parties. Additionally, as Mr Maggs accepted, it is perfectly possible for a transaction between two "associated enterprises"

parties to be at arm's length. This is consistent with the observation of the Special Commissioners in *DSG*, at [73] that:

“[W]e would have to have determine whether the same provision would have been made had the Appellant and DISL been independent.”

195. Therefore, if, as I have found, the parties are acting independently, as Mr Gammie argued, there should be no difference in the financing of the provision made between them. As such I do not consider RBS and BCMCL to be related within paragraph 4A of schedule 28AA.

196. Given that it is a limited company, I do not consider Sugarquay to be related to or associated with BCMCL. Additionally, for the reasons above I consider, in any event, the transaction was at arm's length and, as such not within the statutory provisions. Neither, given their respective self-interests, do I consider WR and MP to be related or associated with BCMCL and, as with Sugarquay, I consider the transactions entered into to be on arm's length terms.

197. In relation to the question as to whether WR and MP were enterprises or can be regarded as such or were private individuals there appears to be little, if anything between the parties. Mr Gammie says that the domestic legislation refers to “persons” which is sufficient to include WR and MP and that although the OECD Guidelines refer to “enterprises” it is the ordinary language of the legislation that should be applied. Mr Baldry contends that there is not a distinction and that the concept of an enterprise is sufficient to include individuals. Accordingly it would seem that it is not disputed that the transfer pricing provisions apply to the transactions between BCMCL and RBS and also BCMCL and the Loan Note holders.

198. Turning to the “thin capitalisation” issue on which HMRC relies in relation to the rules on permanent establishments to contend in relation to any deduction on borrowing being reduced, s 11AA ICTA provided:

**11AA.—Determination of profits attributable to permanent establishment**

(1) This section provides for determining for the purposes of corporation tax the amount of the profits attributable to a permanent establishment in the United Kingdom of a company that is not resident in the United Kingdom (“the non-resident company”).

(2) There shall be attributed to the permanent establishment the profits it would have made if it were a distinct and separate enterprise, engaged in the same or similar activities under the same or similar conditions, dealing wholly independently with the non-resident company.

(3) In applying subsection (2)—

- (a) it shall be assumed that the permanent establishment has the same credit rating as the non-resident company, and
- (b) it shall also be assumed that the permanent establishment has such equity and loan capital as it could reasonably be expected to have in the circumstances specified in that subsection.

No deduction may be made in respect of costs in excess of those that would have been incurred on those assumptions.

(4) There shall be allowed as deductions any allowable expenses incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the United Kingdom or elsewhere.

*“Allowable expenses”* means expenses of a kind in respect of which a deduction would be allowed for corporation tax purposes if incurred by a company resident in the United Kingdom.

(5) The Board may by regulations make provision as to the application of subsection (2) in relation to insurance companies. The regulations may, in particular, make provision in place of subsection (3)(b) as to the basis on which, in the case of insurance companies, capital is to be attributed to a permanent establishment in the United Kingdom. In this subsection “insurance company” has the meaning given by section 431(2).

(6) Schedule A1 to this Act contains provisions supplementing the provisions of this section. ...

199. Schedule A1 ICTA provided:

## **SCHEDULE A1**

### **Part 1 Introduction**

#### **1 Introduction**

(1) The provisions of this Schedule have effect for supplementing section 11AA as regards the determination of the profits attributable to a permanent establishment in the United Kingdom of a company that is not resident in the United Kingdom (“the non-resident company”).

(2) In this Schedule “*the separate enterprise principle*” means the principle in section 11AA(2) (read with subsection (3) of that section).

### **Part 2 General provisions**

#### **2. Transactions treated as taking place at arm’s length**

In accordance with the separate enterprise principle, transactions between the permanent establishment and any other part of the non-resident company are treated as taking place on such terms as would have been agreed between parties dealing at arm’s length.

#### **3. Application of general provision as to allowable deductions**

(1) Section 11AA(4) (general provision as to allowable deductions) applies whether or not the expenses are incurred by, or reimbursed by, the permanent establishment.

(2) The amount of expenses to be taken into account under section 11AA(4) is the actual cost to the non-resident company.

#### **4. Prohibition of deductions for payments in respect of intangible assets**

(1) No deduction is allowed in respect of royalties paid, or other similar payments made, by the permanent establishment to any other part of the non-resident company in respect of the use of intangible assets held by the company.

(2) This does not prevent a deduction in respect of any contribution by the permanent establishment to the costs of creation of an intangible asset.



(3) In this paragraph “*intangible asset*” has the meaning it has for accounting purposes, and includes any intellectual property (as defined in paragraph 2(2) of Schedule 29 to the Finance Act 2002).

## **5. Prohibition of deductions for interest or other financing costs**

(1) No deduction is allowed in respect of payments of interest or other financing costs by the permanent establishment to any other part of the non-resident company, except as provided by sub-paragraph (2).

(2) The restriction in sub-paragraph (1) above does not apply to interest or other costs of financing that are payable in respect of borrowing by the permanent establishment in the ordinary course of a financial business carried on by it.

(3) In sub-paragraph (2) “*financial business*” means any of the following—

- (a) banking, deposit-taking, money-lending or debt-factoring, or a business similar to any of those;
- (b) dealing in commodity or financial futures.

200. There is also an OECD Report on this issue, *Report on the Attribution of Profits to Permanent Establishments* (17 July 2008) from which the following extracts are taken:

### **“B-5. Summary of the two-step analysis**

47. The attribution of profits to a PE of an enterprise on an arm’s length basis will follow from the calculation of the profits (or losses) from all its activities, including transactions with other unrelated enterprises, transactions with related enterprises (with direct application of the Guidelines) and dealings with other parts of the enterprise (under step 2 of the authorised OECD approach). This analysis involves the following two steps:

#### *Step One*

A functional and factual analysis, leading to:

- The attribution to the PE as appropriate of the rights and obligations arising out of transactions between the enterprise of which the PE is a part and separate enterprises;
- The identification of significant people functions relevant to the attribution of economic ownership of assets, and the attribution of economic ownership of assets to the PE;
- The identification of other functions of the PE;
- The recognition and determination of the nature of those dealings between the PE and other parts of the same enterprise that can appropriately be recognised, having passed the threshold test; and
- The attribution of capital based on the assets and risks attributed to the PE.

#### *Step Two*

The pricing on an arm’s length basis of recognised dealings through:

- The determination of comparability between the dealings and uncontrolled transactions, established by applying the Guidelines’ comparability factors directly (characteristics of property or services, economic circumstances and business strategies) or by analogy

(functional analysis, contractual terms) in light of the particular factual circumstances of the PE; and

- Applying by analogy one of the Guidelines' traditional transaction methods or, where such methods cannot be applied reliably, one of the transactional profit methods to arrive at an arm's length compensation for the dealings between the PE and the rest of the enterprise, taking into account the functions performed by and the assets and risks attributed to the PE.

The pricing on an arm's length basis of any transactions with associated enterprises attributed to the PE should follow the guidance in the Guidelines and is not discussed in this Report. The order of the listing of items within each of the steps above is not meant to be prescriptive, as the various items may be interrelated (eg risk is initially attributed to a PE as it performs the significant people functions relevant to the assumption of that risk but the recognition and characterisation of a subsequent dealing between the PE and another part of the enterprise that manages the risk may lead to a transfer of the risk and supporting capital to the other part of the enterprise).

48. It can be seen that the functional and factual analysis is primarily needed to hypothesise the PE as a functionally separate entity, to identify the significant people functions relevant to determining which part of the enterprise assumes and/or subsequently manages particular risks and economically owns particular assets, and to attribute to the PE as a hypothetically separate entity an appropriate amount of capital. This step of the analysis is likewise necessary to identify which part of the enterprise should be hypothesised to have undertaken the enterprise's rights and obligations arising from transactions with other enterprises and what dealings should be hypothesised to exist between the PE and other parts of the enterprise. Secondly, it is important to identify the respective functions performed by both the PE and other parts of the enterprise with which it is hypothesised to have dealings in order to price those dealings under the second step of the authorised OECD approach."

201. I was also taken to the further following extracts from section D of the OECD Report concerning 'Determining the profits attributable to the Permanent Establishment':

***(iv) Attributing rights and obligations to the PE***

129. As indicated in Section B, the profits (or losses) of the PE will be based on all its activities, including transactions with other unrelated enterprises, transactions with related enterprises, and dealings with other parts of the enterprise to which it belongs. Accordingly, as part of the functional and factual analysis carried out in step one, it will be necessary to attribute to the PE those rights and obligations of the enterprise of which it is a part which arise out of that enterprise's transactions with separate enterprises as are properly attributable to the PE. In effect, this involves identifying those of the enterprise's transactions with separate enterprises which should be hypothesised to have been entered into by the PE. This should become clear as a result of analysing the PE's functions in light of its assets used and risks assumed. The PE's profits (or losses) attributable to its participation in these transactions can be computed directly in the case of transactions with unrelated enterprises, or through direct application of the Guidelines under Article 9 in the case of transactions with related enterprises, in either case taking into account the effect of the PE's dealings with other parts of the same enterprise under step two of the authorised OECD approach.

**(v) Capital: Drawing up a “tax balance sheet” for the PE under the authorised OECD approach**

*(a) Attributing creditworthiness to the PE*

130. It is an observable condition that PEs generally enjoy the same creditworthiness as the enterprise of which they are a part. Accordingly, under the authorised OECD approach, the “distinct and separate enterprise” hypothesis requires that an appropriate portion of the enterprise’s “free” capital be attributed to its PEs for tax purposes and that the PE be attributed the creditworthiness of the enterprise as a whole. It is worth re-emphasising that an attribution of “free” capital in excess of the amounts recorded in or allotted to the PE by the home country may have to be made for tax purposes, even though there may be no need to formally allot “free” capital to the PE for any other purpose.

...

*(3) Thin capitalisation approach*

163. Another approach would be to require that the PE has the same amount of “free” capital as would an independent enterprise carrying on the same or similar activities under the same or similar conditions in the host country of the PE by undertaking a comparability analysis of such independent enterprises. The functional and factual analysis would identify the assets and risks to be attributed to the PE and this would determine the amount of funding *per se* (i.e. without distinguishing between debt and “free” capital) that would be required by the PE. The next stage would be to determine the allocation of the funding into interest-bearing debt and “free” capital.

164. There are a number of factors relevant to the determination of an arm’s length amount of debt and “free” capital for PEs. These include:

- The capital structure of the enterprise as a whole
- The range of actual capital structures of independent host country enterprises carrying on the same or similar activities as the PE under the same or similar conditions (including the condition discussed in Section D-2(v) that generally the PE has the same creditworthiness as the enterprise as a whole).

165. Issues arise in seeking to apply a thin capitalisation approach to non-financial enterprises. For non-financial enterprises it will probably be necessary to focus on capital structure, such as debt-to-equity ratios, rather than on “free” capital in isolation. This would require a determination first of all the arm’s length amount of funding that should be attributed to the PE to support its functions, assets and risks. Then comparable debt-to-equity ratios in the host country could be used to determine which part of the arm’s length funding should be made up of “free” capital.

166. One concern with such an approach is what appears to be the wide range of debt-to-equity ratios observable at arm’s length and whether, given the diverse range, it is possible to apply a thin capitalisation approach outside the financial sector. However, the debt-to-equity ratio of a particular enterprise within the wide range is unlikely to be the result of random chance, but is rather likely to be the outcome of a number of factors. A critical issue is whether it is possible to take into account all the factors that underlie such different debt-to-equity ratios. Further consideration perhaps needs to be given as to why certain enterprises are highly geared and some are not. Differences in shareholders’ appetite for risk have already been identified as

one contributing factor, but in the context of an adequately capitalised enterprise the authorised OECD approach significantly decreases the importance of that variable by making the creditworthiness/capital structure of the enterprise one of the internal conditions of the PE.

167. Other key variables, the “external” conditions – location of the borrowing PE, quality and nature of assets, cash flows, business sector, business strategies, capital acquisitions and disposals, market conditions in the host jurisdiction, etc. — could be identified and an effort made to quantify the effect of those variables on gearing, where possible by examination of the accounts of comparable independents or by researching the criteria used by independent bankers when lending to particular categories of borrowers. A functional and factual analysis of the assets, risks and activities of the PE would reveal the extent to which the key variables were present in its business, and it could be possible to attribute to the PE an appropriate amount of “free” capital for a business with these features.

168. The thin capitalisation approach has the advantage of avoiding some of the issues that arise in determining the amount of “free” capital to be attributed in situations where the enterprise as a whole is entirely debt-funded. However, a weakness of a thin capitalisation approach is that the aggregate amount of “free” capital it attributes to individual PEs may be greater than the amount of free capital in the enterprise as a whole.

#### *(4) Safe harbour approach – Quasi thin capitalisation /regulatory minimum capital approach*

169. Another possibility discussed in Part II for banks would be to require the PE to have at least the same amount of “free” capital required for regulatory purposes as would an independent banking enterprise operating in the host country (quasi thin capitalisation/regulatory minimum capital approach). This approach is not an authorised OECD approach as it ignores important internal conditions of the authorised OECD approach, *e.g.* that the PE generally has the same creditworthiness as the enterprise as a whole. However, it may be acceptable as a safe harbour as long as it does not result in the attribution of more profits to the PE than would be attributed by an authorised OECD approach.

170. In practice there are likely to be significant problems in finding sufficiently objective benchmarks outside the regulated financial sector to apply the quasi thin capitalisation/regulatory minimum capital approach. More generally, there may be limited scope for having fixed ratios based on sector benchmarks for particular industries outside the financial sector, but only as part of a safe harbour regime.

171. However, the main disadvantage of the quasi thin capitalisation/regulatory minimum capital approach is that it is unlikely to provide a solution for all taxpayers in all sectors, it relies on sector benchmarks which may not meet comparability standards, and the more refined and wide-ranging the approach becomes the more it resembles the thin capitalisation approach (and therefore loses the advantages of administrative simplicity).

...

#### *(6) Attribution of capital to the PE of a thinly capitalised enterprise*

174. Outside the regulated financial sector a difficulty arises that there is often no requirement for individual enterprises within the Group to have an arm’s length amount of “free” capital. The enterprise of which the PE is a part may

for example be almost entirely debt-funded (so-called \$2 companies, with \$2 equity and \$1m debt) so that even attributing all such an entity's "free" capital to the PE is likely to leave the PE thinly capitalised. Accordingly a separate discussion of the problems connected with thinly capitalised enterprises now follows the main discussion of capital attribution approaches.

175. In circumstances where the capital structure of the enterprise to which the PE is a part does not provide an arm's length result it is necessary to look outside the enterprise itself for suitable data. There are two possible solutions to arrive at a result consistent with Article 7:

A thin capitalisation approach

An approach which adjusts the "free" capital of the enterprise to an arm's length amount before allocating that capital to the PE.

176. The thin capitalisation approach looks at the capital structures of comparable independent enterprises in comparable circumstances, etc. The objective under this approach is to determine an arm's length amount of "free" capital. Consistent with the conclusion for PEs of non-thinly capitalised enterprises, the creditworthiness implied by that amount of "free" capital would be assumed to belong to the enterprise as a whole, with the consequence that internal dealings in respect of guarantee fees and creditworthiness differentials affecting intra-enterprise interest rates would not be recognised.

177. A second approach would be to first adjust the "free" capital of the enterprise of which the PE is a part to an arm's length amount. The PE would subsequently be attributed an arm's length amount of the adjusted "free" capital under Article 7 through a capital allocation approach.

178. In determining whether a particular capital attribution approach gives an arm's length result for a PE of a thinly capitalised enterprise it may be necessary to consider why the enterprise as a whole is thinly capitalised.

179. In applying a thin capitalisation approach, if any commercial reasons for the enterprise being thinly capitalised had nothing to do with the business operations of the PE, then the attribution to the PE of more than the enterprise's "free" capital may well be consistent with the arm's length principle. If such commercial reasons did relate to the business operations of the PE, then this must be accounted for in seeking to benchmark the PE's capitalisation against whatever uncontrolled comparables are selected. This would be either by selecting comparables that are similarly affected by such factors, by adjusting the comparables to account for any differences in such factors, or if the available comparables data cannot reliably be used because of such factors, using a different authorised OECD approach that would be more consistent with the arm's length principle."

202. It is not disputed that BCMCL is a Cayman Islands company that is trading in the UK through its being a member of BCM LP in the UK which, for the purposes of s 11AA ICTA is its PE. As is clear from the OECD guidance it is necessary to consider the debt/equity ratio of BCMCL. However, this is another area in which the experts could not agree.

203. This is clear from their Joint Report which notes, in relation to the debt/equity structure of BCMCL that:

"(i) MJS [Mr Stanton] is of the view that, as an SPV, BCMCL's debt/equity ratio is consistent with the debt/equity structures of SPVs generally, which can encompass a very diverse range depending on the special purpose for which an SPV is formed.

(ii) MJS is also of the view that the debt funders (RBS and the Loan Note Holders) would lend to BCMCL, or an equivalent independent BCMCL UK Permanent Establishment, with the debt/equity structure that BCMCL had in place (as indeed they, the lenders, both did).

(iii) PM [Mr Maggs] does not believe RBS or the Loan Note Holders would lend to BCMCL, under either of the arm's length hypotheses that he has considered, with the equity and debt structure that it had or with an alternative equity and debt structure save for the case of hypothesising that BCMCL is a more diversified business with substantial debt or equity financing beyond that required for the acquisition of the 19% partnership interests. In PM's view, changing the proportions of debt and equity used to finance the acquisitions does not alter the fundamental risks to lenders that would result from a lack of control over the target hedge fund management business, and its ability to issue debt. PM also believes that hypothesising a more diversified business with additional assets would depart too far from the original transactions and the arm's length test."

204. Mr Stanton's reasons for reaching the conclusions he did are set out in his report in response to the set of questions referred to in the "Questions for the Expert" dealing with the large level of debt in BCMCL's PE in the UK of US\$365 million, relative to its equity capital, in which he explains that in his view:

"(a) ...BCMCL was a special purpose vehicle which, ultimately being owned by a charitable trust (BCCT), could not look to BCCT to provide any further share capital. As a special purpose vehicle, BCMCL was only permitted to undertake certain defined activities and could not undertake other activities. Given that these activities were expected to be time limited, debt would be an appropriate form of financing. In terms of amount, this would need to be as much as was necessary to undertake these defined activities, which was \$365m, as supported by the underlying cash flows.

(b) That this amount of debt was greatly larger than BCMCL's equity of \$1 would be a consequence of BCMCL's role as a special purpose vehicle and is consistent with, a) the aim of the transaction arrangements (to acquire and hold a 19% interest in BCM LP), b) the activities of special purpose vehicles generally (in fulfilling a special purpose), and c) the role of BCMCL specifically (within the overall Cayman structure).

(c) To the extent that the UK PE of BCMCL undertook the same activities as BCMCL, in my view the UK PE of BCMCL would be expected to have the same debt/equity levels as BCMCL.

(d) On the basis that the UK PE of BCMCL did have the same debt/equity levels as BCMCL, my comments in connection with Section 8 ("The Nature of the Lending Arrangements"), would apply equally as regards the Loan Note holders and the RBS Loan Facility.

(e) Based on my experience, special purpose vehicles have a huge range of debt/equity structures, depending on the purpose for which they were set up. More specifically, I have experience of many special purpose vehicles which have extremely high levels of debt relative to their equity base (and vice versa)."

205. In essence Mr Baldry contends that it is appropriate to treat the PE as if it had a different equity/debt balance as, to quote the paragraph 176 of the OECD guidance above, "any commercial reasons for the enterprise being thinly capitalised had nothing to do with the business operations of the PE". However, I agree with Mr Gammie that the UK PE is everything

there is of BCMCL and, as such, it is not possible to distinguish how the PE could have a different debt/equity ratio from BCMCL itself.

206. Having found that the borrowing from RBS and that the Loan Notes were issued on an arm's length basis I am unable to find that the UK PE could or would have acted differently or that there would have been any other debt/equity ratio than the one that there was. Indeed that is the evidence of Mr Stanton.

### **Issue 5 – Interest Deductibility Issue**

*Are the RBS Loan Facility and the Loan Notes to be classified as “trading loan relationships” or “non-trading loan relationships” for the purposes of Part 5 of the CTA 2009? In relation to this, was BCMCL party to the RBS Loan Facility and the Loan Notes (i.e. to the Sugarquay Loan, the MP Loan and the WR Loan) for the purposes of a trade it carried on (a) at the time of the loans and (b) during each accounting period when the loan interest expense was incurred?*

207. This issue raises the question as to whether the RBS loan and Loan Notes can be classified as trading loan relationships or non-trading loan relationships. It is therefore necessary to consider whether the loan relationship rules originally introduced by FA 1996 and now contained in Part 5 of the CTA 2009 apply to BCMCL.

208. Section 297 CTA 2009 provides:

#### **297 Trading credits and debits to be brought into account under Part 3**

(1) This section applies so far as in any accounting period a company is a party to a loan relationship for the purposes of a trade it carries on. ...

209. This raises the question of whether BCMCL entered into the arrangements to borrow \$200 million from RBS so for the purpose of a trade it carried on?

210. The evidence of Mr Dodd and Mr Aitchison was that it borrowed that sum to acquire an interest in BCM LP rather than the trade being carried out by that partnership. Unlike *Major v Brodie* in which the borrowing was used for the purposes of trade, in the present case the sum received from RBS was not used for the purposes of the trade of BCM LP, the trade that has brought BCMCL within the territorial scope of corporation tax. Similar considerations equally apply to interest paid in accordance with the Loan Notes.

211. Accordingly BCMCL cannot be entitled to relief on the interest costs on the RBS Loan Facility and the Loan Notes entered into in acquiring its 19% interest in BCM LP.

### **Issue 6 – Discovery**

*In relation to the Discovery Amendment:*

(1) *Was the Discovery Amendment validly made under s.30B of the TMA 1970?*

(2) *If so, were the adjustments made thereunder correct?*

212. It is not disputed that it is for HMRC to establish that the Discovery Amendment to the 2007-08 and 2008-09 tax returns of BCMC LP to reflect HMRC's view that BCMCL, rather than Fyled, was the person to whom the Superprofits should have been allocated. This is clear from the letter, dated 4 April 2013 that HMRC Officer Carmel Coles sent to BCMCL as nominated partner of BCMC LP, the material parts of which stated:

#### **“Amendment to your Partnership Statement - year ended 5 April 2009**

It appears to me that your Partnership Statement for the above year is inaccurate. At this stage HMRC does not have all the relevant facts and we will continue to work with BlueCrest Capital Management Cayman Ltd to arrive at the correct position.

I am sending a copy of this letter to your advisers.

I am now amending the partnership return. I attach a statement that shows the amendment.”

213. It is not disputed that this amendment (the details of which are set out in the Statement of Agreed Facts at paragraph 8(42), above) was made after the expiry of the enquiry window and will therefore only be valid if the statutory conditions in s 30B TMA are satisfied.

214. Section 30B TMA as in force at the relevant time, provided:

**30B.— Amendment of partnership statement where loss of tax discovered.**

(1) Where an officer of the Board or the Board discover, as regards a partnership statement made by any person (the representative partner) in respect of any period—

- (a) that any profits which ought to have been included in the statement have not been so included, or
- (b) that an amount of profits so included is or has become insufficient, or
- (c) that any relief or allowance claimed by the representative partner is or has become excessive,

the officer or, as the case may be, the Board may, subject to subsections (3) and (4) below, by notice to that partner so amend the partnership return as to make good the omission or deficiency or eliminate the excess.

(2) Where a partnership return is amended under subsection (1) above, the officer shall by notice to each of the relevant partners amend—

- (a) the partner's return under section 8 or 8A of this Act, or
- (b) the partner's company tax return,

so as to give effect to the amendments of the partnership return.

(3) ...

(4) No amendment shall be made under subsection (1) above unless one of the two conditions mentioned below is fulfilled.

(5) The first condition [not applicable in the present case] ...

(6) The second condition is that at the time when an officer of the Board—

- (a) ceased to be entitled to give notice of his intention to enquire into the representative partner's partnership return; or
- (b) informed that partner that he had completed his enquiries into that return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

(7) Subsections (6) and (7) of section 29 of this Act apply for the purposes of subsection (6) above as they apply for the purposes of subsection (5) of that section; and those subsections as so applied shall have effect as if—

- (a) any reference to the taxpayer were a reference to the representative partner;



- (b) any reference to the taxpayer's return under [section 8 or 8A]<sup>6</sup> were a reference to the representative partner's [partnership return; and
- (c) sub-paragraph (ii) of paragraph (a) of subsection (7) were omitted.

(8) An objection to the making of an amendment under subsection (1) above on the ground that neither of the two conditions mentioned above is fulfilled shall not be made otherwise than on an appeal against the amendment.

(9) In this section—

‘profits’ —

- (a) in relation to income tax, means income,
- (b) in relation to capital gains tax, means chargeable gains, and
- (c) in relation to corporation tax, means profits as computed for the purposes of that tax;

‘*relevant partner*’ means a person who was a partner at any time during the period in respect of which the partnership statement was made.

(10) Any reference in this section to the representative partner includes, unless the context otherwise requires, a reference to any successor of his.

215. Sub-sections (6) and (7) of s 29 TMA which, in accordance with s 30B(7) TMA, apply for the purposes of s 30B(6) TMA as they apply for s 29(5) TMA provided:

(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if—

- (a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;
- (b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;
- (c) it is contained in any documents, accounts or particulars which, for the purposes of any enquires into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer, whether in pursuance of a notice under section 19A of this Act or otherwise; or
- (d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above—
  - (i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or
  - (ii) are notified in writing by the taxpayer to an officer of the Board.

(7) In subsection (6) above—

- (a) any reference to the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment includes—

- (i) a reference to any return of his under that section for either of the two immediately preceding year of assessments; and
  - (ii) where the return in under section 8 and the taxpayer carries on a trade, profession or business in partnership, a reference to [any partnership return with respect to the partnership for the relevant year of assessment or either of those periods; and
- (b) any reference in paragraphs (b) to (d) to the taxpayer includes a reference to a person acting on his behalf.

216. HMRC contend that Mrs Coles made a discovery in accordance with s 30B TMA on 4 April 2013 and that she was entitled to do so as the condition in s 30B(6) TMA, that at the time the enquiry window closed an officer could not reasonably be expected to have been aware of the actual insufficiency of tax in the return, had been satisfied. It is clear from the authorities that a discovery is something that is made by an actual or real officer, in this case Mrs Coles, but that it is necessary to consider the knowledge or otherwise of a hypothetical officer in relation to whether the s 30B(6) TMA condition has been satisfied.

217. A convenient summary of the relevant authorities in relation to discovery assessments can be found in *Anderson v HMRC* [2018] STC 1210 in which the Upper Tribunal (Morgan J and Judge Berner) said:

18. The meaning of the word ‘discover’ was considered by the House of Lords in *Cenlon Finance Co Ltd v Ellwood (Inspector of Taxes)* [1962] 1 All ER 854, [1962] AC 782. The House rejected the argument that a discovery entailed the ascertainment of a new fact. That case was considered by the Upper Tribunal in *Charlton* and the relevant part of the decision in *Charlton* is considered below.

19. The decisions of the Divisional Court in *R v Kensington Income Tax Comrs* and in *R v Bloomsbury Income Tax Comrs* were heavily influenced by the scheme of the legislation being considered in those cases. The scheme of the current version of the Taxes Management Act 1970 is significantly different from the scheme of the earlier legislation. That might have led to an argument that the earlier cases were no longer authoritative and that the meaning of the word ‘discover’ should be considered afresh in the context of the current legislation. In fact, the courts have not adopted that approach. Indeed, in *Hankinson v Revenue and Customs Comrs* [2011] EWCA Civ 1566, [2012] STC 485, [2012] 1 WLR 2322, Lewison LJ said at [15]:

‘[15] ... I begin with s 29(1). This subsection comes into operation if an officer of the board “discovers” an undercharge. The word “discovers” in this context has a long history. Although the conditions under which a discovery assessment can be made have been tightened in recent years following the introduction of the self-assessment regime, the meaning of the word “discovers” in this context has not changed. In *R v Comrs for the General Purposes of Income Tax for Kensington* (1913) 6 TC 279 at 283, [1913] 3 KB 870 at 889 Bray J said that it meant “comes to the conclusion from the examination he makes and from any information he may choose to receive” and Lush J said that it was equivalent to “finds” or “satisfies himself” ((1913) 6 TC 279 at 290, [1913] 3 KB 870 at 898).’

20. The approach taken in *Hankinson* to the statutory interpretation of the word ‘discover’ in s 29 TMA appears to have been based on the view that before the enactment of the TMA, the word ‘discover’ had an established meaning and when the same word was used in s 29 TMA as originally enacted,

the word was intended to have its established meaning. Similarly, the amendments made to s 29 TMA following the introduction of self-assessment were not meant to change the meaning of the word ‘discover’ which continued to be used.

21. In *Charlton*, the Upper Tribunal considered the earlier authorities and, in relation to the specific point which had been argued, said (at [28]):

‘[28] We agree with Mr Gordon that the word “discovers” does connote change, in the sense of a threshold being crossed. At one point an officer is not of the view that there is an insufficiency such that an assessment ought to be raised, and at another he is of that view. That is the only threshold that has to be crossed. We do not agree that the lawyer, in Lord Denning’s example [this was a reference to *Cenlon Finance Co Ltd v Ellwood (Inspector of Taxes)* (1962) 40 TC 176 at 207, [1962] AC 782 at 799–800], would be regarded as having made a discovery any the less by waking up one morning with a different conclusion from the one he had earlier reached, than if he had changed his mind with the benefit of further research. It is, we think, evident that the relevant threshold for there to be a discovery may be crossed as a result of a “eureka” moment just as much as by painstaking research.’

22. The Upper Tribunal in *Charlton* also said at [37]:

‘[37] In our judgment, no new information, of fact or law, is required for there to be a discovery. All that is required is that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment. That can be for any reason, including a change of view, change of opinion, or correction of an oversight. The requirement for newness does not relate to the reason for the conclusion reached by the officer, but to the conclusion itself.’

...

28. In *Sanderson*, Patten LJ described the power under s 29(1) in this way (at [25]):

‘The exercise of the s 29(1) power is made by a real officer who is required to come to a conclusion about a possible insufficiency based on all the available information at the time when the discovery assessment is made.’

We consider, with respect, that this test is in accordance with the earlier authorities. This passage describes the test somewhat briefly because, of course, that case concerned s 29(5) rather than s 29(1). Having reviewed the authorities, we consider that it is helpful to elaborate the test as to the required subjective element for a discovery assessment as follows:

‘The officer must believe that the information available to him points in the direction of there being an insufficiency of tax.’

That formulation, in our judgment, acknowledges both that the discovery must be something more than suspicion of an insufficiency of tax and that it need not go so far as a conclusion that an insufficiency of tax is more probable than not.”

218. In *Charlton and others v HMRC* [2013] 866, the Upper Tribunal (Norris J and Judge Berner) which considered s 29(5) TMA, the corresponding provision to s 30B(6) TMA, observed in relation to the conditions that must be satisfied:

“55. ... The officer referred to in s 29(5) is a legal fiction. He does not require to be imbued with personality or any particular characteristics. To do so inevitably involves seeking some form of typical or average officer, the search for which, in our view, is futile. The purpose of s 29(5) is to make it clear that the test of reasonable awareness is objective, and does not depend on the particular individual officer who considers the information made available.

56. Section 29(5) is focused on the quality and extent of the information, and not on the quality of the officer, or the extent of the officer's knowledge. Section 29 provides a balance between the taxpayer and HMRC. The ability of HMRC to make a discovery assessment is balanced by the protection afforded to a taxpayer who, before the enquiry window closes, makes an honest and complete return. The emphasis therefore is on what the taxpayer provides. It would disturb the balance of s 29 to infer from s 29(5) a particular notional officer of only limited ability.

57. The requirement to consider a purely notional officer makes irrelevant the particular officer who considers the return. It also makes irrelevant the way in which HMRC organises itself into separate departments dealing with certain specialist issues. As Auld LJ noted in *Langham v Veltema* ([2004] STC 544 at [32], 76 TC 259 at [32]), the customary practices of HMRC cannot affect the proper interpretation of s 29(5). The average officer may not be a specialist, but in our view the requirement of s 29(5) to consider the reasonableness of the awareness of a hypothetical officer does not carry with it the need to confine the view to that through a prism of the eyes of an officer of only general capability and experience.

58. There is thus no single eponymous hypothetical officer. Nor is there any single benchmark of the knowledge and experience the hypothetical officer should be expected to have. The test of reasonable awareness must be applied to the circumstances of each case. The necessity to assume an officer of reasonable knowledge and understanding, recognised by the Chancellor in *Lansdowne* ([2012] STC 544 at [50], 81 TC 318 at [50]), does not suggest that such reasonable knowledge and understanding must be confined to an assumed average, to be applied in all cases. How would such an average be determined? The test of reasonable awareness must in our view be applied to the particular context in which the question arises, and without regard to any perceived lack of expertise or specialisation of individual officers. The officer must be assumed to have such level of knowledge and understanding that would reasonably be expected in an officer considering the particular information provided by the taxpayer.

59. That is not to say that there might not be cases where the complexity of the relevant law would lead to a conclusion that, even where the taxpayer has disclosed enough factual information, such a hypothetical officer could not reasonably be expected to be aware of an insufficiency. That was the view expressed by Moses LJ in *Lansdowne* ([2012] STC 544 at [69], 81 TC 318 at [69]). In that case the court found that the legal points were not complex or difficult. But we find support for our view that complexity or difficulty should not routinely present an obstacle (as they would if all specialist knowledge had to be assumed away) from the fact that Moses LJ considered this only to be a mere possibility, and thus at most an exception and not the rule.

60. ... We accept, as a general proposition, that the more complex the case the more information that might be required to be provided to give rise to a reasonable awareness of the insufficiency. But in our view that illustrates the correct focus of s 29(5): that it is on the quality and extent of the information made available, and not on the qualities of the hypothetical officer.

...

65. Our conclusion on this point, therefore, is that s 29(5) does not require the hypothetical officer to be given the characteristics of an officer of general competence, knowledge or skill only. The officer must be assumed to have such level of knowledge and understanding that would reasonably be expected in an officer considering the particular information provided by the taxpayer. Whilst leaving open the exceptional case where the complexity of the law itself might lead to a conclusion that an officer could not reasonably be expected to be aware of an insufficiency, the test should not be constrained by reference to any perceived lack of specialist knowledge in any section of HMRC officers. What is reasonable for an officer to be aware of will depend on a range of factors affecting the adequacy of the information made available, including complexity. But reasonableness falls to be tested, not by reference to a living embodiment of the hypothetical officer, with assumed characteristics at a typical or average level, but by reference to the circumstances of the particular case.

