[2014 UKUT 0269 (TCC)
Appeal number FTC/93/2012

CORPORATION TAX – whether penalty imposed by Formula One governing body for breach of its non-statutory code deductible in computing profits to be charged to corporation tax - held no - appeal allowed

**UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER**

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

Appellants

- and –

MCLAREN RACING LIMITED

Respondent

**Tribunal: Mr Justice Warren, Chamber President
Judge Greg Sinfield**

Sitting in public at the Royal Courts of Justice, The Rolls Building, Fetter Lane, London EC4 on 9 and 10 December 2013

Akash Nawbatt and Christopher Stone, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Alun James, counsel, instructed by KMPG LLP, for the Respondent

DECISION

Introduction

1. The Commissioners for Her Majesty's Revenue and Customs ("HMRC") appeal against the decision of the First-tier Tribunal (Judge Charles Hellier and Tribunal Member Nicholas Dee) ("the FTT") released on 7 September 2012 ("the Decision"). The only issue before the FTT was whether a penalty paid by McLaren Racing Limited ("McLaren") for a breach of Article 151(c) of the International Sporting Code ("ISC") of the Federation Internationale de l'Automobile ("FIA") was deductible by McLaren in computing its taxable profits. The FTT allowed McLaren's appeal by casting vote of the Judge.

2. For the reasons given below, we consider that the £32 million penalty paid by McLaren was not an allowable deduction. Accordingly, we allow HMRC's appeal.

Facts

3. The facts found by the FTT are set out at [45] – [78] of the Decision. The findings of fact were not disputed by either party, although HMRC criticised several of the conclusions drawn by Judge Hellier based on those facts. We summarise the relevant facts below.

4. McLaren is a well known Formula One motor racing team. It designs, develops, manufactures and races Formula One cars at grand prix events throughout the world. McLaren derives its income from sponsorship, advertising and payments under the Concorde Agreement.

5. The Concorde Agreement is an agreement with the other Formula One teams, the FIA and Formula One Administration Limited ("FOA"), a company engaged in the promotion of the Formula One World Championship. The Concorde Agreement provides, among other things, for the commercial exploitation of broadcasting rights and other commercial activities in relation to Formula One which generate income for those involved. Under the Concorde Agreement, the Formula One teams agreed to accept the Sporting Regulations of the Formula 1 Championship laid down by the FIA which were deemed to be imported into the ISC.

6. The ISC is the document by which the FIA prescribes rules for the conduct of its motor sports events. The ISC takes effect as an agreement among the FIA's members which are national and other motoring associations in different countries. The ISC confers on members the right to issue licences to participate in motor sports competitions such as the Formula One World Championship. By accepting a licence, the holder agrees to be bound by the provisions of the ISC. McLaren submitted an entry form for the 2007 Formula One World Championship on 3 November 2006. In that form, McLaren expressly agreed to be bound by and to observe the FIA's 2007 Sporting Regulations and the ISC.

7. Chapter XI of the ISC provided for penalties for breach of the code. Regulation 153 provided for a scale of penalties ranging through reprimand, fines, time penalties,

exclusion, suspension and disqualification. In relation to the Formula One World Championship, it provided that a penalty of the withdrawal of points may be imposed. Article 27 of the FIA's statutes provided that the World Motor Sport Council ("WMSC") could directly impose the sanctions provided for in the ISC. The WMSC is a committee of the FIA. The WMSC is responsible for the enforcement of the FIA's statutes and the ISC.

8. In relation to fines we note that, at [55] of the Decision, the Tribunal quotes the wording of Article 155 of the ISC and appears to draw the conclusion that fines are limited (subject to a power to change the maximum level which has not been exercised so far as we know) to US$50,000. The Tribunal, basing itself on that, said at [85] it could not conclude that McLaren was liable to pay any more than that sum. However, this reading of Article 155 is, in our view, clearly wrong. Articles 153 and 154 confer power to impose fines (as to which there is no stated limit in amount). Article 154 states that fines may be inflicted by an ASN (a national authority) or by the stewards of a meeting, providing that fines inflicted by the stewards may not exceed a certain sum fixed each year by the FIA. Article 155 is not, as the Tribunal seems to have thought, a general limit on the amount of fines: rather, it sets the maximum level of the fine which may be inflicted by the stewards as is made clear by the introductory words: "Maximum fine given by the stewards of the meeting".

9. The FTT found that each Formula One team took an interest in the construction of its competitors' cars and spent a lot of time in viewing recordings of races and trying to discover the details of their construction. The FTT had no doubt that each team would take whatever practical and legal steps it could to keep its designs secret. Further, some teams sought to employ persons who had been employed by other teams in order to learn details of their competitors' cars or methods.

10. Starting in 2006, an employee of a rival Formula One team, Ferrari, passed detailed plans and information about Ferrari's cars to Mr Mike Coughlan, the chief designer at McLaren at the time. In 2007, Ferrari discovered what had happened and asked the FIA to investigate. McLaren did not dispute that Mr Coughlan had the information but argued that it was not disseminated within its engineering team and that Mr Coughlan's possession of the information was not authorised by McLaren.

