Neutral Citation Number: [2021] EWCA Civ 1180

Case No: A3/2020/0007

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
FALK J AND JUDGE HERRINGTON
[2019] UKUT 226 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 04/08/2021

Before:

LORD JUSTICE HENDERSON
LORD JUSTICE PHILLIPS
and
SIR DAVID RICHARDS

- -

Between:

INGENIOUS GAMES LLP **INSIDE TRACK PRODUCTIONS LLP** **INGENIOUS FILM PARTNERS 2 LLP**	**Appellants**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

- -

Mr Jonathan Peacock QC, Mr Richard Vallat QC, Mr James Rivett QC and Mr Edward Waldegrave (instructed by **White & Case LLP**) for the **Appellants**
Mr Malcolm Gammie QC, Mr Jonathan Davey QC, Mr Imran Afzal, Mr Sam Chandler and Mr Nicholas Macklam (instructed by **The General Counsel and Solicitor for HMRC**) for the **Respondents**

Hearing dates: 11, 12, 15, 16, 17 and 18 March 2021

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Approved Judgment

Approved Judgment Covid-19 Protocol: This judgment was handed down remotely by circulation to the parties' representatives by email, release to BAILII and publication on the Courts and Tribunals Judiciary website. The date and time for hand-down is deemed to be 10.00 a.m. on Wednesday 4 August 2021

Lord Justice Henderson, Lord Justice Phillips and Sir David Richards:

1. This is the judgment of the court, to which all its members have contributed.

I. Introduction

2. In this second appeal, the appellant limited liability partnerships (which we will call "IG", "ITP" and "IFP2" respectively, and collectively "the LLPs") challenge the decision of the Upper Tribunal ("the UT") dated 26 July 2019 (the UT Decision) (Falk J and Judge Herrington). The scope of the appeal is confined, by the permission granted by Arnold LJ, to two issues which lie at the heart of tax avoidance schemes which were marketed by the Ingenious Media Group ("Ingenious") to wealthy individual taxpayers in the tax years 2002/03 to 2009/10 inclusive.

3. As with so many tax avoidance schemes which the courts have had occasion to examine over the last thirty and more years, the schemes were designed to operate in the context of the real-world film industry (or, in the case of IG, in the similar industry of making and exploiting video and computer games). Specifically, the schemes were designed to take advantage of the well-known fact that, although many films are made (whether by studios or independent producers) with the hope and intention that they will be commercially successful, only a small and unpredictable number of films do in fact achieve that aim. In the great majority of cases, the film (when made) does not generate enough income to return a profit for its makers, after all the costs of its production and distribution have been taken into account; and even in the comparatively rare cases where the film does eventually make a profit, this cannot normally be forecast with any degree of confidence while the film is being made.

4. It is therefore an inherent feature of the film industry that very substantial sums of money are spent on making a product (the completed film) which is statistically unlikely to generate a profit for its funders, but which may of course do so if it achieves commercial success, and to an extent which makes the overall business profitable even after the losses from the unsuccessful majority of films are taken into account. In this respect, there are some similarities with other industries (such as the pharmaceutical sector) in which heavily front-loaded expenditure is incurred in developing products of which only a handful will turn out to be commercially viable, but where huge profits may ultimately be made from the few products which do succeed. In the present case, it so happens that one of the films which was partially funded by the LLPs was "*Avatar*", which has turned out to be the highest-grossing film of all time.

5. In broad and heavily simplified terms, the schemes were marketed as a means of enabling higher-rate UK taxpayers to shelter income which would otherwise have been subject to the higher rate of income tax (then 40%) by claiming "sideways" loss relief available to them as individual members of the LLPs. In the earlier years under appeal, this relief was provided by section 380 of the Income and Corporation Taxes Act 1988 ("ICTA 1988"). In the later years, it was provided in materially similar terms by section 64 of the Income Tax Act 2007 ("ITA 2007"), subsection (1) of which provided that:

> "A person may make a claim for trade loss relief against general income if the person—
>
> (a) carries on a trade in a tax year, and
>
> (b) makes a loss in the trade in the tax year ("the loss-making year")."

It follows that, in order for the relief to be available, the taxpayer must carry on a trade in the relevant tax year, and he must make a loss in that trade.

6. Although an LLP has separate legal personality, it is treated for income tax purposes as "transparent" provided that certain conditions are satisfied. The key provision for this purpose is section 863(1) of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005"), which says that:

> "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."

7. It follows from these provisions that, if the individual members of the LLPs were to be entitled to claim loss relief for the LLPs' trading losses, it was necessary not only that the LLP should carry on a trade in which the loss was incurred, but that it should carry on the trade "with a view to profit". Those, in short, are the two underlying issues of principle on which the LLPs have been granted permission to appeal to this court. The first issue is whether the relevant activities of the LLPs constituted a trade for income tax purposes. The second, and separate, issue is whether the LLPs carried on the relevant activities with a view to profit. Although the two questions obviously overlap, they are not co-terminous. Although most trades are carried on with a view to profit, at least in the longer term, that is not a necessary requirement. For example, a trade may be carried on as a means of providing community or other forms of benefit or even as a hobby or pastime, with no intention that it should be profit-making.

8. Furthermore, both issues have wider repercussions outside the field of tax law. The need for a business to be carried on with a view to, or with a view of, profit is a pre-condition of the existence of an unincorporated partnership under the general law (see section 1(1) of the Partnership Act 1890, which defines partnership as "the relation which subsists between persons carrying on a business in common *with a view of profit*"), as it is of the incorporation of an LLP (see section 2(1)(a) of the Limited Liability Partnerships Act 2000, which provides that for an LLP to be incorporated "two or more persons associated for carrying on a lawful business *with a view to profit* must have subscribed their names to an incorporation document").

9. Trade is also a concept which has been left undefined for tax purposes, the only relevant guidance (now contained in section 989 of ITA 2007) being that it includes "any venture in the nature of trade". Previously, the word used was "adventure" in the nature of trade (see the definition in section 832(1) of ICTA 1988, which applied generally in the interpretation of the Tax Acts), but the meaning of the two expressions is presumably the same. As Lord Wilberforce said, in *Ransom v Higgs* [1974] 1 WLR 1594 at 1610, referring to corresponding provisions in the Income Tax Act 1952:

> "We have rather to apply to the facts the legal concept of "trade."…This may be called a concept of common law. Trade has for centuries been, and still is part of the national way of life: everyone is supposed to know what "trade" means: so Parliament, which wrote it into the Law of Income Tax in 1799, has wisely abstained from defining it and has left it to the Courts to say what it does or does not include."

10. It is therefore important that, in considering these two issues of principles, we should bear in mind the wider contexts in which they are relevant, and resist any temptation to give them an unduly narrow meaning because of the tax avoidance context in which the questions arise.

11. If the taxpayers at whom the present schemes were targeted were to obtain initial sideways relief from income tax at 40% in an amount sufficient to recoup their initial

contribution to the LLP, it was necessary for their investment to be geared so that the sums contributed by the LLP to the making of a film would be substantially greater than the sums put in by the individual partners, but the anticipated losses would nevertheless be allocated in their entirety to the individual members. The way in which it was planned to achieve this objective involved the establishment of a corporate member of each LLP, which was always an entity controlled by Ingenious. Although the figures varied in some cases, the typical arrangement was that (in nominal terms) for every 30 contributed by the individual members to the LLP, a further 70 would be contributed by the corporate member. This 70 was, at least ostensibly, borrowed by the corporate member from the "Commissioning Distributor" of the film, helpfully defined in the Glossary at the start of the UT Decision (under the acronym "CD") as:

> "a Hollywood studio or vehicle formed by independent producers and other financiers and which entered into contractual arrangements with an LLP in relation to the production and distribution of a film."

12. The loan was to be made on limited recourse terms, repayable only from the corporate member's drawings from the LLP. The stated purpose of the loan was to enable the corporate member to make a capital contribution to the LLP, but the amounts advanced were to be paid direct by the Commissioning Distributor to the Production Services Company ("PSC") which was the special purpose vehicle set up to make the film. It is important to appreciate that both the Commissioning Distributor and the PSC were not Ingenious entities. Thus the 70 which was ostensibly to be contributed to the film budget by way of a loan to the corporate member channelled through the LLP to the PSC was in fact paid direct by the Commissioning Distributor to the PSC. A further significant aspect of the arrangements was that a so-called executive producer fee, amounting to 5% of the total film budget of 100, was deducted at an early stage from the 30 contributed by the individual members and paid to Ingenious, with the result that only 95 reached the PSC (paid as to 70 by the Commissioning Distributor, and as to 25 by the LLP out of the capital contributions of the individual members).

13. On the assumption that the LLPs were engaged in a trade, the schemes were designed so that substantial first-year losses would be generated and allocated to the individual members. The losses would arise because each film had to be valued, for accounting purposes, at the end of each accounting period at its net realisable value, or "NRV". The NRV was individually calculated for each film but would typically be 20% of the cost upon completion of the film, thus generating a loss of 80% of the cost. The whole of this loss could be allocated to the individual partners, even though 70% of the cost had been contributed by the corporate member, in reliance on the reasoning of the House of Lords in *Reed v Young* [1986] 1 WLR 649, where it was held that the trading losses of a limited partnership (not an LLP, which did not then exist) were conceptually distinct from its debts and liabilities, and did not have to be allocated in accordance with the capital shares of the partners in the business. So far as limited partnerships were concerned, this outcome was reversed by statute in 1985, restricting the availability of relief by reference to the individual's contribution (as defined) to the firm. But similar restrictions were not enacted in relation to LLPs until 2009, and HMRC have confirmed in written submissions provided to this court after the hearing that it has never been HMRC's case that the appellant LLPs were prevented from agreeing the allocation of profits and losses that they did.

14. Since (as we have explained) each film was actually made by the PSC, which was not an Ingenious entity, the next piece in the jigsaw is to understand how the LLPs sought to portray themselves as being engaged in the trade of film production. The answer lies in the complex and interlocking suite of documents, all executed on the same day, which were brought into existence for each film. In broadest outline, the purported effect of these documents was that:

> (a) the film would be made by the PSC in accordance with the agreed specification, cashflow and budget;
>
> (b) when the film had been made, it would be distributed by the Commissioning Distributor, and the proceeds of distribution would be divided in accordance with the terms of a "waterfall" that specified who should receive what and in what order; but
>
> (c) the LLP was interposed into this structure in such a way that it ostensibly undertook the primary obligation to make the film in accordance with the same specification, cashflow and budget, and sub-contracted the performance of this work to the PSC; and
>
> (d) upon completion of the film, the LLP would assign to the Commissioning Distributor all its rights to the film, and until such assignment the LLP granted the Commissioning Distributor a sole and exclusive licence of its rights to the film.

15. At a high level of generality, therefore, the business model which the LLPs sought to create was one where they engaged in the business of film production, through the services of the PSC as their sub-contractor, contributing 100% of the budgeted cost (although 70% of it originated with the Commissioning Distributor, and was paid direct to the PSC in the way we have described), in return for a share of revenues from the completed film in the amounts specified in the waterfall as due to the LLP, amounting to up to 54.45% of the gross distributable income derived from the film. This was the model which Ingenious used to sell the schemes to potential investors, and the true legal effect of the composite transactions entered into by the parties had to correspond with the model if the individual members were to obtain the first-year loss relief which (for them) was the primary objective of the whole exercise. For convenience, this model is often referred to in submissions and the Tribunal decisions as the Ingenious, or 100%, basis, and is to be contrasted with the so-called 30:30 basis, which denotes what HMRC have consistently argued was the true effect in law of the arrangements, namely that the LLPs contributed 30% of the film's budget in return for 30% of the gross proceeds under the waterfall.

16. We hope it will be helpful at this stage to set out the high-level summary of the parties' respective contentions on the business model given by the UT in the introductory section of the UT Decision. After observing that the arrangements for films and games were "broadly similar", and providing an outline of the relevant arrangements upon which we have already drawn in our description of the background, the UT continued as follows:

> "17. The LLPs contend that the legal, accounting and taxation effect of these arrangements can be summarised as follows:

(1) Each LLP had capital of 100… consisting of the amounts contributed by the individual members and the [*Corporate Member*].

(2) Each LLP incurred expenditure of 100 in making a film pursuant to its obligations under the relevant [*Commissioning and Distribution Agreement, or "CDA*"] (and discharged those obligations by sub-contracting to the relevant PSC).

(3) The LLP acquired a beneficial ownership interest in the copyright to the film as it was made.

(4) Each film was stock which was, on completion, sold to the [*Commissioning Distributor*] in return for the amounts specified in the Waterfall as due to the LLP, the amounts receivable by the LLP amounting to up to 54.45% of the gross distributable income derived from the film.

(5) The LLPs intended to make a profit from the films and there was a realistic possibility that they would do so.

(6) The LLPs were carrying on a trade and doing so with a view to profit.

(7) For accounting purposes, each film had to be valued (at each accounting period end) at its [*NRV*]. NRV was individually calculated for each film, but on completion of the film might typically be 20% of cost. This gave rise to a significant loss in the first period.

(8) In later periods, profits would arise as amounts in excess of the NRV were received under the relevant Waterfall. From a tax perspective, given that it was expected that the LLP would generate such profits, the effect of the accounting treatment combined with the allocation of losses/profits to individual members would give rise to a reduction in income tax liabilities for those members in the early years, but this reduction would be reversed as the film generated taxable profits. In other words, the anticipated tax benefit was a deferral of tax (from the early loss-making years to the later profitable years), not an absolute reduction in tax.

18. HMRC contend that the LLPs' position does not reflect the substance and reality of the arrangements entered into by them. They contend that the arrangements were designed to generate first-year losses and to facilitate claims by the investors for sideways loss relief in respect of those losses, but the correctness of those claims depends upon whether, having regard to the substance and reality of the arrangements entered into by the LLPs, the following legislative conditions were satisfied:

(1) the conditions for sideways loss relief, which is only available in respect of trading losses, so that it is only if the LLP is trading that the members were entitled to offset their respective shares of the LLP's losses against other income in that manner;

(2) the conditions for the LLP to be taxed as a partnership (essentially, on a transparent basis rather than as a body corporate); it is only if the LLP is carrying on a trade with a view to profit that this condition can be satisfied; and

(3) the condition that the expenditure claimed by each LLP in the computation of its taxable profits and losses must be properly deductible for income tax purposes, as provided by the statutory provisions referred to at [13] and [14] above [*in short, the requirement in section 25(1) of ITTOIA 2005 that the profits of a trade must be calculated for tax purposes in accordance with generally accepted accounting practice ("GAAP"), the requirement in section 33 that, in calculating the profits of a trade, no deduction is allowed for items of a capital nature; and the requirement in section 34 that no deduction is allowed for expenses "not incurred wholly and exclusively for the purposes of the trade*"].

19. HMRC contend that what the activities of the LLPs and the transactions which they entered into amounted to can be encapsulated in the following seven short propositions:

(1) The LLPs were used by Ingenious as vehicles through which to raise finance for investment in films and games, which Ingenious was to identify.

(2) In the course of that activity, the LLPs generated for Ingenious substantial fees from individual investors.