66. This conclusion does not have the consequence that the hypothetical officer must be regarded as the embodiment of HMRC as a whole. He cannot in this way be treated as possessing information relevant to his awareness that is held elsewhere within HMRC or is known to any particular officer, including the officer dealing with the case. That is clear from *Langham v Veltema*, and from the exhaustive nature of the information that can be considered to be made available to the hypothetical officer in accordance with s 29(6). Our conclusion relates only to the knowledge and skill to be attributed to the hypothetical officer in each case. In particular, we do not accept Mr Gordon's [counsel for the taxpayer] argument that the reference to 'an officer' in s 29(5) should be construed as a reference to HMRC as a whole. The use by Lewison J of 'HMRC' in this context in *Lansdowne* (High Court) ([2011] STC 372 at [59], 81 TC 318 at [59]) is clearly not intended to represent the test, which is immediately expressed in terms of 'an officer of the Board' in the succeeding paragraphs."

219. Given the references to *Lansdowne*, to which I referred in relation to Issue 2, in *Charlton*, it is helpful in relation to this issue, to refer to several passages in which the Chancellor, Sir Andrew Morritt, commented on the extent to which information previously provided by the taxpayer could be taken into account when determining whether the hypothetical officer should have opened an enquiry or raised an assessment during the enquiry period.

220. At [50] of *Charlton* he said,

"In these circumstances the question is whether on this information an officer of the Board could have been reasonably expected to be aware that the amount of the profits included in the partnership return was insufficient. Plainly it is necessary to assume an officer of reasonable knowledge and understanding. He would have been aware of the decision of the House of Lords in *Arthur Young*. He would see from the partnership return and statement that the income included management and performance fees and that some of them had been deducted from the income because they had been 'rebated'. He would know from the letter from Mr Tai that at least some of those rebates had been made to limited partners in LPLP [Lansdowne Partners Limited

Partnership]. And he would know from his general knowledge of *Arthur Young* and s 74(1)(a), ICTA that payments to partners are not usually deductible for tax purposes. But is that enough?”

Having discussed these matters, the Chancellor continued, at [56]:

“In the end, this part of the appeal boils down to a very short point. The question, to adopt the formulation used by Auld LJ, is whether the hypothetical inspector having before him those three documents and the note of the meeting held on 22 February 2006 would have been aware of 'an actual insufficiency' in the declared profit. I would answer that question in the affirmative. He could see from those documents:

- (1) The income of LPLP consisted of management and performance fees.
- (2) There had been deducted from that income what was described as 'rebates.'
- (3) 'Rebates' had been paid to limited partners.
- (4) Arthur Young had established that all payments to partners should be included in gross income and were not, generally, deductible for tax purposes.
- (5) There was no indication on the face of the accounts or in Mr Tai's letter to suggest any special treatment of 'rebates' paid to limited partners either by omission from the gross income or in their deduction therefrom.

I do not suggest that the hypothetical inspector is required to resolve points of law. Nor need he forecast and discount what the response of the taxpayer may be. It is enough that the information made available to him justifies the amendment to the tax return he then seeks to make. Any disputes of fact or law can then be resolved by the usual processes. For these reasons I would dismiss the appeal of HMRC.”

221. At [59] of *Lansdowne* Moses LJ added his own views to those of the Chancellor, with whom he agreed, “for the purpose of reflecting on the application of s 30B(6) [TMA], the condition which is relevant to the third question [in the case]”. He continued:

“69. But even if the information had been obtained shortly before the time for enquiry expired, I would have taken the view that an officer could have reasonably been expected to be aware that the profits stated were insufficient. The legal points were not complex or difficult. As the Chancellor points out (at [56]), awareness of an insufficiency does not require resolution of any potential dispute. After all, once an amendment is made, it may turn out after complex debate in a succession of appeals as to the facts or law, that the profits stated were not insufficient. I have dwelt on this point because I wish to leave open the possibility that, even where the taxpayer has disclosed enough factual information, there may be circumstances in which an officer could not reasonably be expected to be aware of an insufficiency by reason of the complexity of the relevant law.

70. I also wish to express polite disapproval of any judicial paraphrase of the wording of the condition at s 30B(6) or s 29(5). I think there is a danger in substituting wording appropriate to standards of proof for the statutory condition. The statutory condition turns on the situation of which the officer could reasonably have been expected to be aware. Awareness is a matter of perception and of understanding, not of conclusion. I wish, therefore, to express doubt as to the approach of the Special Commissioner in *Corbally*-

*Stourton v Revenue and Customs Comrs* [2008] STC (SCD) 907 and of the Outer House in *R (on the application of Pattullo) v Revenue and Customs Comrs* [2009] CSOH 137, [2010] STC 107, namely that to be aware of a situation is the same as concluding that it is more probable than not. The statutory context of the condition is the grant of a power to raise an assessment. In that context, the question is whether the taxpayer has provided sufficient information to an officer, with such understanding as he might reasonably be expected to have, to justify the exercise of the power to raise the assessment to make good the insufficiency.”

222. As to the information to be taken into account, it is clear from the decision of the Court of Appeal in *Sanderson v HMRC* [2016] STC 638 at [17(5)] that:

“... the assessment of whether the officer could reasonably have been expected to be aware of the insufficiency falls to be determined on the basis of the types of available information specified in s 29(6). These are the only sources of information to be taken into account for that purpose: see *Langham v Veltema* at [36]:

223. In evidence, Mrs Coles explained that on 15 July 2009 she had received a copy of an avoidance scheme notification (the “DOTAS Form”) and was advised that the “main participant” was BCM LP. She therefore opened an enquiry into BCM LP on 19 October 2009.

224. The section of the DOTAS form summarising the proposed arrangement states:

“What is described below is a bespoke tax planning arrangement. The actual transaction, reflecting the entirety of the commercial arrangements between all parties, is more complex and we describe and illustrate only the elements relevant to tax advantages that might arise under the arrangements, to which the provisions of Part 7 FA 2004 might be applicable.

#### **Proposed Transaction**

- “GP”, a company not resident in the UK, requires debt funding to fund investment in a UK trading partnership. GP will be the general partner of a non-UK limited partnership ('LP'). LP will be a limited partner in a UK trading limited partnership ('UK LP'),
- Under the terms of the loan agreement with a bank, under which the debt funding is provided, there are certain "trigger events" which will result in part of the principal lent being repayable, in instalments, earlier than would otherwise have been the case.
- The structure described effectively enables pre-tax income to be applied to fund repayment of the debt, should a trigger event occur. The use of this structure will also facilitate a more commercially acceptable trigger level for the group.
- The transaction will result in more UK tax than would otherwise be the case if there is no trigger event.”

A diagrammatic representation of the transaction structure and detailed explanation of the tax impact (which is not reproduced here) was also included on the DOTAS Form which continued:

“The main commercial benefit of the arrangements is that it enables the trigger to be set at a more favourable level than might otherwise be the case. The possible reduction in tax, should there be a trigger event, might be seen as a main benefit of the arrangements.”

225. Additionally, the “white space” information provided in the 2008-09 tax return of BCM LP stated:

1.The total income of the partnership was its profit allocation from BlueCrest Capital Management LP (UTR ...). Turnover in Box 3.29 represents the sterling value of the trading profit allocated by BlueCrest Capital Management LP.

The profit allocation from BlueCrest Capital Management LP is reflected in USD in the accounts and converted at the exchange rate of 1.8790.”

226. Mrs Coles opened an enquiry into BCMCL’s tax return for the period to 30 November 2007 on 24 October 2009. This was to look into the use of the scheme and the deductions claimed by BCMCL in respect of its loan relationships. On 24 October 2009 she wrote to BCMCL to clarify certain aspects of the tax return.

227. In a letter, dated 30 March 2010, EY responded to the letter from Mrs Coles with the following further explanation the scheme, with reference to its DOTAS number, under the sub-heading “Tax Avoidance Scheme”:

“The following sets out a summary of the Company's [ie BCMCL’s] involvement in a commercial restructuring which was disclosed under the scheme reference number above.

The Company went into partnership as general partner of BlueCrest Capital Management Cayman LP (BMC LP) on 22 June 2007, with Mr Andrew Dodd of [address] as sole limited partner. This is documented in the initial LP agreement between BCMCL and Andrew Dodd dated 22 June 2007.

The Royal Bank of Scotland plc (RBS) became a limited partner in BMC LP as documented in the LP Agreement dated 6 July 2007. RBS has subsequently assigned its limited partnership interest to Fyled ... . This is documented in the Deed of Assignment and a new LP Deed both dated November 2008.

A number of individuals became limited partners in BCMCL pursuant to Deeds of Adherence of various dates.

The Company received \$200,000,000 in loan funding from RBS on 6 July 2007 which is documented in the Facility Agreement dated 6 July 2007. The Company loaned a small portion of this cash to its parent company, BlueCrest Capital Management Cayman Holdings Limited (BCMCHL) (which, as an intercompany balance, was not formally documented). The majority of the cash, \$192,000,000, was paid to [WR] to acquire c.10% of the capital and income sharing rights in BlueCrest Capital Management LP (BCM LP) from him. This is documented in the Deed of Assignment dated 6 July 2007.

The Company acquired a further c.9% of capital and income sharing rights in BCM LP through the issue of three interest bearing loan notes of \$55,000,000 to [WR], [MP] and Sugarquay, with additional cash consideration of \$2,000,000 each paid to Sugarquay and [MP]. This is also documented in the Deed of Assignment dated 6 July 2007. The loan notes are documented in the Loan Note Instrument dated 6 July 2007.

The Company contributed its interest in BCM LP to BMC LP on 6 July 2007, which is documented in the Deed of Contribution dated 6 July 2007.

The effect of the above transactions was that the Company had a c.19% interest in the income and capital rights of BCM LP, held through BMC LP. As noted above, further to the transfer of trade and assets from BCM LP to BCM LLP, the company now ultimately has rights over an interest in BCM LLP.”



Copies of the Deed of Subscription and the Contribution Deed, both dated 6 July 2007, were enclosed with that letter.

228. However, Mrs Coles explained that neither this information nor the documents increased her understanding of the “remarkably complex” facts underlying the scheme. Having undertaken a review of BCMCL’s returns for the year ended 30 November 2008 and the 2008-09 returns of BCM LP and BCMC LP, Mrs Coles noted that BCMC LP had made profit allocations to BCMCL and to Fyled and that the use of the avoidance scheme declared in the DOTAS Form was also declared on the returns for BCMCL and BCMC LP, in particular that the BCMC LP return detailed that it had received a profit allocation from BCM LP.

229. At the time she reviewed the 2008-09 returns Mrs Coles did not understand how, because of its complexity, its various agreements (such as the TRS), overseas entities and numerous participants, the profit sharing arrangement of the scheme operated.

230. On 13 October 2010 she opened an enquiry into BCMCL in relation to the year ended 30 November 2008. This was because she wanted to understand how BCMCL’s share of profits from BCMC LP had been derived although she understood that it was from the 19% partnership interest BCMC LP had acquired in BCM LP.

231. On 12 November 2010 Mrs Coles opened an enquiry into BCM LP in relation to the year 2008-09. She explained that this was because she wanted to ascertain why a larger number of partners had left the partnership, to understand how the Partner Incentivisation Plan (“PIP”) worked, and to obtain further information regarding the more than £30 million that had been claimed as deductible for tax purposes.

232. At the time she opened the enquiries into BCM LP and BCMCL in October and November 2010, Mrs Coles did not believe a challenge to the profit allocations from BCMC LP was an appropriate way of tackling the arrangements that had been put in place and therefore, as she was satisfied that opening enquiries into BCMCL and BCM LP was sufficient to protect HMRC from the loss of tax arising from these arrangements, she did not open an enquiry into BCMC LP’s 2008-09 return. Mrs Coles explained that this was because she understood that BCMC LP was not a legal person but a “mere conduit” which could not be a partner in BCM LP and, as such, was not able to receive a profit allocation.

233. However, Mrs Coles also considered what the position would have been if she was wrong about this. She observed that a partnership has power to allocate its profits as it chooses and that the profit share allocated to Fyled shown in BCMC LP’s return was to an independent third party and, therefore, did not pose a risk to HMRC, notwithstanding that it was one of the steps in the arrangements. For this reason, and because she thought the position was adequately protected by the enquiries that had been opened into BCMCL and BCM LP, Mrs Coles did not open an enquiry into BCMC LP and said that she was not, at that time, in a position to determine what amendment of the return, if any, might be required. She remained of this view as at 31 January 2011 when the time limit for opening an enquiry into BCMC LP had passed.

234. However, the partnership profit share was explained in further correspondence between HMRC and EY in relation to BCMCL. Also provided in the course of that correspondence were the accounts of BCMC LP for the year ended 30 November 2008 and a copy of the BCM LP Deed.

235. At a meeting, on 19 September 2011, between HMRC and EY it was explained by EY why the arrangements were put in place, the nature of those arrangements, eg that a Charitable Purpose Trust was the ultimate owner of BCMCL, the involvement of RBS and Trigger Events regarding profit allocations. The question of whether BCMC LP could legally be a partner in BCM LP or BCM LLP was also discussed. Following that meeting Mrs Coles sought further

information to enable her to gain a full understanding of how the arrangements worked. She also requested that she be provided with all of the relevant underlying agreements and documents.

236. On 31 October 2011 Mrs Coles opened enquiries into BCMCL and BCMC LP for the year ended 30 November 2009 and the year ended 5 April 2010 respectively. She explained that she opened the enquiry into BCMCL to obtain full information on its use of the scheme and to clarify the tax treatment of the loan interest and expense deductions it was claiming and why it considered that certain expenses were deductible from its profit share.

237. Mrs Coles said that she had opened the enquiry into BCMC LP because she had been concerned that, as a result of the information obtained at the meeting on 19 September 2011, it was necessary to establish whether BCMC LP could be a partner in BCM LP and/or BCM LLP. Mrs Coles also wanted to clarify the basis on which it was considered by BCMC LP that certain expenses were deductible from its profit share. However, because she believed that her enquiries into BCM LP and BCMCL covered the risk regarding diversion of income to a financial trader and the deductibility of expenses in BCMC LP Mrs Coles did not, at this stage, consider whether to issue discovery amendments for earlier years.

238. On or about 9 January 2012, Mrs Coles received a response from EY to a letter she had sent on 31 October 2011 regarding BCMC LP and, on 14 February 2012, she received several lever arch files of information and documents in response to the comprehensive information request that she had sent on 30 September 2011. She explained that her review of these documents “highlighted the interdependencies and circularity of the steps” in the arrangements which prompted a review of the technical arguments, including seeking legal advice over which HMRC maintain privilege.

239. Although Mrs Coles had, around November 2012, handed responsibility for the BlueCrest Cayman arrangements to a colleague (Gregory Smythe) in March 2013 she arranged for another colleague to issue discovery assessments on the individual partners in connection with the PIP operated by BCM LP and subsequently BCM LLP. She explained that as the time limit for issuing a discovery assessment on the individual partners for 2008-09 expired on 5 April 2013 that, on or around 4 April 2013, she was “double checking” that these had been issued in time.

240. Mrs Coles also explained that, in applying her mind to these discovery assessments, she reflected on the development of HMRC’s technical arguments on the PIP and the basis on which these assessments had been issued. By 4 April 2013 these technical arguments had received further internal consideration by HMRC and it had been decided that the profit sharing arrangements should be challenged principally on the grounds that, on a realistic view of the facts, the partnership return did not reflect the actual profit sharing arrangements and, as such, the allocation of profits in the partnership return should be amended.

241. Mrs Coles realised on 4 April 2013 that, on her understanding of the facts regarding the profit sharing arrangements, HMRC could apply this principle to BCMC LP and that the allocation of profits in the partnership return should be amended to show all of BCMC LP’s profits allocated to BCMCL with no profits allocated to Fyled. Mrs Coles explained that this was because from the review of the information and documents received on 14 February 2012 she had “become aware of the interdependencies and circularity of the steps in the arrangements in which BCMCL and BCMC LP “had participated”. In her view it was arguable that on a realistic view of the facts, “the actual profit sharing arrangements were that the profit ostensibly allocated to BCMC LP was always destined for BCMCL and that any allocation to BCMC LP was simply a step in the allocation of profits from BCM LP (and subsequently BCM LLP) to BCMCL, with BCMC LP “acting as a conduit”.

242. On 4 April 2013 Mrs Coles had noted that HMRC had not opened an enquiry into BCMC LP for 2008-09 and, as such, a discovery amendment was required to give effect to her view that the profits allocated to BCMCL on BCMC LP's partnership statement were insufficient. Mrs Coles calculated the figures on the discovery amendment by reviewing the figures on BCMC LP's existing return changing the allocation of profit so that all of the profit was allocated to BCMCL and none to Fyled. On this basis Mrs Coles, issued the discovery amendment to BCMC LP as stated in paragraph 212, above.

243. Mr Baldry contends that Mrs Coles made a discovery and was entitled to do so on the basis that the s 30B(6) TMA condition was satisfied.

244. Mr Gammie, who did not appear to seriously challenge the evidence of Mrs Coles that she made a discovery, says that the hypothetical officer, who would have had the tax return and DOTAS Form, would have been aware that he or she was concerned with a "bespoke tax planning arrangement". He says that although Mr Baldry contends that TRS transactions were unusual, the evidence of Mr Aitchison was that these were a commonly used and a "well known tax planning technique" (see paragraph 55, above) of which the hypothetical inspector would be aware. Mr Gammie also contends that the hypothetical inspector would be aware of the particular structure in the present case especially as it was described in straightforward terms in EY's letter of 30 March 2010 (see paragraph 227, above) and that HMRC had, with the DOTAS form, been provided with a "relatively explicit" diagram as to how it was designed to operate.

245. Such information, Mr Gammie contends, would "ring some bells" for the hypothetical inspector with the sort of knowledge described in *Charlton* and *Lansdowne* who would have taken action as a result.

246. However, as is clear from *Sanderson* the only information to be taken into account by a hypothetical officer is that within s 29(6) TMA. This does not include the letter of 30 March 2010 from EY to Mrs Coles, which concerned BCMCL in its own right and not in its capacity as representative partner for BCMC LP. Also, as Mr Baldry says, the test is not that hypothetical inspector would have been put on notice or that it would "ring bells" but that he or she would have been "aware" of an insufficiency.

247. In my judgment the information provided, although sufficient to have alerted a hypothetical inspector to make further enquiries, was not enough of a disclosure in respect of which it would have been reasonable to expect such an officer to be aware of an insufficiency. I therefore conclude that the condition in s 30B(6) TMA has been met, allowing HMRC to make a discovery assessment under section 30B(1) TMA in the circumstances of this case.

#### **SUMMARY OF CONCLUSIONS IN CAYMAN APPEALS**

248. In relation to Issues 1 and 2, the Profit Allocation Issues:

- (1) As only BCMCL was a partner in BCM LP, and not BCMC LP or all the partners of BCMC LP, BCMCL is liable to corporation tax on all of the profit allocation of BCM LP in respect of the 19% interest in BCM LP sold by WR, MP and Sugarquay; and
- (2) If BCMCL had not been liable to corporation tax as set out at paragraph 248(1), above, BCMCL's entitlement to profits would not have included those allocated to RBS/Fyled and the profit sharing arrangements were confined to the BCMC LP Deed.

249. In relation to Issues 3, 4 and 5, the Interest Deductibility Issues:

- (1) BCMCL's interest costs on the RBS Loan Facility and Loan Notes are not allowable deductions under the CTA 2009;

(2) The equity and debt structure of BCMCL's UK PE establishment was operating on an arm's length basis with the result that the deduction claimed in respect of interest costs on the RBS Loan Facility and Loan Notes should not be restricted; and

(3) The RBS Loan Facility and Loan Notes are to be classed as non-trading loan relationships as BCMCL was not party to the RBS Loan Facility or Loan Notes for the purposes of a trade it carried on either at the time of loans or subsequent accounting periods.

250. The discovery assessment was valid and adjustments made thereunder correct.

251. Accordingly, for the reasons above the Cayman Appeals are dismissed.

## **PIP APPEALS**

252. I now turn to the PIP appeals

### **FACTS**

253. As in the Cayman appeals, the parties produced a statement of Agreed Facts and Issues:

## **AGREED FACTS**

### **Introduction**

(1) This is the statement of facts as agreed between the parties.

(2) The business in which the Appellants (all members of the BlueCrest group) were engaged is henceforth referred to as the "**BlueCrest business**".

### **The BlueCrest business**

(3) BlueCrest is an international alternative asset management business, founded in 2000 by WR and MP, which has specialised in a number of diversified investment strategies involving both discretionary and quantitative investment management (i.e. portfolio management).

(a) On 4 August 2000 a limited partnership deed establishing BCM LP (the "**BCM LP Deed**") was entered into by BCML, MP and WR; BCML was the General Partner of BCM LP, which was thereafter engaged in the trade of investment fund management.

(b) In December 2000 the fund called BlueCrest Capital International was launched and BCM LP was appointed as investment manager. This fund was managed by the two founder partners (WR and MP) on behalf of BCM LP on a discretionary basis.

(c) In 2003, Sugarquay, a company incorporated in England and Wales, acquired a 25 per cent interest in BCM LP from WR and MP. Sugarquay was the corporate vehicle through which Man Group (a third-party investor) acquired and held its investment.

(4) The individual partners who conducted the Partnership's UK trade can be categorised according to the element of the business in which they operated, namely:

(a) investment management, comprising:

(i) discretionary trading (i.e. portfolio management); and

(ii) systematic activities; and

(b) infrastructure services.

(5) On 1 December 2008 the business of BCM LP was transferred as a going concern to BCM LLP. To effect this change, BCML, the General Partner of BCM LP, transferred the business of the Partnership, together with its assets and liabilities, to BCM LLP. The rights in BCM LP were assigned and transferred to BCM LLP, and all partners in BCM LP became members of BCM LLP.

(6) On 1 December 2008 BCML changed its name to BCMSL and BCML's function became predominantly the provision of services to BCM LLP and other BlueCrest entities.

(7) By 2010 the BlueCrest group had become international, with the expansion of the New York office established in 2007 and the opening of an office in Geneva. In April 2010 a reorganisation was effected under which BCM LLP migrated to Guernsey with effect from 1 April 2010 and no longer traded in the UK; a number of individual partners of BCM LLP also moved offshore at around that time. A new entity, BCM (UK) LLP, had been incorporated on 29 October 2009 and commenced trading in the UK on 1 April 2010, carrying out fund management activities pursuant to agreements with BCM LLP.

(8) At all relevant times thereafter BCM (UK) LLP continued to act as the UK sub-investment manager of the BlueCrest funds.

#### **The PIP**

(9) The PIP was put in place in April 2008.

(10) The PIP was implemented in three phases:

(a) Phase I, which involved a limited group of nine senior personnel,<sup>18</sup> and operated for the period ending 30 November 2008. This phase is also referred to as the "pilot phase".

(b) Phase II, which involved a wider group of senior personnel with participation by default, but subject to opt-out.

(c) Phase III, in which it was mandatory (with some exceptions) for all individual partners of the Partnership to participate in the PIP. This phase commenced in February 2010 and applied to the periods ending 31 December 2010 onwards; it continued for the entirety of the remainder of the period relevant to this appeal.

(11) The PIP was implemented by introducing corporate partners into BCM LP, namely:

(a) SCL, which was incorporated by BCPT in England and Wales on 25 April 2008 and became a partner of BCM LP, by a Deed of Adherence, on 30 April 2008; and, later

(b) Avon, which was incorporated in England and Wales on 18 November 2008 and became a partner of BCM LP on 27 November 2008.

---

<sup>18</sup> The partners in question were MP (the CEO), Andrew Dodd (the CFO), Luigi La Ferla (Head of Mercantile), David Phitoussi (Head of Equity Derivatives), and David Abbou, Neil Cooper, Pascal Foulon, Vivek Luthra, Mahmood Noorani (portfolio managers).

(12) SCL contributed £100 of capital and acquired a 0.00001% interest in the capital profits or losses of the partnership and rights to a discretionary allocation of income points at the absolute discretion of BCM LP as general partner. Subsequently, SCL contributed a further £20,074,000 of ordinary capital.

(13) On 27 November 2008, Avon entered into a Deed of Adherence pursuant to which it was admitted as a partner in BCM LP with effect from that date. Avon made a capital contribution of £15,000 and purchased £50 of SCL's ordinary capital in the partnership.

(14) On 21 January 2009 SCL assigned its rights over the remaining Special Capital to Avon and entered into a Deed of Assignment.

(15) On 23 January 2009 SCL entered into a Declaration of Trust which, together with the Deed of Assignment, meant that SCL held the remaining Special Capital on trust for Avon.

(16) SCL remained a partner so that after November 2008 each of SCL and Avon facilitated the PIP. From November 2009 onwards, however, Avon took on the principal role of doing so without support from SCL.

(17) Partners might receive a letter indicating the potential award of Special Capital which might be made to them. Over the period relevant to these appeals, approximately 10 per cent of provisional awards by number (2-3 per cent of provisional awards by value)<sup>19</sup> were forfeited by PIP participants.

#### **BCMCL and BCMC LP**

(18) The parties adopt paragraphs (2) to (37) of the Statement of Agreed Facts and Issues in the appeals by BCMCL and BCMC LP (with appeal numbers TC/2017/04430 and TC/2017/04431, respectively) (the “**Cayman Appeals**”) (see paragraph 8, above).

#### **HMRC's tax enquiries**

(19) HMRC opened enquiries into the Appellants' tax returns under s 12AC of the Taxes Management Act 1970 (the “**TMA 1970**”) on the following dates:

<b>Entity</b>	<b>Return under enquiry</b>	<b>Date of enquiry notice</b>
BCM LP	Year ended 5 April 2009	12 November 2010
BCM LLP	Year ended 5 April 2010	12 December 2011
BCM LLP	Year ended 5 April 2011	19 December 2012
BCM LLP	Year ended 5 April 2012	29 August 2013
BCM LLP	Year ended 5 April 2013	28 November 2014
BCM LLP	Year ended 5 April 2014	10 November 2015
BCM (UK) LLP	Year ended 5 April 2011	19 December 2012
BCM (UK) LLP	Year ended 5 April 2012	29 August 2013
BCM (UK) LLP	Year ended 5 April 2013	28 November 2014

<sup>19</sup> These figures state the position as at January 2014. Since then there have been further awards and forfeitures.

BCM (UK) LLP	Year ended 5 April 2014	10 November 2015
--------------	-------------------------	------------------

(20) By letters dated 25 May 2017, HMRC sent Closure Notices to the Appellants in respect of the above enquiries.

(21) There are two principal issues which underlie the conclusions expressed by HMRC in the Closure Notices, which are termed the “**PIP Issue**” and the “**Profit Allocation Issue**”.<sup>20</sup>

(22) The amendments required in the Closure Notices were based on HMRC’s conclusions in respect of the PIP Issue and the Profit Allocation Issue.<sup>21</sup> The Appellants are appealing on the grounds that HMRC’s conclusions on both of the above issues are incorrect and therefore the Appellants’ tax returns do not, on the correct analysis, require any amendment.

#### **HMRC’s conclusions in the Closure Notices**

(23) In the Closure Notices, HMRC concluded that the Appellants’ tax returns required amendment, as summarised below.

(24) As a result of HMRC’s analysis in respect of the PIP Issue, the consequent profit allocations are set out in the table below.

<b>Entity</b>	<b>Return under enquiry</b>	<b>Reduction in profit allocation to Avon</b>	<b>Reduction in profit allocation to SCL</b>	<b>Total increase in profit allocation to individual PIP participants</b>
BCMLP	Y/E 5 April 2009	£90,001,859 to £0	£38,393,208 to £2,159	£128,392,908
BCMLLP	Y/E 5 April 2010	£225,825,183 to £13,431,446	£(1,780,652) to £(1,891,116)	£212,504,201
BCMLLP	Y/E 5 April 2011	£237,901,573 to £0	£5,583,284 to £0	£243,484,857
BCMLLP	Y/E 5 April 2012	-	-	-
BCMLLP	Y/E 5 April 2013	-	-	-
BCMLLP	Y/E 5 April 2014	-	-	-

<sup>20</sup> This is effectively the same issue as the “Profit Allocation Issue” in the Cayman Appeals, brought by BCMC LP and BCMCL against HMRC’s Closure Notices in respect of a number of their tax returns.

<sup>21</sup> HMRC made reference to certain alternative arguments within the supplementary analysis covering notes to the Closure Notices. These alternative arguments do not impact the tax returns of the Partnership, but instead directly affect the tax returns of individual partners.

BCM (UK) LLP	Y/E 5 April 2011	£15,229,570 to £0	-	£15,229,570
BCM (UK) LLP	Y/E 5 April 2012	£26,812,209 to £0	-	£26,812,209
BCM (UK) LLP	Y/E 5 April 2013	£61,357,591 to £0	-	£61,357,591
BCM (UK) LLP	Y/E 5 April 2014	£32,237,271 to £0	-	£32,237,271

(25) As a result of HMRC's analysis in respect of the Profit Allocation Issue, the consequent profit allocations are set out in the table below.

<b>Entity</b>	<b>Return under enquiry</b>	<b>Reduction in profit allocation to BCMCLP</b>	<b>Increase in profit allocation to BCMCL</b>
BCMLP	Y/E 5 April 2009	£37,847,693 to £0	£0 to £37,847,693
BCMLLP	Y/E 5 April 2010	£55,019,763 to £0	£0 to £55,019,763
BCMLLP	Y/E 5 April 2011	£78,042,748 to £0	£0 to £78,042,748
BCMLLP	Y/E 5 April 2012	£46,595,394 to £0	£0 to £46,595,394
BCMLLP	Y/E 5 April 2013	\$91,911,958 to \$0	\$0 to \$91,911,958
BCMLLP	Y/E 5 April 2014	\$199,508,361 to \$0	\$0 to \$199,508,361
BCM (UK) LLP	Y/E 5 April 2011	£2,489,823 to £0	£0 to £2,489,823
BCM (UK) LLP	Y/E 5 April 2012	£3,804,953 to £0	£0 to £3,804,953
BCM (UK) LLP	Y/E 5 April 2013	£3,554,328 to £0	£0 to £3,554,328
BCM (UK) LLP	Y/E 5 April 2014	£1,307,281 to £0	£0 to £1,307,281

#### **AGREED ISSUES**

This is the statement of issues as agreed between the parties.



The question for the Tribunal's determination is whether HMRC's amendments to the Appellants' tax returns, as detailed in the Closure Notices, should be set aside. The parties envisage that this raises the following issues for the Tribunal's determination:

(In the terminology adopted in the Appellants' Grounds of Appeal, HRMC's Statement of Case, and the Appellants' Reply, Issue 1 below falls within the "**PIP Issue**", and Issues 2 and 3 fall within the "**Profit Allocation Issue**".)

(1) Did the PIP arrangements form part of the "profit-sharing arrangements" of the Partnership, within the meaning of s 850 ITTOIA 2005 and/or s 1262 CTA 2009? In particular, did the individual partners who participated in the PIP thereby have rights to share in the profits of the Partnership and, if so, what is the correct amount of profits to be allocated to them in each year under appeal and/or did SCL and/or Avon have rights to share in the profits of the Partnership and, if so, what is the correct amount of profits to be allocated to them in each year under appeal?

(2) Is BCMCL liable to corporation tax on all of the profit allocations of BCM LP in respect of the 19% interest in BCM LP sold by WR, MP and Sugarquay in July 2007? In this regard was BCMC LP a partner of BCM LP and, if not, were all the partners of BCMC LP to be treated as partners of BCM LP?

(3) Did BCMCL's entitlement to the profits of BCMC LP include those allocated to RBS/Fyled (less amounts retained by Fyled as fees for its involvement in the arrangements)? In this regard:

(a) What were the "profit-sharing arrangements", within the meaning of s.1262 CTA 2009, relevant to BCMC LP?

(b) In particular, were they confined to the BCMC LP Deed, or did they encompass other contractual agreements and, if so, which other agreements?

## **Evidence**

254. As in the Cayman Appeals, in addition to the Statement of Agreed Facts and Issues I was provided with extensive documentary evidence. I also heard from the following witnesses:

(1) Andrew Dodd, who also gave evidence in the Cayman Appeals.

(2) Robin Aitchison, who like Mr Dodd gave evidence in the Cayman Appeals.

(3) Andrew Beverly who is director of Avon, a special purpose vehicle which was incorporated on 18 November 2008 for the purpose of becoming, from 27 November 2008, a corporate partner in BCM LP. Subsequently, from 1 December 2008 until 1 July 2014, it was a corporate partner in BCM LLP and, from 31 March 2010 to 12 August 2015, a corporate partner in BCM (UK) LLP.

(4) Catherine Kerridge who began working for BCM LP and its general partner, BCML, as Head of Tax, between 2007 and 31 December 2017. She was a partner in BCM LP from November 2008 to April 2010. Since 1 December 2008 she has been a partner in BCM LLP and has been a partner in BCM (UK) LLP since 4 September 2016. On 31 March 2010 she was appointed to the Board of BCM LLP and as a member of its Executive Committee on 31 March 2010. Between 2010 and 2016 she held various directorships within the business of BCM LP (subsequently BCM LLP and then BCM (UK) LLP), acting as investment manager (or, in BCM (UK) LLP's case, sub-investment manager) of the funds it managed and continues to advise it on ongoing tax projects.

255. HMRC did not call any witnesses in the PIP appeals.

### **Further findings of fact**

256. As in the Cayman Appeals there was little, if any, difference between the parties on the facts. However, as in that appeal, a better understanding of the surrounding circumstances may be gained by expanding on the Statement of Agreed Facts with reference to the evidence and documents.

257. By 2008 BCM LP had around 60 partners, AUM of some US\$60 billion and that BCML had over 300 employees. To achieve such an expansion from its beginnings in 2000 BCM LP had attracted high quality personnel. The key to its success was, Mr Dodd explained, the skill, reputation and performance of both its discretionary traders and the members of its Systematic trading team. He said that a very significant, “possibly the most significant”, driver of any firm’s investment performance and consequently its ability to attract further AUM, was (and remains) the quality of the people carrying out the investment activities.

258. Mr Dodd described the hedge fund industry as a “people business” in which the requirement to deliver the very best performance to capture as large a share of AUM as possible drives very high levels of reward to secure the highest quality talent available. He said that as those working in that industry were inherently mobile and capable of being poached or lured away by rival hedge funds this created an even stronger requirement to pay high rewards and to mitigate against poaching by the inclusion of contractual notice periods, non-competitive provisions and other restrictive covenants. Therefore, the level of fees available to successful businesses made the attraction and retention of key individuals an essential element of commercial success with the reward received by individual partners being key to that attraction and retention.