11. Following a meeting in July 2007, the WMSC found that McLaren had breached article 151c of the ISC in that McLaren:

> "… were in possession of Ferrari secrets or Ferrari information, by virtue of Mr Coughlan's possession thereof, irrespective of certain other elements. We therefore find [McLaren] in breach of article 151c. However, the evidence of any use of this material in a manner calculated to interfere with the Formula 1 World Championship is insufficient for us to impose any penalty. Should, in the future, evidence emerge showing that the Formula One World Championship was prejudiced in any way by the possession of this information by [McLaren], either in 2007 or 2008 or any years subsequent to that, we reserve the right to invite the team back in front of the [WMSC], where they would be faced with the possibility of exclusion, not only from

> the 2007 World Championship, but also from the 2008 World Championship."

12. After the July 2007 decision, further information came to light and there was another meeting of the WMSC in September 2007 which showed that confidential Ferrari information had been disseminated within McLaren and the WMSC concluded that McLaren had obtained some degree of sporting advantage although it was impossible to quantify how much. The WMSC revised the view that it had reached in July and decided to impose a penalty as follows:

> "The WMSC therefore, in accordance with the provisions of the International Sporting Code, imposes the following sanctions [in] relation to the 2007 FIA Formula One World Championship:
>
> -- a penalty consisting of exclusion from and withdrawal of all points awarded to McLaren in all rounds of the 2007 constructors' championship
>
> ...
>
> -- a sum of USD 100 million (less any sum that would have been payable by Formula One Management Limited on account of McLaren's results in the 2007 constructors championship had it not been excluded)."

13. The effect of the decision was that, because it lost its points, McLaren lost that share of its income under the Concorde Agreement which depended on its place in the World Championship. That resulted in a loss of income of $35.6m. The amount of the penalty payable by McLaren was $100m less the lost income, ie $64.5m or £32,313,341.

14. The FIA issued a press release following its September decision in which it said:

> "One hundred million dollars is a large sum of money but in such a serious case any fine has to be large enough to deter similar behaviour in future whilst remaining proportionate to the resources of the team."

15. McLaren did not appeal against the ruling. In December 2007, McLaren issued a statement in which it acknowledged that it had become clear that the Ferrari information was more widely disseminated than was previously communicated and indicated that it wished to make a public apology. In a letter of 5 December 2007 (after completion of a technical inspection report ordered by the WMSC) to the FIA McLaren said:

> "we accept the central conclusion that some pieces of Ferrari information may have been disclosed via Nigel Stepney and Mike Coughlan, directly or indirectly to individuals within McLaren other than [the two drivers] … It is a matter of deep regret for us that our understanding of the facts has improved as a result of the FIA inspection rather than our own prior investigations. We apologise unreservedly …"

16. In December 2007, there was another WMSC hearing in relation to another Formula One team, Renault. McLaren had discovered that confidential information belonging to it had been taken by an ex-employee when he joined Renault. The information had been uploaded onto Renault's computer and distributed within Renault. The WMSC held that Renault was in breach of article 151c but imposed no penalty, saying:

> "In these circumstances, although a number of very unsatisfactory elements were noted during the deliberations, in assessing the gravity of the breach, the WMSC concluded that there was insufficient evidence to establish that the information was used in such a way as to interfere with or have an impact upon the championship."

The FTT accepted that the difference between Renault's case and that of McLaren was that McLaren obtained some element of sporting advantage. We note, however, that the WMSC itself recorded that it did not need to show that any information held led to any specifically identifiable sporting advantage or any other advantage. It was enough to establish an offence and to warrant a penalty that McLaren was in possession of another team's information.

Legislation

17. The tax legislation does not contain express provisions which identify what items are deductible in the computation of the profits or gains chargeable under Case I or Case II of Schedule D. It does, however, identify certain items that are not deductible. The applicable provisions in the present case were found in section 74(1) of the Income and Corporation Taxes Act 1988 ("ICTA"). Whether McLaren could deduct the £32 million penalty in computing its taxable trading profits depended on whether the penalty fell within the relevant paragraphs of that sub-section. During the period under consideration in this appeal, section 74(1) ICTA relevantly provided as follows:

> "74 General rules as to deductions not allowable
>
> (1) Subject to the provisions of the Corporation Tax Acts, in computing the amount of the profits to be charged to corporation tax under Case I or Case II of Schedule D, no sum shall be deducted in respect of -
>
> (a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, or profession;
>
> …
>
> (e) any loss not connected with or arising out of the trade or profession;
>
> …"

If the penalty fell within either (a) or (e) then it was not deductible by McLaren for the purposes of tax.

18. The rule in section 74(1)(a) raises the following questions:

(1) what were the purposes of McLaren's trade;

(2) was the penalty paid for the purposes of McLaren's trade; and

(3) was the penalty paid wholly and exclusively for the purposes of McLaren's trade?

If the answer to question (2) or (3) is 'no' then the penalty was not deductible by McLaren in computing its taxable profits.

19. In relation to the rule in section 74(1)(e), the following questions arise:

(1) was the loss connected with McLaren's trade;

(2) did the loss arise out of the trade?