(3) The finance raised by the LLPs would ultimately buy them a potential income stream under the Waterfall.

(4) The size of the LLPs' share in the Waterfall broadly reflected the size of their contribution to the budget of the film or game concerned. They put up 30% of the budget and they were entitled to 30% of the Waterfall.

(5) The LLPs thereafter retained their rights under the Waterfall indefinitely. They were not traded but they received such income as might flow from those rights.

(6) The majority of the income would arise in the first five years, though the rights lasted as long as the business lasted, and monies could be paid under the Waterfall for a long period.

> (7) The LLPs did not have to recoup their costs before individual investors started to make a positive after-tax return. Virtually any film income from the Waterfall secured an after-tax profit for an investor.
>
> 20. As a consequence, HMRC contend that the substance and reality of the arrangements was as follows:
>
> (1) None of the LLPs was carrying on a trade but merely bought and then held rights in a potential income stream from a film, which was an investment and not a trading activity.
>
> (2) The LLPs were not carrying on business with a view to profit. Rather, their businesses were being conducted with the objective of providing tax shelter for their individual investors on the basis that any amount of income, not profit, would make an investment in that tax shelter a viable proposition and generate fees for the Ingenious group.
>
> (3) The LLPs did not incur 100% of the budget but only the 30% of the budget that their investors actually contributed.
>
> (4) The LLPs did not compute the losses in accordance with GAAP, because their accounts did not recognise the substance of what they had done.
>
> (5) What the LLPs acquired were capital rights under the Waterfall which they did not intend to sell, with the result that no income tax losses could arise in respect of those assets in any event."

The decisions of the First-tier Tribunal ("the FTT")

17. The rival contentions outlined above led to litigation on an epic scale before the FTT (Judge Hellier and Mr Julian Stafford), which as the UT observed at UT/22 "had to assimilate and analyse a vast amount of evidence and submissions which were made to it during the course of a series of hearings extending over more than a year and taking some 48 days." Those hearings resulted in two decisions: the first, and main, decision ("the FTT Decision"), which was released on 14 October 2016 (and subsequently amended); and a further decision ("the Further FTT Decision") which was released on 17 May 2017. The appeals to the FTT were against closure notices issued to the LLPs by HMRC, which amended their partnership tax returns to deny their claims for trading losses in the relevant tax years (2002/03 to 2005/06 for ITP, 2005/06 to 2009/10 for IFP2, and 2005/06 to 2008/09 for IG). (References to paragraphs of the FTT Decision and of the UT Decision are shown respectively as FTT/X and UT/X.)

18. The FTT Decision, which ran to some 343 pages and comprised 1826 paragraphs, dealt with the question whether the claims for trading losses should be allowed. It did so under five main headings, after first examining at length the construction and true legal

effect of the suite of agreements. The conclusions of the FTT on that critical analysis were summarised at UT/23, from which we extract the following salient points:

> (1) The corporate member was not obliged to contribute capital to the LLPs, and in the case of ITP it was unclear whether the corporate member had in fact contributed capital. It was also doubtful whether the payment by the Commissioning Distributor under the Loan Agreement of 70 to the PSC constituted the making of a capital contribution.
>
> (2) The LLPs were not contractually liable for the whole of the budgeted cost of each film or game. Their obligation was limited to pay no more than 30% to the PSC and that liability arose only once the whole of the 70% was paid.
>
> (3) The LLPs had a right to receive from the Commissioning Distributor only a share of the gross distributable income of the film after those amounts had been reduced by sums payable to the Commissioning Distributor in respect of the repayment of the 70 lent to the corporate member, a share which the FTT found to amount to 30% of gross distributable income.
>
> (4) The LLPs did not acquire any rights in the films (or games) beneficially, and they were or were equivalent to mere (or bare) trustees in respect of such rights as they held.

In a nutshell, therefore, the FTT upheld the 30:30 basis contended for by HMRC, as opposed to the Ingenious basis for which the LLPs contended.

19. In the light of those conclusions on the construction and legal effect of the documents, the five main issues which the FTT proceeded to consider were:

> (1) whether the LLPs were trading (the "trading issue");
>
> (2) whether the LLPs were carrying on their activities with a view to profit (the "view to profit issue");
>
> (3) whether the LLPs incurred expenditure equal to 100% of the budget of the film or game (the "incurred issue");
>
> (4) whether the LLPs' expenditure was incurred wholly and exclusively for the purposes of their trade or business (the "wholly and exclusively issue"); and
>
> (5) whether the LLPs' losses were computed correctly as a matter of GAAP (the "GAAP issue").

20. We will need to examine the findings, reasoning and conclusions of the FTT on the trading issue and the view to profit issue in considerable detail later in this judgment. For now, it is sufficient to record that, on the trading issue, the FTT found that the activities of the LLPs analysed on the 30:30 basis did amount to a trade, in relation to ITP and IFP2, but that the way in which IG operated was different, and its activities did not amount to the conduct of a trade. The FTT also held, at FTT/436, that, if it had found that the legal effect or commercial substance of the transactions was to be determined on the Ingenious basis, then it would have found that the deal was not commercial and therefore did not amount to a trade. With regard to the view to profit

issue, the FTT again drew a distinction between the position on the 30:30 basis, on which they found the view to profit test was satisfied, and the position if the transactions were properly to be analysed on the Ingenious basis, in which case they would have concluded that the test was not satisfied. It is therefore a striking feature of the FTT's conclusions on the two issues of principle which we now have to examine that the outcome differed according to whether or not the true legal effect of the transactions was to be determined on the 30:30 basis or the Ingenious basis.

21. In relation to the other main issues dealt with in the FTT Decision, and the further issue whether the expenditure on the rights to income acquired by the LLPs was in the nature of revenue or capital (the "income/capital issue"), which was the subject matter of the much shorter, but still substantial, Further FTT Decision, the gist of the FTT's decision was summarised at UT/32-36, in terms which we can gratefully adopt and summarise as follows:

> (1) On the *incurred issue*, on the realistic view of the facts which a purposive interpretation of section 34 of ITTOIA 2005 required, the question was whether the taxpayer bore the economic burden of an expense. On the basis of the FTT's analysis of the LLPs' obligations, the only economic burden they suffered was the outflow of 30, so that was all that was incurred.
>
> (2) On the *wholly and exclusively issue*, if it could be said that the LLPs incurred expenditure of 100, then 70 of that expenditure was not incurred for the purposes of the LLPs' business but for the purpose of providing a benefit to the Commissioning Distributor, viz. enabling the latter to reap a share of the benefits from the exploitation of the films. If, however, the transactions were correctly to be analysed on the 30:30 basis, then apart from the 5% executive producer fee the expenditure of 30 was wholly and exclusively incurred by the LLPs for business purposes.
>
> (3) On the *GAAP issue*, the FTT concluded that the accounts of the LLPs did not comply with GAAP. Changes were needed in order to produce profits and losses computed in accordance with GAAP, and thus produce profits and losses for the purposes of income tax. In essence, this required the losses to be calculated, in line with the FTT's analysis of the contractual position, on the 30:30 basis and not on the Ingenious basis. The FTT also decided that the LLPs' calculations of the NRVs of the films on completion (which was an important component of the calculation of the first-year losses) were too low.
>
> (4) Finally, on the *income/capital* issue, the FTT concluded "with misgivings and reluctance" at [88] of the Further FTT Decision that the rights acquired by the LLPs were capital in nature. The FTT considered that the period over which the rights were to play a part in the business was the factor which weighed most heavily in reaching that conclusion, despite the fact that the rights arose from ordinary commercial contracts and were the source of income rather that the setting in which it was generated.

22. The overall effect of the FTT's decisions was to disallow approximately 97% of the trading losses claimed by ITP, and 96% of the trading losses claimed by IFP2. Despite the partial success of those two LLPs on the trading and view to profit issues, the findings of the FTT on the capital/income issue meant that the major part of the limited

expenditure found by the FTT to have been incurred by them was capital expenditure which could not create a trading loss: see UT/6. Accordingly, their trading losses as calculated for income tax purposes "were limited to a relatively modest operating fee": ibid. The trading losses claimed by IG were disallowed in full, because of the FTT's conclusion that IG was not carrying on a trade: see UT/7.

23. It is convenient to mention at this point that the appeals of the LLPs to the FTT were lead appeals for five follower LLPs. The total loss claims in dispute, including those of the follower LLPs, amounted to over £1.6 billion.

The appeals to the Upper Tribunal

24. An appeal to the UT lies only "on any point of law arising from a decision made by the [FTT]": see section 11(1) of the Tribunals, Courts and Enforcement Act 2007 ("TCEA 2007"). Both the LLPs and HMRC appealed to the UT on the main issues which had been decided adversely to them by the FTT.

25. HMRC's appeal was confined to the trading and view to profit issues, given their comprehensive success on all the other issues considered by the FTT. HMRC's grounds of appeal are summarised in UT/38-41. On the trading issue, HMRC contended that the FTT had been wrong to conclude that the activities carried on by ITP and IFP2 amounted in law to a trade. In particular, it was said that the FTT misunderstood the relevant law on what amounts to a trade; that the FTT reached the wrong conclusion when applying the law to the facts it found in relation to those two LLPs; that the FTT further erred in law in its approach to fiscal purpose; and that having reached the correct conclusion in relation to the trading issue as it applied to IG, the reasons which the FTT gave for distinguishing the position of ITP and IFP2 from that of IG were faulty.

26. On the view to profit issue, HMRC's case, in summary, was that the FTT had erred in its interpretation of the relevant statutory language, and/or in the application of that test to the facts found. In particular, the FTT was said to have made an error of law in holding that the test contained an "objective override" such that it would necessarily be satisfied if it was "inevitable" or "almost certain" that the LLP would make a profit irrespective of the subjective intentions of the participants. The test is a purely subjective one, although HMRC accepted that "an objective analysis of the likelihood of profit constitutes a useful cross-check for the FTT in testing protestations of subjective intent": see FTT/40.

27. The LLPs had eight grounds of appeal, which are summarised in UT/42. For present purposes, it is enough to concentrate on the first four grounds. The first ground was that the FTT erred in law in its construction of the contractual agreements entered into by the LLPs. The second ground challenged numerous findings of fact made by the FTT, on the basis that they were erroneous in point of law in accordance with *Edwards v Bairstow* [1956] AC 14 and other well-known authorities. The third ground challenged the conclusions of the FTT on the trading issue, alleging in particular that the FTT erred in law in concluding that whether the LLPs intended to make a profit depended on whether the profit was determined on the 30:30 basis or the Ingenious basis, and in concluding that the LLPs only intended to make a profit on the former basis. The FTT should have determined that the LLPs were trading, whether or not the Ingenious basis was correct. The FTT also erred in law in concluding that IG was not trading. The fourth ground dealt with the view to profit issue, alleging that the FTT erred in law in finding

that, if the relevant arrangements were carried out on the Ingenious basis, the LLPs were not carrying on business "with a view to profit". This contention was fleshed out in various ways, as summarised at UT/42(4).

28. For completeness, the LLPs' remaining four grounds of appeal dealt with the incurred, wholly and exclusively, GAAP and income/capital issues, alleging in each case that the FTT had erred in law in various ways.

29. As the UT recorded at UT/43, permission to appeal was granted to each side on all the grounds which they wished to pursue. It is therefore unsurprising that the appeal to the UT was itself a marathon undertaking for all concerned. The appeal was heard over twenty-two sitting days in March and early April 2019. The LLPs' team of leading counsel was at that stage headed by Pushpinder Saini QC and David Milne QC, of whom Mr Saini had not appeared before the FTT. HMRC's team was headed, as it has been throughout, by Malcolm Gammie QC. The UT Decision was released, as we have said, on 26 July 2019. It runs to 634 paragraphs and over 150 pages. We pay tribute to the meticulous care and industry which both Tribunals brought to bear in dealing so comprehensively with the manifold issues which they had to decide.

30. The outcome of the appeals was summarised by the UT as follows:

> "48. For the reasons set out in detail below, we have decided the Trading Issue entirely in favour of HMRC. That finding is sufficient to dispose of the entirety of the appeals, because the subject matter of these appeals is the LLPs' claims for trading losses in the relevant tax years which have been denied by HMRC in the closure notices…
>
> 49. However, the View to Profit Issue is relevant to the question as to whether the LLPs are to be treated as partnerships (and its members as partners)…and taxed accordingly. That depends on whether the relevant LLP was carrying on a business with a view to profit in the relevant tax year. The issue also raises questions on which authority is lacking and guidance is appropriate. We have therefore set out in some detail our views on that issue…
>
> 50. Because of the way in which we have determined the Trading Issue we also do not need to determine the other issues, but in case this matter goes further we have set out our views on those issues relatively briefly."

31. In the concluding part of the introductory section of the UT Decision, the UT rightly reminded itself of the limited scope for interfering with findings of fact made by the FTT on an appeal confined to points of law, as well as the general reluctance of any appellate court to differ from evaluative conclusions of a multi-factorial nature made by the tribunal of fact which has heard and reviewed all the evidence, both oral and documentary. As the UT pointed out, at UT/71:

> "Inevitably, where as in this case there is voluminous documentary evidence (we were told over 1 million pages the vast majority of which we fortunately received in electronic

> form) the heavy burden on the LLPs to establish a negative (such as that there was no evidence for a particular finding) is particularly difficult to satisfy…"

32. The UT went on to observe:

> "73. … in a decision as long as the one that we are concerned with in this case, and bearing in mind the amount of evidence made available to the FTT, it was impossible for the FTT to capture every element of its impressions. It is also the case that some of its findings may have been better expressed. However, we are unable to conclude that, taken cumulatively, such of the Ground 2 challenges as our later findings demonstrate have been made out amount to an error of law of such materiality that we should exercise our discretion to set aside the FTT's findings on the matters to which those errors relate.
>
> 74. In summary, extreme caution is required to be exercised before setting aside conclusions based on careful evaluative findings of fact made on the basis of extensive evidence, in contrast to the position where an *ex facie* error of law is identified."

33. In the next section of the UT Decision, running from UT/75 to 163, the UT dealt with the issues of contractual analysis which comprised the LLPs' first ground of appeal. It is worth spending some time on this part of the UT Decision, not only because the issues of construction, and the distinction between the 30:30 basis and the Ingenious basis, underpin much of the argument on the trading and view to profit issues, but also because the conclusions of the UT on these issues are now final, in the absence of any permission to challenge them in this court.

34. After reviewing a number of basic principles of contractual construction, particularly in a fiscal context, the UT identified the key provisions to be construed:

> "131. In this case, in construing the contractual arrangements, the key questions to bear in mind include (i) what an LLP was required to pay to the PSC; (ii) what rights the LLP acquired under the arrangements; and (iii) what the LLP's role was in the film or game production process. In addressing these questions, the FTT was entitled to look carefully at the true effect of the arrangements and was not prevented from doing so either by the fact that there were a number of different agreements or by the fact, urged on us by the LLPs, that individual features of the arrangements, such as the use of sub-contractors, SPV production companies, non-recourse loans or security arrangements, are common in the film industry.
>
> 132. In the light of our discussion above, we consider the position both on the basis of conventional contractual construction and legal principles and, having regard to the

> Trading Issue in particular, by reference to an overall assessment of the nature of the arrangements entered into by the LLPs.
>
> 133. We set out at [134] to [163] below a summary of our conclusions on the contractual arrangements, with a more detailed analysis of the funding and income distribution arrangements in the Appendix to this decision [*which runs from [564] to [634]*]. Unless otherwise indicated, the provisions referred to are those in the documentation for *Hot Fuzz*."