259. Before the institution of the PIP in 2008, partners’ drawings and profit allocations were determined by or on behalf of the Board of BCML, the general partner of BCM LP, and profits were allocated by BCM LP in accordance with the “profit waterfall” provisions in clause 12 of the BCM LP Deed (see paragraph 94, above) under which, after allocation to BCML for its costs, capital expenditure, working capital requirements and other contingencies, profits were allocated to partners as follows:

- (1) Discretionary profit allocations would be made to partners.
- (2) Following the establishment of BCMC LP in 2007, so-called “Special Limited Partner (SLP) Profits” would be allocated to BCMC LP to match the drawings that had been made to allow BCMCL, the general partner of BCMC LP, to pay interest under its loan facility with RBS of the funding for the purchase of the 19% interest in BCM LP (as described in the Cayman Appeals).
- (3) The remainder of the profits would be used to make non-discretionary profit allocations to individual partners in accordance with their respective “Agreed Proportions” of income, as set out in the letters of allocation between BCML, as general partner of BCM LP, and each of the partners, which were typically referred to by partners as “income points”.

The level of each partner's overall profit allocation was intended to reflect his or her contribution to BCM LP and profit allocations were drawn in cash. Partners would typically receive an advance drawing (known as a “discretionary drawing”) on account, and in anticipation, of the profit allocation which would typically be made around the time the Partnership’s audit had been completed.

260. Mr Dodd explained that the process by which discretionary profit allocations were determined depended on the type of partner to which the allocation was to be made. In the case of discretionary traders, their performance over the year would be reviewed, generally by

reference to their individual profit and loss (“P&L”) on the portfolio that they were managing. The total monetary “reward” then proposed for the traders would be calculated by using a standard methodology which would then be reviewed by Mr Dodd, the Finance Department and senior traders. The proposed discretionary profit allocation would then be determined by subtracting the salary that the trader had received during the year (pursuant to his/her employment contract with BCML) from the “award” and, after review by MP and Mr Dodd, the recommended profit allocation would be decided upon by the board of BCML, the general partner of BCM LP.

261. A payment of 95% of the approved discretionary drawing would be made by early February, with the remainder of the drawing being paid once the P&L had been verified through the fund accounting process, usually two months later. Final profit allocations would then be determined and notified to the partners after the audit process had been completed and final approval given by the Board.

262. For partners who were members of the Systematic team, the determination of the total “reward” and discretionary allocations involved what Mr Dodd described as “a more subjective” assessment of their contribution and importance to the team. This was not based directly on the P&L. Leda Braga, as head of the team, took a central role in recommendations concerning those partners. These recommendations would be discussed with Mr Dodd and, in the case of the most senior members of the team, MP. Ultimately the discretionary allocations were determined by the board of BCML.

263. The total “reward” and discretionary allocations for partners in senior non-investment functions were determined by MP and Mr Dodd on a similar “subjective” basis, taking into account factors such as contribution to the BlueCrest business, how much that partner might be expected to be paid in the market and his or her importance to the BlueCrest business. The final determination of the discretionary allocations was by the board of BCML.

264. There were no provisions entitling BCM LP to defer payment, to require partners to invest their own money into BlueCrest Funds or to claw back profit allocations after they had been made (for example, as a sanction for subsequent poor performance, or for leaving the Partnership). As described above, partners were subject to contractual notice periods, a non-compete obligation and other restrictive covenants, but there was nothing more to incentivise them to stay with the BlueCrest business. As such, because a profit allocation to a partner was determined by the Board of BCM LP on the basis of what had happened in the past year without any means of future adjustment or reallocation as a result of future events (such as an individual incurring losses or leaving the business) and as there were no conditions in the BCM LP Deed permitting profit allocations to be deferrable or conditional, Mr Dodd explained that the means open to BCM LP to deter individual partners from leaving were inadequate.

265. He described how this problem was exacerbated by the effect of the so-called “high-water mark” (“HWM”) principle (the “HWM Principle”), which applied to the BlueCrest Funds and to the performance of individual traders, and BCM LP’s approach to so-called “netting risk”. Mr Dodd explained that under the HWM Principle, which is “almost universally incorporated in the investment terms for hedge funds in relation to the payment of performance fees and reflected in the basis on which performance fees were and are paid to the investment manager by the funds that it manages”, performance fees are only paid at the end of the relevant calculation period (typically annually on 31 December) if the value of the fund in question is higher than when a performance fee was most recently paid (ie at the end of a previous calculation period).

266. The “netting risk” Mr Dodd said, referred to the mismatch that arises when, in relation to a given fund, some traders delivered a positive performance over the year and some deliver

negative performance, with the result that the fund value at year-end does not exceed its previous HWM. This results in the investment manager receiving no performance fee in relation to that fund, even though some individual traders have delivered positive performance for which they would expect to be rewarded. However, to enable it to offer a competitive package to current and potential traders, BCM LP always adopted a “no netting risk” policy so that irrespective of whether BCM LP had received performance fees in any given year in relation to a particular fund (which will depend on whether the previous HWM was exceeded), traders would generally be rewarded on the basis of the amount of profits that their book had produced, provided that there were sufficient overall profits to enable this.

267. Mr Dodd explained that because of the HWM Principle and the no netting risk policy of BCM LP, a number of what he described as, “particularly costly episodes occurred between 2006 and 2008 in which losses were incurred at the fund and trader level”. These had occurred following profit allocations that BCM LP had made to certain traders who had made trading profits in 2006 and 2007. However, when those traders then made significant trading losses in the latter part of 2007 and 2008, BCM LP had no recourse against them and was not in practice able to recover the drawings, or retrospectively cancel the profit allocations, made in respect of earlier years, to the partners in question and it had been necessary to subsequently divert performance fees from profitable funds in order to make profit allocations to other traders whose positive trading performance had recovered previous losses (or who had only ever experienced positive results), despite the fact that overall no performance fees were received by BCM LP in relation to this positive performance because the relevant funds were below their HWM.

268. As a result of such a “salutary experience” it was considered that a change to BCM LP’s reward model was needed and, towards the end of 2007 the advice of Mr Aitchison, who had recommended the TRS structure described above in relation to the Cayman Appeals, was sought.

269. Mr Aitchison proposed offering partners the prospect of a greater share in its capital by the introduction of a corporate partner into BCM LP which, like all partners, could be awarded a portion of the profits by way of discretionary allocation. The corporate partner could then re-invest those profits back into the business as a capital contribution, to be called “special capital” in order to distinguish it from ordinary capital. This could then be used to invest in a BlueCrest Fund or Funds. Although this would reduce the profits available for allocation to the other partners those partners could be made eligible for consideration for potential discretionary awards by the corporate partner of special capital in BCM LP if that is what it recommended.

270. Under the proposed plan the awards that were to be made by the corporate partner to the other partners would not be an allocation of profits of BCM LP but an award of capital from the corporate partner. It was decided to implement the proposal through what was described as a “Partner Savings Plan”, which later became known as the PIP.

271. Mr Aitchison explained that the concept of introducing a corporate partner into a partnership, allocating profits to that corporate partner, and “warehousing partnership capital” with that corporate partner, was something that he considered to be “very commonplace” and had been implemented by partnership businesses for as long as he could recall, “especially where there was a disparity between the rates of UK income tax and UK corporation tax”. He said that standard textbooks on UK taxation would have mentioned this type of a structure, to address commercial and tax planning reasons. He described this as a “not particularly innovative nor a novel concept”.

272. Further details of the proposal were provided to BCM LP by EY in a “question and answer” format that explains that it was produced further to discussions with BlueCrest partners in order to answer any questions they had about the PIP. The questions and answers included:

**“Q: Has this scheme been seen in the market before?”**

**A:** This is a bespoke piece of planning developed by Ernst & Young and has been used by a number of hedge funds since 2003/04. At least one implementation of the strategy has been considered by Her Majesty's Revenue & Customs (HMRC), who did not seek to challenge this.

...

**Q: How much tax risk does this planning involve?**

**A:** All tax planning carries the risk of HMRC challenge and the tax authorities' attitude to what is acceptable is subject to change. As a result, BlueCrest partners should be aware that there will always be a risk that planning may [be] challenged by HMRC, and that what the tax authorities find acceptable today may be challenged in the future.

However, this strategy is not in our view aggressive tax planning and on a scale of 1 to 10 we believe that a 6 is the appropriate score in respect of the risk of HMRC challenge. Putting the 6 rating in context, a 10 rating would cover schemes such as remuneration planning where HMRC has threatened to issue retrospective legislation to close down such schemes. In contrast, the strategy in question has a genuine commercial underpinning and has real capital at risk.

As regards the risk of a successful challenge by HMRC, we believe that this planning would warrant a score of 3 out of 10 and, as noted above, the UK tax authorities have seen this strategy implemented in the past and not sought to challenge this.”

273. In evidence, in relation to the PIP, Mr Dodd said,:

“Clearly when the time came the fact that the scheme could be implemented in such a way that a modest amount of tax could be saved, the difference between the corporate rate of 28 and the then upper rate of 40, yes, clearly that would create a larger pool of money, and that was helpful, because we were asking partners to accept that monies that hitherto they would have taken the cash, admittedly there was a partner allocation process, but they'd taken the cash in the February after the year-end, we were now asking them to wait a considerable amount of time and accept that provisional awards of special capital might not go final and accept some risk. Clearly it was the prospect of the pool of special capital being larger would help us in selling the proposal to the partners.”

274. As Mr Aitchison had recommended that the new corporate partner should be independent, and not controlled by BCM LP, the assistance of Dominion Fiduciary Trust Limited, the trustee of the BCPT, was sought. On 25 April 2008, Dominion Fiduciary Trust Limited incorporated SCL in England and Wales with Dominion Fiduciary Nominee Limited as subscriber shareholder on its behalf. As such, Dominion Fiduciary Trust Limited was the ultimate controlling party of SCL. Mr Dodd said that he considered that it was important for the partners to feel that there was objectivity, fairness and a degree of separation between BCM LP and the corporate partner which was achieved by the utilisation of an independent corporate partner in the administration of the plan and the making of awards.

275. On 28 April 2008, SCL's memorandum of association was amended to include the object, “to participate in incentivisation and retention strategies for the partners of [BCM LP] and (if

appropriate) its successors”. In accordance with a Deed of Adherence, dated 30 April 2008, SCL became the corporate partner of BCM LP for the purposes of performing the role of receiving profit allocations and making calculations and awards of special capital under the PIP. In doing so, it was able to contribute 72% of its gross profit allocation into BCM LP, after payment of corporation tax, as special capital.

276. Material provisions of the Deed of Adherence provided:

**“2 Adherence to Partnership**

**2.1 Covenant**

The Further Limited Partner covenants with the Partners for the time being to observe and perform the terms and conditions of the LP Deed [ie the BCM LP Deed, see paragraph 94, above] on terms that the Further Limited Partner becomes a Further Limited Partner under the LP Deed with effect from the date hereof.

...

**2.3 Entitlements**

- (A) The Further Limited Partner shall be entitled, subject to the terms of the LP Deed, to a 0.00001 % interest in the capital profits or capital losses of the Partnership in accordance with clause 12.4 of the LP Deed.
- (B) In addition, the Further Limited Partner may be entitled to an allocation of income profits in accordance with clause 12.1(A)(2) of the LP Deed, in the absolute discretion of the General Partner.
- (C) For the avoidance of doubt, the Further Limited Partner’s entitlement under clause 12.1(A)(4) of the LP Deed will be zero.

**2.4 Reallocation by the Further Limited Partner**

On receipt by the Further Limited Partner of any Discretionary Drawings or income profits allocations, the Further Limited Partner agrees to consider, at the request of the General Partner, to contribute all or part of such amount to the Partnership as Special Capital (as defined in the LP Deed ..., less UK corporation tax considered likely to be due on the aforementioned profit allocation and reasonable expenses.”

277. This was reflected in the written resolutions of the sole director of SCL, dated 30 April 2008 which noted, inter alia:

“1. BlueCrest Capital Management LP (the “**Partnership**”) (through its general partner BlueCrest Capital Management Limited (the “**General Partner**”) was proposing to implement an arrangement for the incentivisation and retention of its individual limited partners (the “**Incentivisation Scheme**”), a step plan for the implementation of which, prepared by Ernst & Young LLP, is attached.

2. In order to effect the Incentivisation Scheme, the Company [ie SCL] was to be admitted as a further limited partner of the Partnership pursuant to the terms of a deed of adherence, a draft copy of which was provided to the sole Director (the “**Deed of Adherence**”).

3. Broadly speaking, it was proposed that the Company would, on receipt of its allocation of income profits in the Partnership (by way of advance drawings) agree to consider the reinvestment of all or part of this income profit allocation into the Partnership at the request of the General Partner. Any amount paid to the Partnership by the Company in this way would be deemed

to be a “Special Capital Contribution”, having the rights set out in the Partnership Deed.”

278. As stated in clause 2.4 of the Deed Adherence, “special capital” is defined at clause 7.4(A) of the BCM LLP Deed (BCM LP had transferred its business to BCM LLP on 1 December 2008) which is set out below.

279. In the second half of 2008, BCM LP became aware, through a pre-existing business relationship with three individuals, of an opportunity to take on an alternative independent corporate partner which would be able to contribute as special capital 85% of its profit allocation back to BCM LP, a higher proportion of the profit allocation than the 72% that SCL had made. Mr Dodd explained that business relationship with those individuals was in relation to Cayman reorganisation in particular the replacement of RBS by Fyled in the TRS as described in the Cayman Appeals, above.

280. It was agreed that, following the incorporation of a company, Avon, by the three individuals (one of whom was Andrew Beverly who gave evidence), Avon, would take the place of SCL in facilitating the PIP by receiving profit allocations, and making contributions and awards of special capital. Avon was incorporated on 18 November 2008.

281. Under clause 3 of a Deed of Assignment, dated 21 January 2009, between SCL and Avon SCL assigned “the benefit of its rights in relation to the Special Capital Amount set out in the LLP Agreement” to Avon (the reference to the LLP Agreement was because, as explained in the Statement of Agreed Facts in the Cayman Appeals, on 1 December 2008 the business of BCM LP had been transferred as a going concern to BCM LLP (see paragraph 8(34), above).

282. Clause 3 of that Deed of Assignment continues by setting out the entitlement of Avon under the assignment as follows:

“3.2 Pursuant to the Assignment, [Avon] shall be entitled to:

- (a) receive any monies received by SCL on account of, or in relation to, the Special Capital Amount pursuant to clause 7.4(B), clause 18.5, clause 20.3, clause 20.4 or any other provision of the LLP Agreement;
- (b) receive either (i) any assets forming part of the Special Capital Assets transferred to, or otherwise delivered to, SCL pursuant to clause 7.4(B), clause 18.5, clause 20.3, clause 20.4 or any other provision of the LLP Agreement or (ii) the proceeds of realisation of any assets forming part of the Special Capital Assets, as determined by the board of BCM LLP in accordance with the foregoing provisions of the LLP Agreement;
- (c) exercise the power to request a withdrawal of all or part of the special Capital Amount pursuant to clause 7.4(B) of the LLP Agreement; and
- (d) exercise the power to reallocate all or part of the Special Capital Amount pursuant to clause 7.4(C) of the LLP Agreement.

3.3 [Avon] hereby irrevocably authorises SCL to exercise (in its absolute discretion) the following powers on behalf of [Avon] and any such exercise by SCL of such powers shall be binding in all respects upon [Avon]:

- (a) the power to request a withdrawal of all or part of the Special Capital Amount pursuant to clause 7.4(B) of the LLP Agreement; and

- (b) the power to reallocate all or part of the Special Capital Amount (and accordingly the relevant part of the Special Capital Assets) pursuant to clause 7.4(C) of the LLP Agreement.

3.4 [Avon] confirms and acknowledges that it shall have no right to exercise any of the powers that it has authorised SCL to exercise in accordance with clause 3.3 or to require SCL to exercise the powers referred to in clause 3.3 In any way and hereby irrevocably waives all rights to raise any objections whatsoever as to how such rights are exercised by SCL.

283. Material clauses of the BCM LLP Deed (to which SCL and Avon were party) provided:

**“7. Capital Contributions, other Contributions and Loans**

...

**7.4**

- (A) Any of the Members may with the agreement of the Board make further contributions (which shall not be ordinary capital contributions and which shall not be treated as constituting part of the Maximum Amount) in cash or in specie (“Special Capital”) and the letters of allocation between the Partnership and each relevant Member shall be amended on an annual basis not less than one month prior to the end of each financial year of the Partnership to reflect all such further contributions made during the previous twelve months and not already recorded in an amended letter of allocation (or in the case of a Further Member a letter of allocation shall be entered into between such Further Member and the Partnership by way of an amendment to the Deed of Adherence executed by such Further Member to reflect any such further contributions). Any contributions of Special Capital that have been or are so, or are treated as, made to the Partnership pursuant to this Clause 7.4(A) have been or shall be credited (in the case of an in specie contribution, in the amount agreed between the relevant Member and the Board) to the relevant Member’s Special Capital Account and shall be subject to the provisions as to deemed transfer set out in this Clause 7.4. Certain of the Members at the date hereof have made further contributions in accordance with the foregoing as recorded in the letters of allocation between the Partnership and each such relevant Member entered into on the date hereof. The Special Capital contributed by certain of the Members at the date hereof has been invested in assets by the Partnership. Any further Special Capital contributed by a Member may, at the discretion of the Board, be invested by the Partnership in such assets (which may include shares or other interests in any of the BlueCrest Funds) as the Board, in its sole and absolute discretion, may determine (any assets in which Special Capital is invested at the date hereof or in which Special Capital is invested in the future being “Investment Assets”).

Subject as hereinafter provided, the monies standing to the credit of a Special Capital Account (and any Investment Assets acquired with any such monies) shall be held exclusively for the benefit of the relevant Member and only the relevant Member shall be entitled to such monies, any Investment Assets acquired with such



monies and the proceeds of realisation of any such Investment Assets, and no other Member shall have any interest in such monies or such Investment Assets save as specifically provided for in this Agreement or as agreed in writing with the relevant Member.

Any income arising or derived from any monies standing to the credit of any Special Capital Account or from any Investment Assets in which such monies are invested and any income losses arising or derived from any monies in any Special Capital Account or from any Investment Assets in which such monies are invested shall be allocated to the Distribution Account of the Member who is entitled to the relevant part of such Special Capital (and the relevant part of any Investment Assets acquired with such Special Capital) as at the time that such income profits arise or income losses are incurred.

- (B) Any Member who for the time being has any Special Capital credited to his Special Capital Account may (by written notice to the Board) withdraw all or part of such Special Capital (on giving 3 months' notice or such other period of notice as shall be agreed with the Board) and on the expiry of any such notice the Board shall, in its absolute discretion, repay such Special Capital in cash or (if such Special Capital shall have been invested in Investment Assets) by the transfer of the relevant Investment Assets to the relevant Member in satisfaction of such repayment obligation or dispose of the relevant Investment Assets and transfer the proceeds of such disposal to the relevant Member in satisfaction of such repayment obligation. In the event that any Investment Assets (or the proceeds of the disposal of any Investment Assets) are transferred to any Member in accordance with the foregoing then the proportion of the Special Capital that the Member withdrew pursuant to the written notice to the Board shall be deemed to have been repaid by such transfer (regardless of whether or not the value transferred to the Member shall exceed or be less than the value of the Special Capital deemed to have been repaid) and the relevant Member's Special Capital Account shall be reduced by such amount.
- (C) Subject to the provisions below any Member who for the time being has Special Capital credited to his Special Capital Account may, in its sole and absolute discretion, decide (following, and only following, the receipt of a recommendation from the Board that such Member should consider a reallocation of such interest in such Special Capital) that all or part of the interest of such Member in any Special Capital (and accordingly in any Investment Asset acquired with such Special Capital) should be reallocated to any other Member or Members so that such other Member or Members will, following such reallocation, become beneficially entitled to the relevant part of such Special Capital (and the relevant part of any Investment Assets acquired with such Special Capital and any proceeds of the realisation of any such Investment Assets) and shall give notice of any such decision to the Board provided that no such reallocation shall be made by any such Member prior to the expiry of the period of six months following the date upon which the Special Capital was contributed to the Partnership and used (either directly or indirectly) to acquire

the relevant Investment Assets unless the Board shall specifically consent to a period of less than six months in writing. On the making by any Member of any reallocation there shall be a deemed transfer of the relevant proportion of the Special Capital used to acquire the relevant Investment Assets and the amount of Special Capital deemed transferred shall be deducted from the Special Capital Account of the Member that contributed the same and shall be credited to the Special Capital Account of the Member to which such Special Capital has been reallocated.

To the extent that the Partnership believes that the arrangements described in the foregoing provisions would be likely, if Special Capital was reallocated to Members in accordance therewith, to constitute a collective investment scheme, the Partnership may require that, forthwith following any reallocation in accordance with the foregoing provisions, (a) the Member to whom any Special Capital (and any related Investment Asset) has been reallocated or (for the avoidance of doubt following such Member's death his personal representatives) shall be required to withdraw such Special Capital in accordance with Clause 7.4(8), or (b) all such related Investment Assets shall be registered in a sub-account in the name of the Member to whom any Special Capital has been reallocated in such manner as shall ensure that the Partnership will not be categorised as a collective investment scheme.

...

## **10. Allocations**

- 10.1 The Board shall procure that accounts are drawn-up in accordance with the provisions of this Agreement and otherwise in accordance with the Accounting Principles in respect of each financial year of the Partnership.

Such accounts shall comprise a profit and loss account for the Partnership in respect of such financial year and a balance sheet for the Partnership as at the end of that financial year (together the "Partnership Accounts") and the Board shall arrange for the Partnership Accounts in respect of each financial year to be audited in accordance with the requirements of the Act.

- 10.2 The Board shall following the end of each financial year by reference to the Partnership Accounts drawn-up in respect of that financial year determine the allocation of the profits and losses amongst the Members in accordance with the provisions of Clauses 10.3, 10.4 and 10.6.

In addition the Board shall have the discretion to make interim profit allocations to such of the Members as the Board shall determine (on account of their entitlement to receive allocations of profits following the end of each financial year of the Partnership in accordance with the provisions of Clauses 10.3 and 10.5) subject in all respects to the Board being satisfied as to the level of profits available in respect of any financial year. In determining the level of profits available, the Board shall consider, on a prudent basis, the profits available based on the accounts relating to the previous financial year, monthly managements accounts, any other profit allocations already made in respect of the relevant financial year and any current or forecast income, liabilities and expenditure of the Partnership and may also elect to draw up

accounts for the Partnership for an interim period within a financial year of the Partnership in order to determine an interim allocation of profits or losses to such of the Members as the Board may determine.

#### **10.3 Expenses of First Corporate Member and other allocations**

(A) Subject to the further provisions of this Clause 10.3 and to Clause 10.6, in respect of each financial year of the Partnership the profits of the Partnership (before tax) (and after the deduction of any sums payable to an Outgoing Member pursuant to the provisions of Clause 18.4 (other than for the avoidance of doubt any sums representing such Outgoing Member's ordinary capital contribution or Special Capital)) shall, subject as provided in this Clause, be allocated amongst the Members as follows:

(1) firstly, there shall be allocated:

- (a) to BCMSL such amount of profits as shall be required to cover any expenses of BCMSL incurred in connection with services made available to the Partnership which have not been paid or reimbursed under the Services Agreement or which have not been otherwise reimbursed by the Partnership; and then.
- (b) to BCMSL or SCL or such other Member or Members as the Board shall in its absolute discretion decide such amount of profits as shall in the good faith opinion of the Board be required to be retained in the Partnership (i) as working capital to meet anticipated, current or foreseen liabilities and expenditure of the Partnership, (ii) to cover other contingencies in accordance with general principles of prudent management and (iii) to satisfy any obligation imposed on the Partnership by the FSA or any other regulatory body to maintain a minimum level of financial resources;

(2) secondly, there shall be allocated to each Member who has received Priority Distributions during the relevant financial year of the Partnership, such amount of profits as are equal to the Priority Distributions [ie distributions not in excess of £200,000 per Member unless otherwise notified BCMC] to made to such Individual Members during the relevant financial year of the Partnership and in the event that the profits in any financial year shall not be sufficient to meet these allocations in full then such profits shall be allocated on a pro rata basis as between the Priority Distributions made to the relevant Members;

(3) thirdly, there shall be allocated to such of the Members (if any) as the Board shall in its absolute discretion determine (i) such amount of profits, in aggregate not exceeding the performance fees due and payable to the Partnership in the relevant financial year ("Performance Fees"), as the Board shall in its absolute discretion determine; and (ii) such amount of profits (in aggregate not exceeding 15 per cent of the amount of the Performance Fees as reduced by any allocations pursuant to (i) above) as the Board shall in its

absolute discretion determine, in order to recognise management performance during the relevant financial year;

- (4) fourthly, there shall be allocated to BCMC such amount of profits (“BCMC Profits”) as is equal to the aggregate Advance Drawings made by BCMC during such financial year;
- (5) the remainder of the profits, which for the purposes of the operation of this sub-clause shall be increased by adding thereto an amount equal to any BCMC Profits in respect of the relevant financial year, shall then be allocated to the Members in the Agreed Income Proportions provided that the amount allocated to BCMC under this sub-clause (5) shall be reduced by an amount equal to any allocated BCMC Profits in respect of the relevant financial year.

...

## **11. Members’ Accounts and Distributions**

- 11.1 Each Member shall have, inter alia, an Ordinary Capital Account and a Distribution Account which shall be operated in accordance with the provisions of Clauses 11.2 to 11.5 and any Member who has, or who is deemed to have, contributed Special Capital (and any Member to whom any Special Capital is reallocated) shall have a Special Capital Account which shall be operated in accordance with the provisions of Clause 7.4 and Clause 11.2. In addition, BCMSL and any other Member to which profits are allocated in accordance with Clause 10.3(A)(1) shall have a Retention Account which shall be operated in accordance with the provisions of Clause 10.5
- 11.2 The ordinary capital contributions of each Member shall be credited to that Member's Ordinary Capital Account. Any contribution of Special Capital by a Member shall be credited to that Member's Special Capital Account and any reallocation of Special Capital pursuant to Clause 7.4 shall be credited to the Special Capital Account of the Member that receives such reallocation.
- 11.3 The profits (or losses) allocated or to be allocated to the Members in respect of each financial year of the Partnership pursuant to Clause 10.3, Clause 10.4 and Clause 10.6 shall be credited (or debited as the case may be) to the Distribution Accounts of the Members as to 70% of the Board's good faith estimate of the profits (or losses) of the financial year within 30 days of the end of the relevant financial year and as to the balance within 30 days of the completion of the preparation of the accounts of the Partnership for the relevant financial year in accordance with Clause 10. Any withdrawal by BCMC of any profits so allocated to BCMC shall only be made by way of a payment to the New LP Bank Account (as defined in the Facility Agreement).

Clause 11.4(A) deals with discretionary drawing that are allowed, 11.4(B) with advance drawings and 11.4(C) with further drawings. Clause 11.5 concerns “priority distributions”. The Deed continues:

- 11.6 Save as provided in Clause 10.10(8) and Clause 18.4, no Member shall have an obligation to pay back to the Partnership any of the profits credited to the Distribution Account of that Member.
- 11.7 Each Member shall discharge on or before the due date for payment in each case all tax (whether in the United Kingdom or elsewhere) for which he or it is primarily liable in respect of his or its share of any profits of the Partnership and shall indemnify each other Member for itself (or, if that Member is itself a Partnership, as agent for the partner or partners in it) in respect of any loss, expense, cost or liability which that other Member (or, as the case may be, the relevant partner or partners in that other Member) may incur to the extent that the other Member (or, as the case may be, the relevant partner or partners in that other Member) would not have incurred that loss, expense, cost or liability but for a failure on the part of the first mentioned Member to comply with his or its obligations under this Clause 11.7.
- 11.8 The Board may make arrangements for benefits (including but not limited to medical insurance, permanent health insurance and travel insurance) to be available for certain Members (and any such arrangements may be set out in the Members Handbook that sets out various terms that are applicable to each Member's membership of the Partnership).

284. What was understood by “Special Capital” was further clarified in an email, dated 2 April 2012, to ..... From the Partnership’s legal counsel, Jeremy Sambrook, under the heading “Ordinary Capital”, wrote:

“A number of members (partners) have asked for further clarification regarding ordinary capital following Sharlene’s recent email requesting documents to be signed and returned.

There are three types of capital a member may have in BlueCrest Capital Management LLP (“BCM LLP”):

- Ordinary Capital
- A Special Capital
- B Special Capital

None of these relate in any way to a member’s capital ownership of the business.

‘A’ Special Capital is used for Partnership incentivisation Awards (the PIP) and hence you may have A Special Capital if you have received a final PIP award. ‘B’ Special Capital is only relevant to Geneva based members ...

Ordinary Capital is something all members have to contribute in order to legally be a member. BlueCrest has determined that to satisfy its requirements Partners should have £5k of ordinary capital in BCM LLP. ...”

285. Mr Beverly could not explain why Avon had been given the powers it had but said that, although Avon began to perform its functions in relation to the PIP from 27 November 2008, there continued to be some involvement from SCL as provisional awards remained outstanding.

286. Over time, as BCM LLP developed and became, as Mr Dodd described it, “more institutional”, the process of decision-making in relation to the amount of partners’ total rewards evolved and became more formal.

287. Before the PIP was instituted the profit allocations for BCM LP were determined by the Board of BCML, as its general partner. MP and Mr Dodd, assisted by other senior members of staff, would approve the calculations and, in practice, the discretionary drawings of the partners. The subsequent profit allocations were recommended to, and formally approved by, the board of BCML following completion of the audit of BCM LLP. The decision making process in relation to partners' drawings and profit allocations remained the same following the introduction of the PIP.

288. Following the establishment of BCM LLP, although the board of the LLP delegated the operation of the PIP and the authority to determine partners' drawings to its Executive Committee, the partners' profit allocations were nevertheless determined by the board of BCM LLP itself, as did the board of BCM (UK) LLP, even though it had delegated the running of the PIP and the authority to determine partners' drawings to the UK Executive Committee.

289. Mr Dodd explained that the institution of the PIP introduced an additional step to the decision-making process, specifically in respect of the determination of the proposed awards of special capital which were recommended to the corporate partner. Initially this was to the board of BCML (as general partner of BCM LP) and, once this was established as part of the formalisation of the PIP process, the PIP Recommendations Sub-Committee (the "PRSC") of BCM LLP and subsequently of BCM (UK) LLP, would consider whether to make a non-binding recommendation to the corporate partner that certain partners should receive a provisional indication of a potential future award of special capital.

290. The PRSC would have received from the Executive Committee of BCM LLP or UK Executive Committee of BCM (UK) LLP, the proposed total rewards which the Executive Committee or UK Executive Committee, as applicable, had decided were appropriate for the individual partners in question. Based on these proposals, the PRSC would consider what awards of special capital to recommend be made by the corporate partner. As part of the PRSC meetings, names were considered on a line-by-line basis, with further discussion taking place as and when it was deemed that their potential awards were worthy of such discussion. When the PIP was first implemented, and for a time thereafter, the ratio of the size of the potential award of special capital which would be recommended to the corporate partner to the discretionary profit allocation which a partner would receive varied. However, from 2010 onwards the ratio was approximately 2:1.

291. BCM LLP and BCM (UK) LLP each had its own PRSC which was made up of their respective Executive Committee members and Mr Beverly of Avon. The Board of Avon would then decide whether it would accept these recommendations and thus which provisional indicative awards to make to the individual partners. If Avon (or originally SCL), the corporate partner, adopted the PRSC recommendations individual partners would be provided with a non-binding, provisional indication of a discretionary award of special capital by the corporate partner which was often referred to as a "provisional award". This sum, which represented the deferral, would potentially be made final at a date in the future and was frequently described as a "final award". This would be a reallocation of a fractional interest in the investment assets held by the Partnership.

292. The eligibility of a partner for a final award of special capital would depend on the fulfilment of a number of "eligibility conditions" which included his or her continuing to be a partner of BCM LP (and subsequently BCM LLP and BCM (UK) LLP). It was for Avon as the corporate partner to decide whether to make such a final award at the conclusion of the deferral period having been provided with a second recommendation from the PRSC which would have considered a number of factors including the partner's performance over the intervening period,

whether or not he had submitted a resignation, and his level of risk taken in the market and current P&L (if a portfolio manager).

293. The provisional, indicative awards of special capital made by Avon could only be made final after the “deferral period” had passed. The deferral period initially was for a period of six months. This ensured that should a partner leave he or she would automatically breach the eligibility criteria or “forfeit” the possibility of an award being made final, and therefore lost not only any prospect of receiving as a final award the existing provisional, indicative award from the previous year's performance, but also the prospect of any future award arising from positive performance generated and accrued in the current calendar year.

294. Mr Dodd said that this conditionality in the potential awards meant that, because the cycle was repeated annually, an individual partner was incentivised to remain with the business for the duration of the deferral period and beyond as reallocation of special capital could only take place if the eligibility conditions were fulfilled. Over time, and following the success of the introducing the concept, a variety of deferral periods were used across the BlueCrest business. The period was extended to three years for partners, and from 2009 it was set at two years for those in the Systematic team. A two-year deferral period was subsequently introduced on a gradual basis for discretionary trading partners.

295. The length of the deferral was determined so as to ensure that there was always a significant amount at stake for each individual partner if he or she were to resign or breach any of the eligibility conditions stated in the provisional award letters, as this would lead to the forfeiture of the possibility of receiving a final award and any future awards or, if he or she had incurred losses, could lead to the receipt of a final award that was less than the amount which had been communicated as a provisional, indicative award.

296. The role of Avon in the PIP process was described by Mr Beverley as follows.

297. BCM LLP would decide as a business matter how much of its anticipated profit distribution it wished to be subject to the PIP arrangements. Avon would then be asked to make an advance drawing on account of its expected allocation of profits, and would subscribe the amount of the advance as special capital. Avon's special capital accounts were credited accordingly when these contributions were made (and would also be credited when gains were subsequently realised on assets acquired using special capital) with gains only being recognised in BCM LLP's accounts on realisation. BCM LLP would then recommend the levels of special capital awards to be made to individual partners. These recommendations from BCM LLP to Avon were made by the PRSC, on which Mr Beverley sat as an independent to, as he described it in evidence, “make sure that the decision making of the partnership was consistent and met their own principles” and that he saw himself, “to some extent” as “a sort of independent conscience.”

298. Mr Beverley explained that the recommendations of the PRSC were generally applied by Avon but recalled instances when that was not the case giving the following examples:

- (1) On 10 May 2010 Avon increased the amount of a final award over the recommended amount, pointing out to BCM (UK) LLP that the recommended award was less than the indicative award and clarified that this was not for a good reason;
- (2) On 11 October 2011, Avon pointed out to BCM (UK) LLP that it was minded not to accept a recommendation to make an award to a person that was no longer a partner. BCM (UK) LLP agreed to withdraw the recommendation and no award was made; and
- (3) On 1 September 2011, Avon noticed inconsistencies in the proposed forfeiture conditions between the letter of recommendation to Avon and in the draft indicative

award letter to the participant. These inconsistencies were resolved satisfactorily and an award was made.