35. The UT began its analysis by considering whether the LLP was obliged to pay 100 for the funding of a film or game, and whether it had any right to receive Borrower's Distributable Receipts ("BDR"). Its conclusions on this important issue were as follows:

> "136. Although at first sight the LLP appears to take on an obligation to pay 100 to the Production Account we conclude, based on our analysis set out in more detail in the Appendix, that the LLP only has to pay 30 and is never exposed to the risk of paying any more than 30. We come to that conclusion on the conventional approach to the construction of the [*Production Services Agreement*] by reference to the factual matrix, without any reference to the *Ramsay* principle.
>
> 137. Neither in our view does the LLP ever obtain any substantive legal or equitable rights to BDR, which are paid to or retained by the [*Commissioning Distributor*] as lender in satisfaction of the repayment obligations of the [*Corporate Member*] under the Loan Agreement. Those rights are assigned by the LLP from the outset of the arrangements. Although that was effected by means of an assignment by way of security (with an equity of redemption), in practice those rights will be exhausted in repaying the sums due under the Loan Agreement to the [*Commissioning Distributor*]. As we explain in more detail in the Appendix, a scenario under which the option to prepay the loan from other sources is exercised is quite unreal…
>
> 138. In our view it makes no material difference to the issues to be decided whether the payment of 70 was characterised as a loan made by the [*Commissioning Distributor*] as lender to the [*Corporate Member*], or as a capital contribution by the [*Corporate Member*] to the LLP. The LLP is never obliged to pay 70, and BDR amounts are never realistically amounts to which the LLP can be said to be entitled.
>
> 139. These conclusions fit with the economic and factual realities. It is clear from the findings of the FTT and the terms of the contractual arrangements that the [*Commissioning Distributor*] (and its associated entities) was not prepared to take any risk that would arise if the funds passed through the LLP (either the funding advanced to the PSC or the BDR which came

> from the [*Commissioning Distributor*] through the Waterfall). Neither would the LLP take any risk that it might have to pay any part of the 70. As demonstrated by the FTT in tables that it set out at [251] in relation to ITP and [264] in relation to IFP2, the true position was that GDI [*gross distributable income*] was split as to 70 to the [*Commissioning Distributor*] and 30 to the relevant LLP."

36. The UT next considered the acquisition, ownership and disposal of film and game rights. At UT/150, it upheld the view of the FTT, at FTT/193, that "whether or not it was a constructive trustee of the rights it held in the film it was clear that the LLP 'was always devoid of any of the benefits of ownership of the film'. As the FTT said at FTT/187 it was 'bound by iron fetters'."

37. At UT/156, the UT observed that, in the context of the trading issue, "a realistic approach is needed which takes account of the substance, rather than theoretical and implausible possibilities which neither party contemplated." At UT/158, it concluded "that the LLP had a mere shell of ownership rather than any meaningful rights in the film. It had no control of the rights and was powerless to prevent delivery of the film to the [*Commissioning Distributor*]." At UT/159, it concluded:

> "The true nature of the transactions, viewed realistically, was that they did not involve the acquisition, ownership and disposal of film rights."

38. Finally, the UT considered whether the LLPs were "in reality producers of films", observing at UT/160 that this question is clearly material to the trading issue and, in particular, to the point that in deciding whether the activities of the LLPs constituted a trade it is necessary to examine what they actually did. The UT then quoted the FTT's summary of the contractual arrangements relating to the control exercised by the LLPs over the making of the film *Hot Fuzz* at FTT/233-238, and the FTT's conclusion at FTT/239 that "after the documents were signed all the LLP had to do under the agreements was to pay and sit back and wait." Similarly, the FTT said at FTT/240:

> "In summary: the [*Commissioning Distributor*] had control over the creative content of the film. The LLP had a right to be heard but was incentivised not to interfere."

39. The UT then expressed its own assessment, as follows:

> "163. In our view, the FTT was entitled to conclude that, reading the [*relevant agreements together*], the LLP just had to "pay and sit back and wait" once the agreements were signed. The LLPs say that is not the case with reference to the Completion Guarantor, which was a third party for independent films and was not necessarily associated with the [*Commissioning Distributor*]. However, in our view, that does not help the LLPs. The point correctly made by the FTT at [239] and [240] was that the LLP had a limited role in relation to the production of films and either the [*Commissioning Distributor*], or the

> [*Commissioning Distributor*] and the Completion Guarantor, in practice called the shots."

40. In summary, therefore, the UT upheld in all essentials the conclusions of the FTT on the construction and legal effect of the suite of agreements entered into in relation to each film or game. It also upheld the FTT's conclusion that the 30:30 basis, not the Ingenious basis, correctly described the overall legal effect of the arrangements.

The LLPs' appeal to this court

41. Having lost comprehensively in the UT, the LLPs sought permission to appeal from this court on seven grounds which again covered the main areas of contention below. Permission to appeal was refused by the UT on 4 December 2019. The LLPs renewed their application in this court, and on 24 February 2020 Arnold LJ granted the limited permission to which we have already referred. He observed, in his written reasons, that the trading and view to profit grounds had a real prospect of success, as demonstrated by the fact that the specialist tribunals below disagreed in relation to them, and he also considered that both grounds raised important points of principle, thus justifying a second appeal. Permission was refused on grounds 2 (contractual construction), 4 (incurred), 5 (wholly and exclusively), 6 (GAAP) and 7 (capital or income).

42. An appeal from the UT to this court is confined to any point of law arising from the UT Decision: see section 13(1) of TCEA 2007. The normal requirements for the grant of permission to bring a second appeal, relevantly that it would raise some important point of principle, also apply by virtue of an order made under section 13(6). These requirements are reflected in the reasons which were given by Arnold LJ.

43. Since it is no longer open to the LLPs to challenge the conclusions of the UT on the issues for which permission to appeal was refused, it seems to us that the most the LLPs could hope to achieve from a successful appeal on both the trading and the view to profit issues would be the restoration of the very limited trading losses which the FTT found to be available to ITP and IFP2, amounting to approximately 4% of the total claimed, together with a similarly small percentage in respect of IG. Nevertheless, a successful appeal on either or both of those issues may well have repercussions in other areas which we have not been asked to consider, quite apart from the question of the costs of this mammoth litigation. Moreover, if the total amount of losses claimed is as much as £1.6 billion, even 4% of that amount is still a very substantial sum (£64 million).

44. There is one further procedural matter which we need to mention. It was clear from the skeleton argument which the LLPs filed on 12 March 2020, after permission to appeal had been granted, that they interpreted the scope of the permission as extending to permit numerous challenges to the findings of fact made by the FTT and/or to the review by the UT of those findings of fact. On that basis, the LLPs estimated that fifteen days should be allocated for the hearing of the appeal, instead of the four days estimated by Arnold LJ. On 20 May 2020, Lewison LJ directed that the time estimate would remain at HMRC's estimate of six days, pointing out that the time estimate given by Arnold LJ showed that he clearly did not consider that fifteen days of this court's time would be devoted to a detailed examination of the facts on a second appeal. If this court decided that there had been an error of law in the approach of the UT, it would remit the matter for detailed examination of the facts.

45. Despite this clear indication, however, disagreement continued about the proper scope of the appeal for which permission had been granted, and HMRC eventually applied in December 2020 for a case management hearing to take place. This application was granted by Lewison LJ on 17 December 2020, and the hearing duly took place before David Richards LJ on 2 February 2021. By his order of that date, David Richards LJ ordered that the grounds for which Arnold LJ had given permission to appeal were those set out in the grounds of appeal dated 2 January 2020 in paragraphs 9 to 12 and 15 to 17 only. Permission to appeal had not been given in respect of challenges to the FTT's findings of fact or the UT's review of those findings. The parties were therefore directed to try to agree which paragraphs in the LLPs' skeleton argument of 12 March 2020 were impermissible, and to inform the court of any areas of disagreement. The LLPs were further directed to file and serve an amended skeleton argument by 15 February 2021, to be followed by an amended skeleton argument in response from HMRC by 1 March 2021.

46. In the event, David Richards LJ determined the deletions to be made from the LLPs' original skeleton argument, with the exception of one issue which was adjourned to be heard with the appeal. That issue, to which we will return in due course, concerns the question whether it is open to the LLPs to argue in this court that they engaged in the business of film production through the engagement of sub-contractors. The amended skeleton arguments to which we have referred were duly filed, and they formed the basis of the oral submissions which we heard over six days in March 2021. The LLPs' team of counsel was now headed by Jonathan Peacock QC, who did not appear below and replaced both Mr Saini (now Saini J) and Mr Milne.

47. We heard oral argument from Mr Peacock on both the trading and the view to profit issues. On behalf of HMRC, Mr Gammie made opening and closing submissions, and dealt with the trading issue, but Mr Davey QC argued the view to profit issue. We are grateful to all three of them for their clear and ably presented submissions.

48. Having completed this introductory survey, we now turn to the two main issues. In common with the UT, we prefer to start with the trading issue.

II. The trading issue

The law

49. There appears to be no substantial disagreement between the LLPs and HMRC about the basic tests which have to be satisfied if an activity is properly to be characterised as a trade. Nor is it now contended by either side that the Tribunals below materially misunderstood the relevant legal principles. We can therefore deal with the underlying law relatively briefly, before turning to a more detailed examination of the decisions of Millett J (as he then was) in the High Court, and of the House of Lords, in *Ensign Tankers Ltd v Stokes* [1989] 1 WLR 1222, [1992] 1 AC 655, ("*Ensign*") upon which the LLPs have at all stages placed considerable reliance. We will also need to refer to a series of more recent cases in this court, starting with *Eclipse Film Partners No. 35 LLP v HMRC* [2015] EWCA Civ 95, [2015] STC 1245 ("*Eclipse*"), in which this court has consistently declined to interfere with evaluative conclusions of the FTT that the activities there in question did *not* constitute a trade, but were instead investments.

50. A good starting point remains *Ransom v Higgs*, to which we have already referred for Lord Wilberforce's description of the legal concept of "trade" as a concept of common law, which Parliament has left it to the courts to develop: see [9] above. As Lord Wilberforce observed, shortly before the passage we have quoted, the court was there "concerned with some sophisticated transactions, evidently the product of expert intellects in the tax avoidance business". He continued to give this guidance, at 1610-1611:

> "Trade is infinitely varied; so we often find applied to it the cliché that its categories are not closed. Of course they are not: but this does not mean that the concept of trade is without limits so that any activity which yields an advantage, however indirect, can be brought within the net of tax…
>
> "Trade" cannot be precisely defined, but certain characteristics can be identified which trade normally has. Equally some indicia can be found which prevent a profit from being regarded as the profit of a trade. Sometimes the question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, of organisation, even of intention, and in such cases it is for the fact-finding body to decide on the evidence whether a line is passed. The present is not such a case: it involves the question as one of recognition whether the characteristics of trade are sufficiently present.
>
> …
>
> Trade involves, normally, the exchange of goods, or of services, for reward…Trade, moreover, presupposes a customer (to this too there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral—you must trade with someone.
>
> …
>
> Then there are elements or characteristics which prevent a trade being found, even though a profit has been made—the realisation of a capital asset, the isolated transaction (which may yet be a trade)…Although these are general characteristics which one cannot state in terms of essential prerequisites, they are useful benchmarks, so when one is faced with a novel set of facts, as we are here, the best one can do is to apply them as tests in order to see how near to, or far from, the norm these facts are. I attach no importance to the fact that, if there was trade, there is a difficulty in knowing what to call it. Christening normally follows some time after birth…"

51. In the same case, Lord Morris of Borth-y-Gest said at 1606D:

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

In the present case, the FTT quoted that statement, although they misattributed it to Lord Reid, before continuing, in terms which we would respectfully endorse, at FTT/358:

> "That means what the LLPs did, not their members, and not what was done by Ingenious for itself or other persons. It will involve a weighing of a number of factors, the relevance and importance of which will depend on the circumstances. There is no complete list of those factors and no rule that any one or more of them are decisive…"

52. A number of factors which experience has shown to be useful in performing this exercise have come to be known as the "badges of trade". They were conveniently set out by Sir Nicolas Browne-Wilkinson V.- C. in *Marson v Morton* [1986] 1 WLR 1343 at 1348-1349, but Sir Nicolas emphasised at 1348C that the factors were "in no sense a comprehensive list of all relevant matters", and after setting them out he said at 1349C:

> "I emphasise again that the matters I have mentioned are not a comprehensive list and no single item is in any way decisive. I believe in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question – and for this purpose it is no bad thing to go back to the words of the statute – was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?"

It should be noted, however, that these observations were made in the context of a "single transaction" case, where the question was whether it constituted an adventure in the nature of trade.

53. In *Eclipse*, the judgment of this court was delivered by Sir Terence Etherton C, who said at [112]:

> "As an ordinary word in the English language "trade" has or has had a variety of meanings or shades of meaning. Its meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation, depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular factual characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of

> the applicable legal principles. To that extent the conclusion is one of fact, or, more accurately, it is an inference of fact from the primary facts found by the fact-finding tribunal."

54. Sir Terence Etherton C went on to say, at [113]:

> "It follows that the conclusion of the tribunal of fact as to whether the activity is or is not a trade can only be successfully challenged as a matter of law if the tribunal made an error of principle or if the only reasonable conclusion on the primary facts found is inconsistent with the tribunal's conclusion. These propositions are well established in the case law…"

Ensign

55. A convenient summary of the background facts in *Ensign* is provided at UT/84-85, based on the similar summary at FTT/77-78:

> "(1) The case concerned a film, Escape to Victory being made by Lorimar [*which was a Hollywood studio*].
>
> (2) Ensign became a partner in Victory Partnership, a limited partnership, and together with other partners contributed capital equal to 25% of the budget for the film ($3.25m).
>
> (3) On the same day 16 further documents were entered into involving eight further parties. The most important of these were:
>
> (a) a loan agreement between Lorimar and Victory Partnership under which Lorimar agreed to lend Victory Partnership 75% of the cost of the film;
>
> (b) a production services agreement between Lorimar and Victory Partnership under which Lorimar agreed to complete the making of the film and Victory Partnership agreed to pay Lorimar 25% of the budget immediately and the remaining 75% in stage payments; and
>
> (c) a distribution agreement between Victory Partnership and two distributors under which the Victory Partnership granted the distributors exclusive distribution rights over the film in return for the gross receipts after deducting distribution fees and expenses.
>
> (4) The agreements provided that the loan was to be provided to Victory Partnership in tranches as Victory required the funds to meet the budgeted cost of the film, but that those sums be paid

> into a special restricted bank account of Victory Partnership and on the same day repaid to Lorimar. The payments into the account were described as the making of the loan, and the payments out as the funding of expenditure on the film. The loan was expressed to be repayable only from 75% of the net proceeds of distribution (termed a non-recourse loan). By a letter the distributors were irrevocably directed to pay 75% of the net receipts to Lorimar. Those payments were documented as repayments of the non-recourse loan.
>
> The central issue in the case was whether the Victory Partnership was entitled to first-year capital allowances in respect of the whole of the cost of the film."