299. Although the PIP was initially introduced as a pilot for the period ending 30 November 2008 with SCL as the corporate partner with MP and Mr Dodd and seven other partners joining on a voluntary basis, a wider group of individual partners was involved for the period ending 30 November 2009. In this initial phase, a small number of senior partners (including MP and Mr Dodd) agreed to the Partnership reallocating some of their income points to the corporate partner, in return for the corporate partner considering those partners for discretionary awards of special capital under the PIP which enabled BCM LP to bring the proportion of their total reward represented by awards of special capital more into line with that of partners who did not have many (or any) income points.

300. Participation in the PIP became mandatory for individual partners from February 2010 and it has been applied to all BlueCrest offices throughout the world irrespective of its treatment for tax, including where no distinction is drawn between allocations of profit and awards of capital, although the structural implementation has varied with BlueCrest's legal structure in different jurisdictions.

301. The annual operation of the PIP was summarised by Catherine Kerridge in the table below in relation to the PIP cycle commencing 1 January 2012 which was the first full PIP cycle following the migration of BCM LLP to Guernsey in 2010 and in respect of which BCM (UK) LLP is the Partnership involved.

	<b>Date</b>	<b>Description</b>
1.	1 January 2012	Commencement of the BCM (UK) LLP financial year.
2.	Q4 2012	Performance reviews were completed for non-traders and systematic traders in respect of the financial year ending 31 December 2012. (Discretionary traders were not considered until 2013, after the performance fees due from the funds to the Partnership had crystallised.) At this stage the individuals concerned were not advised of their performance assessment as this was subject to review by BCM (UK) LLP's Compensation Committee.
3.	21 December 2012	Crystallisation of the performance fees due from the BlueCrest-managed funds to the Partnership. This enabled the total cash pool available for distribution by the Partnership through discretionary drawings by partners (both individual partners and the corporate partner) to be determined. It also enabled guidance to be given to managers of non-traders and systematic traders as to the total amount likely to be available for their teams' rewards.
4.	January 2013	Following completion of the performance review for non-traders and systematic traders (see 1 above), managers then submitted year-end proposals for the total reward for each non-trader and systematic trader partner, taking into account sustained individual contribution, size and scope of individual role, historic and forecast business profitability and present market environment.



		<p>The proposals were reviewed by the Compensation Committee, taking into account the expected overall available cash pool, and there was a process of discussion and challenge with management before that Committee submitted the provisional total reward amount for the non-traders and systematic traders to the PRSC.</p>
5.	February-April 2013	<p>A number of steps took place in this period.</p> <ul style="list-style-type: none"> <li>• P&amp;L statements were drafted for each discretionary trader partner to assess his performance in calendar year 2012.</li> <li>• Based on these calculations, details of the proposed provisional total rewards for trader partners were passed to the PRSC.</li> <li>• The PRSC reviewed the provisional total rewards and decided how each individual partner's provisional total reward should be split as between the amount to be (i) made available to the individual partner by way of discretionary drawing in anticipation of a discretionary profit allocation and (ii) the subject of a recommendation made by the PRSC to the corporate partner to make a provisional indicative award of special capital to the relevant individual partner.</li> <li>• Once the PRSC had made its decision as to the recommendations to be made, it wrote to Avon, making recommendations regarding the quantum of provisional indicative awards of special capital to individual partners and the “deferral period” which had to elapse before they could be made final.</li> <li>• Avon considered the recommendations of the PRSC and, at its discretion, issued provisional indicative award letters to the relevant individual partners stating that those partners would be considered for an award, or series of awards, of special capital on a specific date or series of dates in the future (after the specified “deferral period”), subject to the fulfilment of specified eligibility conditions. The “deferral periods” ranged from 6 months to 3 years, and could be staggered over a number of years (with each deferral the subject of a separate provisional, indicative award).</li> <li>• The Partnership confirmed to the individual partners and the corporate partner the amounts available to take as discretionary drawings on account of their anticipated profit allocations.</li> <li>• Individual partners then took their discretionary drawings and the corporate partner (Avon), to the extent required, took a discretionary drawing such as to cover the proposed awards of special capital, in each case in anticipation of their discretionary profit allocation for the financial year ended 31 December 2012.</li> <li>• Avon requested BCM (UK) LLP to direct the entire amount of its discretionary drawing to its special capital account as a contribution of special capital.</li> <li>• BCM (UK) LLP invested the amounts contributed as special capital by Avon in underlying investment assets, following (non-binding) consultation as to the selection of appropriate investments with the partners who had received indicative award letters from Avon, and subsequently, on a monthly basis, kept</li> </ul>

		Avon and the individual partners apprised of the performance of those assets or any changes to their composition.
6.	September 2013	The profit allocations by BCM (UK) LLP for the year ended 31 December 2012 were approved by the Partnership Board.
7.	September 2013, February 2014, February 2015 and February 2016	<p>The “deferral period” of the relevant provisional indicative awards ended for those provisional awards of special capital for which the “deferral period” was 6 months, 1 year, 2 years or 3 years, respectively.</p> <p>On each occasion, the PRSC of BCM (UK) LLP met and considered whether any individual partner had failed to satisfy the eligibility conditions for an award or whether any of the previous recommendations should be varied. The recommendations made were then sent to the corporate partner, Avon.</p> <p>Avon considered the recommendations and, as it thought fit, made the final awards and instructed BCM (UK) LLP to reallocate special capital to the relevant individual partners.</p> <p>Avon wrote to individual partners informing them that the reallocation of Special Capital to the relevant special capital accounts would now occur. The relevant partners' special capital accounts were credited accordingly and the individuals were informed accordingly by the Partnership.</p>
	Any time following the respective reallocations in September 2013, February 2014, February 2015 and February 2016	Special capital allocated to the individual partners' special capital accounts was available for withdrawal on notice.

302. The table illustrates the various stages in the timeline from the point at which the performance fees earned by BCM LLP crystallised (such that the cash pool available for individual partners' rewards was capable of being established on an indicative basis pending audit) through to awards of special capital being made to the individual partners (from which point the individual was free to continue holding a special capital account or to withdraw the capital by an in specie transfer of the underlying assets or in cash on three months' notice).

303. Mr Dodd said that a total of 723 provisional UK awards have been made to 175 individuals, and the concepts embedded in the PIP are the basis of BlueCrest's reward philosophy for all its portfolio managers and senior staff. Outside of the UK, 827 provisional awards have been made to 228 individuals. Approximately 16% of the UK provisional awards have not been made final, due to departures and/or losses being incurred, as compared to approximately 12.2% of the provisional awards outside of the UK which have not been made final. The total value of awards of special capital which were provisionally indicated but which were not ultimately made (either because the final award was smaller, or no award was made

at all) amounts to approximately US\$136 million globally (or US\$43 million in respect of the UK awards).

304. He explained that this value stayed in the relevant partnerships as special capital and has assisted them in materially offsetting BlueCrest's "netting risk" exposure as described above (in paragraph 266). Additionally, he said, instances of trading in the face of losses that was (in the opinion of management) inappropriately risky have been much less than would have been the case without the introduction of the PIP and, unwanted departures among traders and senior staff have been low, despite many sustained attempts by competitors to poach BlueCrest's senior traders in an increasingly competitive environment. Mr Dodd said that he, MP and other members of BlueCrest senior management are aware, from anecdotal conversations with head-hunters and other industry participants, that the PIP structure makes BlueCrest traders very difficult to poach.

305. Mr Dodd described the commercial benefit of the PIP in the following terms:

(1) Partners were incentivised to remain with the Partnership on an ongoing cycle and to continue to deliver returns for investors. If they were to leave, they would not receive a final award of special capital which had been provisionally awarded to them.

(2) The Partnership was now protected to some extent against downside risk from an individual trader's negative P&L in the next year because it was now possible for potential awards of special capital to be adjusted or, indeed, not be made at all, with the special capital remaining in the Partnership instead.

(3) The Partnership was similarly protected against netting costs since it was now possible to adjust downwards the potential award of special capital to one trader (who had made losses) in order to free up special capital which could be used to reward a second trader (who had made back those losses but in circumstances where no performances fees would be earned). Traders who had received provisional indications of awards, but who subsequently had a negative P&L, were no longer incentivised to take risky bets to try to make back the losses (with the back-up option of resigning and finding new employment if they incurred further losses) since the indicative provisional award set by reference to their good performance could be reduced, or not be made at all, in the light of partners' subsequent poor performance. They could not simply take a profit allocation based on their previous good performance, then walk away and keep it after subsequently causing losses to the Partnership.

306. An additional benefit identified by Mr Dodd was the alignment created due to the requirement that provisional indicative awards were invested in BlueCrest-managed funds. This, he said, increased the AUM of the Partnership and therefore the management fees earned; it also increased the potential for earning performance fees. For individual partners who were traders, their exposure to fund performance through the PIP benefited their market credibility as investors liked to see this as part of their due diligence process and, indeed, it was a standard question/requirement of external investors.

307. Mr Dodd also said that the existence of the PIP encouraged departing traders to leave on good terms and less likely to leave for a competitor or attempt to poach their colleagues. This was because, although anyone who had handed in his or her notice would forfeit the right to be considered for an award of special capital, those he described as "good leavers" would often receive a severance payment. In determining the amount of any such payment, one factor of the many that would be taken into account, was the value of the award of special capital which the leaver might have received under the PIP had he or she stayed with BCM LP.

## Issue 1 – PIP Issue

*Did the PIP arrangements form part of the “profit-sharing arrangements” of the Partnership, within the meaning of s 850 ITTOIA 2005 and/or s 1262 CTA 2009? In particular, did the individual partners who participated in the PIP thereby have rights to share in the profits of the Partnership and, if so, what is the correct amount of profits to be allocated to them in each year under appeal and/or did SCL and/or Avon have rights to share in the profits of the Partnership and, if so, what is the correct amount of profits to be allocated to them in each year under appeal?*

308. I now turn to the PIP issue and, as in the Cayman Appeals, first set out the relevant legislative provisions.

309. The following provisions of ITTOIA are applicable:

### **848 Assessment of partnerships**

Unless otherwise indicated (whether expressly or by implication), a firm is not to be regarded for income tax purposes as an entity separate and distinct from the partners.

### **849 Calculation of firm's profits or losses**

(1) If–

- (a) a firm carries on a trade, and
- (b) any partner in the firm is chargeable to income tax,

the profits or losses of the trade are calculated on the basis set out in subsection (2) or (3), as the case may require.

(2) For any period of account in which the partner is a UK resident individual, the profits or losses of the trade are calculated as if the firm were a UK resident individual.

(3) For any period of account in which the partner is non-UK resident, the profits or losses of the trade are calculated as if the firm were a non-UK resident individual.

### **850 Allocation of firm's profits or losses between partners**

(1) For any period of account a partner's share of a profit or loss of a trade carried on by a firm is determined for income tax purposes in accordance with the firm's profit-sharing arrangements during that period. This is subject to subsections (2) and (4).

(2) If for the period of account the calculation under section 849 in relation to the partner produces a profit, but there is at least one loss-making partner–

- (a) each loss-making partner's share is neither a profit nor a loss, and
- (b) each profit-making partner's share is given by the formula in subsection (3).

(3) The formula is–

$$FP \times \frac{PP}{TP}$$

where–

FP is the amount of the firm's profit calculated under section 849 in relation to the partner,

PP is the amount determined under subsection (1) to be the profit of the profit-making partner in question, and

TP is the total of the amounts determined under subsection (1) to be the profits of all the profit-making partners.

(4) If for the period of account the calculation under section 849 in relation to the partner produces a loss, but there is at least one profit-making partner—

- (a) each profit-making partner's share is neither a profit nor a loss, and
- (b) each loss-making partner's share is given by the formula in subsection (5).

(5) The formula is—

$$\text{FL} \times \frac{\text{PL}}{\text{TL}}$$

where—

FL is the amount of the firm's loss calculated under section 849 in relation to the partner,

PL is the amount determined under subsection (1) to be the loss of the loss-making partner in question, and

TL is the total of the amounts determined under subsection (1) to be the losses of all the loss-making partners.

(6) In this section—

*“loss-making partner”* means a partner whose share is determined under subsection (1) to be a loss,

*“partner”*, in relation to a firm, means any partner in the firm, whether or not chargeable to income tax,

*“profit-making partner”* means a partner whose share is determined under subsection (1) to be a profit, and

*“profit-sharing arrangements”* means the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade.

### **851 Calculations etc. where firm has other income or losses**

(1) This section applies if—

- (a) sections 849 and 850 apply in relation to the profits or losses of a trade carried on by a firm, and
- (b) the firm has other income or losses.

(2) Those sections also apply as if references to the profits or losses of the trade were references to the other income or losses.

### **852 Carrying on by partner of notional trade**

(1) For each tax year in which a firm carries on a trade (the “actual trade”), each partner's share of the firm's trading profits or losses is treated, for the purposes of Chapter 15 of Part 2 (basis periods), as profits or losses of a trade carried on by the partner alone (the “notional trade”).

(2) A partner starts to carry on a notional trade at the later of–

- (a) when becoming a partner in the firm, and
- (b) when the firm starts to carry on the actual trade.

This is subject to subsection (3).

(3) If the partner carries on the actual trade alone before the firm starts to carry it on, the partner starts to carry on the notional trade when the partner starts to carry on the actual trade.

(4) A partner permanently ceases to carry on a notional trade at the earlier of–

- (a) when the partner ceases to be a partner in the firm, and
- (b) when the firm permanently ceases to carry on the actual trade.

This is subject to subsections (5) and (6).

(5) If the partner carries on the actual trade alone after the firm permanently ceases to carry it on, the partner permanently ceases to carry on the notional trade when the partner permanently ceases to carry on the actual trade.

(6) If–

- (a) the firm carries on the actual trade wholly or partly outside the United Kingdom, and
- (b) the partner becomes or ceases to be UK resident,

the partner is treated as permanently ceasing to carry on one notional trade when the change of residence occurs and starting to carry on another immediately afterwards.

(7) Subsection (6) does not prevent a loss made before the change of residence from being deducted under section 83 of ITA 2007 from profits arising after the change

...

### **863 Limited liability partnerships**

(1) For income tax purposes, if a limited liability partnership carries on a trade, profession or business with a view to profit–

- (a) all the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),
- (b) anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and
- (c) the property of the limited liability partnership is treated as held by the members as partnership property.

References in this subsection to the activities of the limited liability partnership are to anything that it does, whether or not in the course of carrying on a trade, profession or business with a view to profit.

(2) For all purposes, except as otherwise provided, in the Income Tax Acts—

- (a) references to a firm or partnership include a limited liability partnership in relation to which subsection (1) applies,
- (b) references to members or partners of a firm or partnership include members of such a limited liability partnership,
- (c) references to a company do not include such a limited liability partnership, and
- (d) references to members of a company do not include members of such a limited liability partnership.

310. These provisions which applied in 2009-10 were amended from 2010-11 as follows:

#### **850 Allocation of firm's profits or losses between partners**

(1) For any period of account a partner's share of a profit or loss of a trade carried on by a firm is determined for income tax purposes in accordance with the firm's profit-sharing arrangements during that period. This is subject to sections 850A and 850B.

(2) In this section and sections 850A and 850B "*profit-sharing arrangements*" means the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade.

#### **850A Profit-making period in which some partners have losses**

(1) For any period of account, if—

- (a) the calculation under section 849 in relation to a partner ("A") produces a profit, and
- (b) A's share determined under section 850 is a loss,

A's share of the profit of the trade is neither a profit nor a loss.

(2) For any period of account, if—

- (a) the calculation under section 849 in relation to A produces a profit,
- (b) A's share determined under section 850 is a profit, and
- (c) the comparable amount for at least one other partner is a loss,

A's share of the profit of the trade is the amount produced by the formula in subsection (3).

(3) The formula is ...

#### **850B Loss-making period in which some partners have profits**

(1) For any period of account, if—

- (a) the calculation under section 849 in relation to a partner ("A") produces a loss, and
- (b) A's share determined under section 850 is a profit, A's share of the loss of the trade is neither a profit nor a loss.

- (2) For any period of account, if—
  - (a) the calculation under section 849 in relation to A produces a loss,
  - (b) A's share determined under section 850 is a loss, and
  - (c) the comparable amount for at least one other partner is a profit, A's share of the loss of the trade is the amount produced by the formula in subsection (3).
- (3) The formula is ...

311. The legislation remained broadly in such form until the insertion, from 5 December 2013, of s 850C, s 850D and s 850E. The material parts of which provide:

**850C Excess profit allocation to non-individual partners**

- (1) Subsections (4) and (5) apply if—
  - (a) for a period of account (“the relevant period of account”)—
    - (i) the calculation under section 849 in relation to an individual partner (“A”) (see subsection (6)) produces a profit for the firm, and
    - (ii) A's share of that profit determined under section 850 or 850A (“A's profit share”) is a profit or is neither a profit nor a loss,
  - (b) a non-individual partner (“B”) (see subsection (6)) has a share of the profit for the firm mentioned in paragraph (a)(i) (“B's profit share”) which is a profit (see subsection (7)), and
  - (c) condition X or Y is met.
- (2) Condition X is that it is reasonable to suppose that—
  - (a) amounts representing A's deferred profit (see subsection (8)) are included in B's profit share, and
  - (b) in consequence, both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would otherwise have been.
- (3) Condition Y is that—
  - (a) B's profit share exceeds the appropriate notional profit (see subsections (10) to (17)),
  - (b) A has the power to enjoy B's profit share (“A's power to enjoy”) (see subsections (18) to (21)), and
  - (c) it is reasonable to suppose that—
    - (i) the whole or any part of B's profit share is attributable to A's power to enjoy, and
    - (ii) both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would have been in the absence of A's power to enjoy.
- (4) A's profit share is increased by so much of the amount of B's profit share as, it is reasonable to suppose, is attributable to—
  - (a) A's deferred profit, or
  - (b) A's power to enjoy,



as determined on a just and reasonable basis. But any increase by virtue of paragraph (b) is not to exceed the amount of the excess mentioned in subsection (3)(a) after deducting from that amount any increase by virtue of paragraph (a).

(5) If B is chargeable to income tax, in applying sections 850 to 850B in relation to B for the relevant period of account, such adjustments are to be made as are just and reasonable to take account of the increase in A's profit share under subsection (4). (This subsection does not apply for the purposes of subsection (7) or section 850D(7).)

(6) A partner in a firm is an "*individual partner*" if the partner is an individual and "*non-individual partner*" is to be read accordingly; but "*non-individual partner*" does not include the firm itself where it is treated as a partner under section 863I (allocation of profit to AIFM firm). ...

### **850D Excess profit allocation: cases involving individuals who are not partners**

(1) Subsections (4) and (5) apply if—

- (a) at a time during a period of account ("the relevant period of account") in respect of a firm, an individual ("A") personally performs services for the firm,
- (b) if A had been a partner in the firm throughout the relevant period of account, the calculation under section 849 in relation to A for the relevant period of account would have produced a profit for the firm,
- (c) a non-individual partner ("B") in the firm (see subsection (6)) has a share of that profit ("B's profit share") which is a profit (see subsection (7)),
- (d) it is reasonable to suppose that A would have been a partner in the firm at a time during the relevant period of account or any earlier period of account but for the provision contained in section 850C (see also subsections (8) to (10)), and
- (e) condition X or Y is met.

(2) Condition X is that it is reasonable to suppose that amounts representing A's deferred profit (see subsection (11)) are included in B's profit share.

(3) Condition Y is that—

- (a) B's profit share exceeds the appropriate notional profit (see subsection (12)),
- (b) A has the power to enjoy B's profit share ("A's power to enjoy") (see subsection (13)), and
- (c) it is reasonable to suppose that the whole or any part of B's profit share is attributable to A's power to enjoy.

(4) A is to be treated on the following basis—

- (a) A is a partner in the firm throughout the relevant period of account (but not for the purposes of section 863I (allocation of profit to AIFM firm)),

- (b) A's share of the firm's profit for the relevant period of account is so much of the amount of B's profit share as, it is reasonable to suppose, is attributable to—
  - (i) A's deferred profit, or
  - (ii) A's power to enjoy,
 as determined on a just and reasonable basis, and
- (c) A's share of the firm's profit is chargeable to income tax under the applicable provisions of the Income Tax Acts for the tax year in which the relevant period of account ends.

But A's share of the firm's profit by virtue of paragraph (b)(ii) is not to exceed the amount of the excess mentioned in subsection (3)(a) after deducting from that amount A's share of the firm's profit (if any) by virtue of paragraph (b)(i).

(5) If B is chargeable to income tax, in applying sections 850 to 850B in relation to B for the relevant period of account, such adjustments are to be made as are just and reasonable to take account of A's share of the firm's profit under subsection (4). (This subsection does not apply for the purposes of subsection (7) or section 850C(7).)

(6) “Non-individual partner” is to be read in accordance with section 850C(6).

(7) B's profit share is to be determined by applying section 850 and, if relevant, section 850A in relation to B for the relevant period of account (whether or not B is chargeable to income tax) on the assumption that the calculation under section 849 in relation to B produces the profit for the firm mentioned in subsection (1)(b).

(8) The requirement of subsection (1)(d) is to be assumed to be met if, at a time during the relevant period of account, A is a member of a partnership which is associated with the firm. ...

### **850E Payments by B out of the excess part of B's profit share**

(1) Subsection (2) applies in a case in which section 850C(4) or section 850D(4) applies if—

- (a) there is an agreement in place in relation to the excess part of B's profit share,
- (b) as a result of the agreement, B makes a payment to another person out of the excess part of B's profit share, and
- (c) the payment is not made under any arrangements the main purpose, or one of the main purposes, of which is the obtaining of a tax advantage for any person.

(2) For income tax purposes, the payment—

- (a) is not to be income of the recipient,
- (b) is not to be taken into account in calculating any profits or losses of B or otherwise deducted from any income of B, and
- (c) is not to be regarded as a distribution.

(3) In this section—

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

“B’s profit share” has the same meaning as in section 850C or 850D (as the case may be),

“the excess part of B’s profit share” means so much of the amount of B’s profit share as is represented by the amount of, as the case may be—

- (a) the increase under section 850C(4), or
- (b) A’s share of the firm’s profit under section 850D(4), and

“tax advantage” has the meaning given by section 1139 of CTA 2010.

312. Section 1262 CTA, which is also applicable, is set out above in relation to the Cayman Appeals (see paragraph 153, above).

313. Mr Gammie contends that the statutory context for PIP appeals which sets out the statutory regime applicable to partners is “fundamentally different” from that for employees under Income Tax (Employment and Pensions) Act 2003 as it reflects the fact that partners have a stake in the business.

314. In *Rossendale Borough Council v Hurstwood Properties (A) Limited and others* [2019] 1 WLR 4567 the Court of Appeal considered whether the doctrine of piercing the corporate veil was applicable to SPVs and whether leases fell to be disregarded by virtue of the *Ramsay* principle in relation to two schemes designed to avoid the payment of national non-domestic rates (“NDR”). As David Richards LJ explained:

“11. As appears from section 45(1) [Local Government Finance Act 1988], NDR are payable in respect of a property if four conditions are satisfied. First, on the day in question, the entirety of the property is unoccupied. No issue arises on the applicability of this condition in the present cases. Second, the person liable for the NDR must be “the owner” of the whole of the property. The “owner” is defined by section 65(1) as “the person entitled to possession of it”. As entitlement to possession connotes the exclusive entitlement to occupy the property (see *Brown v City of London Corpn* [1996] 1 WLR 1070, 1080, per Arden J), it is not in dispute that the tenant under a lease of a property is the “owner” for these purposes. Third, the property must be shown for the day in question in a local non-domestic rating list in force for the year. Again, no issue arises in these cases on that condition. Fourth, on the day in question, the property must fall within a class prescribed by regulations, which in these cases are the Non-Domestic Rating (Unoccupied Property) (England) Regulations 2008. By regulation 3, all relevant non-domestic properties are prescribed for these purposes other than those described in regulation 4. Regulation 4 includes any property whose owner is a company “which is being wound up voluntarily” under the Insolvency Act 1986: regulation 4(k).

12. The schemes in issue in these cases that involved the grant of a lease to an SPV followed by the voluntary winding up of the SPV sought to take advantage of the exception from NDR created by regulation 4(k). In those cases where the SPV was simply dissolved as a dormant company, the lease would vest as bona vacantia in the Crown or the Duchy of Lancaster or Cornwall (as appropriate). Whether NDR were in such circumstances payable by the Crown or either Duchy was not explored in submissions before us.

13. From this it can be seen that the lynchpin to the success of the avoidance schemes used in these cases was the grant of leases to the SPVs. If the leases could be disregarded either as shams or by the application of the *Ramsay* principle or if the SPVs could be disregarded by piercing their corporate veils, the schemes would not achieve their purpose and the defendant companies would be liable for NDR on the properties.”

315. Having considered the *Ramsay* principle and subsequent authorities Henderson LJ said, at [60]:

“Of equal importance is the salutary warning which Lord Nicholls proceeded to give, at paras 36–39 [of *BMBF*], that the mere fact of entering into a composite transaction which includes elements devoid of any commercial purpose does not necessarily lead to the conclusion that the composite transaction will fail in its objective of escaping a charge to tax or, as the case may be, falling within an exemption from tax. Everything always depends, as Lord Nicholls said at para 39, on “the need for a close analysis of what, on a purposive construction, the statute actually requires”. Thus, in the *BMBF* case itself, the taxpayer was entitled to a capital allowance for the expenditure of £91m which it had incurred in the provision of a pipeline for the purposes of its finance leasing trade, even though the financing arrangements which the taxpayer had made for the purchase and leaseback of the pipeline were not only preordained and circular, but also resulted in “the bulk of the purchase price being irrevocably committed to paying the rent”: see para 42.”

Henderson LJ continued, at [62]:

“The judgment of the Appellate Committee in *BMBF* was delivered some 14 years ago, but it remains in my view the leading modern authority on the nature and scope of the *Ramsay* principle. To say that, however, is not in any way to diminish the significance of the more recent restatement of essentially the same principles by Lord Reed JSC (with whom the other members of the Supreme Court agreed) in *UBS AG v Revenue and Customs Comrs* [2016] 1 WLR 1005. The section of Lord Reed JSC’s judgment dealing with the *Ramsay* approach runs from paras 61–68. After referring to Lord Nicholls’ formulation of “the essence of the new approach” in *BMBF* at para 32, Lord Reed JSC continued in a passage which I need to quote in full:

‘64. This approach has proved to be particularly important in relation to tax avoidance schemes as a result of two factors identified in the *BMBF* case, at para 34. First, ‘tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said, “in the real world”’. Secondly, tax 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 the scope of the charge’. In other words, as Carnwath LJ said in the Court of Appeal in the *BMBF* case [2003] STC 66, at para 66, 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 usually be said, as Carnwath 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’. Accordingly, as Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* (2003) 6 ITLR 454, at para 35, where schemes involve intermediate transactions inserted for the sole purpose of tax avoidance, it is quite likely that a purposive interpretation will result in such steps being disregarded for fiscal purposes. But not always.

65. As was noted in the *BMBF* case [2005] 1 AC 684, at para 35, there have been a number of cases since *Ramsay* in which it was

decided that elements inserted into a transaction without any business or commercial purpose did not prevent the composite transaction from falling within a charge to tax, or bring it within an exemption from tax, as the case might be. Examples include *Inland Revenue Comrs v Burmah Oil Co Ltd* 1982 SC (HL) 114, *Furniss v Dawson* [1984] AC 474, *Carreras Group Ltd v Stamp Comrs* [2004] STC 1377, *Inland Revenue Comrs v Scottish Provident Institution* [2004] 1 WLR 3172 and *Tower MCashback LLP v Revenue and Customs Comrs* [2011] 2 AC 457. In each case the court considered the overall effect of the composite transaction, and concluded that, on the true construction of the relevant statute, the elements which had been inserted without any purpose other than tax avoidance were of no significance. But it all depends on the construction of the provision in question. Some enactments, properly construed, confer relief from taxation even where the transaction in question forms part of a wider arrangement undertaken solely for the purpose of obtaining the relief. The point is illustrated by the decisions in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311 and the *BMBF* case itself.

66. The position was summarised by Ribeiro PJ in *Arrowtown Assets* 6 ITLR 454, para 35, in a passage cited in the *BMBF* case [2005] 1 AC 684, at para 36: ‘The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.’

“67. References to ‘reality’ should not, however, be misunderstood. In the first place, the approach described in the *BMBF* case and the earlier cases in this line of authority has nothing to do with the concept of a sham, as explained in *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786. On the contrary, as Lord Steyn observed in *Inland Revenue Comrs v McGuckian* [1997] 1 WLR 991, 1001, tax avoidance is the spur to executing genuine documents and entering into genuine arrangements.

“68. Secondly, it might be said that transactions must always be viewed realistically, if the alternative is to view them unrealistically. The point is that the facts must be analysed in the light of the statutory provision being applied. If a fact is of no relevance to the application of the statute, then it can be disregarded for that purpose. If, as in *Ramsay*, the relevant fact is the overall economic outcome of a series of commercially linked transactions, then that is the fact upon which it is necessary to focus. If, on the other hand, the legislation requires the court to focus on a specific transaction, as in *MacNiven* and the *BMBF* case, then other transactions, although related, are unlikely to have any bearing on its application.”

316. Having set out “basic propositions” of land law Henderson LJ continued, saying it followed that:

“73. ... once each scheme lease was executed, the right to legal possession of the property passed from PAGL to the lessee. Accordingly, the liability to NDR in respect of the property also passed from PAGL to the lessee, because from the day the lease was granted it was the lessee, and not PAGL, which satisfied the ownership condition in section 45(1)(b) of the 1988 Act. For the

purposes of the statutory scheme, that is the relevant condition which had to be satisfied, and as a matter of law the transfer of ownership took effect immediately upon the execution of the lease, regardless of the motivation of the parties in entering into it. Moreover, since the lease was not sham, it validly conveyed a legal estate in land to the lessee in the form of a term of years absolute, with all the necessary incidents of such a term, including the right to exclusive possession. None of this can be altered by the fact that the lease may have omitted some usual provisions, or that the intention of the parties was for the lessee to divest itself of its own liability to NDR by quickly entering into members' voluntary liquidation. Those factors help to explain the structure and motivation of the scheme, but for the purposes of section 45 the only relevant concept is whether ownership of the property has passed from the lessor to the lessee. On the agreed facts in the cases with which we are concerned, that condition was unquestionably satisfied, and I cannot see any scope for giving to the concept of ownership in this context, as defined in section 65(1), anything other than its normal legal meaning. The legislation is therefore not amenable to a wider, purposive construction which could allow scope for the *Ramsay* principle to operate. Conceptually, the case is of the same general type as the *MacNiven* case [2003] 1 AC 311 or *BMBF* [2005] 1 AC 684, or indeed the wider *Ramsay* argument which the Supreme Court rejected in the *UBS* case [2016] 1 WLR 1005.

74. Counsel for the claimants sought to persuade us, in their written and oral submissions, that there was at least arguably still scope for the *Ramsay* principle to operate, with the consequence that the actions should not be struck out and there should be a full investigation of the facts at trial after the parties had fully pleaded their respective cases and disclosure had taken place. In their written argument, they submitted that:

“the notion of an owner of a hereditament as a person entitled to possession has to be interpreted purposively as an owner with a *real* entitlement to possession, such that an SPV whose only reason for existence was to accept a lease, with no commercial purpose other than to avoid the liability to pay [national non-domestic rates], is not the owner of a hereditament.”

The fundamental problem with this submission, however, is that it elides the steps which have to be followed in deciding whether a *Ramsay* approach is possible. One step must always be to construe the relevant legislation, to see whether it admits of a *Ramsay* approach. For that purpose, it is not enough (as cases like *MacNiven* and *BMBF* show) merely to point to the tax-avoidance motive of the ratepayer, or the preordained nature of the transactions which are undertaken, or to aver that the SPV company's entitlement to possession is “unreal” where it has been brought into existence for the sole purpose of taking the lease. As I have sought to explain, the concept of entitlement to possession in section 65(1) of the 1988 Act is an intrinsically legal one, which is satisfied the moment that a valid lease to the SPV company has been executed. Where the relevant concept is of such a nature, the tax avoidance motivation of the parties and the artificiality of the arrangements become irrelevant, because they have nothing to do with the relevant legal concept.”

317. Mr Baldry contends that *Rossendale*, even though it concerned whether rates were payable and turned on the question of whether there was a company in occupation of properties under a lease, as is clear from observation of David Richards LJ at [11] and [13], was determined by way of a straightforward application of statutory construction. As Henderson LJ confirmed at [60]:

“... everything always depends, as Lord Nicholls said at para 39, on “the need for a close analysis of what, on a purposive construction, the statute actually requires”.

Mr Baldry also referred to [67] of *Rossendale* in which Henderson LJ said:

“Section 65 of the 1988 Act deals with interpretation of Part III, and section 65(1) states that: “The owner of a hereditament or land is the person entitled to possession of it” As Mr Mathew [leading tax counsel who appeared for *Rossendale*] rightly accepted in oral argument, this is clearly an exhaustive definition which leaves no room for other criteria by reference to which the owner of a hereditament may be identified for the purposes of Part III. Thus the second of the conditions which have to be fulfilled under section 45(1) must be read as meaning: “(b) on the day the ratepayer is *the person entitled to possession* of the whole of the hereditament.”

318. As cited above, Henderson LJ went on to observe, at [73] that the legislation in that case was, “not amenable to a wider, purposive construction which could allow scope for the *Ramsay* principle to operate” and continued, at [74], to dismiss the submission advanced by counsel for the claimants on the basis that:

“... it elides the steps which have to be followed in deciding whether a *Ramsay* approach is possible. One step must always be to construe the relevant legislation, to see whether it admits of a *Ramsay* approach. For that purpose, it is not enough (as cases like *MacNiven* and *BMBF* show) merely to point to the tax-avoidance motive of the ratepayer, or the pre-ordained nature of the transactions which are undertaken, or to aver that the SPV company's entitlement to possession is “unreal” where it has been brought into existence for the sole purpose of taking the lease. As I have sought to explain, the concept of entitlement to possession in section 65(1) of the 1988 Act is an intrinsically legal one, which is satisfied the moment that a valid lease to the SPV company has been executed. Where the relevant concept is of such a nature, the tax avoidance motivation of the parties and the artificiality of the arrangements become irrelevant, because they have nothing to do with the relevant legal concept.”

319. However, I agree with Mr Gammie who contends that, although *Rossendale* relates to land law and leases it is also applicable in the present appeal as it is necessary to consider the fundamental way in which people agree to carry on business together in partnership and how they agree to share profits. Although the present case is not concerned with a fundamental principle of land law it does involve a fundamental principle of partnership law and, as such, as Mr Gammie says, HMRC are not entitled to substitute some different agreement to that arrived at by the parties concerned which was clearly a commercial agreement entered into to achieve a commercial purpose. Some support for this can be found in *Lewis v Commissioners of Inland Revenue* [1933] 2 KB 557, which was also cited by Mr Gammie. In that case there was a partnership deed which, although never executed, was in fact agreed to be binding and acted upon in matters relating to the case. As such, there was no need to look beyond the terms of the deed which gave Mr Lewis a fixed share of the profits and the issue arose in that case because of the commission Mr Lewis had earned.

320. Mr Gammie contends that the PIP Appellants’ case under s 850 ITTOIA is “straightforward” – SCL and subsequently Avon were admitted as partners of the Partnership (BCM LP, BCM LLP or BCM(UK) LLP as appropriate) and, in accordance with the relevant partnership agreement, SCL and Avon were entitled to and were allocated a share of the profits. Their share was accordingly brought into charge to corporation tax and the post-tax share kept by the Partnership (BCM LP, BCM LLP or BCM(UK) LLP) as special capital and (usually)

invested in BlueCrest funds. In due course, following a recommendation by the PIP recommendation sub-committee and a decision by the board of SCL/Avon exercising their discretion following the recommendation of the sub-committee they directed the Partnership (BCM LP, BCM LLP or BCM(UK) LLP) to transfer an entitled to the company's special capital to the individual partners.

321. Mr Baldry advocates a purposive construction of s 850 ITTOIA. He says that the PIP concerns how the profits were shared under the arrangements in place for the relevant partnership for the years in question, and that this turns first on the true meaning of "profit sharing arrangements" in s 850 ITTOIA and secondly on the application of those rules to the facts of the case when viewed realistically. He contends that the arrangements were not constituted solely by partnership deed. Rather, in reality, the special capital represented a share of the profits and the corporate partners were set up to play out their role within the purpose of the scheme and follow the steps as they are instructed. HMRC say it is necessary to look at the arrangement as a whole and wrong to single out one step out of the arrangements and give that single step all the fiscal significance, ignoring everything else.

322. Additionally, Mr Baldry does not accept that HMRC are seeking to tax the individual partners as if they were employees. HMRC's case, he says, respects the partnership and simply seeks to tax the partners as such. The question for the Tribunal is, Mr Baldry says, whether as a result of the true effect of the partnership sharing arrangements, viewed realistically, the profits in question were shared between the individual partners in accordance with the terms of the PIP or whether it was only the company, SCL/Avon the corporate partner, that had the right to share in the profits.

323. I have already referred *Rangers* (see paragraphs 126 and 127, above) in which the Supreme Court considered the correct approach in constructing statutory provisions in relation to their context. Lord Hodge (with whom the other Justices agreed) observed:

"8. ... the central concept in the tax regime governing employment income is the payment of emoluments or earnings derived from employment; and an employer who pays emoluments or earnings to or on account of an employee is obliged to deduct tax in accordance with the PAYE Regulations.

...

10. The legislative code for the taxation of income has developed over time to reflect changing governmental policies in relation to taxation, to remove loopholes in the tax regime and to respond to the behaviour of taxpayers. Such responses include the enactment of provisions to nullify the effects of otherwise successful tax avoidance schemes (or schemes which were apparently successful pending a definitive judicial determination). As a result, the legislative code is not a seamless garment but is in certain respects a patchwork of provisions. Over time, judicial decisions on the interpretation of sections of the tax legislation have assisted in clarifying the boundaries of those provisions. Such decisions have influenced Parliament in the re-enactment of legislation. Some judicial decisions, for example, as I discuss in paras 42-44 below, the requirement that a "perquisite" in section 131 of ICTA be convertible into money, have been definitional."

He continued:

"12. Another, more recent, judicial development in the interpretation of taxing statutes is the definitive move from a generally literalist interpretation to a more purposive approach. This can be traced to the speech which Lord Nicholls of Birkenhead delivered in the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684, in which he



explained the true principle established in *WT Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300 and the cases which followed it. As he explained (para 28), the modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. In the past, the courts had interpreted taxing statutes in a literalist and formalistic way when applying the legislation to a composite scheme by treating every transaction which had an individual legal identity as having its own tax consequences. Lord Nicholls described this approach as “blinkered” (para 29). Instead, he removed the interpretation of taxing statutes from its literalist enclave and incorporated it into the modern approach to statutory interpretation which the court otherwise adopts. He stated (para 32):

“The essence of the new approach 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. ... [T]he question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311, 320, para 8: ‘The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case’.”

13. Lord Nicholls (para 34) recognised two features which were characteristic of tax law. First, tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said (in *WT Ramsay*, 326) “in the real world”. In the Court of Appeal in *Barclays Mercantile* [2003] STC 66, para 66, Carnwath LJ made the same point: taxing statutes generally “draw their life-blood from real world transactions with real world economic effects”. Secondly, the prodigious intellectual effort in support of tax avoidance results in transactions being structured “in a form which will have the same or nearly the same economic effect as a taxable transaction but which it is hoped will fall outside the terms of the taxing statute”. He continued: “It is characteristic of these composite transactions that they will include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge.” The correct response of the courts was not to disregard elements of transactions which had no commercial value. That, he said, was going too far. Instead the court had, first, to decide, on a purposive construction, exactly what transaction would answer to the statutory description and secondly, to decide whether the transaction in question did so (para 36).

14. Lord Reed in *UBS AG v Revenue and Customs Comrs* [2016] 1 WLR 1005, para 62, has helpfully summarised the significance of the new approach, which *WT Ramsay*, as explained in *Barclays Mercantile*, has brought about, in these terms:

“First, it extended to tax cases the purposive approach to statutory construction which was orthodox in other areas of the law. Secondly, and equally significantly, it established that the analysis of the facts depended on that purposive construction of the statute.”

15. In summary, three aspects of statutory interpretation are important in determining this appeal. First, the tax code is not a seamless garment. As a result provisions imposing specific tax charges do not necessarily militate against the existence of a more general charge to tax which may have priority over and supersede or qualify the specific charge. I return to this point towards the end of this judgment (paras 68-72 below). Secondly, it is necessary to pay close attention to the statutory wording and not be distracted by judicial glosses which have enabled the courts properly to apply the statutory words in other factual contexts. Thirdly, the courts must now adopt a purposive approach to the interpretation of the taxing provisions and identify and analyse the relevant facts accordingly.”

324. In *Rangers* the issue before the Supreme Court was the concept of earnings or emoluments and whether there was a statutory purpose that could be discerned that limited those emoluments to those actually paid over to the employees and, impliedly, excluded payments made to a third party such as an EBT.

325. Lord Hodge took such an approach at [35] onwards saying:

“35. Income tax on emoluments or earnings is, principally but not exclusively, a tax on the payment of money by an employer to an employee as a reward for his or her work as an employee. As we have seen from the use of the word “therefrom” in section 19 of ICTA (para 5 above), income tax under Schedule E was charged on emoluments from employment. In other words, it was a tax on the remuneration which an employer pays to its employee in return for his or her services as an employee. This concept also underpins the concept of “earnings” in ITEPA (para 6 above) which in section 9(2) refers to “taxable earnings from an employment” and in section 62 defines earnings in relation to an employment. Included in that definition in section 62(2)(c) is the catch-all phrase: “anything else that constitutes an emolument of the employment”. That which was an emolument under prior legislation remains an emolument under ITEPA. What is taxable is the remuneration or reward for services: *Brumby v Milner* [1976] 1 WLR 29, 35 per Lord Russell of Killowen in the Court of Appeal; [1976] 1 WLR 1096, 1098-1099 per Lord Wilberforce in the House of Lords. That is not in dispute.

36. The central issue in this appeal is whether it is necessary that the employee himself or herself should receive, or at least be entitled to receive, the remuneration for his or her work in order for that reward to amount to taxable emoluments.

37. A careful examination of the provisions of the primary legislation reveals no such requirement. First, section 13 of ITEPA defines “the taxable person” who is liable for any tax on employment income. Subsection (2) of that section provides: “If the tax is on general earnings, the ‘taxable person’ is the person to whose employment the earnings relate.” The employee, whose work gives rise to the remuneration, is taxed, not the recipient of the earnings. This is consistent with the prior history of the tax charge under Schedule E which, as RFC acknowledged in its written case, made the employee the taxable person even if the emoluments were received by a third party.

...

39. I see nothing in the wider purpose of the legislation, which taxes remuneration from employment, which excludes from the tax charge or the PAYE regime remuneration which the employee is entitled to have paid to a third party. Thus, if an employee enters into a contract or contracts with an employer which provide that he will receive a salary of £X and that as part of his remuneration the employer will also pay £Y to the employee’s spouse or

aunt Agatha, I can ascertain no statutory purpose for taxing the former but not the latter. The breadth of the wording of the tax charge and the absence of any restrictive wording in the primary legislation, do not give any support for inferring an intention to exclude from the tax charge such a payment to a third party which the employer and employee have agreed as part of the employee's entitlement. Both sums involve the payment of remuneration for the employee's work as an employee.

...

41. As a general rule, therefore, the charge to tax on employment income extends to money that the employee is entitled to have paid as his or her remuneration whether it is paid to the employee or a third party. The legislation does not require that the employee receive the money; a third party, including a trustee, may receive it. While that is a general rule, not every payment by an employer to a third party falls within the tax charge. It is necessary to consider other circumstances revealed in case law and in statutory provisions which fall outside the general rule. Those circumstances include: (i) the taxation of perquisites, at least since the enactment of ITEPA, (ii) where the employer uses the money to give a benefit in kind which is not earnings or emoluments, and (iii) an arrangement by which the employer's payment does not give the intended recipient an immediate vested beneficial interest but only a contingent interest.

At [50] Lord Hodge referred to the decision of the Privy Council in the New Zealand case of *Hadlee v Comr of Inland Revenue* [1993] AC 524 ("*Hadlee*") before concluding at [59]:

"Parliament in enacting legislation for the taxation of emoluments or earnings from employment has sought to tax remuneration paid in money or money's worth. No persuasive rationale has been advanced for excluding from the scope of this tax charge remuneration in the form of money which the employee agrees should be paid to a third party, or where he arranges or acquiesces in a transaction to that effect. Having adopted this purposive construction of the legislation, ..."

326. *Hadlee* concerned New Zealand income tax legislation and a contention by a partner in an accountancy firm that he was that he was not liable to income tax on a proportion of his annual partnership income which he had assigned to a trust under which the primary beneficiaries were his wife and child. This was rejected by the New Zealand courts and the Privy Council upheld their decision, holding that income tax was a tax on income which was the product of the taxpayer's personal exertion and that the taxpayer could not escape liability to pay that tax by assigning a part of his share in the partnership. However, as Mr Gammie pointed out, and as is apparent from the decisions of the New Zealand courts in *Hadlee*, the structure of the New Zealand tax legislation is fundamentally different to that of the UK structure of taxation of partnerships in that it does not isolate partnership income as a separate source of income.

327. Mr Gammie referred to the judgment of Richardson J in the New Zealand Court of Appeal in *Hadlee* [1991] 3 NZLR 517 where, in relation to "personal exertion income" and whether similar overriding considerations preclude recognition of income splitting of other personal income, he said, at 532-533:

"But in policy terms the same general considerations that led to the conclusion that the Income Tax Act require wage and salary earners to pay the tax on their earnings, must apply equally to the earnings of the self-employed from their personal exertions. The character or quality of the income which arises is the same in either case. Future wages and future receipts for personal services do

not arise without that work. Personal exertion income has been deliberately distinguished from income from property in our legislation and in the legislation of other countries because of that perception that they are quite different in character. If the income is the product of personal exertion that stamp requires that it be taxed accordingly, and that any disposition of a related property interest should take effect subject to that charge for tax. In such cases and whether the taxpayer is employed or self-employed, attaching the label of a property right to an assignment does not change the character off the income that is thereafter derived. The contract is merely the vehicle through which the earnings by personal effort are obtained.

Obviously there are cases when entitlement to professional or business income is not dependant on personal energy input; one partner may contribute labour, another capital. More often, while capital assets may play some part in the derivation of income, the element of personal exertion is clearly predominant. In some circumstances it may be necessary to analyse a particular income-earning activities in some detail; see Mannix and Harris, *Australian Income Tax Law and Practice* (11<sup>th</sup> ed) para 6/46 and 23 *Halsbury's Laws of England* (4<sup>th</sup> ed) para 881. But common experience confirms that in general working professionals earn their incomes from their exertions and if they do not perform they may be fired by their partners. There is no justification in principle for differentiating between salary and wage earners and professionals whose income is the product of their personal exertion. In either case the person whose it personal exertion earns income derives the income. It would be wrong to impute an intention to Parliament that income spitting, with its inevitable undermining of the graduated rate structure should be widely available to professional and commercial taxpayers allowed tonight a salary and wage earners.”

328. Mr Gammie says that it is clear that it is impossible to apply this to the UK structure where it is the trade itself that is the source of the profits, with the question being how the profits are then divided between the partners. The present case can be distinguished as the PIP award was not made for any work done by the particular partner but was established as a recruitment and retention policy and was not a share of the profits.

329. Although HMRC accept that *Rangers* is an employment case, Mr Baldry contends that the same principles apply. As is apparent from *Hadlee*, cases dealing with employments and cases dealing with partnerships are not unrelated and, as *Hadlee* makes clear, a taxpayer cannot escape liability to tax on income that is the product of his exertions whether a partner or employee.

330. Lord Hodge, having looked at the matter as a composite whole noted in *Rangers*:

“65. There was a chance that the trust company as trustee of the Principal Trust might not agree to set up a sub-trust and there was a chance that as trustee of a sub-trust it might not give a loan of the funds of the sub-trust to the footballer. But that chance does not alter the nature of the payments to the trustee of the Principal Trust. In applying a purposive interpretation of a taxing provision in the context of a tax avoidance scheme it is legitimate to look to the composite effect of the scheme as it was intended to operate. In *Inland Revenue Comrs v Scottish Provident Institution* [2004] 1 WLR 3172 Lord Nicholls stated (para 23): “The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned.” The footballers, when accepting the offer of higher net remuneration through the trust scheme which the side letters envisaged, were prepared to take the risk that the scheme might not operate as planned. The

fact that the risk existed does not alter the nature of the payment to the trustee of the Principal Trust.

66. The bonuses which RFC and the other employing companies gave their executives were made available through the same trust mechanisms. See para 31 above. The employees had no contractual entitlement to the bonuses before their employers decided to give them but that does not alter the analysis of the effect of the scheme. The fact that bonuses were voluntary on the part of the employer is irrelevant so long as the sum of money is given in respect of the employee's work as an employee: *Blakiston v Cooper* [1909] AC 104, 107 per Lord Loreburn LC, *Hartland v Diggines* [1926] AC 289, 291 per Viscount Cave LC. For the same reasons as those which cause the footballers' remuneration paid to the Principal Trust to be subject to taxation, the bonuses which were paid to the employees though the trust mechanism fall within the tax charge as emoluments or earnings when paid to the Principal Trust."

331. Similarly the PIP traders in the present case were effectively willing to take a risk, given the discretions involved, that an award might not be paid. Mr Baldry contends that as a result of *Ramsay*, etc tax law has been absorbed into general law and is no longer an island or enclave, but that the PIP Appellants are, in essence, trying to argue setting up partnership law as "another little atoll ... outside the scope of the *Ramsay* principle". However, I agree with Mr Gammie that it is implicit in the speech of Lord Hodge in *Rangers* that the Supreme Court was concerned with whether an employee's remuneration was taxable as his or her earnings when it is paid to a third party in circumstances in which the employee had no prior entitlement to receive it him or herself (see *Rangers* at [1]).

332. In such circumstances it is the payment in respect of the work done by an employee that is subject to tax. As Lord Hodge observed at [35]:

"Income tax on emoluments or earnings is, principally but not exclusively, a tax on the payment of money by an employer to an employee as a reward for his or her work as an employee."

333. However, in the case of a partnership, a provisional award, such as under the PIP, is not an allocation of profits but drawings from a partnership which is not within the scope of tax. The taxation of partners is in relation to the profits of the underlying trade and the division of profits as agreed between the partners. As such I am unable to derive an assistance from *Rangers* in this case where it is necessary to consider what the partners actually received under the PIP.

334. It is apparent from the PIP arrangements that it was not a share of the profits that the partners received or had credited to their accounts but special capital credited to the corporate partner, SCL and/or Avon, which it agreed to transfer to the partners and was a transfer of part of the amount credited to the corporate partner as a result of previously being allocated profits which removed the corporate partner's debt on its distribution account. As Mr Gammie submits, this is not in the character of income or a share of profits.

335. The Partnership profits, ie the profits that were agreed to be allocated were, in fact, allocated by BCM LP (BCM LLP or BCM(UK) LLP) to SCL and Avon and were correctly brought into charge to corporation tax with the post-tax share of the profits of the corporate partners' being invested in partnership assets as special capital which formed the basis of the awards made to individual partners under the PIP.

## **Issues 2 and 3 – Profit Allocation Issues**

336. Issues 2 and 3 in the PIP Appeals, the Profit Allocation Issues, replicate Issues 1 and 2 of the Cayman Appeals. Given my conclusions in relation to those in that appeal, which are

equally applicable to the PIP Appeals, other than confirm my decision in relation to both, it is not necessary to consider these issues further.

#### **SUMMARY OF CONCLUSIONS IN PIP APPEALS**

337. For the reasons above I find in favour of the PIP Appellants in relation to the PIP Issue but against them on Issues 2 and 3 the Profit Allocation Issues.

#### **IP APPEALS**

338. Notwithstanding my conclusion in the PIP Appeals, HMRC contend that the appellants in this appeal, Mr Dodd, MP, Leda Braga, Simon Dannatt and Jonathan Ward who are or were all partners in either BCM LP, BCM LLP and/or BCM (UK) LLP are subject to income tax on the sums received under the PIP as either miscellaneous income, under s 687 ITTOIA, or, alternatively, if the receipts were capital in accordance with Chapter 4 of Part 13 of ITA.

339. As the periods concerned encompass those when the business was transferred from BCM LP to BCM LLP and BCM (UK) LLP, I shall use the expression the “Partnership” or Partnerships to described any or all of these entities as the context requires where it is not necessary to distinguish between them. I should also note that, although there is no formal rule 18 (of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009) direction in place, the IP Appellants are intended to be representative of the larger number of partners who participated in the PIP.

340. The following Statement of Agreed Facts and Issues was provided by the parties in the IP appeals:

#### **AGREED FACTS**

##### **Introduction**

(1) This is the statement of facts as agreed between the parties.

##### **Partnership Appeals**

(2) The parties adopt the facts and matters stated in the Agreed Facts as stated in the Statement of Agreed Facts and Issues in the appeals by BCM LP, BCM LLP and BCM (UK) LLP (appeal numbers TC/2017/05553, TC/2017/05704 and TC/2017/05705, respectively) (together, the “**PIP Appeals**”) in relation to the PIP.<sup>22</sup>

(3) Where it is unnecessary to distinguish between them, BCM LP, BCM LLP and BCM UK LLP are collectively referred to as the “**Partnerships**”.

##### **The Appellants**

(4) At all times material to their appeals, the Appellants were partners of the Partnerships.

(5) In each of the years in which they have been assessed to tax, and in respect of which they make their appeals, the Appellants received sums from the corporate partners in the Partnership, namely SCL and/or Avon, pursuant the PIP.

(6) At the times material to their Appeals, the Appellants (respectively, “**Mr Dodd**”, “**Ms Braga**”, “**Mr Dannatt**”, “**MP**” and “**Mr Ward**”) had the following roles in the Partnerships:

---

<sup>22</sup> The appeals by BCMCL and BCMC LP (appeal numbers TC/2017/04430 and TC/2017/04431, respectively) (together, the “Cayman Appeals”), are not relevant to the Appellants’ appeals.

- (a) Mr Dodd: CFO;
- (b) Ms Braga: Head of Systemic Trading;
- (c) Mr Dannatt: Business management/investor relations;
- (d) MP: Portfolio management and CEO; and
- (e) Mr Ward: Product management/systematic trading.

### The Appeals

(7) Mr Dodd, Ms Braga, Mr Dannatt, MP and Mr Ward, are appealing against the following closure notices issued in August 2018:

<b>Taxpayer</b>	<b>Date of Individual Partner Closure Notice</b>	<b>Tax year of Closure Notice</b>	<b>Increased amount said by HMRC to be chargeable by way of income tax pursuant to ss 687-689 of the ITTOIA 2005 or s.776 of the ITA 2007</b>
Mr Dodd	28 August 2018	Year ended 5 April 2010	██████████
Mr Dodd	28 August 2018	Year ended 5 April 2011	██████████
Ms Braga	31 August 2018	Year ended 5 April 2010	██████████
Ms Braga	31 August 2018	Year ended 5 April 2011	██████████
Ms Braga	31 August 2018	Year ended 5 April 2012	██████████
Mr Dannatt	30 August 2018	Year ended 5 April 2010	██████████
Mr Dannatt	30 August 2018	Year ended 5 April 2011	██████████
Mr Dannatt	30 August 2018	Year ended 5 April 2012	██████████
Mr Dannatt	30 August 2018	Year ended 5 April 2014	██████████
Mr Dannatt	30 August 2018	Year ended 5 April 2015	██████████
Mr Dannatt	30 August 2018	Year ended 5 April 2016	██████████
MP	30 August 2018	Year ended 5 April 2009	██████████

MP	30 August 2018	Year ended 5 April 2010	██████████
MP	30 August 2018	Year ended 5 April 2011	██████████
MP	30 August 2018	Year ended 5 April 2012	██████████
MP	30 August 2018	Year ended 5 April 2013	██████████
Mr Ward	30 August 2018	Year ended 5 April 2011	██████████
Mr Ward	30 August 2018	Year ended 5 April 2012	██████████

The figures in the fourth column in the above table were redacted following an application made by the IP Appellants on 1 July 2020 (see appendix for further details).

(8) On HMRC's analysis, should the Partnerships be successful in the PIP Appeals, the individual partners in the Partnership would be liable to tax in respect of their awards under the PIP on two alternative bases, each of which treats sums received by the Appellants pursuant to the PIP as income. The issues relating to HMRC's secondary and tertiary arguments will be termed the "**Miscellaneous Income Issue**" (pursuant to Part 5, Chapter 8 of the ITTOIA 2005) and the "**Sales of Occupation Income Issue**" (pursuant to Chapter 4 of Part 13 of the ITA 2007), respectively. The Appellants deny that sums received under the PIP are liable to be taxed as income on either of these bases.

### AGREED ISSUES

This is the statement of issues as agreed between the parties.

The question for the Tribunal's determination is whether HMRC's amendments to the Appellants' tax returns, as detailed in the Discovery Assessments and the Closure Notices, should be set aside. The parties envisage that this raises the following issues for the Tribunal's determination:

#### *Miscellaneous Income Issue*

- (1) Were sums received by the Appellants pursuant to the PIP income or capital for the purposes of the Income Tax Acts?
- (2) If they were income, were they charged to tax under s.687(1) of the ITTOIA 2005?

#### *Sales of Occupation Income Issue*

- (3) If they were capital, were the sums received by the Appellants pursuant to the PIP charged to income tax under Chapter 4 of Part 13 of the ITA 2007? In particular:
  - (a) Was the main object, or one of the main objects, of the transactions or arrangements the avoidance or reduction of the Appellants' liability to income tax?



(b) In respect of each Appellant, were the transactions effected, or arrangements made, to exploit the earning capacity of that individual in an occupation? In this regard:

(i) Was the relevant Appellant carrying out an “occupation” within the meaning of s.777(2) of the ITA 2007, i.e. was the Appellant undertaking activities of a kind undertaken in a profession or vocation?

(ii) If so, were the transactions effected, or arrangements made, to exploit that Appellant’s earning capacity in the occupation by putting another person in a position to enjoy:

(1) all or part of the income or receipts derived from the individual’s activities in the occupation; or

(2) anything derived directly or indirectly from such income or receipts?

## **Evidence**

341. In addition to documentary evidence and Agreed Statement of Facts and Issues the following witnesses gave evidence on behalf of the IP Appellants:

(1) Andrew Dodd, who also gave evidence in the Cayman Appeals and PIP Appeals.

(2) MP, who, with WR, established the BlueCrest business in 2000 and is its chief executive officer.

(3) Leda Braga, who is the founder and CEO of Systematica Investments GP Limited (“Systematica”). In 2015, she headed a “spin-off” of the systematic division within BlueCrest into Systematica which manages approximately US\$ 7 billion worth of investments, including in Systematica Blue Trend Master Fund Limited and Systematica BlueMatrix Master Fund Limited, and has around 100 employees. In addition she has, until recently, served as an advisor to the board of the pension fund of the CERN in Geneva. She also sits on the advisory board of the London School of Economics Systemic Risk Centre.

(4) Jonathan Ward, who is a portfolio manager with a hedge fund. In December 2007 he became a partner of BlueCrest and the prefix of “Principal” was added to his job title to reflect his promotion to the Partnership and share of an equity stake.

(5) Simon Dannatt, who has since February 2018 been the Chief Operating Officer of ExodusPoint Capital Management UK LLP (“ExodusPoint”). Before joining ExodusPoint, Mr Dannatt had spent over 14 years with BlueCrest in a number of different roles. These included the development of tools for discretionary traders primarily focused on fixed income but also supporting those operating in equities and foreign exchange that the traders could use to improve their analysis, pricing and risk management capabilities. Around 2008 he transferred to the role of co-head for FX Volatility, working alongside the existing head of the team. This role involved overseeing the performance of portfolio managers and assessing risk on both an individual and aggregated basis. He also directed research and analytics for this team, which included designing and implementing systematic strategies and involved building relationships with internal teams and applying his understanding of BlueCrest’s trading strategies to ensure their efficient integration. From September 2009 (following the establishment of BCM LLP in 2008) Mr Dannatt became business manager for Marketing and Investor Relations where, working with the head of Marketing and Investor Relations, his role was to ensure that the appropriate resources,

structure, systems and processes were in place for the Marketing and Investor Relations team to function effectively.

### **Further findings of fact**

342. I have set out above (see paragraphs 283 and 294) how, according to the relevant agreements between the parties, “Special Capital” is defined and operated. Clearly this has to be borne in mind in relation to this appeal which concerns the operation of the PIP and how special capital is to be regarded in the hands of its recipients.

343. The operation of and reason for implementing the PIP have been described in the PIP Appeal. However, as he did not give evidence in the PIP Appeal it is worth noting that, in his evidence in the IP Appeal MP explained that, when it was originally conceived, the PIP was “just copying” the J P Morgan Group (“JPM”) bonus deferral programme under which a percentage of pay was deferred. MP explained that this was “extremely effective” in ensuring people did not leave the business. He said that at that time the Partnership was “having significant problems” with poaching from other firms and with people losing money which the Partnership was not able to claw back. He therefore sought a way to “lock my people in”.

344. Although MP emphasised that the PIP applied in other jurisdictions where BlueCrest operated where there was not any “tax benefit” and that he considered that the PIP had been established to, “protect our business and lock in our people” he did not, “deny that getting a tax saving” was a “good thing” and that he was “happy” that there was a tax benefit. However, MP confirmed that he was not personally involved in the “detail” of the plan and how it worked as that was, “all really left to the accountants.”

345. An example of how the PIP operated in practice can be seen in the “final award” letter to Mr Dodd from SCL, dated 30 January 2009. It states:

“Further to our letter to you of 2<sup>nd</sup> June 2008, informing you that you had been recommended by BlueCrest Capital Management Limited, as general partner of BlueCrest Capital Management LP (“BCM LP”), to receive an award by way of a reallocation of special capital (the “Award”), we write to provide further details in respect of this Award.

As stated, the potential Award was subject to certain forfeiture provisions and we confirm the potential award has not been forfeited under these rules. In addition, we have received a further recommendation from the Board of BlueCrest Capital Management LLP (“BCM LLP”) (following the transfer to BCM LLP of the business of BCM LP) to make the Award to you (the “Further Recommendation”).

Having taken Into consideration the Further Recommendation, we are delighted to confirm that we made an unconditional award to you of special capital equal to a minimum of £296,400. This award will be satisfied (in order to reflect the transfer referred to above and the fact that the “incentivisation” pool is held within BCM LLP) by a reallocation to you of special capital In BCM LLP which will be credited to your special capital account in BCM LLP on 30<sup>th</sup> January 2009. Such special capital shall be subject to the terms of the BCM LLP limited liability partnership agreement entered into on 01 December 2008 (the “LLP Agreement”). Please note that in accordance with the provisions of the LLP Agreement, you have the right to withdraw such special capital, subject to providing 3 months' prior notice to the Board of BCM LLP or such other period of notice as shall be agreed with the Board of BCM LLP and that the Board of BCM LLP may satisfy such withdrawal request in case or in specie.”

346. Mr Dodd responded to this letter on 30 January 2009:

**“Withdrawal of special capital**

Please accept this letter as my request to withdraw the sum standing to the balance of my special capital account in BlueCrest Capital Management LLP.”

347. On 16 February 2009 Ms Kerridge, then the Partnership’s Head of Tax, sent, as an attachment to an email, to Mr Dodd a note on the PIP which she intended to circulate to all of the partners together with a note of their proposed awards. She asked Mr Dodd to let her know when he had decided what he “would like to go into the plan” for himself.

348. Mr Dodd replied, on 17 February 2009 that the note “looks very good” and that he thought that his:

“...amount for investment for 2009 will be approximately £1.2m gross of tax provision. What % tax provision should I assume when determining the allocation, 28% or some lower number?”

Ms Kerridge responded by email later that day (17 February 2009):

“The £1.2m mentioned below [in Mr Dodd’s email] can be funded now. But you might want to think about putting in another £1.2m out of the proceeds of November award, due to you 1<sup>st</sup> April. It seems to me you might want to shelter £2.4m in total as your overall profit for the year, even assuming no more drawings between Feb and Nov, will be £2.67m. eg Dec 1.51, Jan 1.16.”

Although in evidence Mr Dodd could not remember what he understood in 2009, he agreed that, “one can reasonably conclude”, that by using the word “shelter” in her email Ms Kerridge “was talking about shelter from tax” which was “of course a benefit of the scheme.”

349. Similarly, Simon Dannatt, in an email to Mr Dodd of 1 February 2011, had referred to the “obvious tax angle” as a reason for stating that, “it would be good if we could find some way for some of the partnership income to make its way in to the PIP”. Mr Dannatt explained in evidence that he had meant this to mean the potential for a “lower tax level” associated with the PIP.

350. The tax implications of the PIP was also something that was explained to new recruits to the Partnership. This is apparent from the following email, dated 19 June 2012, to Mr Dodd from one such new recruit:

“Hope you’re well. Definitely feel like I’m settling in to the group and very happy I made the move. When we discussed the terms for working at Bluecrest you mentioned when I joined I could see a copy of the accountants view on the tax scheme used for bonuses. Also have you got the final number/date for the payment of the deferred I lost when I left [previous employer].”

In evidence Mr Dodd confirmed that the “tax scheme” referred to in the email was indeed the PIP.

351. A further example of a reference to tax can be seen in an email, dated 15 October 2013, to Mr Dodd from a trader who had been involved in the recruitment process. In relation to the 2013 PIP he asked:

“So if we promised 500k net which we have paid out in special capital and there is some tax due on that through the settlement (if that were to happen!!) they are assuming that [BlueCrest] will pay that tax as the deferrals were promised net.”

Mr Dodd responded:

“Let’s see. Everyone knew there was some risk but I take your point. I gave some soft promises to some of them.”

In relation to this, Mr Dodd explained that it was known at the time the PIP was implemented that there might be some discussions with HMRC as to its operation and that he had been asked by the individual concerned who had accepted what Mr Dodd had told him about how the PIP worked but had nevertheless asked what the position would be if this was not correct.

352. In addition to explaining how they regarded the PIP from a tax position, each of the IP Appellants who gave evidence also described his or her background and subsequent role in the Partnerships.

353. Mr Dodd graduated from the University of Oxford in 1993 with a BA in Philosophy, Politics, and Economics focussing on philosophy and politics after completing the first year of his degree course. During his time at university he did not have any particular career in mind but, towards the end of his course, attended a series of recruitment presentations by major financial institutions and successfully applied for a graduate position at Goldman Sachs.

354. He subsequently joined Goldman Sachs’ London office in the general UK corporate finance practice in the summer of 1993 as an analyst. At the commencement of his employment Mr Dodd attended a six week induction training programme in New York. He explained that half of the induction programme was centred on an introduction to the different parts of the business of Goldman Sachs with the other half consisting of training in more practical tasks which were aimed at those who did not have previous experience of working in the finance industry. Although he described this induction course, which was not examined, as “useful” Mr Dodd said that he learnt how to perform his analyst role at Goldman Sachs from observing, working with colleagues and experience. He received very little formal training.

355. Mr Dodd explained that the role of a Goldman Sachs analyst at that time involved the provision of advisory services to clients. These were usually major listed companies in the UK. The team would be headed by a more experienced individual who was able to give advice on the stock market reaction to a particular course of action and was very experienced in the likelihood of a successful sale of a subsidiary, eg the likely attractiveness to the equity market of a public offering of new shares in a company.

356. Initially Mr Dodd was the “most junior member of the team” and was directed by his senior colleagues to perform financial analyses and look into historical flotations of companies that might be relevant to a financial model and forecasts which might be the basis for evaluating and advising in relation to the business. However, Mr Dodd said that the financial analysis that he undertook when at Goldman Sachs did not require a high level of mathematical training and that this was reflected in the variety of backgrounds of his colleagues many of whom did not have degrees in mathematics.

357. In 1996 Mr Dodd was promoted to the role of associate in the Financial Institutions Group (“FIG”) and was required to attend a further internal training programme which was very similar to the induction programme when he first joined Goldman Sachs. This role involved greater responsibility in transactions and commercial negotiations and he not only had more contact with clients but also a greater involvement in marketing and advisory work. This was in addition to some of the same tasks that he had undertaken as an analyst, eg company research, etc.

358. He was promoted to the position of Executive Director in July 1999 and from then until September 2000 worked in the FIG team in New York. In 2004, Mr Dodd became a Managing Director of Goldman Sachs. Although, as Mr Dodd explained, these titles did not add any

formal managerial responsibility to his role, they were nevertheless career milestones reflecting his progression within the organisation.

359. Whilst he was part of the FIG team at Goldman Sachs Mr Dodd was engaged in a wide range of transactions which included public mergers and acquisitions. These included the Lloyds TSB acquisition of Scottish Widows in 1999 and the merger of General Accident and Commercial Union (subsequently Aviva). He was also involved in more general corporate finance work. In 2003, he advised BlueCrest in relation to the acquisition of a 25% interest in BCM LP and its general partner BCML by Sugarquay working closely with MP.