56. As this summary makes clear, there is a generic similarity between the facts of *Ensign* and those of the present case. A full account of the facts may be found in the judgment of Millett J in the High Court, on appeal from a decision of the special commissioners (whose role was similar to that of the FTT): see *Ensign* at 1226 to 1231. The taxpayer company, Ensign, was a member of an English group of companies engaged in the leasing of plant and machinery in the oil industry. The scheme sought to exploit the availability of 100% first-year capital allowances for expenditure in connection with the making of films, and was marketed in the United Kingdom as a tax deferral scheme. The Victory Partnership was established for that purpose as a limited partnership under the provisions of the Limited Partnerships Act 1907. The whole of its initial capital of $3.25 million was contributed by the limited partners of which Ensign was the largest, contributing $2.375 million. The stated objects of the partnership were

> "to engage in the production making and/or acquisition exploitation and distribution of full-length cinematograph films and all ancillary rights on a commercial basis and with a view to profit."

The general partner, a company called Victory Productions Ltd, had the sole conduct and management of the business, and was beneficially owned by Lorimar. As in the present case, a complex suite of interlocking documents was entered into on the same day, and the investment of the limited partners was geared by limited recourse loans originating from Lorimar and repayable exclusively out of the receipts of the film, without recourse to Victory Partnership or its general or limited partners or their other assets.

57. As Millett J explained, at 1228:

> "In purely financial terms, Victory Partnership was in effect a sleeping partner with a minority interest. It was putting up 25 per cent of the costs and taking a 25 per cent equity participation. In legal terms, however, [*Lorimar*] was not an equity participant, for it was making its contribution by way of loan.
>
> …

> Whatever may have been the substance of the transaction in financial terms, however, this was not the way in which it was structured. Victory Partnership was not in fact a sleeping partner with a minority interest in a joint venture. It did not acquire merely a 25 per cent interest in the ventures. Nor did it pay only 25 per cent of the cost. It would not have suited the purpose of those from whom it was obtaining its finance for it to do so. Instead it acquired a 100 per cent interest in the venture and it paid 100 per cent of the total budgeted cost, though it did so with the assistance of a 75 per cent loan from a creditor whose associated company took a 75 per cent equity participation in view of the unfavourable terms of repayment."

58. In order for the 100% first-year allowances to be available, it was necessary for the Victory Partnership to be carrying on a trade. This was accordingly one of the central issues at all stages of the litigation. It is also important to appreciate that the issue was decided adversely to the taxpayer by the special commissioners, on the basis that "transactions which are entered into with fiscal motives as their paramount object are not… trading transactions": see the judgment of Millett J at 1234C-D.

59. This conclusion was heavily criticised by Millett J, who said at 1234E:

> "the commissioners' whole decision betrays a confusion between the motives of the taxpayer company and the purpose or object of the transaction which led them to concentrate on the motives of the taxpayer company and the Thomas Tilling group in investing in the partnerships instead of on the purpose or object of the transactions into which the partnerships entered."

60. Millett J went on to say:

> "This is the more surprising because the commissioners recorded at the outset not only the taxpayer company's inevitable admission that its investment was tax motivated and the Crown's concession that the question was not whether the taxpayer company was carrying on a trade but whether the limited partnerships were doing so, but also the crucial issue as lying between the parties' rival contentions: (i) that of the taxpayer company, that whatever fiscal motive may have induced it to go into films, once it had done so everything that was done was done on a proper commercial basis; and (ii) that of the Crown, that what was done was so moulded by fiscal considerations that the whole character of the transactions relating to the films was denatured to such an extent that they ceased to be commercial. Despite this, by far the greater part of the commissioners' decision is concerned with establishing the obvious and admitted fact that the taxpayer company's motivation was fiscal rather than commercial or in drawing adverse inferences from conduct which merely reflected that fact, and relatively little is devoted

> to any proper attempt to evaluate the commerciality of the transaction in question."

61. Millett J went on to examine the commissioners' reasoning in more detail, describing part of it as "an astonishing mixture of error and irrelevance" at 1237B, before concluding that the only possible conclusion from the facts they had found was that the partnerships were trading: see 1239C. Millett J then added that this accorded with the justice of the case (ibid):

> "The fiscal advantage which the commissioners found so unpalatable was obtained by the element of "gearing" which inflated the amount of the first-year allowances beyond the sums which the partnerships had to finance out of their own resources… But that was the result of the use by the partnerships of borrowed money to finance their activities, not of anything uncommercial in the nature of those activities."

62. Millett J then considered, and rejected, an argument advanced by the Crown that the limited partnerships were not trading at all, but merely investing in films to be made and distributed by others. He said, at 1239G, that the submission appeared "promising at first sight", but it had to be rejected because:

> "the subject matter of the purchase was an uncompleted film, and the partnership arranged for it to be completed on its behalf with a view to its commercial exploitation. The returns were incapable of calculation. The film might have yielded substantial profits or no net receipts at all. Once fully exploited, the film would have negligible residual value. The transaction has all the characteristics of a typical though speculative trading transaction and none of the characteristics of an investment."

63. In coming to these conclusions, Millett J had set out his understanding of the relevant law in nine numbered sub-paragraphs at 1232D to 1234B. The passage is of considerable length, so we will not reproduce it in full. The passage as a whole is set out at UT/164. We will content ourselves with the following brief extracts:

> "(1) In order to constitute a transaction in the nature of trade, the transaction in question must possess not only the outward badges of trade but also a genuine commercial purpose.
>
> (2) If the transaction is of a commercial nature and has a genuine commercial purpose, the presence of a collateral or ulterior purpose to obtain a tax advantage does not "denature" what is essentially a commercial transaction. If, however, the *sole* purpose of the transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose.

> (3) Where commercial and fiscal purposes are both present, questions of fact and degree may arise, and these are for the commissioners. Nevertheless, the question is not which purpose was predominant, but whether the transaction can fairly be described as being in the nature of trade.
>
> (4) The purpose or object of the transaction must not be confused with the motive of the taxpayer in entering into it…
>
> (5) The test is an objective one…
>
> (6) In considering the purpose of a transaction, its component parts must not be regarded separately but the transaction must be viewed as a whole…"

64. We have spent some time on the judgment of Millett J, because it brings out a number of important points in a factual context with considerable similarities to the present case. In particular, it illustrates the need to find "a genuine commercial purpose", and the general irrelevance of fiscal motive in answering the objective question whether the transaction viewed as a whole constitutes a trade. The case is also a strong one from the LLPs' point of view, as Mr Peacock rightly reminded us, because Millett J not merely disagreed with the reasoning of the special commissioners, but was satisfied that they had erred in law in finding that no trade was carried on by the partnership. Millett J's conclusion on that critical issue was not overturned in the higher courts, although the House of Lords (in the leading speech of Lord Templeman) disagreed with his acceptance at face value of the non-recourse borrowing, and relied in part on the *Ramsay* principle (as it was then understood) to analyse the true legal effect of the transaction as a joint venture which contained no element of loan: see [1992] 1 AC 655 at 666 to 667. So viewed, the only real expenditure of Victory Partnership was the $3.25 million contributed by the limited partners, and the partnership's claim for capital allowances had to be reduced accordingly. In very general terms, it may be said that the approach espoused by Millett J to the analysis of the facts had much in common with the Ingenious basis in the present case, whereas the approach of the House of Lords accorded much more closely with the 30:30 basis.

65. On the specific issue of trading, Lord Templeman said at 669A that "the contribution by Victory Partnership to the cost of the film of the sum of $3¼ m. in consideration for 25 per cent of the net receipts from the exploitation of the film can only be described as trading". Although this passage appears in what seems to be a summary of the Revenue's submissions, we think that it must reflect Lord Templeman's own analysis, because the Revenue's submission had been that there was "no trading": see the report of the argument at 659E. In any event, if there were any room for doubt about this point, it is laid to rest by the explicit statements of Lord Templeman at 677D-E and 680A-C that the transaction was a trading transaction. As Lord Templeman said, in the second of those passages:

> "In the present case a trading transaction can plainly be identified. Victory Partnership expended capital in the making and exploitation of a film. That was a trading transaction which was not a sham and could have resulted in either a profit or a loss."

Recent cases in the Court of Appeal

66. We have already referred briefly to *Eclipse*, where this court provided a useful and influential summary of the relevant legal principles for determining whether a particular activity is a trade: see [53] and [54] above. The factual context in which the question arose was helpfully summarised by the UT:

> "182. Eclipse 35 was a limited liability partnership which contended that it carried on the trade of acquiring and exploiting film rights. The essence of the arrangements in that case were that a limited liability partnership raised money from individual investors and entered into arrangements with Disney whereby it acquired a licence of rights to a number of films pursuant to which it was obliged to pay royalties to Disney, and then immediately sub-licensed the rights to another Disney entity. As well as an entitlement to predetermined royalties, the limited liability partnership became entitled to highly speculative additional payments ("Contingent Receipts") if the films performed particularly well. There were also another series of agreements under which the limited liability partnership was said to have undertaken obligations to assist Disney in marketing and distributing the films.
>
> 183. The question was whether Eclipse 35's activities amounted to a trade, the basis for that contention being that the receipt of the income streams from the royalties, the marketing activities and the possibility of receiving Contingent Receipts was sufficient to constitute a trade."

67. The tax relief which the scheme in *Eclipse* sought to exploit was loan interest relief under section 362(1) of ICTA 1988 in respect of money borrowed by the members of the LLP to inflate their contributions to its capital. The members borrowed in total approximately £790 million, and contributed only some £50 million from their own resources: see the judgment at [18]. In order to obtain the tax relief, it was necessary to show that the LLP was carrying on a trade and that the borrowed money had been used wholly for the purposes of that trade. The FTT concluded that Eclipse 35 did not carry on a trade, and that the transactions were essentially of an investment character. This conclusion was upheld by both the Upper Tribunal and this court on the basis that it had been open to the FTT to reach it. Indeed, the Court of Appeal went further, and said at [139]:

> "Against that background the FTT's conclusion that Eclipse 35 was not in reality carrying on a trade was justified and indeed correct. Eclipse 35 did not discharge the evidential burden of showing that it was engaged in trade in any realistic or meaningful way. The possibility of obtaining a share of Contingent Receipts did not give the business of Eclipse 35, looking at it as a whole, a trading character: having regard to the business as a whole, the right to Contingent Receipts was no more than a potential additional return on a fixed term investment."

68. Another film scheme of a different character was in issue in *Samarkand Film Partnership No. 3 v HMRC* [2017] EWCA Civ 77, [2017] STC 926 ("*Samarkand*"), where the leading judgment in this Court was given by Henderson LJ. In bare outline, the cases involved Jersey partnerships which entered into sale and leaseback transactions for certain films in return for fixed, increasing, secured and guaranteed rental payments over a fifteen-year period. The individual partners, who were resident but not domiciled in the United Kingdom, wished to generate substantial first-year losses to set against their taxable income. That purpose could only be achieved if the partnerships were carrying on a trade. The FTT found that the partnerships were not trading, so the schemes failed. This conclusion was then upheld on appeal by the Upper Tribunal and this court.

69. For present purposes, the important point is that this court applied the principles in *Eclipse*, and as in that case found no grounds upon which to interfere with the multi-factorial evaluation carried out by the FTT: see in particular the judgment of Henderson LJ at [59] to [64].

70. A similar result was also reached in yet another film scheme case, *Degorce v HMRC* [2017] EWCA Civ 1427, [2018] 4 WLR 79 ("*Degorce*"), where the leading judgment in this court was again delivered by Henderson LJ. The film scheme was of a different character from those in *Eclipse* and *Samarkand*, and indeed from the scheme in the present case. But we do not consider it necessary to describe the case in any more detail, because it added nothing of significance to the legal principles which we have already discussed. The same is true of a fourth case to which we were referred, *Brain Disorders Research Ltd Partnership v HMRC* [2018] EWCA Civ 2348, [2018] STC 2382, in which the leading judgment in this court was delivered by Patten LJ.

The decision of the FTT

71. The FTT dealt with the trading issue in Chapter VI of the FTT Decision running from FTT/348 to 456. The first section, at FTT/348-356, was headed "What did the LLPs do?" As we have already observed, this question reflected the guidance given nearly half a century ago in *Ransom v Higgs*, although the FTT postponed their consideration of the legal principles to the second section of their discussion, at FTT/357-384.

72. In this introductory section, the FTT referred back to conclusions which they had already reached when considering the documentation and the true legal effect of the obligations undertaken by the parties. They therefore noted at FTT/349 that "the obligation of the LLP to deliver the film to the [*Commissioning Distributor*] was almost meaningless since all the material rights in the film were held by the [*Commissioning Distributor*] or the PSC at all times", and that "the rights the LLP held in the film – both the IP rights and in the physical film – were nugatory." In FTT/350, the FTT referred to their earlier conclusions that the contracts gave effective creative control over the production of the film to the Commissioning Distributor (through the LLP), and provided an incentive for the LLP not to interfere.

73. In FTT/351, the FTT referred back to the detailed findings they had made at FTT/327-344, and in an appendix, in relation to the so-called Avatar Hedge. This was a complex transaction negotiated in November 2006 with the object of limiting the exposure of IFP2 in relation to the film *Avatar*. With the benefit of hindsight, this was a spectacularly bad move, because the film achieved the largest worldwide box office

takings of all time following its release in 2009. However, that all lay in the future when the Hedge was negotiated, and in FTT/351 the FTT summarised their earlier conclusions in these terms:

> "(a) By entering into the Hedge, IFP2 was in effect buying interests in the income streams from the films rather than the right or obligation to produce them.
>
> (b) It was acceptable for any creative influence over the production of the film residing in the LLPs to be exercised jointly with one or more other LLPs.
>
> (c) The negotiation of these agreements would not have been a simple process. They were complex arrangements. It was not analogous to buying an investment."

We emphasise in particular the third of those conclusions.

74. The FTT then referred to the evidence of Mr McKenna, who was the founder and chief executive of Ingenious, finding at FTT/352 that "in practice Ingenious regarded the creative aspects of the production of the film as settled at the time the agreements were signed". The FTT added, at FTT/353, that although Mr McKenna had wide experience in the commercial and financial side of the film industry, and there were other Ingenious personnel who had an informed interest in film production, "the only person with any previous experience in film production was Paula Jalfon, and we obtained the impression that her contribution to the making of a film after the documentation was signed was nominal."