360. Mr Dodd left Goldman Sachs in January 2006 and joined BlueCrest in March 2006 to take up the role of CFO which he had been offered by MP the previous autumn after a number of informal discussions between them. Mr Dodd said that his title of CFO was, "somewhat unrepresentative" of his role, which he described as being responsible for the finance function for the BlueCrest management entities (but with no responsibilities in relation to the funds) as the day-to-day running of the finance team is the responsibility of the Head of Finance, a qualified accountant. Mr Dodd explained that he is not, and never has been, involved in the preparation of financial statements for the funds other than, like other directors, in the "signing off" process. He explained that he is concerned with the strategic direction of the business and acts as a key adviser to MP and considers that his role could possibly be described more accurately as "Chief of Staff".

361. While there has been a great degree of change in the business of BlueCrest since Mr Dodd took on his role it has remained broadly consistent with varied responsibilities, which include general corporate finance work such as advising MP, managing the non-trading functions of the business, and, together with the Chief Operating Officer, being the reporting line for the non-trading areas of the business. He is a member of the Executive Committee of the Partnership which includes BCM LP and (subject to the definition of UK Executive Committee) BCM (UK) LLP, at which key strategic and operational decisions are debated and made. However, Mr Dodd said that his qualifications for this role included his commercial experience, project management skills and personal relationship with MP.

362. MP explained that all hedge funds are "the same" in that they all have computers and screens, money and an FSA registration. He said that the "only thing that differs between our businesses is the people and the quality of those people. It's purely a people business."

363. In relation to what makes a good trader he said, in evidence, that:

"... the simple answer to that is, a trader that makes money, and I'm not being facetious when I say that, it is incredibly difficult in financial markets to make money. It's the most competitive environment there probably is. Everything that works very soon doesn't work because people find out and they get onto it and everybody starts doing it and it's gone, so the half-life of anything that works is extremely short. ... It's a really rapidly and continuously evolving space and you've got to be able to reinvent yourself continuously in real time and recognise that when what you're doing doesn't work anymore and be very disciplined about that."

364. MP explained that when recruiting traders he looked for a track record rather than any particular skill set. He compared "good traders" to tennis players saying that they are people that "just know how to play and adapt". He said that it was not possible to tell who it was going to be and could be "anybody from any background". When asked to give an example MP referred to a trader on the floor of the London financial futures exchange ("Liffe"), which he described as being the venue in which about the most money was traded in the world. The particular trader, who was known as a "local" (ie someone who speculated with their own

money) was, for a number of years, the most profitable earning “tens of millions of dollars” a year. MP recalled seeing him in one of his visits to the Liffe and asked what he had done before becoming a trader to which he replied he was at Allied. MP asked if this was the Allied Irish Bank to which trader had said, “no, Allied Carpets”, having previously been a carpet-fitter.

365. There was, MP said, to his knowledge, no university course in the world to teach trading. It was not a subject that can be taught. Although it was possible to learn what a market is and what, eg a bond convention is, he thought that it was not possible to teach “trading” as the market evolves so rapidly that by the time it was taught anything that had worked would no longer do so.

366. In evidence he described BlueCrest traders as, a “collection of gamblers” saying:

“... when you buy a government bond, which is traded on the futures exchange, it's moving around so erratically, you can't say you have any real knowledge, you have an inkling that it might go up or down based on, let's be honest, your gut feel. I mean, it is wholly true to say that trading is a gut feel kind of business, by which I would say a lot of the analysis that happens, it's the subconscious analysis. Subconsciously, you know, you look at a market and you think: I don't know why, but I just don't like this, and these are the strongest kind of signals that you get. Your subconscious, it's not that your stomach is doing anything, your brain is doing it. You are subconsciously analysing the markets and the way it's moving. It's an emotional thing. The markets are very emotional and you react and you either can read it or you can't read it.

So when investors come to the fund, they have a collection of individuals who kind of gamble in all their own little spaces and they hope that the diversification over that group will produce a return, ...”

367. Ms Braga, who has a first degree and Masters (MSc) in mechanical engineering from the Pontificia Universidade Católica do Rio de Janeiro and studied for a PhD in mechanical engineering at Imperial College London, decided, in 1994, to leave an academic career to move into banking and successfully applied for a job at Morgan Guaranty Trust, part of JPM. Although no specific qualifications were required, the mathematical and computing skills that Ms Braga had obtained through her general education and subsequent academic teaching could, she said, be put to use in a banking environment.

368. Initially Ms Braga joined the “Analytics Group” a division within JPM that had responsibility for developing the modelling tools used for the trading it undertook. This group later merged into a front office team with a similar mandate called “Derivatives Research” which was, like the Analytics Group, responsible for supporting the derivatives systems and models used by the trading desks for pricing and risk management issues. However, there was no accreditation specific to her role and she was not a member of any professional body neither was there any training specific to derivatives modelling. Rather, she said, it was something learned while working in the job.

369. In March 2000, as part of six-person management team, Ms Braga established Cygnifi Derivative Services Ltd (“Cygnifi”). She described it as being, “essentially a start-up business, spun-off from JPM, and based in New York, London and Tokyo which set out to provide online derivatives services”. However, despite their efforts, Cygnifi failed to raise a needed second round of finance and, in September 2001, it filed Chapter 11 in the US and for administration in the UK.

370. Ms Braga joined BlueCrest as an employee having been recruited by MP and WR to develop a systematic trading business which she described as an approach to buying and selling

assets, usually securities, in all shapes and forms, using information and technology to achieve sustainable results. She said that the day-to-day work of systematic traders is to build algorithms that autonomously conduct the processes of signal generation, portfolio construction and the execution of trades.

371. She explained that signal generation was the process by which the algorithms built by the systematic traders evaluate or “forecast” which securities or assets should be traded, ie whether a particular security is a “good buy” and will increase in value. The algorithm would look for factors that indicate whether a company, currency or country’s stock market would increase or decrease in value in the future. It would also analyse data from a variety of sources and perform such techniques as regressions, statistical measurements that attempt to determine the strength of a relationship between one dependent variable such as a commodity price and a series of changing variables such as the stocks of businesses dealing in those commodities; natural language processing, where unformatted data such as company filings, press material or events are processed into a score or a forecast, eg it is able to monitor press activity in relation to a particular stock and decide that, following positive reports, the price of that stock might rise.

372. Portfolio construction, Ms Braga explained, followed the selection by an algorithm of the securities to trade or “take a position on”. The next step was the execution of trades which Ms Braga said occurred once the algorithm had selected which trades should be placed or executed. These should, she explained, ideally be executed at a good price and in a way that does not impact the market. To achieve sound execution, all traders, whether systematic or discretionary, will use execution algorithms. These are automated pre-programmed trading instructions that determine when a trade should be executed and account for variables such as the time, price and volume of the trade and ensure that systematic traders do not need to watch a stock constantly and repeatedly execute trades manually.

373. Generally, systematic traders will use the algorithm to execute ‘slices’ of the trade throughout the day in line with the volume of trades in that asset in the market which, Ms Braga explained, was known as “volume weighted average price execution”. An algorithm would additionally analyse data to optimise the execution of trades, taking into account trends reflecting how and when in the day trades are being executed; and orderbook information indicating the sales and purchases of a specific asset and deduce from that information what market dynamics are at play. By making use of analysis generated by the algorithm, a systematic trader will time his or her execution of trades to take advantage of market trends and dynamics.

374. In evidence Ms Braga explained the differences between systematic and discretionary trading saying:

“At the top level of the tree of characteristics, it’s the same. We’re trying to find assets to buy and to sell, and we are trying to build a portfolio of assets that will serve clients with some return in a target timeframe, some investors have a long timeframe, some investors have a short timeframe, so you have target returns, and you’re trying to achieve those returns while managing the risk.

...

And at the end of the day, systematic trading and discretionary trading do the same thing which is to try to establish a process to select those assets, buy and sell, and achieve the returns the client demands.

So in systematic trading the difference is that in the discretionary world often a lot of the analysis is in the head of the trader. So he uses tools, we provide

the trader with tools to help, but there's a bit of reading the news, watching the political environment, and it's all in the head of the trader to a certain extent.

The systematic traders tend to articulate their principles more clearly, and because we articulate our principles more clearly, it's a little bit easier to apply those principles to a larger number of assets."

375. When, as she was involved in recruitment, Ms Braga was asked about the qualities sought from potential systematic traders she said that as BlueCrest was very entrepreneurial and was trying to do something that was not "mapped" there was, "no clear training, no clear discipline that you could hire from to do systematic trading." She distinguished financial markets from other data profiling as unlike, eg Netflix, which collects all of the data from all the people that watch particular films and the profile of a particular individual to whom it makes recommendations of what to watch, financial markets have a very large amount of randomness or unpredictability to them. She gave what she referred to the following "very punchy example" that even if 10 million tosses of a coin, a random event, were fed into an algorithm, the algorithm would be no wiser at predicting what the next toss outcome will be.

376. Ms Braga explained that because of this when potential candidates were interviewed for BlueCrest, although they would look for someone who had a very good commercial sense, an interest in the markets, an interest in mathematical formulations and in coding and communicating with a client, it would be possible to complete that skill set on the job. Essentially, she said that systematic trading was "by and large something you learn from experience" and that she was not aware of any courses that can train people up for it. She said that when recruiting although "deferral mechanisms" would be mentioned she would not "normally" bring up the tax element of it but said that in conversations she had, when introducing the idea that they were going to be paid in that way, explained that there was a "tax benefit" and that the scheme was "structured" in a way that "at least it makes it a bit more palatable."

377. Jonathan Ward, who graduated in maths with computer science from the University of Southampton with a first class degree (BSc) in 2004, successfully applied to BlueCrest having seen the following advertisement during his final year at university:

"BlueCrest is looking to hire two recent graduates to expand and support its systematic trading team. The successful candidates will have a first or 2.1 degree in mathematics, physics or engineering and have graduated within the last 12 months. Programming experience would be advantageous however it is envisaged these will be development roles with the candidates to participate in external training as deemed necessary.

The development of the roles will include some 'hands on' trading and analysis and will require the successful candidates to become FSA registered at an early stage. Upon registration, BlueCrest will then provide 75% sponsorship for the two candidates to participate in an MSc in statistics from Birkbeck, University of London, attending part-time evening classes and to commence in October this year."

378. Mr Ward's initial role at BlueCrest was in relation to "trade execution" as the "most junior" in the team. He explained that trades would be produced by the model automatically, which would get sent to the brokers, and that his role was to oversee that the emails to ensure that the trades would get sent to the brokers correctly and that the "fills" for those trade orders were coming back to BlueCrest at an appropriate time. As such, the use of maths was "non-existent, really," as he was just checking that things were running as he was told they should.

379. In June 2005 Mr Ward, having expressed an interest in doing so and having undertaken some research tasks in his previous role, became a member of the Research Team for the



BlueTrend fund with a job title “Quantitative Analyst”. He explained that the main role of the Research Team was to maintain the trading strategies already in use and to devise new ones. Although this role involved the use of statistics, Mr Ward explained that the statistical methods used were “very much customised methods” of the Head of Research and that he had to learn these in order to do research for BlueTrend. He said that it was having to do this research that supported the MSc course he undertook at Birkbeck, University of London during his first two years with BlueCrest rather than the other way round and that he thought that it was his work that had helped him get the top marks in his MSc.

380. While a member of the Research Team, Mr Ward worked on all areas of the BlueTrend fund’s trading model, including upgrading the model for forecasting expected returns for all sectors and portfolio construction. This involved learning and applying the statistical methods applied by senior members of the team. He also focused on practical and technical ways to streamline Systematic Trading strategies. He explained that this required “creativity combined with commercial rationale to find innovations that were not only technically feasible but also commercially viable” to exclude ideas that “were theoretically strong but would not have a real-world application.”

381. In December 2007 Mr Ward became a partner of BlueCrest and the prefix of “Principal” was added to his job title to reflect this. However, there was not any material change in his day-to-day activities even though he was no longer an employee.

382. In 2009 Mr Ward was appointed to a new role, “Product Manager” for the BlueTrend fund. He explained that at this time BlueCrest, which was growing quickly and comprised three funds including BlueTrend, had adopted Ms Braga’s suggestion for a “Product Manager” for each fund. Although the role was seen as experimental and did not have a fixed remit, Mr Ward said that “in broad terms” the product manager would assist with:

- (1) implementing the direction of the particular fund together with Ms Braga, the head of Research, and other senior researchers. This, Mr Ward explained, was something that would follow from an annual meeting in which Ms Braga would set the agenda, eg whether the focus should be on increasing the capacity for assets that could be managed in a particular way, or should it be on new ideas so that the fund behaved differently to those of its the competitors;
- (2) working on the needs of the fund (eg putting new statistical models into the production system, highlighting points for development and advising on the resourcing and streamlining research projects). These would primarily have been determined by Ms Braga or potentially feedback from investors or a “team” decision if it were considered that a change in approach was required. It would then be for Mr Ward to implement any such change;
- (3) coordinating the work of the different teams (such as Research, Trading Implementation and Execution); and
- (4) implementing new processes.

383. In evidence Mr Ward said that the title “Product Manager” was “just a label” and a better description would have been “flag-bearer” for each of the funds but as that was “not really a job title” the term product manager was used.

384. He described his day-to-day role as including liaising with the head of each functional team (Research, Trading, Implementation and Execution) to be aware of any issues with the BlueTrend programme, a review of the previous day’s performance, and highlighting anything unexpected to the relevant individual, reviewing the risk taken in different sectors and markets, reviewing markets that were close to position limits which, Mr Ward explained were the

maximum position the business could hold in a given market with the limits being either those adopted by BlueCrest or imposed by a regulator. In addition he considered new lines of research that could be undertaken and liaised with researchers in regard to ongoing research, as well as adding discussion items to the weekly BlueTrend Product Meeting which would also involve members of each functional team.

385. As a product manager for BlueTrend, Mr Ward was aware of the Systematic Trading competitors in the market which included Man Group, Winton Capital and Aspect Capital. He explained that research projects would often be determined by investors' concerns, eg he said that a number of investors might raise concerns about interest rates going to zero and it would then have been part of his role to work with the Research Team to investigate products for investors in order to report back to them. However, Mr Ward said that his role at BlueCrest was not particularly well-defined as it included both research and managerial-type responsibilities, something noted by other hedge funds when he was exploring the possibility of leaving BlueCrest who had expressed a preference for individuals either in research or management.

386. Mr Ward was also involved in recruitment for BlueCrest's Research Team. He explained that although technical mathematical abilities were an "easily assessable threshold" to limit the number of applicants, his emphasis in asking questions was to identify an individual's creative potential as it was this potential and the ability to think about the facts in a commercial manner that he looked for in a candidate.

387. Simon Dannatt studied mathematics at Fitzwilliam College at the University of Cambridge. He explained that the course covered many different areas of mathematics, including calculus, probability, geometry and electromagnetism, but that it did not particularly focus on the application of mathematics to financial markets. He graduated from Cambridge in 1998.

388. On graduation, having whilst at university undertaken an internship there, he joined JPM's graduate training programme, taking a role in their Equity Derivatives Modelling team, and was involved in coding pricing models for the traders as part of the bank's analytics library which, he said, "sat between the purely quantitative team, who had more of an academic role, and the traders." His job was to translate the research and models of the quantitative team into useable tools for the traders which were typically designed with an Excel-based user interface and connected into a C++ based analytics library. It was during this time that Mr Dannatt came into contact with Ms Braga who was also working at JPM on quantitative models for fixed income and equity related products.

389. After approximately 18 months with JPM, Mr Dannatt sought alternative opportunities and became aware of Ms Braga's venture, Cygnifi which he joined in February 2000 to work on interest rate derivative modelling. His primary role at Cygnifi was to develop pricing models and analytics for both interest rate and fixed income derivatives. As he was dealing with asset classes of assets this required further "on-the-job" learning to become familiar and understand the market techniques and market conventions for these products. In addition to his primary role, as Cygnifi was a new business, Mr Dannatt also supported the business in a variety of ways. This included coding for its platforms, dealing with clients, and, in the early period, purchasing and installing technical equipment.

390. Following Cygnifi's insolvency (see paragraph 369, above) in October 2001 Mr Dannatt joined BlueCrest, which had obtained a licence for Cygnifi's analytics library. He explained that such access meant that tools could be developed in a quicker timeframe for BlueCrest's traders as it was an analytics package with which he was familiar.

391. Initially, Mr Dannatt's role at BlueCrest concerned quantitative analysis and the development of tools for discretionary traders and was primarily focused on fixed income, but also supporting those operating in equities and foreign exchange. This required him to exercise the coding and mathematical skills that he had developed while at JPM and Cygnifi. To do so he continued to develop his understanding of how portfolio managers made trading decisions. This required him to liaise with the portfolio managers to understand how they viewed markets and what was required to model markets to fit in with their approach to be able to translate their feedback into workable product solutions.

392. In 2007, Mr Dannatt was asked to lead the proposed semi-systematic strategies (ie those with a strong systematic component but which also combined some element of discretionary trading) known as the Coded Intuition Initiative. He was responsible for recruiting portfolio managers to join the team and based his selection decisions on the understanding of the different trading strategies gained while at BlueCrest. Having identified and recruited portfolio managers Mr Dannatt was responsible for overseeing the technical implementation of, and integration with, BlueCrest's systems and processes to ensure that their trading activity was efficiently captured into its portfolio management and risk systems. Additionally, Mr Dannatt's role included the performance oversight of live strategies utilising the Partnership's established risk framework and systems.

393. The Coded Intuition Initiative was abandoned in 2008 and Mr Dannatt became co-head for FX Volatility, where he worked alongside the existing head of the team. This role involved overseeing the performance of portfolio managers and assessing risk on both an individual and aggregated basis. Mr Dannatt also directed research and analytics for this team, which included designing and implementing systematic strategies. He explained that one part of this role was focused on managing relationships with counterparties, which was vital in ensuring that portfolio managers had sufficient liquidity to execute trades and visibility over market prices.

394. From September 2009, and subsequent to the replacement of BCM LP by BCM LLP, Mr Dannatt became business manager for Marketing and Investor Relations with responsibility for managing BlueCrest's investor relations (both existing and prospective). He described his role as business manager as being "varied" saying that it, "evolved in response to internal demands and market pressures at the time." Working with the head of Marketing and Investor Relations, Mr Dannatt's role was to ensure that the appropriate resources, structure, systems and processes were in place for the team to function effectively. At this time BlueCrest was rapidly expanding and attracting a greater number of institutional investors which led to a decision to overhaul its marketing presentations, investor letters, due diligence questionnaires and the processes surrounding their production.

395. Mr Dannatt described his day-to-day responsibilities as including:

- (1) working with the head of Marketing and Investor Relations to develop processes, controls and team structure;
- (2) assisting in the management and oversight of Marketing and Investor Relations and its sub-teams;
- (3) management of the Portfolio Specialist and Research Team;
- (4) liaising with portfolio managers to source and provide relevant information to the Sales Team and ultimately the funds' investors;
- (5) producing content for marketing material (often utilising information sourced from internal teams); producing internal management information; and

(6) supporting the Sales Team in conversations with investors (acting as product specialist for certain funds and strategies).

396. Mr Dannatt said that he believed that it was “on-the-job experience” that prepared him most in performing this business focused operational role as it meant that he had built up a high level of knowledge of the different trading teams and functions, had learned to troubleshoot, manage employees, deduce the working habits and preferences of colleagues and develop the ability to grasp complex concepts and explain them to others.

397. Because of his interaction with investors Mr Dannatt was required to be registered (as CF4 Partner, CF30 Customer) with the FSA (and subsequently the FCA) for certain controlled functions for the BCM LLP and BCM (UK) LLP. When asked to explain what he had done that required registration Mr Dannatt said that:

“... there were two principal drivers for that regulated CF1, earlier on where there was an interaction on the trading side, and so CF30 – and I believe these have changed numbers and names over the year, but CF30 is the customer facing function, and that’s relevant either as a trading role where you are interfacing with the market to execute trades and put trades into the market, or on the client side from a marketing role where you are dealing with clients and talking to them about investments, so both regulated activities in the UK financial services industry.”

398. Mr Dannatt also sat on the AllBlue Allocation Committee. He explained that AllBlue was a multi-strategy fund managed by BlueCrest that invested in other BlueCrest funds, both discretionary and non-discretionary, in differing proportions. This Committee met monthly to determine fund allocations and Mr Dannatt’s role included sourcing and collating data for use in committee discussions (on topics such as fund performances) and participating in committee discussions to evaluate issues including the opportunities, risk profiles and performance of underlying strategies and aggregate performance figures based on different allocations. He also spoke to investors to support the Sales Team and to provide insight into the thoughts of the allocation committee and maintained relationships with counterparties who provided leverage to the geared version of the fund, and worked with internal legal and operational teams to ensure the smooth operation of the leverage facility.

399. He said that to perform such a role it was necessary for him to have an understanding of the different strategies used at BlueCrest for which, in addition to using his mathematical and logical skills, he relied on a general market awareness and ability to digest, analyse, and present views from a variety of portfolio managers across a variety of strategies. Mr Dannatt remained as a business manager and an AllBlue Committee member until he left BlueCrest in April 2016.

400. Having set out the factual background in relation to each of the IP Appellants I now turn to the issues in the IP Appeals.

### ***Issue 1 – the Miscellaneous Income Issue***

*(1) Were sums received by the Appellants pursuant to the PIP income or capital for the purposes of the Income Tax Acts?*

*(2) If they were income, were they charged to tax under s.687(1) of the ITTOIA 2005?*

401. As previously, it is first convenient to set out the applicable legislation which in respect of this issue is contained in ITTOIA the material parts of which provide:

#### **5 Charge to tax on trade profits**

Income tax is charged on the profits of a trade, profession or vocation.

...

### **687 Charge to tax on income not otherwise charged**

(1) Income tax is charged under this Chapter on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act.

(2) Subsection (1) does not apply to annual payments.

(3) Subsection (1) does not apply to income that would be charged to income tax under or as a result of another provision but for an exemption.

(4) The definition of “income” in section 878(1) does not apply for the purposes of this section.

(5) For exemptions from the charge under this Chapter, see in particular—

section 768 (commercial occupation of woodlands), and

section 779 (gains on commodity and financial futures).

...

### **689 Person liable**

The person liable for any tax charged under this Chapter is the person receiving or entitled to the income.

402. Although the charge to tax on miscellaneous income is now contained in s 687 ITTOIA, this provision, as Mr Gammie reminded me, which was previously enacted as the basic charge under schedule D Case VI, has a long history dating back to 1803 and, perhaps not surprisingly, has been the subject of judicial comment over the years much of which remains relevant today.

403. In *Ryall (Inspector of Taxes) v Hoare* [1923] 2 KB 447, the issue was whether two directors of a limited company who received sums by way of commission for guaranteeing the company’s overdraft with its bankers were liable to be assessed under case VI of schedule D. Rowlatt J said, at 453-455:

“The facts are that the company, which was in want of money at the time, asked the directors to give a personal guarantee to the company’s bankers in consideration of an increase from 5000*l.* to 10,000*l.* in the company’s overdraft. The directors, although unwilling to do this, ultimately consented. The transaction was not one in which the directors were interested as a matter of business, and one of them, who is a solicitor, declares that he never previously entered upon such a transaction and in all probability would never again do so. Therefore, although the circumstances are that they are men of affairs and that the company is engaged in business, in view of the facts found by the Special Commissioners and included in the case stated I must treat the case as if a person who was not connected with business at all received a commission from another person also not connected with business, in return for the favour of guaranteeing his account at a bank. In these circumstances are these commissions received as “annual profits or gains” under Case 6? Two kinds of emolument may be excluded from Case 6. First, anything in the nature of capital accretion is excluded as being outside the scope and meaning of these Acts confirmed by the usage of a century. For this reason, a casual profit made on an isolated purchase and sale, unless merged with similar transactions in the carrying on of a trade or business is not liable to tax. “Profits or gains” in Case 6 refer to the interest or fruit as opposed to the principal or root of the tree. The second class of cases to be excluded consists of gifts and receipts, whether the emolument is from a gift *inter vivos*, or by will, or from finding an article of value, or from winning a bet. All these cases must be ruled out because they are not profits or gains at all. Without giving

an exhaustive definition, therefore, we may say that where an emolument accrues by virtue of service rendered whether by way of action or permission, such emoluments are included in "Profits or gains." Assuming then that these commissions constitute "profits or gains," the further question for consideration is whether they are "annual" profits or gains. The word "annual" may mean "annually recurring," as applied to the seasons of the year, or "recurring over a long period of years": or it may mean "lasting only for one year," as we speak of certain flowers as annuals which must be sown afresh every year: or, as in the case of interest on a sum of money, it may mean "calculated with reference to a year." In the present case the transaction did last for a year and was renewed for another year, although it did not so continue of its own accord, but by agreement between the parties. I do not think that any of those meanings are applicable to the word "annual" as used in Case 6. Now one is not entirely left without guidance, at any rate as a matter of practice. It has been recognized that if a furnished house is let even for a few weeks during the season in any one year, the letting will attract income tax under Case 6 on the profit so made: the principle of this has never been ruled upon by decision of the Courts, but it has been tacitly assumed that this is so by the Courts in Scotland, and I do not think it is now open to a Court of first instance, at any rate, to say that this practice is wrong. The letting in such a case is not recurring yearly, nor does it last for a year, nor is it calculated with reference to a year, but only with reference to the requirements of a few weeks. Similarly when a person is appointed for a few weeks to an office to perform some services not in the nature of a trade or business in consideration of a lump sum (as for instance a Judge's marshal) income tax is deducted. Nor does it afford a clear explanation of this to say that the servant is taxed in such cases as being the holder of an "office"; for the tax on an office is calculated on the annual amount of profits. The word "annual" here can only mean "calculated in any one year," and "annual profits or gains" mean "profits or gains in any one year or in any year as the succession of years comes round."

404. In *Jones v Leeming* [1930] AC 415, which established, in the days before capital gains tax, the principle that the profit from a single transaction of a purchase and sale of property was taxable only if it amounts to a trade and if not does not fall within Case VI, Viscount Dunedin observed, at 422, that:

"The limitations of the words 'profits and gains' were pointed out by Blackburn J. long ago in the case of *Attorney-General v. Black*, when he said that profits and gains in Case VI. must mean profits and gains ejusdem generis with the profits and gains specified in the preceding five Cases. And then there came the memorable and often quoted words of Lord Macnaghten in the *London County Council* case, when he begged to remind people 'that income tax is a tax on income.' The only question, therefore, here was — Was there in any sense income?"

405. *Brocklesby v Merricks (HM Inspector of Taxes)* (1934) 18 TC 576 is representative of a series of cases in which Case VI has been considered in which a service of some sort has been provided. In that case an architect was, on a social occasion, told by the owner of an estate that he wished to sell his property. Later he arranged a meeting between the owner and a client, the outcome of which was that the client purchased the estate on behalf of his company. The architect subsequently entered into an agreement with a company that purchased the estate under which he undertook to endeavour to dispose of it and to negotiate with the parties concerned on the basis that the company agreed to pay him one-fourth of the net profits of the sale. Although the architect took no part in the negotiations and, other than produce a plan that was not used, did no work in connection with the re-sale of the estate, when it was re-sold he

nevertheless received his share of the net profits from the company. Finlay J (whose decision was upheld by the Court of Appeal) said, at 580-283:

“The case is rather a peculiar one. It is proper to mention at the beginning that it comes before me as a case of assessment under Case VI of Schedule D. At a late stage, it was intimated on behalf of the Inland Revenue that they would also desire to seek to support the assessment as being one which was, or could be, validly made under Case II of Schedule D. It is not necessary that I should go into that, except to say that the learned Attorney-General, while intimating that he was prepared to rest, and did rest, his argument before me upon Case VI, said that he desired to keep open - I mention it only for that purpose - the possibility of an argument that Case II might be applied if he was driven out of Case VI. Having said that, I proceed to deal with it on Case VI, which was the matter before the Commissioners and which was the matter really argued before me.

...

The Appellant's contention was that this sum was not a sum in the nature of income assessable under any of the provisions of the Income Tax Acts. The Respondent's contention is a little important. It was that the Appellant was rightly assessed in the sum of £4,740 under Case VI, “the said sum having been paid to the Appellant as commission for introducing Mr. Dashwood, of Dashwood & Partners, Limited, to the owner of the Estate.” That contention, I think, would not do, and for this very elementary reason: there was no agreement at all that the Appellant, in respect of this introduction arising out of some meeting on a social occasion, was to receive remuneration, and I think it is perfectly well settled that, in those circumstances, anything that might be given to him would be a perfectly voluntary payment and would not be income; it would be merely a present. We are not in the region of cases where tips, or profits of an office or vocation, and matters of that sort, may be part of the profits of, for instance, a waiter. It is, I think, quite clear and quite well settled that if a service of that sort is rendered - rendered with no contract for remuneration at all - then a sum paid afterwards would not be assessable. But what the Commissioners find is not that. What they find is this: “We were of opinion that the payment made to the Appellant was for services rendered and was rightly assessed upon him under Case VI of Schedule D.” It seems to me that it was a payment made to the Appellant for services rendered. It is perfectly true that he did very little. He apparently did nothing except prepare an estate plan. He did very little, doubtless because the estate was promptly and favourably sold, and, in consequence, there was not much of that architect's and surveyor's work which he had agreed to do without charge, nor had he to take any trouble in connection with finding people willing to buy and negotiating with them. The transaction was a fortunate one and went through promptly, but I cannot doubt that this was a contract for remuneration in respect of services rendered. I think the truth of the matter is this: the Appellant had rendered, and rendered voluntarily and without remuneration, an important service to the company. The company was therefore disposed to give him, and did give him, a very advantageous contract in respect of these services which he was to render, but the circumstance that, so to speak, an inducement for the favourable terms which he there got was the fact that he had rendered an important service to them, does not prevent it, to my mind, from being a contract in respect of services rendered. After all one has to consider what he was paid for. He was paid this sum, because he had an enforceable right to get it, and that enforceable right was based on this, that he had got a contract in respect of which, for certain services to be rendered by him specified in the contract, he was to be entitled to remuneration.”

406. Similarly in *Scott (Inspector of Taxes) v Ricketts* [1967] 1 WLR an auctioneer who had received a payment of £39,000 for withdrawal from participation in a business venture was assessed under Case VI. Lord Denning MR said, at 831-832:

“The one point now is whether this £39,000 is chargeable under Case VI. That Case is a “sweeping up” provision. It catches “annual profits or gains” which have not been caught by the other provisions. It is difficult to construe and we have to go by the decided cases.

In *Ryall v. Hoare* Rowlatt J. staked out the guide-lines: and there have been other cases following it. Some things are clear. “Annual” profits does not mean profits which are made year by year. It is satisfied by profits made in one year only. “Profits and gains” include remuneration for work done, services rendered or facilities provided. They do not include gratuitous payments which are given for nothing in return. Nor do they include profits in the nature of capital gains. So they do not include gains made on purchase and sale of an asset. Such gains (except for recent legislation) are only taxable if the transaction was an adventure in the nature of trade.

The crux of the present case is that Mr. Ricketts had no legal ground to be paid anything. All he had — to use the judge's words — was a moral claim or a nuisance value. Ravenscroft paid him £39,000 in order that he should not feel aggrieved, and to get rid of any possible claim. If they had paid this sum over to him as a gratuitous payment, it would not have come within Case VI. But because it was “dressed up” as a contract — to use the judge's own words — he has held that it is caught by Case VI. I do not think that is right. Take the case where a man has a good legal claim which he agrees to forgo in return for a sum of money, such as a claim for personal injuries which is compromised by payment of a lump sum. That is not an annual profit or gain within Case VI. It is the sale of an asset — namely, his legal claim — for a price. Next, suppose that the man has a claim which he believes to be good but which is in fact unfounded — and he agrees to forgo it in return for a sum of money.

It might be a claim for personal injuries when he has no evidence of negligence. It is not strictly an “asset,” because it would not stand up in the courts. But the compromise is binding. The payment has the same quality as if the claim was well founded. It is not an annual profit or gain within Case VI. Finally, take a man who has a moral claim but knows that he has no legal claim. He tries it on so as to see if the defendants will pay him something. They agree to buy him out so as to save the cost of fighting it. It seems to me that the payment for tax purposes has the same quality as that in a compromise. It is not an annual profit or gain within Case VI.

The judge seems to have thought that, as the payment was made under a contract, that was enough to bring it within Case VI. I cannot agree with him. It must be a contract for services or facilities provided, or something of that kind.

The present case is rather like *Leeming v. Jones*. If the sum was taxable at all, it was taxable as part of the profits of Mr. Ricketts' trade or profession. Once that is negated, it becomes simply a sum received in compromise of a disputed claim: whether legal or moral makes no difference.

I think that this case does not fall within Case VI. I would allow the appeal and restore the decision of the commissioners”

407. Davies LJ, agreeing with Lord Denning, said, at 833-834:



“It seems to me that the payment made by Ravenscroft to Mr. Ricketts in those circumstances was either a gratuitous payment or a payment for the buying out of Mr. Ricketts' possible claim. The special commissioners came to the conclusion that it was a gratuitous payment. The judge thought otherwise, and I am in agreement with him on that point.

The judge expressed his conclusion in these words:

“I cannot see, therefore, how the payment can properly be described as a gratuitous payment. But equally I fail to see how it can be described as the purchase price of any asset owned by Ricketts. What he had was a moral claim or a nuisance value, whichever way you like to put it, and that cannot properly be described as an asset susceptible of being sold even though it may in fact yield money. In this case the money which Ricketts received from it was not a gratuitous payment but a payment under a contract in consideration of his consent to the deal between Ravenscroft and the society and I can see no reason why it should not be taxed as a casual profit under Case VI.”

With the first part of that, as I have said, I agree. The second I cannot accept. It does not matter, as I think, whether Mr. Ricketts had any real or legally enforceable claim or not. It is perfectly plain, from the short passages I have read, that the parties were negotiating on the basis that he had a claim. Whether a moral claim, whether a commercial claim, or whether a claim under some sort of gentlemen's agreement matters not. They were proceeding on the basis that he had a claim, and that in those circumstances it was right and proper, and no doubt, in view of Mr. Ricketts' position and experience, expedient, that he should be persuaded to waive or give up any such rights as he thought he had or the other parties thought he had. It is perfectly true that the payment made to him was a payment made under a contract; but the only contract was the contract by Ravenscroft to pay and by Mr. Ricketts to accept payment in return for the giving up of such rights as Mr. Ricketts might or might not have

...

In my judgment, without referring to any authorities, it is clear that this was not in any sort of form an annual receipt of a profit or gain. It was the buying out, as I have said, of Mr. Ricketts' claim.”

408. *Alloway v Phillips (Inspector of Taxes)* [1980] 1 WLR 888 concerned a payment of £39,000 by the *News of the World* to the wife of Charles Wilson for her account of his part in the 1963 “Great Train Robbery” and his life “on the run”. Upholding an assessment under Case VI, Lord Denning MR said at 893:

“In conclusion I may say that many people regret the practice of such newspapers in paying money to criminals or their wives — so as to get a sensational story to publish. There is nothing illegal in it, so far as I know. But on one point I am clear: if the criminals or their wives get money by relating their stories to newspapers, they ought to pay tax on their profits and gains. That is this very case. The wife is now in England. She is outside the jurisdiction of the Canadian courts. She received the money here and ought to pay tax here on the sums she received here.”

409. In *Manduca v HMRC* [2015] STC 2002 the then President of the Tax and Chancery Chamber of the Upper Tribunal, Rose J (as she then was), considered whether a payment, in settlement of litigation, for a hedge funds failure to pay a bonus fell within Case VI. As Rose J observed, at [14], it was:

“...common ground between the parties in this appeal, as it was before the First-tier Tribunal, that the correct tax treatment of the settlement sum is the same as the correct treatment of the Bonus if it had been paid by Dexia to Mr Manduca in accordance with the terms of the Bonus Agreement.”

She continued:

“35. In my judgment the Bonus was remuneration for services provided to Dexia by Mr Manduca and those services fall firmly within Case VI. I accept Mr Bremner's [counsel for HMRC] submission that *Brocklesby v Merricks* and *Bradbury* show that once it is established that the payment was an income receipt rather than a capital receipt and that it was paid pursuant to a binding contract in return for some kind of service then there is no need to go further to inquire into the extent of the services in fact provided.

36. Further, in my judgment it is clear that the Bonus was to pay for services which are akin to profits and gains that fall within the other Cases. Mr Bremner drew my attention to an extract from *Whiteman and Sherry On Income Tax* paras 12-001 to 12-041. After discussing *Leeming v Jones*, the authors give as examples of income which is **not** *ejusdem generis* betting winnings, gifts and receipts by finding. Mr Bradley argued that all Mr Manduca and Mr de Jerez agreed to do in return for the Bonus was to tell Tilney that it was Dexia, rather than any other potential acquirer, to whom Tilney should transfer the business. That, and entering into the employment contract, was all that was required of the two men. He therefore argued that the supposed services were akin to the passive receipt of shares in *Versteegh* or the introduction of Major Martineau to the ice show promoter in *Bradbury*.

37. I reject that characterisation of the facts here. Mr Manduca recognised in his evidence before the Tribunal that he and Mr de Jerez had the track record and expertise to launch One Europe and put together the team to undertake the research and make the investment management decisions for the Fund and they managed the team. He and Mr de Jerez grew the business from its inception. He says in his evidence that in order for Dexia to make money after the transfer it was important that the independent directors and administrator stayed with the Fund and even more important was that the investors kept their investment in the Fund so that ongoing performance bonuses could be made. Further, although he said that Dexia would give the Fund access to their own client base as a source of potential further investors, 'without fail, investors want to invest in a fund with an established “presence” and track record (via the reputation and track record of the individuals behind the fund manager)'.

38. Applying the business common sense referred to by Upjohn J in *Bradbury*, I consider that Dexia would have been concerned that during the crucial period of uncertainty shortly before the transfer was effected, there was a risk that investors and staff might drift away from the business, diminishing its value. Mr Manduca and Mr de Jerez were the key people on whose reputation the continued confidence of employees and investors rested. It was important for Dexia to obtain their commitment to the transfer, before the formal employment relationship started. The role they would play in facilitating the transfer was to cooperate and so conduct themselves as to ensure that staff and investors stayed on board and that such a drift of money and talent did not occur in that interim period. I do not see any difficulty in describing that as a service provided by Mr Manduca or in holding that that service is *ejusdem generis* with the services listed in the other Cases in Sch D.”

410. Section 687(1) ITTOIA was considered by the Upper Tribunal (Zacaroli J and Judge Brannan) in *Kerrison v HMRC* [2019] STC 614 (“*Kerrison*”) which observed:

“66. Prior to the enactment of ITTOIA, the residual charge to income tax arose under Sch D Case VI on any annual profits or gains not falling under any other Case of Sch D, not charged under Schs A, E and F (s 18(3) ICTA).

67. This residual charge to income tax is now found in s 687(1) ITTOIA. This re-enactment was part of the Tax Law Rewrite Project and it was intended that the scope of the re-written taxing provisions should be the same as in the predecessor statute. It follows, and this was common ground, that the earlier authorities relating to Sch D Case VI remain relevant to the interpretation of s 687(1) ITTOIA.

68. We consider that those earlier authorities can be summarised in the following propositions. The receipt must:

- (1) have the nature of ‘annual profits’. That simply means that the receipts must be capable of being ‘calculated in any one year’ (per Rowlatt J in *Ryall (Inspector of Taxes) v Hoare* [1923] 2 KB 447 at 454, 8 TC 521 at 526). It does not mean that the income must recur every year (*per* Viscount Dunedin in *Leeming v Jones (Inspector of Taxes)* [1930] AC 415 at 422, 15 TC 333 at 359) (*Leeming*’);
- (2) be of an income nature (*Leeming, ibid*);
- (3) be analogous to some other head of charge under what was previously Sch D (*Leeming, ibid*) – this is the *eiusdem generis* principle;
- (4) be the recipient's income (*Spritebeam* at [54]); and
- (5) involve a sufficient link between the source and the recipient (*Spritebeam* at [54]).

69. Before the FTT, Mr Ewart QC [counsel for the appellant] also argued that it was necessary for the receipt to have a ‘source’ for tax purposes and because the Loan Waiver was purely gratuitous there was no source. The need for a source was not itself disputed before the FTT but Mr Ghosh [counsel for HMRC] submitted that the Loan Waiver had a source, viz the appellant’s shareholding in Broadgate.

70. In relation to the source issue, the Upper Tribunal noted in *Spritebeam* at [55] that the House of Lords in *Brown (Surveyor of Taxes) v National Provident Institution*, *Ogston (Surveyor of Taxes) v Provident Mutual Life Association* [1921] 2 AC 222, 8 TC 57 left open the question whether it is necessary to identify a source before a Case VI liability can arise. We note, however, that s 687(1) expressly refers to ‘income from any source’ which suggests to us that in order for income to be taxable under Case VI it requires a source. Moreover, it is hard to see how a receipt which had no source could be *eiusdem generis* with the other heads of charge in what was formerly Sch D, all of which require a source for the receipt in question. Nonetheless, although we would be minded to accept that a receipt taxable under s 687(1) ITTOIA must have a source, it is not necessary for us to reach a decision on this point for the reasons set out below.

71. In our judgment, the FTT was plainly correct to decide at [143] that the Loan Waiver did not result in a charge to income tax under s 687(1) ITTOIA.

72. We consider that the FTT was correct when it concluded at [143](1) that the Loan Waiver was an entirely voluntary transaction. Although Mr Ghosh QC argued that a dividend was similarly a voluntary event, we reject that argument. It is true that a shareholder cannot usually compel the declaration of the dividend (either by the board of directors or by the company in general meeting), but the right to a dividend once declared forms part of the bundle of

rights comprising a shareholder's entitlement *qua* shareholder. A dividend is therefore different from an entirely voluntary transaction.”

411. Mr Gammie, noting what was said in *Kerrison*, contends that it is necessary to identify a source for the receipt to come within s 687(1) ITTOIA and cites *Stainer's Executors v Purchase (Inspector of Taxes)* [1952] AC 280 and *Carson (Inspector of Taxes) v Cheyney's Executor* [1959] AC 412 in support of his argument.

412. *Stainer's Executors* concerned an amount received by the executors of the actor Leslie Howard who had been killed by enemy action in the Second World War. Lord Simonds LC, giving the leading speech in the House of Lords said, at 288:

“... It is common ground between the parties that the position would be precisely the same if Mr. Howard had not died but had retired from his profession in the year 1943. His liability to tax would be the same as that of his executors. It is further agreed that, had Mr. Howard been still carrying on his profession at the time when the sums in dispute were received, they would have been properly included in the account of the profits, gains and emoluments of his profession under Case II and would not have fallen under any other Case. It was not suggested that the sums received in respect of any particular contract could be isolated: all of them would be aggregated with any other profits of his professional activity and the balance after deducting the expenses properly deductible would be chargeable under Case II: see *Davies v. Braithwaite*. But, it was said, and this is the short point of the case, Mr. Howard died before the sums were received, and in the hands of his executors, as they would have been in his hands if received by him after his retirement, they are no longer to be regarded as the profits and gains of his profession but assume a different character and fall under Case III or Case VI.

My Lords, if this contention had not found favour with the learned Master of the Rolls and Somervell LJ I should not have thought it arguable. The principle which is applicable here was stated with his usual clarity by Rowlatt J in *Bennett v Ogston* and I will cite his words: “When a trader or a follower of a profession or vocation dies or goes out of business ... and there remain to be collected sums owing for goods supplied during the existence of the business or for services rendered by the professional man during the course of his life or his business, there is no question of assessing those receipts to income tax: they are the receipts of the business while it lasted, they are arrears of that business, they represent money which was earned during the life of the business and are taken to be covered by the assessment made during the life of the business, whether that assessment was made on the basis of bookings or on the basis of receipts.” I am satisfied that this is a correct statement of the relevant principle of income tax law, though I have some doubt — it is not necessary to decide it — whether the learned judge correctly applied the principle in the case before him”

He continued, at 289 and 290:

“My Lords, it appears to me that the issue is confused by raising in general terms the question whether professional remuneration may in certain circumstances assume a different character for tax purposes when the taxpayer is dead or has retired. At least the case of *Asher v. London Film Productions Ltd* is no authority for such a proposition. In that case there was no question of the same sum assuming a different quality in changing conditions. I am content to assume that there may be such a case though I find it difficult to imagine. But here I cannot see how or where the change takes place. The source of these payments was the professional activity of Mr. Howard: it was never anything else. It is true that his remuneration took the form of annual

payments which, if other conditions were satisfied, might fall within Case III. But other conditions were not satisfied, for ex hypothesi the source of the remuneration was the exercise of a profession falling within Case II.”

...

If I am right in thinking that the sums in question were not assessable under Case III because they were nothing else than remuneration professionally earned by Mr. Howard in his lifetime, this disposes also of the alternative claim under Case VI.”

413. A similar issue arose in *Cheyney’s Executor* concerning royalties received following the death of the author Peter Cheyney and whether these were taxable, as HMRC contended, under Case III or Case VI of schedule D. In that case Viscount Simonds said, at 423-425:

“The principle which emerges [from *Stainer’s Executors*] is clear. Payments which are in historical fact (I adopt the language of the late Lord Asquith of Bishopstone in the same case) exclusively the fruit or aftermath of professional activities do not change their taxable character when the profession is discontinued.

But there was another aspect of *Stainer’s* case which is relevant to the present case. Perhaps it is no more than a different way of stating the same point. It was urged that the contracts made by Leslie Howard were “income bearing assets” and that the payments made to his executors were the income of such assets. To this the same noble Lord gave an answer which I venture to quote, so completely does it dispose of a similar argument in the present case. “The contracts,” he said, “in the present case enjoy, in my view, no such independent vitality. The consideration for what Mr. Howard was to do — to act or manage — was not the grant of a contract or contracts but the payment of money under the terms of those contracts. Mr. Howard acted for money; he did not act for contracts. The contracts were mere incidental machinery regulating the measure of the services to be rendered by him on the one hand and, on the other, that of the payments to be made by his employers: they were not the source, but the instrument of payment, and his death, in my view, did nothing to divest them of this character.” My Lords, I do not see how in the face of this decision the appellant’s argument can succeed without a degree of refinement which is to be avoided in the realm of fiscal law. In *Stainer’s* case it could not be denied that the taxpayer acquired under his contracts certain contractual rights nor that those rights could in a certain context be called property. So it was argued that the payments were the income and the contracts were the “income bearing assets.” I will again content myself with the description given to this argument by Jenkins LJ and ask how it is to be distinguished from the argument in the present case. When I do so, I find myself using again the same language that Lord Asquith used and I used in *Stainer’s* case. What else were these payments than the fruit of Peter Cheyney’s professional activities? How is it relevant that in order to reap his harvest he had to enter into contracts under which he acquired rights and incurred obligations as did the publishers with whom he contracted? And how is it relevant that it was a term of those contracts that there should be vested in the publishers a right created by the law to protect him in the exploitation of his work? It was by entering into such contracts that he was able to carry on his profession gainfully. It was because he did so that he was assessable to tax under Case II of Schedule D. I reject, therefore, the plea that the royalty payments could, whether during the carrying on of the profession or after its discontinuance, be regarded as “income from property constituting a substantive subject-matter of taxation under Schedule D” — I use the words of the appellant’s formal case. ... First and last and all the time the payments

are professional earnings, whatever be the mechanism through which they are paid. Upon this part of the case I will offer a final consideration. In *Stainer's* case I said: "If in all the circumstances it was not possible to bring the sums into account in the years in which they were earned ... the result is not to change the character of the payment but to exhibit that some professional earnings may escape the income tax net." There, I believe, lies the root of the trouble. Prima facie there is no reason why a professional man should not be taxed on an earnings basis, but in the case of an author, whose earnings depend on the unpredictable popularity of his books in future years, an assessment in the earning year would be so arbitrary as to be patently unfair. But that I repeat, does not entitle the Crown to regard payments in future years as anything but what they essentially are.

...

It is not necessary, my Lords, to say anything about Case VI or Case V. The reasons for dismissing an appeal which relies on Case III are fatal to them also."

414. Lord Reid, in that case, said, at 434:

"To my mind, if a person receives as part of his remuneration an asset which yields income, that income is not the fruit of his professional activity any more than it would be if that person had received his remuneration in money and had then used that money to buy that asset. From the moment when the asset comes into his hands, the source of any income which it yields is that asset and not his professional activities. There would be no question of the income falling under Case II during his life and then being taxable under some other Case after his death. The receipt by a professional man of income yielded by an asset which has been transferred to him is not a method of gaining professional income whether or not the asset came to him as professional remuneration. But for an author exploitation of his copyright is a method of gaining professional income. Therefore this matter is of no assistance to the appellant's case. I am of opinion that this appeal should be dismissed."

415. The issue of a source was one of several issues considered by the Upper Tribunal (Proudman J and Judge Bishopp) in *Spritebeam Ltd and others v HMRC and another* [2015] STC 1222 ("*Spritebeam*"). The Tribunal observed that:

"77. The judgments in the Court of Appeal and House of Lords in *National Provident* use a different label, namely that the source must be in existence. For example, Lord Sterndale MR ([1920] 3 KB 35 at 53, 8 TC 57 at 73) said that a taxpayer could not be taxed 'in respect of a source of income which does not exist', and in *Bray (Inspector of Taxes) v Best* [1989] STC 159 at 163, [1989] 1 WLR 167 at 173, Lord Oliver of Aylmerton said:

'It is a well-established principle deriving from the nature of the income tax as an annual tax, that a receipt or entitlement arising in a year of assessment is not chargeable to tax unless there exists during that year a source from which it arises.'

78. In *Property Co v Inspector of Taxes* [2005] STC (SCD) 59 the Special Commissioners considered the situation where an individual not domiciled in the UK and taxable on the remittance basis sold shares in a non-resident company and remitted dividends previously received in the following tax year. They said (at para 89):

'... such income is not taxable because the individual did not possess the source in the year in which it is remitted.'

79. Park J, at [20] in *Pumahaven* [2002] STC 1423 (quoted above) expressed the rule in similar terms.

80. However this is no more than saying that if a taxpayer's connection with the source ceases, he can no longer be taxed on receipts from that source, irrespective of a different connection with the source. Similarly, we regard Mr Prosser's argument [for the taxpayer] from the situation where the taxpayer has never possessed the source as merely a logical extension of the rule that a taxpayer cannot be taxed on receipts when he no longer possesses the source. When rephrased to remove the language of possession, no extension is appropriate or necessary. The rule is merely that the taxpayer cannot be taxed on receipts if he does not have the necessary connection with the source. Once the connection has been identified, it is necessary to look behind the receipts in the tax year in question to see if the source of income continues or has ceased. But that necessity says nothing about the nature of the connection which must be demonstrated.

81. Mr Ghosh's argument [for HMRC] was that it was the Share Recipient's status as a counterparty to an absolute obligation of the Borrower to pay interest on the Loan (an obligation satisfied by the issue of the shares) that is relevant. The validity of that contention was demonstrated, he said, by a comparison between *Drummond v Collins* [1915] AC 1011, 6 TC 525 and *Stedeford v Beloe* [1932] AC 388, 16 TC 505. In the former, the will which permitted the payment to be made also limited the class of persons who would be entitled to any payment made pursuant to it to the named beneficiaries. The beneficiaries therefore, by virtue of that status, were entitled to the payment, had a sufficient connection to the source, and were liable to tax on the income. By contrast, in the latter, the payment was made pursuant to the College statutes, under which only the College was a beneficiary. It could therefore not be said that the former headmaster was entitled to the payment by reference to that instrument. He had no identifiable source of the income beyond the College's generosity, but a voluntary payment of that kind was not taxable.

82. Here, the source of the Share Recipient's income was the Loan Agreement, in which it was the named beneficiary. It was entitled to receive the shares, by reason of its being so named, even if it did not have the capacity to enforce that entitlement itself: it was in a similar position to that of the beneficiaries in *Drummond v Collins* but not in an analogous position to that of the former headmaster. Although, in *Cunard's Trustees* [1946] 1 All ER 159, 27 TC 122, the court was addressing the question whether the payments were or were not voluntary, what Lord Greene said (see para [67] above) was equally relevant to the question whether there was a connection between the recipient and a source. The source in that case was 'the joint operation of the will and the exercise of their discretion by the trustees.' Once it was accepted (as the taxpayers had done in their skeleton argument) that the shares were derived from the Loan Agreement there was no need to enquire further: the source of the shares was identified, and sufficient.

83. On this issue we prefer Mr Ghosh's arguments. Although we accept Mr Prosser's argument that the categories of property and activities do demonstrate what constitutes a necessary connection, we are not persuaded that the test for necessary connection is limited to them. In short, Mr Prosser's test under this head is too narrow. It implies that 'possession' is to be equated with ownership, but we do not find anywhere in the authorities to which we were referred any support for the proposition that ownership is required. The beneficiaries in *Drummond v Collins* and *Cunard's Trustees* did not own the

fund from which their income was derived, but they were nevertheless found to 'possess' (if that is the right word—as we have said, other terms have been used) a sufficient connection to the source.

84. We think, rather, that Mr Ghosh is correct to say that the required connection between taxpayer and source need not be limited to legal rights but can include the situation where the payment is made pursuant to any legal duty owed by the payer. That proposition is consistent with what was said by Lord Greene in the passage we have set out at para [67] above, in which the focus was on the payer's obligation to the recipient, and not on the recipient's ability to enforce it.”

416. As for the connection with the source in the present case, I agree with Mr Baldry who says that there is “no difficulty” in identifying this – it is the decision of the company, be it SCL or Avon, to pay the awards.

417. A further argument advanced by Mr Gammie additionally is that HMRC are wrong to seek to impose a charge to tax under the miscellaneous income heading as it offends the principle of double taxation. For this he relies on the decision of the House of Lords in *Inland Revenue Commissioners v F S Securities Limited* [1965] AC 631.

418. It was common ground in that case that it depended on how the dividends in question ought to have been treated in making up the company's profit and loss account under Schedule D Case I. The Crown contended that dividends that had suffered a deduction under s 184 of the Income Tax Act 1952 did not fall to be brought into the computation for the purposes of Case I of Schedule D whereas the company argued that they did.

419. In his speech Lord Reid observed, at 642-643:

“It is now common ground between the parties that this case depends on how these large dividends ought to have been treated 643 in making up the respondent's profit and loss account under Schedule D, Case I. The Crown says that the method which was in fact followed was correct, and that the dividends were properly left out of that account. If that is right, then it is not now disputed that these dividends were investment income, that the respondent was an investment company, and that the special commissioners' direction was properly given. But the respondent now says that these dividends ought not to have been excluded from the profit and loss account and that therefore a properly framed account would have shown no loss. Counsel for the respondent agrees that if his contention is right the respondent ought not to have been repaid anything under section 341 but the respondent has not offered to repay the sum of £404,020.

So the question now in issue is the question how a dealer in stocks and shares ought to treat dividends accruing to him from shares which he has bought in the course of his trade. It was decided in *Cenlon Finance Co. Ltd. v Ellwood* that a capital dividend which is not paid under deduction of income tax must enter his profit and loss account and the respondent maintains that the same rule must apply to dividends paid under deduction of tax.”

He continued, at 644 and 645:

“It is now agreed by counsel for both parties that there never was such a practice as that to which Lord Simonds refers. At one time there was a somewhat similar practice with regard to claims based on losses, but as regards the ordinary profit and loss account to show the profits or gains chargeable under Schedule D, Case I, it was always the practice before the *Cenlon* case for a trader to leave out of the account those trading receipts which consisted of dividends received by him after deduction of tax. The



respondent now says that the practice has always been wrong. In my opinion, it was right.

Neither view can be derived directly from any provisions of the Income Tax Act. If the words of the Act were applied literally the result would be double taxation of the same income, but it has been said again and again that the Act cannot be so read as to authorise that.”

...

If the appellants' view is right the proper procedure is much simpler. In the case I have supposed, the trader would simply leave the dividends out of his profit and loss account, which would then show a profit of £4,000, and he would pay £2,000 on that profit, so if there is a profit apart from the dividends it makes no difference which view is adopted. But it does make a difference if, apart from the dividends, the trader's operations show a loss. How great a difference that can be is shown by the present case.

Your Lordships must now choose between those two methods without any authoritative guidance. I have no hesitation in preferring the appellants' method, for a number of reasons. In the first place, it is in accord with long standing practice and it has never been challenged: the matter was only considered incidentally in the *Cenlon* case, and I do not think that it was the subject of any detailed argument. Secondly, it is much simpler and more direct. Thirdly, it avoids the fiction of having to regard the trader's trading receipts as including not only the net dividends which he actually receives but also the tax deducted by the company paying the dividends which the trader never did or could receive. And, fourthly, it appears to me to carry out more reasonably the principle that money once taxed cannot again be subjected to income tax. It appears to me more reasonable to say that dividends which have already borne tax shall not be brought into any further income tax calculation than to say, as the respondent does, that they can be brought in so as to swell the assessment of profits under Schedule D, Case I, but that then there shall be an abatement not authorised by the Act.”

420. Viscount Radcliffe, who with Lord Hodson, Lord Guest and Lord Upjohn agreed with Lord Reid in allowing the appeal, said, at 649-653:

“In my opinion, there is by now really no room for doubt that dividends, for income tax as well as surtax, are just as much a taxable subject as any other form of income, or for doubting that, for the purposes of income tax as distinct from surtax when they are distributed by a limited company out of a fund of profit that has been taxed in its hands, the proportionate shares of the taxed fund so distributed are not liable to taxation again in the hands of the recipients. The operation of transferring the residue of the taxed fund from the company's hands to the hands of the owners no more creates a fresh accrual of income than does the operation of a trustee paying over to his beneficiary the net amount of the trust income that has borne tax in his hands. Dividends which represent the distribution of a taxed fund are therefore “franked” income so far as concerns any further taxation at the standard rate, that is, the rate at which deduction has been made; while, for the purposes of administering reliefs against tax at standard rate and of assessing to surtax, it is proper to treat the net sum received as grossed up in the way that the statute (Income Tax Act, 1952, s. 184) requires. This account of the status of dividends in the tax system is in line with the analysis offered by Lord Phillimore in *Bradbury v English Sewing Cotton Co. Ltd*, where he points out that the Income Tax Act, 1842, the basic instrument of our income tax code, treated a joint stock company as if it were “a large partnership, so that the

payment of income tax by a company would discharge the quasi-partners.” In my opinion, this analysis is now accepted as being correct: and it remains essential to the application of the whole system even though the connection between any particular fund of profits and a dividend paid has now become in effect untraceable and the rule that the company recoups itself at the standard rate of tax that is current at the date of payment means that company and shareholder do not necessarily equate their respective positions as completely as the theory of the matter would require.

...

To my mind, to allow it to do so would be to recognise double taxation in its most obvious form: not the less so, as I see it, because on the one side dividends are taxed as an aliquot share of a fund of profit and on the other they would be brought in as “mere” contributors to establish the balance of the trading profit of the individual recipient. But double taxation in itself is not something which it is beyond the power of the legislature to provide for when constructing its tax scheme. It is rather that, given that a situation really involves double taxation (see *Canadian Eagle Oil Co Ltd v The King* it is so unlikely that there would have been an intention to penalise particular forms of income in this way that the law approaches the interpretation of the complicated structure of the code with a strong bias against achieving such a result. This, after all, is the general principle upon which rests the particular and well-accepted rule that a form of income which is made the subject of taxation under one of the five Schedules cannot be included, directly or indirectly, as a taxable subject under another Schedule, whatever general words or general theories might seem to require. I shall allude to this principle later, since it affords, I believe, the answer to the argument of the respondent.

...

In my opinion, there was no misconception and no delusion. Dividends that had borne tax or suffered deduction of tax — I see no difference in this context between the two ways of putting it — before receipt are, to use Lord Dunedin’s phrase, “exhausted as a source of income,” and the general principle applied to the construction of the provisions of the Income Tax code prevents their being brought in again, directly or indirectly, as a subject of taxation in the form of another class of taxable income. It is neither here nor there that in the words of section 127 of the 1952 Act tax is to be charged under Cases I and II of Schedule D on “the full amount of the profits or gains.” That has no effect on the principle of computation. The rule of excluding income which has been assessed to tax “under its own title” from insertion as an item in an assessment under Case I of Schedule D was recognised and given effect to by this House in the well-known *Salisbury House* decision (rents from land) and again by the Court of Appeal in *Thompson v Trust and Loan Co. of Canada* (interest on Government bonds). The principle is clearly stated in the first case in the speeches of Viscount Dunedin and of Lord Atkin, and in the second case in the judgment of Lord Hanworth M.R. I regard the decision in *Hughes v Bank of New Zealand Ltd* as an enforcement of the same principle.”

421. *FS Securities* was considered by the Tribunal (Judge Nowlan and Ms Bridge) in *Investec Asset Finance plc v HMRC* [2016] SFTD 677 in which it noted, at [143]:

“The present significance of the *FS Securities* case is that the House of Lords then proceeded to review the basis of the original loss claim, in order to see whether there was a case for saying that the dividends should have been recognised as trading income in the first place. The very pertinent conclusions were that:

- there was no statutory provision that excluded the dividends from being included as trading income;
- it had always been the practice, however, that dividends received by a share dealer were not included in the dealer's Case I calculations;
- this practice resulted from the general offence of income being taxed again or included as the gross receipts of a trade when paid out of the dividend paying company's profits that had suffered income tax: so that
- it had indeed been right to exclude the dividends in the Case I calculation.”

422. The Tribunal, in setting out its conclusion in relation to the fourth issue in that case (which it considered to be the most difficult issue) – whether the dealing expense of buying and funding the partnerships could diminish the apparent “and very significant taxable profits” in the partnerships on the receipt or sale of rentals, such that, as the appellants hoped and contended, the appellants are taxable on, and only on, their net profits – stated, at [149]:

“Our conclusion in relation to the fourth issue is that the partnership profits taxed under s 114 should not be brought into account again in the sole trade calculations, but that the dealing costs remain deductible. We accept that the *FS Securities* case had nothing to do with partnership profits, but we regard it as the case that governs the outcome in relation to point 4 in the present case because:

- that case and the present case share the common feature that earlier taxpayers were seeking to avoid tax on income by selling shares or partnership shares to financial dealers in the expectation that the dealers would be able to shelter the tax on the relevant income, to the extent of the dealing costs of acquiring the income;
- just as in the present case, the dealer's costs consisted not directly in buying dividends but in purchasing shares, with the loss resulting from the down-valuation of the shares following the receipt of the dividends, which somewhat mirrors the way in the present case in which the appellants' expenses were incurred in buying or contributing to the partnership, rather than in directly buying the receivables;
- the *FS Securities* case contains numerous references, particularly in the House of Lords, to the offence of income being taxed twice;
- those references repeatedly acknowledge that the objection to income being taxed twice did not derive from any express statutory provision but from a fundamental principle that was simply assumed to be so evident that it had to be respected, even though, as Lord Reid's excerpt quoted above acknowledges, the income would have been taxed twice if the statutory provisions had been construed literally; and
- it is highly relevant that the tax that had initially been charged in the dividend stripping cases was the tax on the dividend paying company's profits that franked the dividends, whereas in the present case it is far more obvious in all seven cases, and particularly in the LAGP and Hong Kong cases that it is the same partnership profits that are being included in the sole trade calculations. The double taxation is in other words far more evident in the present cases than it had been in the dividend stripping cases.”

423. However, I agree with Mr Baldry who says that the present case is “nothing like” *FS Securities* in which it had acquired another company and stripped out its value by way of dividend and where the issue concerned whether or not FS Securities was an investment company with the effect that if it was its dividend income could be deemed to belong to its shareholders. Clearly there would be double taxation if a company pays a dividend after deduction of tax to a shareholder who was then was taxed on that dividend. However, it would be a different situation if a shareholder having received a dividend decided to make a payment out of that income to an employee of the company by way of a bonus.

424. I agree with Mr Baldry that there is not any double taxation in the present case as the same income is not charged to tax twice. Although Mr Gammie contends that this is the case here as there is only one source of profit, ie from the Partnership, and that it is being taxed twice, I disagree. As I have found in the PIP Appeals that the effect of the PIP is that Special Capital “belongs” to the company concerned, ie SCL or Avon, which is not subject to any further charge to tax on that income. It then transfers that income to an individual who was not previously entitled to it under the partnership arrangements. The issue is whether those individuals are subject to tax on what they have received from the company as miscellaneous income.

425. It is clear from the authorities that the distinction between that income which falls within the miscellaneous income charge in s 687(1) ITTOIA and that which does not, is whether the receipts are analogous to income or something charged to income elsewhere in the Taxes Acts. If analogous to income or something charged to tax, it would be within the charge to tax but if it falls within the exclusions identified by Rowlatt J in *Ryall (Inspector of Taxes) v Hoare* it would not. As an example of the distinction to be drawn Mr Baldry compared presents and bonuses both of which as he said, “tend to get paid at Christmas”. He said that the question to be asked was whether the awards of Special Capital in the present case like “the presents under the tree, or are they like the bankers’ bonuses” with the answer being that there was not much doubt that it was the bankers’ bonuses. As such the essential nature of the award was a deferred discretionary bonus which as it was analogous to something taxed by the legislation.

426. I agree.

427. As MP said in evidence (see paragraph 343, above) the decision to introduce the PIP was to implement a type of deferred bonus award scheme similar to that of JPM. However, as it is not paid to an individual as an employee it cannot be taxed as such. Neither, given my conclusion in the PIP Appeals, is it taxable as partnership profits. However, as the award of Special Capital is analogous to a taxable bonus then, subject to the issues of its source and whether there was double taxation, I consider that is to be regarded as income and is taxable under s 687(1) ITTOIA.

428. Such a conclusion disposes of the IP Appeals in favour of HMRC. However, as with the Cayman Appeals, as it was fully argued (and in case of any appeal) I shall nevertheless address HMRC’s alternative argument, the sale of occupational income.

### ***Sale of occupational income Issue***

*If they were capital, were the sums received by the Appellants pursuant to the PIP charged to income tax under Chapter 4 of Part 13 of the ITA 2007? In particular:*

*(1) Was the main object, or one of the main objects, of the transactions or arrangements the avoidance or reduction of the Appellants’ liability to income tax?*

*(2) In respect of each Appellant, were the transactions effected, or arrangements made, to exploit the earning capacity of that individual in an occupation? In this regard:*

(a) *Was the relevant Appellant carrying out an “occupation” within the meaning of s.777(2) of the ITA 2007, ie was the Appellant undertaking activities of a kind undertaken in a profession or vocation?*

(b) *If so, were the transactions effected, or arrangements made, to exploit that Appellant’s earning capacity in the occupation by putting another person in a position to enjoy:*

(i) *(i) all or part of the income or receipts derived from the individual's activities in the occupation; or*

(ii) *(ii) anything derived directly or indirectly from such income or receipts?*

429. The relevant legislation is now contained in the ITA, the relevant provisions of which provide:

### **773 Overview of Chapter**

(1) This Chapter imposes a charge to income tax—

(a) on individuals to whom income is treated as arising under section 778 (income arising where capital amount other than derivative property or right obtained), and

(b) on individuals to whom income is treated as arising under section 779 (income arising where derivative property or right obtained).

(2) Income is treated as arising under those sections only if—

(a) transactions are effected or arrangements made to exploit the earning capacity of an individual in an occupation, and

(b) the main object or one of the main objects of the transactions or arrangements is the avoidance or reduction of liability to income tax.

### **774 Meaning of “occupation”**

In this Chapter references to an occupation, in relation to an individual, are references to any activities of a kind undertaken in a profession or vocation, regardless of whether the individual—

(a) is carrying on a profession or vocation on the individual's own account, or

(b) is an employee or office-holder.

...

### **776 Charge to tax on sale of occupation income**

(1) Income tax is charged on income treated as arising under—

(a) section 778 (income arising where capital amount other than derivative property or right obtained), or

(b) section 779 (income arising where derivative property or right obtained).

(2) Tax is charged under this section on the full amount of income treated as arising in the tax year.

(3) The person liable for any tax charged under this section is the individual to whom the income is treated as arising.

(4) This section is subject to section 784 (exemption for sales of going concerns).

### **777 Conditions for sections 778 and 779 to apply**

(1) Sections 778 and 779 apply only if conditions A to C are met in respect of an individual.

(2) Condition A is that the individual carries on an occupation wholly or partly in the United Kingdom.

(3) Condition B is that transactions are effected or arrangements made to exploit the individual's earning capacity in the occupation by putting another person (see section 782) in a position to enjoy—

(a) all or part of the income or receipts derived from the individual's activities in the occupation, or

(b) anything derived directly or indirectly from such income or receipts.

(4) The reference in subsection (3) to income or receipts derived from the individual's activities includes a reference to payments for any description of copyright or licence or franchise or other right deriving its value from the individual's activities (including past activities).

(5) Condition C is that as part of, or in connection with, or in consequence of, the transactions or arrangements a capital amount is obtained by the individual for the individual or another person.

(6) For the purposes of subsection (5), the cases where an individual (“A”) obtains a capital amount for another person (“B”) include cases where A has put B in a position to receive the capital amount by providing B with something of value derived, directly or indirectly, from A's activities in the occupation.