75. Next, the FTT recorded at FTT/354 that under the Operator's Agreement, the LLPs appointed the Operator to undertake matters on their behalf. The Operator was an Ingenious company which agreed to provide the LLPs with defined services. These included evaluating and identifying suitable films for recommendation to the green-light committee, this being the process through which an LLP's involvement in a film would be approved. The services also included the negotiation and making of agreements on behalf of the LLPs. Since the agreement expressly provided that nothing in it made one party the agent of the other, it was necessary for the FTT to consider with some care which activities performed by the Operator, through Ingenious' staff, were to be treated as performed for the LLPs.

76. The evidence on this issue, and the conclusions drawn by the FTT from it, were set out in Appendix 1 to the FTT Decision at FTT/1278-1410. As the length of the appendix indicates, the question was considered by the FTT in meticulous detail. The conclusions which the FTT reached were helpfully summarised in the main body of the decision at FTT/355, where they said:

> "There [*i.e. in Appendix 1*] we conclude that activity conducted by the LLPs through those persons can be described as constituted by the following principal elements:
>
> (a) Considering for green-lighting films proposed by Ingenious entities. In that context we note here that we do not regard the

> LLPs as having gone out to search for new films [*with one possible exception*];
>
> (b) Complex, serious and detailed negotiation of the commercial terms of agreements for the making of film;
>
> (c) Entering into contracts for the making of films and in relation to their exploitation under which substantial sums were put at risk;
>
> (d) Keeping an eye on what was going on in the making of the films and in particular paying some attention to the costs of production but without any significant involvement in the creation of the films;
>
> (e) Receiving revenue and reviewing revenue statements from films;
>
> (f) Accounting and administration."

See too FTT/1410, from which the summary was derived.

77. Finally, in this introductory section of the discussion, the FTT referred at FTT/356 to their earlier description of the increasing proportion of Studio films which formed part of the "slate" undertaken by each LLP, when compared with Independent films. That description is to be found at FTT/301-323. Among the points there made were that Studio films were likely to be more attractive to the LLPs, because they involved less negotiation, they came packaged by the Studio, they typically had "high visibility", and they were less likely to be loss making. As the FTT put it by way of summary, in FTT/356:

> "We explained that the work involved in putting together a deal for a Studio film and finalising its documentation was less than for an Independent film. For a Studio film Ingenious had a lesser role in the film: the Studios were huge, diversified multinationals with all the requisite resources to produce films without reference to anyone else; they wanted the involvement of the LLPs for their money and to lay off risk; the LLPs and Ingenious had no role in putting the film together, what they did was by comparison closer to buying an income stream in a complex way."

78. In the second section of their discussion, as we have already said, the FTT set out their understanding of the relevant legal principles. Much of this section consists of a lengthy exposition of *Ensign*, to some aspects of which we will need to return when considering the UT's criticisms of the FTT's conclusions on the trading issue. On the FTT's general approach to the issue, we have already cited with approval what they said at FTT/358, and we would likewise endorse what they said at FTT/359:

> "Whatever else in determining whether something is a trade, the tribunal must stand back and take an unblinkered view of all the circumstances: the totality of the person's activity and enterprise. That is not a result of any particular facet of the *Ramsay* doctrine but of the nature of the word "trade" – archetypically whether someone is trading is a conclusion based on commercial substance rather than form. Trade is not a narrow legal concept but a broad commercial one: transactions planned and executed as a single transaction must be viewed as a whole."

79. In the third section of their discussion, the FTT considered *Eclipse*, which had by then been decided in this court as well as the Upper Tribunal. They also referred to *Samarkand* and *Degorce*, although neither of those cases had yet proceeded beyond the Upper Tribunal.

80. With regard to *Samarkand*, the FTT said at FTT/387 that the consequences of the transactions in that case were "quite different from those in the LLPs' appeals and, even if regarded purely as monetary transactions, the return on the LLP's outlay on the film is uncertain and speculative." With regard to *Eclipse*, the FTT made a similar point at FTT/391:

> "To our minds what principally distinguishes the LLPs from Eclipse 35 is the nature of the LLP's receipts. Eclipse received a fixed royalty whose amount was independent of the success of the film… but the LLPs' whole return was speculative and substantial. There are also differences in what the LLPs did. Eclipse entered into agreements in relation to two films; the LLPs evaluated films, and negotiated and entered into many agreements; Eclipse had a marketing services agreement which was moribund; the LLPs played a small administrative role: they also gave approvals – albeit fairly automatically, they interfered a bit, they looked at budgets; they may have done this in order to look like producers, but the question is not why they did it, but what they did."

81. With regard to *Degorce*, the FTT contrasted the clear impression given by that case of "a complex packaged scheme sold to Mr Degorce to reduce his tax bill and put into effect over the course of three or four days", with the conduct of the LLPs through the Operator:

> "396. By contrast the LLPs through the Operator conducted complex negotiations for their contracts, in varying degrees they evaluated the films – they were not just any old films, and were concerned about the size of their budgets. They entered into more than one contract. The nature of what they did was different."

82. In the short fourth section, running from FTT/397 to 401, the FTT addressed the point that the promotional material of the LLPs had sought to portray the LLP as the producer

of the films and games, and the same was true of some of the actions taken by Ingenious' staff after contracts had been signed, which "were designed to give the impression that the LLPs were involved in the actual production of the film during its filming." The FTT commented that activity of that kind would normally be a trade, but it was different from the activity actually undertaken by the LLPs. They continued:

> "400. But Mr Milne made clear that the LLPs were not arguing that they were producers in that sense. This was not a dispute about a name. Instead they relied on what they actually did as being the activity of a trade by whatever name (if there was a name) that activity could be described.
>
> 401. In a similar vein we recall Mr Milne describing the LLP as "seeking commissions" for films and we note that the [*Commissioning and Distribution Agreement*] starts by saying that the [*Commissioning Distributor*] "has commissioned" the LLP to make the film. We would not call the LLP's activity seeking commissions or being commissioned, but the question is: was what they actually did a trade? Not, what sort of trade was it?"

83. We agree with those final observations of the FTT, which echo Lord Wilberforce's point in *Ransom v Higgs* that "[c]hristening normally follows some time after birth": see [50] above.

84. In the next section, running from FTT/402 to 438, the FTT addressed in turn a number of factors which the case law indicated might be relevant to the assessment of whether an activity is a trade. The first two such headings ("A Customer" and "Organisation") were drawn from Lord Wilberforce's guidance in *Ransom v Higgs*. Headings (3) to (11) reflected the badges of trade identified in *Marson v Morton*. Headings (12) and (13) ("Speculation: the possibility of profit; the undertaking of risk" and "A genuinely commercial purpose…") were derived from the judgment of Millett J in *Ensign*.

85. By way of summary, the conclusions reached by the FTT under these headings were as follows:

> (1) There is not such an absence of a counterparty as to deprive each LLP's activity of a trading nature. The Commissioning Distributor was a counterparty with which each LLP had commercial relations under which it agreed to do things and obtained substantial rights to receive money: see FTT/405.
>
> (2) The factor of organisation is present. The work undertaken putting together Independent film projects may have been greater than that in negotiating with Studios, but in each case "there was an organisation geared towards promoting the business of contracting for films and receiving the income from them": see FTT/408.
>
> (3) There was repetition, with a number of distinct transactions in the case of each LLP: see FTT/411.

(4) There was not a transaction related to an existing trade, so this factor did not point to trade: see FTT/413.

(5) The nature of the subject matter of the transactions was neutral, neither pointing to trade nor away from it in the circumstances: see FTT/417.

(6) The way in which the transactions were carried through was not "a structure for dealing in a film but one for the acquisition of an interest in the proceeds of exploitation of a film": see FTT/418. On the other hand, what was typical of the transactions was the effort involved in their arrangement and negotiation, so overall this heading pointed towards trading, or at least not away from it: see FTT/419.

(7) The LLPs did not borrow, because they were financed by the capital subscriptions of their members. This factor therefore did not point towards trade: see FTT/420.

(8) The LLPs did not add anything of substance to the making of the film once the contracts were signed: see FTT/421. The FTT then said:

> "422. Mr McKenna's evidence was that the LLPs' creative input took place before the contracts were signed. We accept that there may have been some such activity in relation to Independent films but we saw no relevant evidence of it in relation to Studio films where the film was developed by the Studio and was ready to go when Ingenious stepped in.
>
> 423. For Independent films we accept that Ingenious [*played*] a greater role in putting together the finance for the film and that to an extent the Ingenious personnel undertaking that activity may have done it in part for the LLP (although it was also clear that in part it was also done for other Ingenious vehicles as, for example, where a sale and lease back of the film was also organised).
>
> 424. Overall we think it can be said that there was some work done by the LLPs which was akin to work done on an object which was to be sold."

(9) This factor (breaking down into lots) did not point to trade: see FTT/425.

(10) This factor (whether the purchaser intended to sell) also did not point to trade. In so concluding, the FTT said at FTT/428:

> "We agree with Mr Gammie, the commercial (and legal) reality was that the right acquired was the right to income and the LLP did not intend to dispose of it although the right was realised (so in effect consumed) as monies flowed into the LLP."

(11) This factor ("Did the asset provide enjoyment or an income pending resale? If so it would be more likely to be an investment") did not point to investment, but on balance did not point towards trade. The FTT commented at FTT/430:

> "Viewed as a right to income the asset was income pending exhaustion, but it was not the type of income one expects from an investment, which would normally have some residual value."

(12) This factor was present, as there was a possibility of profit and a risk of loss: see FTT/432.

(13) There was also a genuinely commercial purpose. As a result of a composite transaction, the LLPs acquired a specified interest in the film revenues, and in each case there was a possibility of profit. On the 30:30 basis, there was "a genuine commercial deal", although if that were wrong, and the Ingenious basis applied, the FTT would have found that the deal was not commercial, and this test was not satisfied: see FTT 435 and 436.

86. The FTT then set out their overall evaluation of the factors which they had considered, as follows:

> "437. We must now stand back and look at the whole picture having particular regard to what an LLP actually did.
>
> 438. In relation to Independent films there was more substance to the LLPs' activities; for Studio films the activities had more of the characteristics of arranging and monitoring investments in an income stream (that was particularly the case where an LLP came into the picture at a very late stage when almost all the elements of the film had been pulled together and principal photography was about to start). But the two activities were part of the one business.
>
> Taking all this together we conclude, on balance, that the LLPs were trading: the Operator did more than act as an investment manager of a portfolio of investments: through its actions and those of its agents the LLPs engaged in speculative, organised, repeated transactions in a way which involved work beyond that which would have been involved in the mere making of an investment."

87. In the final section of the discussion, running from FTT/439 to 456, the FTT considered the topic of "fiscal motive". Despite the apparently unqualified finding of trading which they had just made, they recognised (correctly) at FTT/ 439 that "if the shape and character of the transactions is so affected by fiscal considerations that it ceases to be a commercial transaction it will not be a trading transaction". They then made findings which recognised the obvious facts that the business of Ingenious "included devising tax-advantaged products", that the ability for investors to claim loss relief was an

important part of their investment in an LLP, and that if the tax results of the investment turned out to be as represented in the promotional material (the so-called "Information Memoranda"), "then the effect of the tax repayment or reduction following sideways loss relief would be that the investors' subscriptions would be substantially matched by a repayment or reduction in liability within a few months": see FTT/443. The FTT continued (ibid):

> "Thereafter the investor would suffer no further loss (ignoring for the moment the non-film business) but would realise a net after-tax profit on any distribution by the LLP. It seems to us that when Mr McKenna described it as a business opportunity with a tax advantage, he understated the benefit of the tax advantage – which was substantially to remove, rather than to mitigate, the risk of investment."

88. The FTT then gave more details of how the business models were promoted, including by the use of a "calculator supplied to financial advisers" which "steered the investment decision by reference to the amount of the investor's taxable income which could be sheltered by the first year losses": see FTT/445. The FTT further noted, at FTT/446, that when in 2007 sideways loss relief was withdrawn (by section 26 of, and Schedule 4 to, the Finance Act 2007) "a number of Ingenious staff were made redundant in the expectation that there would no longer be a market for investment in the LLPs".

89. The FTT next referred to various other aspects of the business model, including the routing of the full cost of the film through the LLPs, which were designed to deliver enhanced tax losses to the LLP members.

90. In the light of all these findings, the FTT then considered HMRC's submission that the whole shape and character of the transactions had been so affected by fiscal considerations as to be purely fiscal in nature, before expressing their final conclusions in a passage which we need to set out in full:

> "452. It does not seem to us that this analysis can stand in the light of *Ensign* and our conclusions as to the rights and obligations which arise under the agreements. In *Ensign* an ordinary 25%:25% transaction was dressed up as a 100% investment using money which bounced through Victory Partnership's bank account. The ordinary transaction was a trading transaction. When the clothes of the dressed up transaction were removed, the transaction which remained was the ordinary transaction. The House of Lords held that the attempts to dress it up did not denature it.
>
> 453. The same is true in this appeal. The ordinary transaction is [*on the 30:30 basis*]. It is dressed up to look like [*the Ingenious basis*]. On examination of the composite agreement it is seen that the legal obligation is to make a 30%… investment and the legal right to receive 30%… of [*gross distributable income*]. Once the clothes are removed, the ordinary transaction is revealed. If that ordinary transaction is a trading transaction then attempts to

> dress it differently do not prevent it from being a trading transaction.
>
> 454. We referred earlier to Millett J's summary of the law applicable when there was a fiscal purpose. Applying the relevant parts of that summary to the 30:30 transaction actually entered into by the LLPs: objectively it was a transaction which had a commercial purpose; despite the fiscal motive of the LLP in entering into it and dressing it up as something else, it was not denatured and could fairly be described as a trading transaction; the objective nature of the transaction had at its core a 30% investment for 30% of GDI; the shape and structure of that transaction was not determined by the fiscal purpose.
>
> 455. Mr Gammie says that the question of whether or not the LLPs were trading has to be answered by reference to the tax construct which was designed to give the impression of a 100% investment when only 30%… was contributed, not by reference to the commercial aims of all the other parties. We agree that the aims of the other parties are not relevant, but we consider that the transaction which must be examined is that which is embodied in the actual rights and obligations of the parties and their practical implementation, not the clothes in which they have been disguised, or by reference to a story designed to provide a sequential picture of the acquisition and disposal of rights and obligations, which is not relevant to the ascertainment of the nature of the LLPs' rights and obligations or their financial consequences.
>
> 456. If we are wrong and the legal effect of the agreements is as the Appellants contend (100 of expenditure for no more than 54.55% of GDI etc.) then we would conclude that the transactions lacked commerciality and that the fiscal motive of the LLPs (acquired by them from Ingenious personnel through the Operator) when taken in the balance would mean that they were not trading."

91. Accordingly, on the 30:30 basis which the FTT considered to be the correct analysis of the transactions, the FTT's conclusion was that the transactions objectively had a commercial purpose, and could fairly be described as trading transactions. It was only if the true legal effect of the agreements were to be analysed on the Ingenious basis that, in the view of the FTT, the transactions would have lacked commerciality and therefore could not be trading transactions.

Did the FTT err in law on the trading issue?

92. The UT rightly recognised, at UT/241, that it could only interfere with the FTT Decision if there had been an error of law on the trading issue. In the absence of any identifiable error of law by the FTT in its treatment of the issue, there was no basis upon

which the UT could interfere, and it is immaterial whether the UT would itself have come to the same conclusion on the totality of the evidence. The UT went on to say (ibid) that in its view the FTT did make errors of law, in the sense of errors of principle, in reaching its conclusion that the film LLPs were trading. Furthermore, the UT concluded that those errors were so material that it should set aside and remake that part of the FTT Decision.

93. The UT proceeded to summarise the errors which it had identified at UT/242-255. Although the numbering of the errors is not entirely clear from the UT Decision, it was agreed during the hearing that they could be identified for ease of analysis as follows:

> (1) **Error 1**: the FTT made an error of principle by concluding that the activity in relation to independent films was such as to transform what was fundamentally investment into a trading activity;
>
> (2) **Error 1(b)**: if the FTT had correctly applied its factual findings as to the activities which the Operator undertook on behalf of the LLPs in relation to independent films, it could not have concluded that more complex negotiation alone was sufficient to turn what on the face of it was clearly an investment activity into a trading activity;
>
> (3) **Error 2**: the FTT made errors in its assessment of commercial purpose, and the differing conclusions which it reached on the 30:30 basis and the Ingenious basis were unsustainable and amounted to a finding of partial trading, which is unknown to the law;
>
> (4) **Error 3**: the FTT's reliance on the badges of trade was unhelpful, and obscured the key significance of the nature or character of the activity undertaken, as opposed to the manner in which it was undertaken;
>
> (5) **Error 4**: the FTT wrongly concluded that there was no material distinction from *Ensign* with regard to the fact that the LLPs did not acquire and dispose of films or games; and
>
> (6) **Error 5**: the FTT was wrong to suggest at FTT/430 that an investment should normally have a residual value.

94. We will consider these alleged errors in turn.

95. The fundamental problem with the UT's formulation of errors 1 and 1(b), in our view, is that it takes as its starting point the assumption that the activity of the LLPs was essentially an investment activity, and it was only the findings which the FTT made in relation to independent films which somehow tipped the balance and transformed what was clearly an investment activity into a trading activity. In our view, that is to mischaracterise the reasoning of the FTT, which was explicitly based on an assessment of all the evidence taken in the round, and to substitute the UT's own view of what the evidence prima facie established for the overall assessment conducted by the FTT. On a question of multi-factorial assessment, which the trading issue undoubtedly was, the weight to be accorded to pieces of relevant evidence was a matter for the FTT alone.

96. Our detailed description of the meticulous process by which the FTT sought to build up the overall picture demonstrates, in our view, that it cannot be right to reduce the FTT's reasoning to an alleged prima facie conclusion in favour of investment which then came down in favour of trading merely because of the activities undertaken by the LLPs in relation to independent films. The differences in the work that was needed on Studio films and independent films, and the increasing shift towards Studio films as time went on, were of course highly material factors for the FTT to consider and evaluate. But that is precisely what they did, and as they rightly recognised at FTT/438 "the two activities were part of the one business". It was the nature of that single business which had to be characterised, and that characterisation required an overall assessment by the FTT of the entirety of the evidence. We are therefore wholly unconvinced that the first two alleged errors can fairly be discerned in the FTT Decision.

97. The fundamental difficulty which we have identified seems to us, with the greatest respect, to permeate the UT's discussion of the first two alleged errors at UT/243-246. For example, the activities of Ingenious' staff employed by the Operator which the FTT found to be properly attributable to the LLPs were said at UT/243 to be "all consistent with the acquisition of investments rather than trading activities." That may well be so, but it does not follow that, viewed as part of the overall picture, they could not legitimately be regarded as consistent with a trade. Again, at the end of UT/246, the UT said this:

> "In our view, in reality Green-lighting and negotiation, like sourcing films and assembling finance, were not reflected in any provision of goods or services for reward *by* the LLPs. They were simply services provided *to* the LLPs that facilitated the making of investments by them."

In our view, this is just another instance of the UT seeking to substitute its own assessment for that of the FTT, and to do so in language which assumes the truth of the proposition which it seeks to establish.

98. We are equally unpersuaded by the third of the alleged errors (error 2 in our list). In the first place, it is important to note that the FTT addressed the issue of commercial purpose both before and after it had made its overall assessment that the transactions constituted a trade: see [85(13)] and [87] above. The question in the latter context was therefore whether the transactions fell into the exceptional category of being so affected by fiscal considerations that they could not answer the description of trading at all. The classic example of a case where such an analysis prevailed is the decision of the House of Lords in the *Lupton* case (*FA & AB Ltd v Lupton* [1972] AC 634: see in particular the speech of Lord Morris of Borth-y-Gest at 647-648). In *Ransom v Higgs*, Lord Wilberforce said of this type of case, citing *Lupton*, that:

> "In recent years a transaction, even one of property dealing, which amounts to no more than a planned raid on the revenue… has been held not to be by way of trade – a sophistication which I do not reject, but which must be carefully watched for illegitimate extension."

(see 1611D).

The FTT therefore had well in mind that fiscal motive in itself was no bar to the undertaking of a trade, and that the transactions in question would only lose their character as a trade if, as Lord Morris put it at 647G, they were "so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction."

99. In its discussion of this alleged error, the UT was influenced by the striking fact, upon which we have already commented, that the FTT reached different conclusions depending on whether the transactions were properly to be analysed on the 30:30 or the Ingenious basis. But there is in truth no inconsistency between those conclusions, and, even if there were, the conclusion which matters is the one which the FTT reached on the correct analysis of the transactions, namely the 30:30 basis. To the extent that the UT appears to have considered (at the end of UT/248) that this was an impermissible conclusion of partial trading, it was in our view clearly in error to do so. The task of the FTT was to apply the law to the facts which they had found. The 30:30 basis and the Ingenious basis are shorthand descriptions of two possible ways of analysing the same underlying facts and the same suite of interlocking documents. The 30:30 basis is not a "partial" version of the Ingenious basis, but rather represents what the FTT found to be the true legal nature of the transactions viewed as a whole. Once this is clearly understood, it was in our judgment clearly open to the FTT to conclude, as they did, that on an objective appraisal on the 30:30 basis the transactions had a genuine commercial purpose and were not so denatured that the *Lupton* principle should be applied: see in particular FTT/454. Whether or not the FTT was also entitled to reach the opposite conclusion on the hypothetical basis that the transactions were properly to be analysed on the Ingenious basis is a logically separate question, upon which we do not need to express a view.

100. The next alleged error, namely the reliance by the FTT on the badges of trade, is a curious one, because the FTT can hardly be criticised for taking into account such a long-established part of the law on what constitutes a trade for tax purposes. As we have explained, the FTT went through them one by one, and (as one might expect) found that some pointed in one direction, others in another, and that some were neutral. The assessment of these factors, and the weight to be attached to them, were matters for the FTT, but again the UT seems to us to have been too ready to let its own views intrude. Thus, the main point made by the UT in its brief discussion of this topic at UT/251 was this:

> "In particular, focus on organisation and repetition as indicators of trading, plus the amount of work involved, can lead to error: building a portfolio of investments can involve repetition and significant organisation, but it is still investment. Contrary to the suggestion by the FTT at [1351], investing in, for example, unquoted shares and securities, particularly private equity, real estate and infrastructure investments, can involve a significant amount of complexity, work on legal documentation and subsequent monitoring."

Those observations are undoubtedly true, as far as they go, but they cannot begin to establish any error of law on the part of the FTT. Such activity may be a hallmark of certain types of investment, but equally it is a characteristic of many types of trade. In

the present context, it was for the FTT to decide what weight (if any) to accord to these features of the overall picture which it built up and had to assess.

101. Similar comments apply to the last of the errors identified by the UT, namely that the FTT was wrong to suggest that an investment should normally have a residual value. Again, it is hard to understand how this could possibly be an error of law, given that the FTT was merely referring to what is "normally" the case, and was not purporting to lay down any general rule. Furthermore, the FTT made this comment in the context of considering one of the badges of trade ("Did the asset provide enjoyment or an income pending resale?") and concluded that it pointed neither to investment nor on balance towards trade: see FTT/430. There was no error of law here, let alone a material error.

102. Finally, the remaining alleged error (numbered 4 in our list) raises the question whether the FTT was wrong to conclude, at FTT/417, that there was no material distinction from the facts of *Ensign* with regard to many of the film transactions carried out by the LLPs. That paragraph formed part of the FTT's discussion of another of the badges of trade, under the sub-heading "The nature of the subject matter: was the subject matter the kind of thing which is normally the subject matter of trade or can only be turned to advantage by realisation?".

103. Once more, the conclusion actually reached by the FTT on this point was inconclusive, as we have already recorded: see [85(5)]. In explaining this conclusion, the FTT said at FTT/417:

> "We note that in *Ensign*… Lord Jauncey said that as Lord Templeman had pointed out expenditure "of [25%] on the making of the film in return for 25% of the net receipts carried all the characteristics of trade". Yet Victory Partnership's transaction was not substantially different from many of the film transactions carried out by the LLPs, and the LLPs had, through the Operator, more going on than ever Victory Partnership did. Victory Partnership's "meaningless" right to the copyright in the film makes no commercial difference."

We would accept that the reasoning in this paragraph is a little confused, and could perhaps have been better expressed. There is also force in the point made by Mr Gammie that, in *Ensign*, the ownership by Victory Partnership of the master negative in *Escape to Victory* was absolutely central not only to its claim for first-year capital allowances, but also to the trading activities which it carried out through the complex web of agreements. The use by the FTT of the adjective "meaningless" appears to be a reference to the speech of Lord Goff of Chieveley in *Ensign*, where he said at 682 that "title to the negative did indeed vest in [*Victory Partnership*]; though the distribution arrangements which formed part of the same composite transaction deprived that legal ownership of any meaningful effect." However, there is again force in the point made by Mr Gammie that the distribution arrangements were an important part of the way in which Victory Partnership turned the master negative to account, and if the partnership's legal ownership had ceased to be meaningful, that was only because it had been exploited in this way.

104. For present purposes, however, we do not need to resolve those questions, or enter into an arid debate about the precise extent to which the facts of the present case mirror

those of *Ensign*. It is seldom, if ever, useful to look to earlier authorities for supposed analogies on the facts, when what is in issue is the application of legal principles to a new factual situation. The narrow question which we are now examining is whether a material error of law can be found in FTT/417. Since the FTT was here discussing one of the badges of trade which it found to be inconclusive, it seems to us fanciful to suppose that the views on *Ensign* expressed in this paragraph can have had any material influence on the FTT's ultimate conclusion on the trading issue. Indeed, if anything one might expect the LLPs to complain that the FTT should have found some positive support for the trading analysis in this paragraph, given the FTT's comment that the LLPs had "more going on than ever Victory Partnership did."

105. We have now examined the six alleged errors of law identified by the UT, and concluded that none of them has any substance. Nor is it now suggested that the FTT misunderstood or misdirected itself in relation to the underlying legal principles. It follows that there was no basis upon which the UT could properly interfere with the conclusion of the FTT on the trading issue, so far as the two film LLPs (ITP and IFP2) were concerned. It also follows that this was, in turn, an error of law on the part of the UT, because there was no proper basis upon which they could proceed to remake the decision of the FTT on the trading issue. Our conclusion on this part of the case is therefore that the appeals of ITP and IFP2 on the trading issue must be allowed, and the decision of the FTT restored.

106. Before leaving this part of the case, we should comment briefly on some submissions which Mr Gammie put at the forefront of his oral address to us. His submission was that the 30:30 basis, as applied by the FTT, was a hypothetical construct which could never have operated in the real world, because investment in the LLPs was only solicited, and wealthy UK-resident taxpayers were only willing to subscribe to the LLPs, on the footing that the Ingenious basis was correct. The suggestion was that it would have been commercially impossible for the LLPs to conduct a trade of the nature found to exist by the FTT, because they could never have raised the necessary money to do so on the 30:30 basis.

107. The submission was persuasively advanced by Mr Gammie, but we are unable to accept it. The basis upon which the LLPs were able to obtain funds from investors is, in our opinion, irrelevant to the true analysis of the activities which the LLP itself carried out with the funds which were subscribed. That analysis turns on an objective examination of what the LLPs actually did with the money which they actually had at their disposal. If, as the FTT concluded, the correct analysis in law is that the activities of the LLPs constituted a trade, that is the end of the matter, and it is irrelevant (if it be the case) that the LLPs would have been unable to raise the money in the first place if the true legal analysis of their intended activities could never have provided the fiscal benefits which were held out to potential investors.

108. Furthermore, in his cogent submissions in reply, Mr Peacock pointed out that the hypothetical 30:30 basis which Mr Gammie had appeared to attribute to the FTT was an entirely new point, which had not been argued below or included in HMRC's respondent's notice or skeleton argument, and it would have required evidence to substantiate it. Moreover, and quite apart from those procedural objections, if the suggestion was that the individual investors would have obtained *tax relief* of 30 for the 30 which they put into the LLP, that result would itself have required 100 to have been spent by the partnership as part of the trade. In broad terms, for a 40% taxpayer to

receive sideways relief of 30 in the first year, there would need to be allocated to him a loss of approximately 80 (32 being 40% of 80), and that could only happen if 100 had been spent by the partnership as part of the trade.

The appeal of IG

109. The appeal of IG on the trading issue stands on a different footing, because the FTT concluded that IG was *not* carrying on a trade. IG appeals against that conclusion, but in doing so it faces all the difficulties that confronted HMRC in seeking to overturn the FTT's conclusion that the film LLPs were trading. Mr Peacock confirmed, in his brief oral submissions devoted to IG's appeal, that it was not being suggested that the FTT had made any error of legal principle in its approach to the question. He therefore accepted that IG's appeal could only succeed on *Edwards v Bairstow* grounds.

110. In our view, that is a hopeless endeavour. We are in no position to review the mass of evidence which the FTT had to consider, and we must resist the temptation of assuming that the answer to the trading issue must somehow be the same for IG as it is for the two film LLPs. Absent any identifiable error of law by the FTT, and given the circumscribed nature of the appeal to this court following the procedural skirmishing which we have described, it is enough for us to say that we can see no proper basis for interfering with the FTT's conclusion that IG was not carrying on a trade.

111. This conclusion makes it unnecessary for us to rule on the outstanding question whether the LLPs should have permission to pursue the "sub-contractor" point in this court, or in other words the contention that the LLPs carried on a trade through using the services of the PSCs (in the case of the two film LLPs) or of the equivalent development services company (in the case of IG) in order to produce the relevant films and games. Mr Peacock indicated to us how he would seek to develop this point in relation to IG's appeal, but even assuming he had permission to run it, he would still face the insuperable problem that we are in no position to determine a factual appeal on *Edwards v Bairstow* grounds. Nor have we found it necessary to refer to the sub-contractor argument in dealing with the appeals of the two film LLPs, for the simple reason that, in the absence of any identifiable error of law by the FTT, there can be no basis for interfering with its conclusion that the LLPs were trading.