(7) In this Chapter “*capital amount*” means an amount in money or money's worth which does not fall to be included in a calculation of income for income tax purposes apart from this Chapter.

### **778 Income arising where capital amount other than derivative property or right obtained**

(1) This section applies if the capital amount obtained as mentioned in section 777(5) does not consist of—

(a) property which derives substantially the whole of its value from the individual's activities, or

(b) a right which does so.

(2) The capital amount is treated for income tax purposes as income arising to the individual.

(3) The income is treated as arising in the tax year in which the capital amount is receivable.

(4) A capital amount is not regarded as having become receivable by a person for the purposes of this section until the person can effectively enjoy or dispose of it.

## **779 Income arising where derivative property or right obtained**

(1) This section applies if–

(a) the capital amount obtained as mentioned in section 777(5) consists of–

(i) property which derives substantially the whole of its value from the activities of an individual, or

(ii) a right which does so, and

(b) the property or right is sold or otherwise realised.

(2) For the purposes of subsection (1), it does not matter whether the capital amount is obtained on one occasion or on two or more occasions (for example, because the individual acquires a stock option and subsequently exercises it).

(3) Income of an amount equal to the proceeds of sale or the realised value is treated for income tax purposes as income arising to the individual.

(4) The income is treated as arising in the tax year in which the property or right is sold or otherwise realised.

430. The first issue arising, in relation to the question s 773(2)(b) ITTOIA, is whether “the main object or one of the main objects” of the PIP was the avoidance or reduction of liability to income tax.

431. In *Inland Revenue Commissioners v Brebner* [1967] 2 AC 18 the Special Commissioners had concluded that s 28 of the Finance Act 1960 did not apply to the transactions in question finding that they had been carried out for commercial reasons and did not have as their main, or one of their main objects, the obtaining of tax advantages which concerned arrangements. Lord Pearce, giving the judgment of the House of Lords, having noted, at 26, that the issue before the Special Commissioners was “a question of fact”, continued, at 27-28:

“It would be quite lacking in reality to draw a line between the first part of the arrangement, namely, the purchase of the shares on a short-term overdraft, and the second part of the arrangement whereby the overdraft was repaid, as initially arranged, largely out of the surplus assets of the company. The first part of the arrangement had committed them to the second part whereby the whole original scheme was to be implemented. Unless they abandoned the whole scheme (by selling the shares to somebody who would probably wind up the company) they had to go on with it.

The “object” which has to be considered is a subjective matter of intention. It cannot be narrowed down to a mere object of a company divorced from the directors who govern its policy or the shareholders who are concerned in and vote in favour of the resolutions for the increase and reduction of capital. For the company, as such, and apart from these, cannot form an intention. Thus the object is a subjective matter to be derived in this case from the intentions and acts of the various members of the group. And it would be quite unrealistic and not in accordance with the subsection to suppose that their object has to be ascertained in isolation at each step in the arrangements.

...

As Lord President Clyde said:

“The material question is not what was the effect of each or all of the interrelated transactions, the question is what was the main object or objects for which any of them was adopted. Section 28 (1) of the Act draws a clear distinction between effect and object. It was to this latter question that the Special Commissioners

rightly directed their attention. To do so they had to consider each particular transaction in the series in its proper setting.”

For those reasons, I am of opinion that the Special Commissioners came to a reasonable conclusion on the evidence before them. They could have reached a contrary conclusion, which would have been equally unassailable, had they taken a different view of the evidence. But it was they who heard the witnesses, and I see no reason to suppose that their decision was not just and sensible. I entirely agree with the judgment of the Lord President.”

432. Lord Upjohn in the same case, agreeing that the appeal should be dismissed, said, at 29-30:

“Thus, by reason of a perfectly proper scheme of arrangement, but nearly two years later, the main object of the operation in this chapter was to enable a tax advantage to be obtained because, although it would have been possible to extract the cash from the company by a dividend (subject of course to the surtax consequences as to £58,500 of that dividend), the whole object of the reduction of capital was to extract the cash without paying tax; that, it was strongly urged, showed it to be a main object. So, the argument proceeds, while the first chapter was carried out for purely bona fide commercial reasons without having as a main object the gain of a tax advantage, it must be regarded as purely introductory to the all-important second chapter two years later when the scheme was devised to extract the cash by a reduction rather than the declaration of a dividend, so that it became plain that one of the main objects of the transaction was to enable a tax advantage to be obtained. Accordingly, the transaction fell within section 28 (1) (b).

...

My Lords, I would only conclude my speech by saying, when the question of carrying out a genuine commercial transaction, as this was, is reviewed, the fact that there are two ways of carrying it out — one by paying the maximum amount of tax, the other by paying no, or much less, tax — it would be quite wrong, as a necessary consequence, to draw the inference that, in adopting the latter course, one of the main objects is, for the purposes of the section, avoidance of tax. No commercial man in his senses is going to carry out a commercial transaction except upon the footing of paying the smallest amount of tax that he can. The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence.”

433. More recent consideration of similarly worded legislation can be found in *Lloyds TSB Equipment Leasing (No 1) Limited v HMRC* [2014] STC 2770, which concerned a claim for a 25% writing-down allowance in respect of expenditure incurred on the purchase of two merchant vessels which would not have been available, under s 123(4) of the Capital Allowances Act 2001, if the “main object or one of the main objects” of the transaction was “to obtain a writing-down allowance”. The FTT (at [427] – [428] of its decision reported at [2012] UKFTT 47 (TC)), which was upheld by the Upper Tribunal, concluded that this was not the main object, or one of the main objects, of the transactions concerned. On appeal to the Court of Appeal, Rimer LJ (with whom Patten and Kitchin LJ agreed) said, at [65]:

“The apparent deficiency in [427] is, in my judgment, that although the FTT was no doubt entitled to find that each transaction in the relevant series served a genuine commercial purpose, it does not follow that the obtaining of the capital allowances was incapable of also being a main object of the transactions, even if it was not the main object of the transactions. The FTT



does not explain why it was not such a main object. In my view, the likely explanation for this omission is, as Judge Nowlan concluded, that the FTT was wrongly influenced by *Melluish* into the assessment that, provided all the transactions were entered into for genuine commercial reasons, the obtaining of the capital allowances was necessarily an immaterial, subservient consideration. In my view, however, that does not follow. Even if each of the transactions was entered into for a genuine commercial purpose, it may still be the case that a main object of structuring them in the way they were was to obtain the capital allowances; and the FTT's findings in [218] to [230] might be said to provide a factual basis for a finding that it was."

434. The Court of Appeal remitted the case to the First-tier Tribunal the judges who had heard the original appeal had retired and the case was listed before Judges Bishopp and Short whose decision is reported [2015] SFTD 1012. At [89] of their decision they said:

"At the risk of excessive repetition we observe again that the test is not whether the primary object of the transaction or transactions is to obtain a writing-down allowance, but whether any one of a series of transactions has that object. In our view the only realistic answer to that question is that it was."

435. The phrase "main purpose, or one of the main purposes" was also considered by the Court of Appeal, in the context of the loan relationship provisions of paragraph 13 of schedule 9 FA 1996, in *Travel Document Services and Ladbroke Group International v HMRC* [2018] 723 in which Newey LJ said, at [48]:

"I would add, however, that I do not accept that, as was submitted by Mr Ghosh [counsel for HMRC], "main", as used in paragraph 13(4) of schedule 9 of FA 1996, means "more than trivial". A "main" purpose will always be a "more than trivial" one, but the converse is not the case. A purpose can be "more than trivial" without being a "main" purpose. "Main" has a connotation of importance."

436. In the present case Mr Gammie says that the main object of payment under the PIP was to incentivise and retain staff whereas Mr Baldry contends that, even if this was the case, the PIP was structured in the way it was to obtain a reduction of tax and that, as this was critical to the design and operation of the PIP, it was its main object or one of its main objects.

437. In my judgment, although the PIP arrangements clearly did have a commercial purpose, the retention and incentivisation of partners, they also had as a main object the avoidance or reduction of liability to income tax. This is clear from the evidence of the PIP being "a bespoke piece of planning" developed by EY when explaining the PIP to BCM LP (see paragraph 272, above) and what was said by Mr Dodd, MP, Ms Braga, Mr Ward and Mr Dannatt in relation to it (see eg paragraphs 343 -352, above).

438. Indeed, rather than being merely incidental, the retention and incentivisation of staff was achieved as a result of the avoidance or reduction of tax that the PIP sought to achieve.

439. I now turn to the second issue in this part of the appeal, whether the appellant concerned was carrying on "an occupation" within s 774 ITA, in particular whether the activities of that individual concerned were of a kind undertaken in a "profession or vocation". While Mr Gammie accepts that those concerned in this case did a very professional job he says that is not the sense in which the term "profession" is used in the legislation. Neither, says Mr Gammie, is it used to differentiate between professional and amateur.

440. Turning to the authorities, although Case I of Schedule D referred to a "profession or vocation" and Case II a "trade", there is very little in them in which a profession or vocation is distinguished from a trade or much guidance as to what constitutes a profession or vocation.

441. On an appeal from the Special Commissioners in *Partridge v Mallandaine* (1886) 18 QBD 276 Denman J said, at 277-278:

“The case states the contention of the surveyor that betting systematically and annually carried on came within the provisions of the Income Tax Act [1842] as a vocation. Seeing that the case states enough for us to find here that the appellants are persons who in partnership attend races and systematically and annually carry on that pursuit so as to make profits, — for we must, I think, assume that profits were made — the question is whether the Commissioners were right in holding that those profits were derived from a “vocation” within Schedule D? I think the Commissioners were quite right. The words in 5 & 6 Vict. c. 35, s. 100, Sched. D, second case, are “professions, employments, or vocations.” I am not disposed to put so limited a construction on the word “employment” as that suggested in argument. I do not think that employment means only where one man is set to work by others to earn money; a man may employ himself so as to earn profits in many ways. But the word “vocation” is analogous to “calling,” a word of wide signification, meaning the way in which a man passes his life. The appellants attend races, make bets, and earn profits. Is it to be said that, under these circumstances, they are not to be assessed to the income tax, although every year they may have bets paid which put a thousand pounds into their pockets? Can it be said that because bets are made null and void by Act of Parliament the appellants do not carry on a “vocation”? To put such a construction on the Income Tax Act would unduly favour persons not favoured by the legislature. I think the word “vocation” is not limited to a lawful vocation, and that even the fact of a vocation being unlawful could not be set up against the demand for income tax. I think that the case comes within the word “vocation,” and therefore the Commissioners were right.”

442. Hawkins, J, in the same case, at 278, said:

““Vocation” and “calling” are synonymous terms, and if any one were asked what was the calling of the appellants, the answer would be that they were professional bookmakers. What that means is well known, and is fully described in the case. Mere betting is not illegal. It is perfectly lawful for a man to bet if he likes. He may, however, have a difficulty in getting the amount of the bets from dishonest persons who make bets and will not pay. The appellants, in fact, make considerable profits, and I cannot see why they should not be taxed as those made in any other profession or calling.”

443. Further authority exists in relation to the imposition of excess profits duty. This was charged under s 38 of the Finance (No 2) Act 1915. Section 39 of that Act provided that excess profits duty applied to:

...on all trades or businesses (whether continuously carried on or not) of any description carried on in the United Kingdom or owned or carried on in any other place by persons ordinarily resident in the United Kingdom, excepting—

...

(c) any profession the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on and in which no capital expenditure is required, or only capital expenditure of a comparatively small amount.

...

444. In *Hugh Cecil v Inland Revenue Commissioners* (1919-1920) 36 TLR 164 the issue arose as to whether a man who carried on a business as a “photographer of a special kind”, who, the headnote describes as having, “possessed artistic accomplishment” and whose photographs were “works of art”, carried on a profession. Rowlatt J said, at 165:

“It was commonplace by this time that the word “profession” in that subsection could not be exhaustively defined but, for the purpose of the present case, a man did not exercise a profession unless he exercised an art, the profits of which were dependent mainly on his personal qualifications. It was necessary to inquire whether the decision of the Special Commissioners was erroneous in point of law. It was true that the appellants work different from that of an ordinary photographer. He had gone very much beyond the work of the ordinary trade photographer, but he did not as it appeared to him (his Lordship), do anything in law beyond what an ordinary photographer did. He had great ability in posing his subjects and in seeing how an attractive picture could be made. He did things in a more elaborate way than an ordinary photographer, but it was all a question of degree. It was impossible to decide that the Special Commissioners had gone wrong. Where it was a mere question of degree, as in that case, the decision of the Special Commissioners could not be satisfied unless they had applied the wrong principles or a wrong test. As it could not be said they had gone wrong in law the appeal must be dismissed.”

445. In *Commissioners of Inland Revenue v Maxse* [1919] 1 KB 647 the issue before the Court of Appeal was whether the sole proprietor, editor and publisher of a monthly magazine fell within the exemption from excess profits duty in s 39(c) of the Finance (No. 2) Act 1915. Swinfen Eady MR said, at 652-653:

“In my opinion Mr Maxse is carrying on the profession of a journalist, author or man of letters by writing numerous articles which are published monthly and also by editing the magazine, from which he derives pecuniary profit. An author would not cease to be such if he published or procured to be published his own works at his own expense, and looked only for his remuneration to the sale of a commodity (to wit his books) in the open market. The truth is that Mr. Maxse is a journalist and editor, and is also carrying on the business of publishing a magazine, but the fact that he is a publisher does not prevent him from also exercising the profession of a journalist.”

Warrington LJ observed, at 655:

“It is conceded that the profits made by the owner of a magazine or journal from the publication thereof, the owner taking no part in the literary work, would be profits arising from a trade or business and would not be within exception (c) of s 39. It is conceded on the other hand that profits made by a writer would be profits arising from a “profession,” and in my opinion this would be so whether those profits consist of remuneration received by him from another person or whether they are derived from the sale of his works by the writer himself, or from their publication and sale through another person as publisher, who either pays the author a royalty or a proportion of the profits arising from the publication and sale. The remuneration of an editor of a magazine or a journal would also, in my opinion, be profits arising from a profession.”

In relation to what is a profession, Scrutton LJ asked, at 657:

“... what is a profession? I am very reluctant finally to propound a comprehensive definition. A set of facts not present to the mind of the judicial propounder, and not raised in the case before him, may immediately arise to

confound his proposition. But it seems to me as at present advised that a “profession” in the present use of language involves the idea of an occupation requiring either purely intellectual skill, or of manual skill controlled, as in painting and sculpture, or surgery, by the intellectual skill of the operator, as distinguished from an occupation which is substantially the production or sale or arrangements for the production or sale of commodities. The line of demarcation may vary from time to time. The word “profession” used to be confined to the three learned professions, the Church, Medicine and Law. It has now, I think, a wider meaning. It appears to me clear that a journalist whose contributions have any literary form, as distinguished from a reporter, exercises a “profession”; and that the editor of a periodical comes in the same category. It seems to me equally clear that the proprietor of a newspaper or periodical, controlling the printing, publishing and advertising, but not responsible for the selection of the literary or artistic contents, does not exercise a “profession” but a trade or business other than a profession.”

446. In *Christopher Barker & Sons v Commissioners of Inland Revenue* [1919] 2 KB 222 the issue was whether the exemption in s 39(c) of the Finance (No. 2) Act 1915 applied to stockbrokers who bought and sold stocks shares. Referring to the principle of the “divisibility of activities” propounded by the Court of Appeal in *Maxse*, Rowlatt J said, at 228-230:

“Now assuming this divisibility in point of law whether or not the appellants’ business is divisible depends upon whether the appellants are carrying on a profession the profits of which are dependent mainly on the personal qualification of the appellants, and in which no capital expenditure is required or only capital expenditure of a comparatively small amount. The scheme of the section has already been dealt with in several cases, and it is quite clear from those cases and from the language of the section itself that what is made liable to the excess profits duty is every business and what is taken out of liability is a profession. All professions are businesses, but all businesses are not professions, and it is only some businesses which are taken out of the operation of the section, namely, those which are professions, the profits of which are dependent mainly upon personal qualifications and in which no capital expenditure is required or only capital expenditure of a comparatively small amount. ... but the section does not say “any business the profits of which are dependent mainly” and so on; it says “any profession,” etc. It may be that the profits of some businesses depend upon the personal qualifications of the persons carrying them on rather than upon other matters. That is my construction of the section according to the decision of the Court of Appeal in *Burt’s Case*. At any rate it is the construction which I think the section bears. One has to ask whether the advising and valuing part of the appellants’ business was the carrying on of a profession. It is true that so far as it is purely advisory it does depend upon the personal qualification of the appellants, and does not depend so much upon capital, but one has to see whether the Commissioners have gone wrong in law. It is probable that the appellants, being stockbrokers, attracted a certain amount of advising and valuing business for which they charged a fee. As regards the valuations this fee may have been merely a liquidated commission though not a percentage commission; the fee charged by the appellants for advising may have been a lump sum fee. But that work was probably all attracted by and ancillary to their business of stockbrokers.

Now is a stockbrokers’ business a profession within the meaning of this section? It seems to me that what a stockbroker does is to buy and sell a commodity on the market. It is true he does not expect to have to pay for it himself or to be responsible ultimately to satisfy the contract himself, as he is a buyer and seller in the market for an undisclosed principal to whom he looks

to indemnify him from liability. It does not seem to me that that is a profession within the meaning of this section. The stockbroker is remunerated by a commission which he receives from his principal, the person who takes the liability off his shoulders. In my opinion the advice given by a stockbroker comes within the dictum of Scrutton L.J. in *Burt & Co. v. Inland Revenue Commissioners* because it is the exercise of commercial knowledge in connection with the sale of commodities in the market. Therefore it seems to me that although the appellants do a certain amount of advising for which they are remunerated by fees it is advice given in connection with the exercise of a business of a stockbroker and that in giving that advice they are not exercising any profession at all, even assuming that part of the business can be severed from the purely stockbroking part of their business of buying and selling stocks and shares for which they are remunerated by commission.”

447. Burt’s Case (ie *Barker, Burt & Company v Commissioners of Inland Revenue* [1919] 2 KB 650), to which Rowlatt J referred, also concerned s 39(c) of the Finance (No. 2) Act 1915 in relation to partners in the business of general merchants and commission agents who, in the course of their business, acted as secretaries and/or agents in the UK for certain Eastern produce companies. The firm was remunerated by way of a small fixed annual sum and commission on sales and additionally acted as expert advisers to one of the companies for a fixed remuneration and a small commission on sales.

448. In relation to the remuneration for acting as advisers and commission, Swinfen Eady MR, at 668-669, said:

“The 4198*l.* is remuneration by way of commission which has come to these gentlemen as what I may call market advisers. In all trades the head of the business or somebody in the business must know something about the markets, but in the case of a business carrying on a very extensive trade it may be desirable to pay somebody else to know all about markets, and from the Chinese firm, Hwik Hoo Tong, Messrs. Burt got some 4000*l.* in the particular year of assessment.

Now I am not clear whether it is said that that was an office or employment or a profession or both. If it be treated as an office or employment the same remark that I have made about the 1539*l.* applies to it, that it is the business of a person taking commissions in respect of transactions. If it be treated as a profession, whatever may be the limitation of a profession, I do not think it applies to the exercise of commercial knowledge in connection with the sale of goods, or export or import of goods. For these reasons I am of opinion that the Commissioners would be quite right in saying that this business of market advisers is not a profession which would come within (c). If it were it would be taken out again under the latter part of the section. For these reasons, depending on the construction of the statute, I agree with the view taken by the other members of this Court, the judge below, and the Commissioners.”

449. The question of “profession” under the 1915 Act also arose in *Currie v Commissioners of Inland Revenue* [1921] 2 KB 332 in which Lord Sterndale MR said, at 35-336:

“The first question that has been debated before us is this: Is the question whether a man is carrying on a profession or not a matter of law or a matter of fact? I do not know that it is possible to give a positive answer to that question; it must depend upon the circumstances with which the Court is dealing. There may be circumstances in which nobody could arrive at any other conclusion than that what the man was doing was carrying on a profession; and therefore, looking at the matter from the point of view of a judge directing a jury, the judge would be bound to direct them that on the facts they could only find that

he was carrying on a profession. That reduces it to a question of law. On the other hand, there may be facts on which the direction would have to be given the other way. But between those two extremes there is a very large tract of country in which the matter becomes a question of degree; and where that is the case the question is undoubtedly, in my opinion, one of fact; and if the Commissioners come to a conclusion of fact without having applied any wrong principle, then their decision is final upon the matter.”

Scrutton LJ, having referred to the decision of the Special Commissioners went on to say, at 340-342:

“They are the judges of fact, and whether a man carried on a profession is in the last resort a question of fact. The reason why it appears to me to be so is this. In my view it is impossible to lay down any strict legal definition of what is a profession, because persons carry on such infinite varieties of trades and businesses that it is a question of degree in nearly every case whether the form of business that a particular person carries on is, or is not, a profession. Accountancy is of every degree of skill or simplicity. I should certainly not assent to the proposition that as a matter of law every accountant carries on a profession or that every accountant does not. The fact that a person may have some knowledge of law does not, in my view, determine whether or not the particular business carried on by him is a profession. Take the case that I put during the argument, of a forwarding agent. From the nature of his business he has to know something about railway Acts, about the classes of risk that are run in sending goods in a particular way, and under particular forms of contract. That may or may not be sufficient to make his business a profession. Other persons may require rather more knowledge of law, and it must be a question of degree in each case. Take the case before Rowlatt J. of a photographer: *Cecil v. Inland Revenue Commissioners*. Art is a matter of degree, and to determine whether an artist is a professional man again depends, in my view, on the degree of artistic work that he is doing. All these cases which involve questions of degree seem to me to be eminently questions of fact, which the Legislature has thought fit to entrust to the Commissioners, who have, at any rate, from their very varied experience, at least as much knowledge, if not considerably more, of the various modes of carrying on trade than any judge on the bench.

I was very much struck with, and I agree with, the way in which Rowlatt J. put it in the last paragraph of his judgment in the Stock Exchange case: *Christopher Barker & Sons v. Inland Revenue Commissioners*:

“I very much doubt whether it would be possible for me even if I held a different view to decide otherwise. After all the Commissioners are judges of fact, and they have not disclosed to me what view of the law they took. All that appears on the case is that they decided that the exception did not apply; that the appellants did not carry on a profession and were therefore liable to excess profits. I cannot possibly say there is no evidence in support of that finding. But as the Commissioners have not disclosed to me upon what view of the law they proceeded, I very much doubt whether they have stated a case upon any point which is open to me.”

450. *Carr v Inland Revenue Commissioners* [1944] 2 All ER 163 was another case concerning the exemption contained in s 39(c) Finance (No 2) Act 1915. Having considered the provision Scott LJ said, at 165:

“That goes to indicate that the essential notion of a “business,” as contemplated by the excess profits tax provisions, is that it is commercial in character. I concede that that attribute is not exclusive, because a farmer carries on a business which is primarily not commercial in character, and nevertheless is within the Act; but it leaves in my mind a strong impression that the primary object of the excess profits tax was to deal with profits which were likely to be greatly augmented by the effect of war upon supply and demand without any relation to the efforts of the owner of the business. That aspect of the tax is, of course, merely a consideration of a general character; but it is consistent with that characteristic of the excess profits tax that professions, which are essentially dependent upon individual initiative of a skilled, but non-commercial, character, should be exempt from the tax.

...

The Solicitor-General emphasised that aspect by saying that a profession is attributable to his intellectual qualifications. We ventured to put to him that that was too narrow a view of the different types of qualification which may create a profession. The attribute “intellectual” leaves out of account aesthetic qualifications—the arts, painting, sculpture, music—literary qualifications and a good many other qualifications that may be utilised by a professional man like the appellant, who is dealing with a subject-matter cognate to medicine. McNaughton J treated the work of prescribing spectacles as carried on by the appellant here as a very much simpler task than I think he was justified in treating it; and then added as the conclusion at which he had arrived, “that the General Commissioners were mistaken, in matter of law, in thinking that a person who professes to be an optician is carrying on a profession within the meaning of sect. 12.” With great respect, the present case does not depend upon the consideration of a universal proposition about opticians in general, but solely on the question as to whether or not the conclusion of the Commissioners was based upon some evidence before them which justified it.”

Du Parq LJ, who agreed with Scott LJ, said at 166-167:

“It seems to me to be dangerous to try to define the word “profession,” as Scrutton LJ realised. There are a good many cases about which almost everybody would agree. Everybody would agree, I should think, that when you find a business, however extensive and however distinguished in some ways it may be, which consists merely of selling property, whether real or personal, that is not a profession. It is necessary to add the word “merely,” since a sculptor, for instance, may be said to be selling goods. I know there may be a question whether one can regard the contract in that case as a contract for sale, but, if it is not a contract for sale, it may be described as a contract to do work and labour, and there, again, everybody would agree as a general rule that a man who earns his money merely by doing work and labour, without more, is carrying on a trade and not a profession. Again the word “merely” has to be inserted to guard against it being thought that many people are not carrying on a profession who at the same time may be said to be doing work or labour. I think that everybody would agree that, before one can say that a man is carrying on a profession, one must see that he has some special skill or ability, or some special qualifications derived from training or experience. Even there one has to be very careful, because there are many people whose work demands great skill and ability and long experience and many qualifications who would not be said by anybody to be carrying on a profession.

Ultimately one has to answer this question: Would the ordinary man, the ordinary reasonable man—the man, if you like to refer to an old friend, on the Clapham omnibus—say now, in the time in which we live, of any particular occupation, that it is properly described as a profession? I do not believe one can escape from that very practical way of putting the question; in other words, I think it would be in a proper case a question for a jury, and I think in a case like this it is eminently one for the Commissioners. Times have changed.

There are professions to-day which nobody would have considered to be professions in times past. Our forefathers restricted the professions to a very small number; the work of the surgeon used to be carried on by the barber, whom nobody would have considered a professional man. The profession of the chartered accountant has grown up in comparatively recent times, and other trades, or vocations. I care not what word you use in relation to them, may in future years acquire the status of professions. It must be the intention of the legislature, when it refers to a profession, to indicate what the ordinary intelligent subject, taking down the volume of the statutes and reading the section, will think that “profession” means. I do not think that the lawyer as such can help him very much.”

451. I was also referred, by Mr Gammie, to *Asher v London Film Productions Limited* [1944] 1 KB 133 in which Lord Greene MR (with whom MacKinnon and Goddard LJ) was, at 139, “entirely unconvinced” that, on the facts of that case, a film producer was, “carrying on any ‘profession or vocation’ at all according to the true meaning of those words.”

452. From these authorities it would appear that the issue whether the IP Appellants were carrying on an occupation, ie undertaking activities of a kind undertaken in a profession or vocation, is a question of fact.

453. Mr Gammie, in addition to relying on the authorities referred to *Pride and Prejudice* in which Jane Austen wrote of a relative of who was “merely in commerce” which Mr Gammie says is the distinction in this case. He contends that it is not a matter of defining the characteristics of a profession – something eschewed by the courts – but, having regard to the evidence, it is clear that the individuals concerned are trading which Parliament has chosen not to bring within the scope of the legislation.

454. Like Du Parq LJ in *Carr*, I do not consider it appropriate to define what is meant by “profession”. However, given the comments of Scrutton LJ in *Maxse* of an occupation “requiring purely intellectual skill” and the observation of Du Parq LJ in *Carr*, of the necessity for “some special skill or ability” that is “derived from experience” I consider that the “ordinary reasonable” man or woman, whether on the proverbial “Clapham omnibus”, the Northern Line or DLR going past Canary Wharf, would, having regard to the evidence, regard the term “profession” as including the activities of all of the IP Appellants.

455. It is, after all, over 100 years since Scrutton LJ noted, in *Maxse*, that that the “line of demarcation may vary from time to time” and that the word “profession “has now [in 1919], I think, a wider meaning.”

#### **SUMMARY OF CONCLUSIONS IN IP APPEALS**

456. Therefore, even if the IP Appellants had succeeded on the Miscellaneous Income Issue, given my conclusion on this, the Sale of Occupational Income, issue their appeals would have failed.

457. Accordingly, for the above reasons, the appeals of the IP Appellants are dismissed.

#### **SUMMARY OF CONCLUSIONS**

458. In relation to each of the appeals, for the reasons above:



- (1) The Cayman Appeals are dismissed and the amendments to the closure notices are confirmed as varied according to paragraph 8(44), above;
- (2) The PIP Appeals are allowed; and
- (3) The IP Appeals are dismissed.

#### **RIGHT TO APPLY FOR PERMISSION TO APPEAL**

459. 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.

**JOHN BROOKS  
TRIBUNAL JUDGE**

**Release date: 17 July 2020**

#### **APPENDIX**

##### **IP Appellants application for redaction of figures in the far right-hand column of the table at paragraph 340(7) of the Decision**

1. Given its length and complexity, a draft of this decision was provided to the parties, on 9 June 2020, for the purpose of identifying typing corrections and any other obvious errors in writing to enable these to be incorporated, if accepted, in the final decision.

2. In their response the IP Appellants requested that the figures listed in the far right-hand column of the table at paragraph 340(7) of the decision be redacted or removed on the basis that this was confidential and sensitive information, relating to named individuals, which was not required for the legal analysis.

3. On 1 July 2020 the IP Appellants made a formal application, under Rule 14 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, for the redaction of the figures. This followed a response from the Tribunal on 29 June 2020, written on my instruction, which referred to the observation of Judge Sinfield in *Hastings Insurance v HMRC* [2018] UKFTT 478 (TC) at [20] that:

“If an appellant is concerned that the amount of an assessment should not become public then the appellant should apply for an order under rule 14 of the FTT Rules prohibiting the disclosure or publication of that information...”

4. In essence the IP Appellants contend that the figures should be redacted as it is unnecessary for an understanding of the PIP arrangements, the Tribunal’s analysis and reasons or its decision that the precise figures involved should be a matter of public knowledge. It is made clear that they are not seeking the anonymisation of the Tribunal’s decision (as Dr Banerjee was seeking in *HMRC v Banerjee* (No 2) [2009] STC 1930, see below). Nor are they

seeking any redaction in relation to the relevant arrangements under which they were awarded particular amounts.

5. The IP Appellant contrast their position with that of the PIP Appellants whose appeals disclose the profit allocations that were made in particular years to the Corporate Partner where there has been no request or application for the redaction of those figures. They explain that various awards that the Corporate Partner made to particular individual partners, however, remain confidential to that partner and are neither a matter of public knowledge nor, indeed, a matter of general knowledge as between the whole body of individual partners and that the financial affairs of individuals are generally a matter of greater sensitivity, and hence meriting a higher degree of privacy, than those of corporate entities.

6. In addition, as the five partners whose appeals were before the Tribunal were (as noted in paragraph 339 of the decision) intended to be representative of individual partners generally those other partners' affairs remain entirely confidential. It is argued that the publication of the Closure Notice figures for the IP Appellants will inevitably bring into the public domain figures that will be assumed to represent the individual awards that were made to particular partners (which would not otherwise be known either publicly or within the partnership generally) and may lead to unnecessary speculation as to the awards that were made to other individual partners who were not parties to these proceedings.

7. HMRC oppose the application submitting that it is made on the erroneous basis that the threshold for such a redaction is "relevance to the Tribunal's analysis" rather than exceptionality. They contend that a request that the financial details be removed from a decision for reasons of privacy is governed by the same principles as a request that the decision be anonymised.

8. As the then Chamber President, Judge Bishopp, said, in *A v HMRC* [2012] UKFTT 541 at [6], when refusing an application for anonymity:

"The usual practice in this tribunal is not only to hold its hearings in public, but also to make no attempt to conceal, either during the course of the hearing or in its published decisions, the details of a taxpayer's income and other financial circumstances relevant to the appeal. Redaction of such details ... was exceptional."

9. In *HMRC v Banerjee* (No 2) [2009] STC 1930 Henderson J said that in his opinion:

"[34] ... any taxpayer has a reasonable expectation of privacy in relation to his or her financial and fiscal affairs, and it is important that this basic principle should not be whittled away. However, the principle of public justice is a very potent one, for reasons which are too obvious to need recitation, and in my judgment it will only be in truly exceptional circumstances that a taxpayer's rights to privacy and confidentiality could properly prevail in the balancing exercise that the court has to perform.

[35] It is relevant to bear in mind, I think, that taxation always has been, and probably always will be, a subject of particular sensitivity both for the citizen and for the executive arm of government. It is an area where public and private interests intersect, if not collide; and for that reason there is nearly always a wider public interest potentially involved in even the most mundane-seeming tax dispute. Nowhere is that more true, in my judgment, than in relation to the rules governing the deductibility of expenses for income tax. Those rules directly affect the vast majority of taxpayers, and any High Court judgment on the subject is likely to be of wide significance, quite possibly in ways which may not be immediately apparent when it is delivered. These considerations serve to reinforce the point that in tax cases the public interest generally

requires the precise facts relevant to the decision to be a matter of public record, and not to be more or less heavily veiled by a process of redaction or anonymisation. The inevitable degree of intrusion into the taxpayer's privacy which this involves is, in all normal circumstances, the price which has to be paid for the resolution of tax disputes through a system of open justice rather than by administrative fiat.”

10. In dismissing an application for anonymity in *Clunes v HMRC* [2017] UKFTT Judge Bishopp said, at [10]:

“... Any taxpayer who was not in the public eye but who, for example, would prefer his friends or neighbours not to know of his financial affairs, would find it impossible to persuade the tribunal to grant him anonymity; as Henderson J said, the public interest in the outcome of tax litigation, whether in the High Court or in this tribunal, outweighs the desire of the taxpayer for anonymity, and the inevitable resultant intrusion into matters which might otherwise remain confidential is the price which must be paid for open justice, however unpalatable the individual taxpayer might find it to be.”

11. It is true, as the IP Appellants accept, that *Banerjee* and *Clunes* concerned applications for complete anonymity which should only exceptionally be granted. However, I see no reason why the same principles should not apply here, especially as the figures in the far right-hand column of the table at paragraph 340(7) of the decision were included in the “Statement of Agreed Facts and Issues” in the IP Appeals provided by the parties. As a document which the “judge has been asked to read or has said that he has read” the “default position” is that the public should be allowed access to the “Statement of Agreed Facts and Issues” and therefore the figures (see *Cape Intermediate Holdings Ltd v Dring (Asbestos Victims Support Groups Forum UK)* [2020] AC 629 at [44]).

12. Therefore, for the reasons above the IP Appellants application for the redaction of the figures is dismissed.

13. However, notwithstanding my decision, like Judge Mosedale in *JK v HMRC* [2019] UKFTT 411 (TC) who anonymised her decision despite dismissing the appellant’s application, I have redacted the figures in case of any application for permission to appeal by the IP Appellants which would be rendered nugatory if the figures were published.