112. Accordingly, IG's appeal on the trading issue will be dismissed.

III The view to profit issue

Introduction

113. As the Tribunals below observed, this issue arises only if the LLPs are held to have been carrying on a trade. As we have held that the FTT was entitled to conclude that ITP and IFP2 were trading, albeit on the 30:30 basis and not on the Ingenious basis as they had contended, it is an issue which arises for decision by this court. It is convenient to start with some observations on the applicable law.

The Law

114. Before this court, and indeed before the UT, the relevant legal principles were very largely a matter of common ground.

115. The requirement of section 863(1) of ITTOIA 2005 that "a limited liability partnership carries on a trade, profession or business with a view to profit" repeats the language of section 1(1) of the Partnership Act 1890 which defines a partnership as "the relation which exists between persons carrying on business in common with a view of profit", combined with the definition of "business" in section 45 as including "every trade, occupation, or profession". The creation of limited liability partnerships as separate legal entities is authorised by the Limited Liability Partnerships Act 2000. Among the requirements for the creation of such a partnership is that an incorporation document must be subscribed by "two or more persons associated for carrying on a lawful business with a view to profit": section 2(1)(a).

116. It was common ground, and it is in our judgment clearly right, that the phrase "with a view to [*or* of] profit" has the same meaning in each of these statutory provisions.

117. Association with a view to profit was an essential element for the existence of a partnership before the enactment of the 1890 Act, when partnerships were largely governed by rules of law and equity. It is unnecessary to explore the earlier authorities because in the 5th edition of *Lindley's Law of Partnership* (1888), the last before the 1890 Act, Sir Nathaniel Lindley (then Lindley LJ) wrote:

> "An agreement that something shall be attempted with a view to gain, and that the gain shall be shared by the parties to the agreement, is the grand characteristic of every partnership, and is the leading feature of nearly every definition of the term."

118. In the Supplement to the 5th edition published in 1891, as a commentary on the 1890 Act, Sir Nathaniel Lindley wrote, as regards the words "with a view of profit" in section 1(1), that they "distinguish partnerships from other kindred associations, such as clubs, which do not exist with a view of profit". It is not material to the present appeal, but it may be noted that the other "grand characteristic" of a partnership before the 1890 Act, that of sharing profits, was not stated in the statutory definition of a partnership and, resolving a longstanding debate between Sir Frederick Pollock, who largely drafted the 1890 Act, and the editors of *Lindley*, this court held in *Young (M) Associates v Zahid* [2006] EWCA Civ 613, [2006] 1 WLR 2562 that, whatever the position before the 1890 Act, it was not an essential characteristic of a partnership after the Act.

119. In the present case, the UT held, and the parties are now agreed, that the words "with a view to profit" import a wholly subjective test. It must be the actual subjective intention or purpose of the putative partners to make profits from carrying on their trade, profession or business. This is not a question of motive. People may have many reasons why they aim to make profits, including, for example, to support themselves and their families, to make charitable gifts or to create tax losses. For these purposes, they are beside the point. It is the genuine subjective purpose of the partners to make profits from their trade, profession or business which is the defining feature of a partnership.

120. The FTT held that there was an objective element to the requirement for a view to profit. There had to be a realistic possibility of profit. It is not entirely clear to us whether the FTT understood this to be a further requirement, in addition to showing a genuine subjective purpose, or an alternative way of satisfying the test even where no subjective purpose could be shown. As it was the LLPs who were at that stage advancing this

approach, one might have thought it was the latter, but it does not matter because on either basis it was an error.

121. We endorse the way it was expressed by the UT at UT/333:

> "We consider the better view to be that the test is a purely subjective one. There is no need for profit to be the predominant aim. As is noted in Lindley & Banks, difficult questions can arise when any profit-making aim is subsidiary to other purposes. In those circumstances, it is necessary to consider at what point the line is crossed and there is in fact no view to profit. Some sort of "reality check" is needed. It is necessary to identify whether there is a "real" intention rather than something that was not, in fact or reality, aimed for. The question as to whether a trade was carried on "with a view to profit" also cannot be answered in isolation, divorced from the context of the business in question. The context of "carries on a trade…" directs attention at least to some extent to the way in which the trade is conducted. Furthermore, an indifference to whether a profit is realised is not sufficient to meet the test. In this case, therefore, the FTT would have had to have been satisfied that the LLPs had genuinely intended to seek a profit from their activities."

122. While there is no objective element to the requirement for a view to profit, the likelihood of profits and the timescale in which they might be achieved will often be relevant to testing whether there is a genuine subjective view to profit. This was well expressed by the UT at UT/345:

> "Where the intention being tested is that of experienced businessmen, the lack of any realistic potential for or likelihood of profit on an objective basis may call into question whether there is a (subjective) view to profit. Experienced businessmen of course take risks, and different individuals will be willing to take differing levels of risk, but businessmen will generally seek to satisfy themselves that the risks are worth taking for the potential return on capital employed, at least if they are risking their own funds. The dynamics may differ where it is someone else's money that is at risk of being lost. HMRC repeatedly submitted that this was a case where the investment was being made with other people's money, namely that of the Exchequer in the form of the monies that the investors expected to receive from HMRC by way of tax repayments. And the extent of the risk taken may depend not only on the risk appetite of the investors but on the degree to which the individuals making the decisions are answerable for any failure, or incentivised by success."

123. Other aspects of the test are uncontroversial. First, "profit" has an objective meaning. If putative partners only have a view to making what they wrongly believe to be profits, for example gross revenue, they will not have a view to profit. Second, there is no maximum period during which the partners must intend to make a profit, although no

doubt the longer the period the more searching the inquiry into the real subjective purpose of the partners. Third, in broad terms, "profit" has the basic meaning of an excess of income over costs over a possibly indefinite period. It follows that the complex mosaic of generally accepted accounting practice (GAAP), which enables accounts to be properly prepared for defined periods, most commonly for a year, will generally have little part to play. Fourth, as noted by the UT at UT/333, the view to profit need not be the predominant subjective purpose, but it must be part of the partners' subjective purpose.

124. These propositions accord with the approach taken by the UT in the present case and by a differently constituted UT (Zacaroli J and Judge Jonathan Richards) in *Cobalt Data Centre 2 LLP v HMRC* [2019] UKUT 342 (TCC).

125. Many of the propositions, which derive from a variety of authorities and writings over many years, were considered by the Supreme Court of Canada in *Backman v The Queen* 2001 SCC 10, [2001] 1 RCS 367. In its unanimous judgment, the Court said:

> "22. A determination of whether there exists a "view to profit" requires an inquiry into the intentions of the parties entering into an alleged partnership. At the outset, it is important to distinguish between motivation and intention. Motivation is that which stimulates a person to act, while intention is a person's objective or purpose in acting. This Court has repeatedly held that a tax motivation does not derogate from the validity of transactions for tax purposes…similarly, a tax motivation will not derogate from the validity of a partnership where the essential ingredients of a partnership are present…The question at this stage is whether the taxpayer can establish an intention to make a profit, whether or not he was motivated by tax considerations…
>
> 23. Moreover, in [*Continental Bank Leasing Corp v The Queen* [1998] 2 SCR 298], this Court held that a taxpayer's overriding intention is not determinative of whether the essential ingredient of "view to profit" is present. It will be sufficient for a taxpayer to show that there was an ancillary profit-making purpose…
>
> 24. An ancillary purpose is by definition a lesser or subordinate purpose. In determining whether there is a view to profit courts should not adopt or employ a purely quantitative analysis. The amount of the expected profit is only one of several factors to consider. The law of partnership does not require a net gain over a determined period in order to establish that an activity is with a view to profit. For example, a partnership may incur initial losses during the start up phase of its enterprise. That does not mean that the relationship is not one of partnership, so long as the enterprise is carried on with a view to profit in the future."

126. At [25], the Court said:

> "…to ascertain the existence of a partnership the courts must inquire into the whether the objective, documentary evidence

> and the surrounding facts, including what the parties actually did, are consistent with a subjective intention to carry on business in common with a view to profit."

The FTT

127. Although the FTT rejected the LLPs' case that they were trading on the Ingenious basis, they sensibly considered the question of a view to profit both on that basis, in case they were wrong to hold that it did not constitute a trade conducted by the LLPs, and on the 30:30 basis on which they held that the LLPs were trading.

128. As regards the Ingenious basis, the FTT held that the LLPs did not have a view to profit. After a very thorough review of the evidence, they set out their conclusions at FTT/827-829, finding that "if the relevant test were simply whether the subjective intentions of the LLPs were to deliver a profit on the Ingenious basis we would find that it was not proved that such was the case" (FTT/828). At FTT/829, they also concluded that "it was unrealistic to hope for profit calculated on the Ingenious basis".

129. However, as regards the 30:30 basis, they concluded at FTT/830-833 that the LLPs conducted the trade on that basis with a view to profit. We later set out these paragraphs.

The UT

130. As we have earlier explained, HMRC appealed to the UT against the FTT's findings that the LLPs carried on business on the 30:30 basis as a trade and that they did so with a view to profit and, among their grounds of appeal, the LLPs appealed against the rejection of their case that they were trading on the Ingenious basis with a view to profit.

131. The UT upheld the FTT's decision that the LLPs were not trading on the Ingenious basis, substantially for the same reasons as the FTT.

132. The position was more complicated with regard to the FTT's decision that, even if the LLPs were trading on the Ingenious basis, they were not doing so with a view to profit. The parties were agreed before the UT that the FTT had erred in law in the legal test applied by them. The FTT held that, in addition to the subjective element, there was also an objective element or "override", requiring a realistic possibility of profit before it could be said that a trade was being carried on with a view to profit. It is unnecessary to analyse how they came to this conclusion, but it does appear to have its origin in the case advanced to them on behalf of the LLPs. Whether or not that is the case, the position was different before the UT, where both parties agreed that it was a wholly subjective test, subject only perhaps to those cases where it was obvious that a profit was either impossible or inevitable. The UT recorded at UT/299 Mr Saini QC's submission that there was an objective override in the sense that the intended profit must be more than "entirely fanciful". As an example of an intention to make an entirely fanciful profit, Mr Saini instanced a business to manufacture saddles for unicorns. In our view, an "entirely fanciful" profit in this sense is the same as an impossible profit.

133. It was therefore common ground that the FTT's decision on the issue of a view to profit on the Ingenious basis could not stand. The contentious issue was whether there were findings made by the FTT which would enable the UT to remake the decision. The UT held that, in FTT/827-828, the FTT had made a finding of fact that the LLPs did not

subjectively have a view to profit on the Ingenious basis. They rejected the LLPs' submission that even that finding, properly analysed, was infected by the inclusion of an impermissible objective element.

134. As regards HMRC's appeal against the FTT's decision on the 30:30 basis, the UT held that the LLPs were not trading on that basis either. For the reasons we have given above, we consider that the UT was not entitled to interfere with the FTT's decision on that issue.

135. Assuming, against their decision, that the LLPs were trading on the 30:30 basis, the UT held that the FTT was not entitled to find, applying a wholly subjective test, that they were doing so with a view to profit. We set out below the relevant parts of the UT's decision in this respect.

The issues on this appeal

136. As we have earlier explained, the LLPs were refused permission to challenge in this court the rejection by both Tribunals of their case that they were trading on the Ingenious basis. Instead, they challenge the UT's decision in relation to the 30:30 basis, both as to whether it constituted a trade and, if so, whether it was being carried on with a view to profit.

137. Notwithstanding the absence of any challenge to the rejection of the case based on the Ingenious basis, a substantial part of the LLPs' written and oral submissions before us, and of HMRC's submissions in response, were directed to the FTT's decision on the issue of view to profit on the Ingenious basis, and the UT's treatment of it.

138. In our judgment, this is not an issue before us, and it is neither necessary nor appropriate that we should consider and rule on the decisions of the FTT and the UT respectively on it. Whether there is a view to profit in carrying on a trade is relevant only if there is found to be a trade being carried on. This appeal proceeds on the basis that no trade was being conducted on the Ingenious basis. It follows that whether, if it had been, it would have been carried on with a view to profit simply does not arise. Mr Peacock accepted as much in the course of his oral submissions and, indeed, it became his primary case that we were concerned only with the view to profit issue on the 30:30 basis.

139. The only issue which arises is whether the LLPs were trading on the 30:30 basis with a view to profit. If the FTT had found that they had a view to profit on the Ingenious basis, that would have been relevant in the sense that the greater might arguably be taken to include the lesser. However, no-one suggested that they had made such a finding. On the contrary, their stated decision was that, even if a trade had been conducted on the Ingenious basis, it was not carried on with a view to profit. The LLPs challenged that finding on the grounds that the FTT's analysis and conclusion contained an objective element.

140. The FTT considered the issue of a view to profit on the 30:30 basis at FTT/814-825 and 830-834, and it is necessary to look in some detail at these paragraphs.

141. The FTT said at FTT/819:

> "Ingenious personnel knew that the tax relief advertised to investors was dependent on losses being calculated by reference to expenditure of 100; but that was not the same as knowing that the commercial or legal effect was expenditure of 100 and income of 54.45% of GDI. In the same way that the fact that the controlling minds of the LLPs knew that they had to carry on their business with a view of profit does not mean that they had a view of profit, so too the fact that they knew that the advertised tax loss was dependent on determining profit on the Ingenious basis does not mean that they had a view of profit determined on that basis."

142. At FTT/820, the FTT listed ten items of evidence, introduced as follows:

> "We note the following as examples which were indicative that Ingenious personnel, and those who dealt with Ingenious, knew that in commercial and economic terms the film deals were deals in which the LLP put up 30% of the cost and received 30% of the net revenue (GDI), and therefore as indicative that they knew that any economic profit for the LLP derived from a comparison of those amounts, whatever the formal accounting policies adopted by the LLPs."

143. The inferences they drew from that evidence were stated by the FTT at FTT/821:

> "The Ingenious personnel procured the LLPs to enter into transactions which had that effect. They must have known that this was the result. They must have intended this effect. They must have had a view to the effect those transactions created."

144. At FTT/822, the FTT said that, as they considered that the LLPs should have accounted for costs and income on a 30:30 basis, "the principle underlying it of recognising the commercial substance of the transactions is equally applicable to the question of what is profit for the test being considered in this chapter, and in our view, profit for the purpose of this test should be addressed on that basis".

145. At FTT/823, the FTT rejected the submission of Mr Gammie for HMRC that "the test of whether or not the business of the LLPs was carried on with a view of profit must be conducted against profits calculated on the Ingenious basis" which, he submitted, was "the standard against which the [LLPs] have set themselves". The FTT considered that this would introduce a subjective meaning to "profit" (as opposed to "view"). While we are not sure that this necessarily follows from Mr Gammie's submission, we agree with the FTT's opinion stated at FTT/824 that "profit" in section 863 has "a meaning independent of the understanding of the person whose subjective view is to be tested".

146. On that basis, the FTT said at FTT/825:

> "It seems to us that this alternative test is satisfied: the LLPs had the hope and intention of carrying out, and carried out, actions

> (entering into the film contracts) which would give rise to a realistic possibility of making a profit on the 30:30 basis."

147. Having found that there was not a view to profit if the business was conducted on the Ingenious basis, the FTT set out their conclusion on view to profit on the 30:30 basis:

> "830. However, we find that an expectation of a profit calculated on the 30:30 basis was realistic and not fanciful. On that basis the LLP was, in relation to Studio Films, roughly in the same position as the Studio in relation to production activity (i.e. setting distribution costs and margin aside). The levels of box office performance required to make a profit on that basis were high but not wholly fanciful.
>
> 831. The object of securing the tax benefits carried with it the pretence that profit could be calculated on the Ingenious basis, but the participants knew that the economic effect of the transactions was 30:30 and on that basis a profit was not unrealistic.
>
> 832. While there were some features of the way the business was conducted which did not display a wholehearted pursuit of profit for the LLP, for example the 'flex' given to Fox and the need to find films close to 5 April to use the capital raised, the lack of any financial comparisons by the green-lighting committee, and the imposition of the EP fee for the benefit of Ingenious (see Chapter IX: Expenditure), we did not find these so egregious as to preclude a conclusion that on this basis the business was conducted with a view to profit.
>
> 833. We find that Ingenious' personnel had a view of the 30:30 result when they procured that the LLP entered into the film contracts. As a result the business conducted by the LLP was conducted with a view to obtaining that result and with the hope of a profit on that basis.
>
> 834. We therefore conclude that if profit is properly to be calculated on the 30:30 basis, the LLPs conducted their businesses with a view to such a profit; but if it is calculated on the Ingenious basis, they did not."

148. The UT held that the FTT's conclusion was not open to them, for the reasons set out at UT/349-354:

> "349.We return later to the evidence on which the FTT based its conclusions at [827] and [828] that it was not proved that the subjective intentions of the LLPs were to deliver a profit on the Ingenious Basis. It did however find at [833] that the business conducted by the LLPs was conducted with a view to obtaining a "30:30 result" when the Ingenious personnel procured that the LLPs entered into the film contracts, with the result that the

business conducted by the LLPs was conducted with a view to obtaining that result and with the hope of a profit on that basis.

350.We do not consider that the FTT was correct to look at the question on the 30:30 Basis. The controlling minds approached the transactions on the Ingenious Basis and the documents were drafted with the intention of reflecting that approach. The business was therefore "carried on", as referred to in s 863 ITTOIA 2005, on that basis.

351.The controlling minds of the LLPs knew that the tax test required a view to profit on the Ingenious Basis. The suggestion that the LLPs intended to make a profit on the 30:30 Basis is at odds with the LLPs' case and with all the evidence. The fact that the controlling minds understood that the LLPs were really putting up 30% of the funds for 30% of the revenue does not mean that they intended that the LLPs would make a profit on that basis. The only serious driver for profit was to meet the tax test, and intending to make a profit on the 30:30 Basis was inconsistent with the desired tax treatment.

352. At [820] the FTT gave a number of examples which they said were indicative that Ingenious personnel, and those who dealt with Ingenious, knew that in commercial and economic terms the film deals were deals in which the LLP put up 30% of the cost and received 30% of the net revenue. The FTT said that this knowledge was indicative that those persons knew that any economic profit derived from a comparison of those amounts. From those examples, at [821] the FTT concluded that the Ingenious personnel procured the LLPs to enter into transactions which had that effect, must have known that this was the result, must have intended this effect, and must have had a view to the effect those transactions created. At [825] the FTT, relying on a finding that "profit" in s 863 has a meaning independent of the understanding of the person whose subjective view is being tested, concluded that the LLPs had the hope and intention of carrying out, and carried out, transactions (the 96 film contracts) which would give rise to a realistic possibility of making a profit on the 30:30 Basis.

353.In our view there is an impermissible leap in the logic in those paragraphs, which is reflected in the conclusions that follow at [830] to [834]. The fact that the parties knew that the economic effect of the transactions was 30:30, and the existence of a realistic possibility of profit on that basis, are not by themselves legitimate bases to infer that there was a view to profit on a subjective basis. The FTT's conclusion cannot be saved, as the LLPs suggested it could, by saying that a sub-conscious intention can be enough. In our view, the achievement of a profit was not inevitable or inextricably bound up with either the Ingenious Basis or the 30:30 Basis.

> 354. Accordingly, the FTT's conclusion at [834] that the LLPs conducted their business with a view to profit on the 30:30 Basis, but not on the Ingenious Basis, is based on an error of law."

149. The LLPs appeal against that decision and the issue for us is whether the UT was wrong in law to reach it.

150. In challenging the UT's decision, Mr Peacock for the LLPs submitted that the UT was not saying that the FTT had reached a decision that was not open to it on the evidence – it was not an *Edwards v Bairstow* challenge – but was saying that, in addressing the LLPs' subjective view to profit by reference to the 30:30 basis, rather than the Ingenious basis, the FTT had asked the wrong question. He pointed to UT/350 as containing the UT's essential reasoning. He submitted that, in considering a trade on the 30:30 basis, the FTT was right to ask whether the LLPs had a view to profit on that basis. It was an error of law by the UT to decide otherwise, which vitiated its decision to reverse the FTT's conclusion on this issue. In addition, Mr Peacock challenged the UT's view that the FTT's reasons contained a leap of logic. He submitted that the FTT had not engaged in any process of deductive reasoning but had made a finding of fact on the evidence.

151. In our judgment, Mr Peacock's submissions do not correctly identify the essential elements of the UT's reasoning on this issue. The crucial paragraph is UT/351. The purpose of the schemes implemented by the LLPs was to generate losses, and subsequent income, for investors on a scale that could only be achieved on the Ingenious basis. If the LLPs did not carry on a trade with a view to profit on that basis, the purpose of the schemes would fail. The LLPs' case and evidence before the FTT was therefore directed at establishing that they had a view to profit on the Ingenious basis of trading. It was never part of their case, whether as an alternative or otherwise, that they had a view to profit on a 30:30 basis of trading and, unsurprisingly, they did not lead evidence to establish it. That, and that only, is the point being made by the UT at UT/350.

152. As we see it, the essential basis of the UT's decision is expressed in UT/351 where they say: "The suggestion that the LLPs intended to make a profit on the 30:30 basis is at odds with the LLPs' case *and with all the evidence*" (emphasis added). The UT is clearly saying that there was no evidence on which the FTT could find as a fact that the LLPs had a view to profit from a trade on the 30:30 basis. Contrary to Mr Peacock's submission, this is a decision on the basis of *Edwards v Bairstow*.

153. The central issue is whether there was evidence before the FTT which could justify its finding of a view to profit on the 30:30 basis. It was one of HMRC's grounds of appeal to the UT that "there was no proper evidential basis which permitted the Tribunal or alternatively any reasonable tribunal to make such a finding". Mr Davey QC, arguing this part of the appeal on behalf of HMRC, made the point that the UT reached its conclusion following a hearing that ran for a month and involved a detailed scrutiny of the evidence that had been before the FTT.

154. Mr Davey observed that throughout this extensive litigation, the LLPs had consistently denied that they were carrying on a trade or seeking to make a profit on a 30:30 basis. As it was put by leading counsel for the LLPs in the hearing before the UT: "our position was always subjectively, in terms of consciously turning our minds to matters, we were structuring and conducting this business with a view to profit on the 100 basis".

155. Written and oral evidence was given at the FTT hearing by the three controlling minds of the LLPs. Mr Davey drew attention before the UT and before us that at no time did any of them give any evidence that they had a subjective intention to make a profit on the 30:30 basis, nor was there any other direct evidence that such had been their state of mind. The LLPs did not in their submissions to us (or to the UT, so far as we know) suggest otherwise.

156. In a case where the parties agree that the applicable test is one of the subjective intention of the LLPs and in which the three controlling minds of the LLPs give evidence, but without giving any explicit evidence that they had the requisite subjective intention or adducing any other direct evidence of such intention, it may at first seem hard to discern any proper basis on which a tribunal could find that they did in fact have that subjective intention. Nevertheless, for the reasons which follow, we consider that the FTT were entitled to conclude as they did on this issue, and that the UT's criticisms of that conclusion, although cogently expressed, are mistaken.

157. In the first place, it is important to remember (as we have already pointed out: see [99] above) that the Ingenious basis and the 30:30 basis are no more than shorthand labels for two competing analyses of the true legal nature and effect of the actual composite transactions which the controlling minds caused the LLPs to undertake. The relevant question must therefore be whether the controlling minds had a subjective view to profit in relation to those actual transactions, which are the same whatever the correct legal analysis of their nature and effect might be.

158. Secondly, the FTT made now unchallenged findings that the 30:30 basis represented the true commercial and legal effect of the transactions. In particular, the FTT found at the beginning of FTT/820 (set out at [142] above) that the Ingenious personnel (the controlling minds) "knew that in commercial and economic terms the film deals were deals in which the LLP put up 30% of the cost and received 30% of the net revenue (GDI) *and therefore as indicative that they knew that any economic profit for the LLP derived from a comparison of those amounts*…" (emphasis added).

159. The examples set out in FTT/820 do in our view provide ample support for the FTT's finding of actual knowledge on the part of the controlling minds that any economic profit for the LLP would derive from a comparison of the 30% of the cost which the LLP put in and 30% of the net revenue (in the form of gross distributable income, or "GDI") received by the LLP from the exploitation of the film. In particular, at FTT/820(j) the FTT recorded (and by inference accepted) the evidence of Mr Reid:

> "that at the point when GDI equalled budget: "you would imagine intrinsically that the [*Commissioning Distributor*] is going to break even – or a little bit more – at that point"".

The FTT then commented:

> "If the Studio would break even then (subject to the cost of the [*Executive Producer*] fee etc – Mr Reid's "a little bit more") so would the LLP on a 30:30 basis."

160. It was in the light of that evidence from Mr Reid, which came at the end of the list of examples in [820], that the FTT immediately stated its conclusion in FTT/821, namely that the Ingenious personnel who procured the LLPs to enter into the film deals "must have known that this was the result. They must have intended this effect. They must have had a view to the effect those transactions created".

161. This leads in turn to the FTT's conclusion at FTT/825 that "the LLPs had the hope and intention of carrying out, and carried out, actions (entering into the film contracts) *which would give rise to a realistic possibility of making a profit on the 30:30 basis*" (emphasis added). At FTT/830, it repeated that "an expectation of a profit calculated on the 30:30 basis was realistic and not fanciful", and at FTT/831 it said that "the participants [*i.e. the LLPs acting through their controlling minds*] knew that the economic effect of the transactions was 30:30 and on that basis a profit was not unrealistic". Finally, at FTT/833 it explicitly found ("we find") that the Ingenious personnel had a view of the 30:30 result when they procured the LLP to enter into the film contracts and "[a]s a result the business conducted by the LLP was conducted with a view to obtaining that result *and with the hope of a profit on that basis*" (emphasis added).

162. On a fair reading of the passages in the FTT Decision which we have reviewed, it seems clear to us that the FTT did make a finding of the necessary subjective intention on the part of the controlling minds. The words "with the hope of a profit on that basis" at the end of FTT/833 are necessarily subjective, and help to put at rest any doubt that the FTT may have founded its conclusion on nothing more than their objective finding that expectation of a profit calculated on the 30:30 basis was realistic and not fanciful.

163. Furthermore, and in respectful disagreement with the UT, it seems to us that there was evidence from which the FTT could legitimately infer that this subjective hope or intention actually existed in the controlling minds of the LLPs. Mr Reid's evidence, recorded at FTT/820(j), clearly envisaged the possibility of the LLPs breaking into profit at the point where (or at least not long after) GDI equalled budget. This was in our view material from which the FTT could legitimately infer that such a result formed at least a part of the subjective intention with which Mr Reid and the other controlling minds caused the LLPs to enter into each film transaction. The inference is supported by the FTT's further findings that there was a realistic possibility of such a profit being made, and that this was known to the controlling minds. In the normal way, if business people enter into commercial transactions which may give rise to a profit, it is natural to conclude that this will form part of their subjective intentions in doing so.

164. It will be apparent from what we have already said that we are unable to agree with the view of the UT that "[t]he suggestion that the LLPs intended to make a profit on the 30:30 Basis is at odds… with all the evidence". In our view, there was evidence to support the FTT's finding of a view to profit on the 30:30 basis, and an *Edwards v Bairstow* challenge to that finding on the footing that there was no evidence to support it must accordingly fail.

165. In concluding as it did, the UT was in our judgment understandably but unduly influenced by the fact that the LLPs' case before the FTT was founded exclusively on the Ingenious basis, and the fact that it was only on the Ingenious basis that the projected tax benefits for the individual investors in the LLPs could be achieved. The second of those factors no doubt provides the motivation for the participation of the LLPs in the

transactions, and together they explain why the written and oral evidence of the controlling minds was all directed towards the upholding of the schemes on the Ingenious basis. But those are different questions from the much narrower question which we are now considering, which is simply whether the controlling minds had a subjective view to profit in causing the LLPs to enter into the relevant transactions. It is important that the answer to this straightforward question of fact should not be infected by the underlying fiscal motivation which drove the whole exercise. A genuine subjective view to profit was, in fact, essential if the tax planning was to succeed. The FTT found, rightly or wrongly (it matters not which), that the LLPs had failed to establish the necessary subjective intention on the basis to which their evidence was directed, namely the Ingenious basis; but that did not in our view preclude the FTT from finding that the subjective test *was* satisfied on a correct legal analysis of the composite transactions which the LLPs entered into.

166. For similar reasons, we are unable to accept the other reason which the UT gave for holding that the FTT had erred in law in its conclusion on this issue, namely that "there is an impermissible leap in the logic" in the reasoning of the FTT. The UT may have been right to hold at UT/353 that the existence of a view to profit on a subjective basis cannot legitimately be inferred from nothing more than the fact that the economic effect of the transactions was 30:30 combined with the existence of a realistic possibility of profit on that basis. But the FTT had to review the totality of the evidence, which included (for example) the evidence of Mr Reid recorded at FTT/820(j). As Mr Peacock rightly submitted to us, that was an exercise of overall fact finding, not one of deductive logic.

167. We conclude, therefore, that the UT was itself in error in holding that the FTT had erred in law in reaching its conclusion on this issue. In the absence of any material error of law by the FTT, there was no basis upon which the UT could set aside its conclusion. The UT therefore erred in law by setting aside the conclusion of the FTT and proceeding to substitute its own conclusion. As with the trading issue, the end result, in our judgment, is that the finding of the FTT on this issue stands, because it has not been shown to be erroneous in point of law in any material respect.

168. We should finally mention that Mr Davey submitted that it was not open to the LLPs to challenge the UT's decision to set aside the FTT's finding, because of the terms of the order made by David Richards LJ that permission to appeal had not been given in respect of challenges to the FTT's findings of fact or the UT's review of those findings. We are of the view, however, that the LLPs' challenge in this respect is not, or not simply, to a review by the UT of the FTT's finding of fact, but goes rather to the heart of a decision on a central issue in the case.

IV Overall conclusion

169. For the reasons given above, we consider that the UT was wrong to interfere with the FTT's decision as regards ITP and IFT2 on both the issue of trade and the issue of a view to profit. We accordingly allow the appeals of ITP and IFT2 and dismiss the appeal of IG.