If the answer to both questions is 'no' then the penalty was not deductible by McLaren in computing its taxable profits.

20. The argument has proceeded on the basis that the payment of the penalty may be either (i) a disbursement or expense or (ii) a loss. The question whether a fine should be regarded as a disbursement or expense or as a loss arose in *McKnight v Sheppard* (1999) 71 TC 419 which involved a non-statutory penalty imposed on a stockbroker in a case where, it is fair to say, the broker was guilty of gross misconduct. In the High Court, Lightman J held at 439:

> "The payment of both the fees and fines, as it appears to me, fall within the term disbursement, and the payment of legal fees is also clearly a payment of (legal) expenses. Mr McKay in his helpful submissions referred to a passage in the judgment of Finlay J in *Allen (Inspector of Taxes) v Farquharson Brothers and Co* (1932) 17 TC 59 at 64 where he says:
>
>> '[Section 130(a)] relates to disbursements; that means something or other which the trader pays out; I think some sort of volition is indicated. He chooses to pay out some disbursement; it is an expense; it is something which comes out of his pocket. A loss is something different. That is not a thing which he expends or disburses. That is a thing which, so to speak, comes upon him ab extra. It is not very easy to formulate the thing, but it is easy enough to put illustrations falling on one side or the other of the line which may show what is, I think, the distinction, and the real distinction, between these things. Take the case of money being stolen from a till: I should say that that, quite plainly, was not a disbursement or an expense and, equally plainly, I should say it was a loss. Take, on the other hand, a sum of money expended, let us say, for legal expenses … A trader thinks that he requires legal advice, … that, I should say, could not possibly or properly be said to be a loss, but obviously was a disbursement or expense.'
>
> In reliance on this passage he submitted that the element of volition was absent in case of payment of the fines and legal expenses because

> the requirement to pay them was foisted on Mr Sheppard against his will. This submission misunderstands the meaning of volition in this context. It means only that the payment is knowingly and deliberately made, and not that it is willingly made or made without pressure."

21. We agree with the views expressed by Lightman J in *McKnight*. It seems to us that the payment of the penalty is more properly to be seen as a disbursement or expense. Because both parties made submissions on the assumption that the penalty could be a loss and the FTT considered that the penalty incurred by McLaren could properly be described as either an expense or a loss, we will address the position if the penalty is properly, contrary to our view, to be seen as a loss by way of alternative decision.

FTT's decision

22. The FTT's decision was not unanimous. The FTT agreed on the findings of fact but the section of the Decision headed 'Discussion' contains the different views of the members of the panel. Judge Hellier's conclusions are set out at [89] – [121] of the Decision. Mr Dee's views are in [122] – [135] of the Decision.

23. At [82], the FTT observed that a contractual penalty for breach is unenforceable save as to the amount required to compensate for the breach. We should not be taken as accepting that this jurisprudence has scope for application in the context of an agreement such as the ISC but, as we see it, nothing turns on the issue. The FTT then accepted, as do we, that it would have been commercially impossible for McLaren not to pay the penalty even if it were not enforceable under English law, because that would have led to it being excluded from further participation in Formula One racing.

24. We discuss Judge Hellier's conclusions in more detail below but, in summary, he decided that McLaren was contractually obliged to pay the penalty under agreements that it had entered into for the purposes of its trade. His views were as follows. The penalty was not imposed by an external regulator but by a body with whose rules McLaren had to comply as part of its trade and in order to gain income. McLaren was liable to pay the penalty as a result of the actions of its employees in pursuing a course of conduct normally for the benefit of McLaren's trade and not from actions unconnected with its trade. The payment of the penalty was motivated by commercial policy and the WMSC had regard to commercial considerations more than the public interest. The WMSC had structured the penalty by reference to McLaren's trade. The protection of fairness in motor sport organised by the FIA did not carry the same sort of public interest as that protected by a regulator of a profession based on trust. Judge Hellier concluded that the penalty arose from McLaren's trade, was connected with its trade and was incurred wholly and exclusively for the purposes of its trade. Accordingly, McLaren was entitled to deduct the penalty in computing its taxable profits.

25. Mr Dee took a different view. In summary, he considered that the penalty was clearly intended to punish McLaren. The penalty was an alternative to exclusion from the World Championship that would have threatened McLaren's very existence. Mr Dee recognised that the penalty was paid to secure McLaren's continuing existence

but found it hard to believe that a large amount intended to punish such serious misconduct could constitute an expense laid out wholly and exclusively for the purposes of McLaren's trade. He considered that no part of McLaren's trade could encompass the acts of the employees that led to the penalty. Mr Dee relied on the observations of Lord Hoffmann in *McKnight* in the House of Lords ((1996) 71TC 419) to conclude that, where the expense is a punishment, it is not laid out wholly and exclusively for the purposes of the trade within section 74(1)(a) ICTA. Applying the same reasoning, Mr Dee also concluded that the penalty was not deductible because it was a loss not connected with or arising out of the trade within section 74(1)(e). Mr Dee considered that the penalty was imposed because the conduct of McLaren, as found by the WMSC, fell completely outside any normal and acceptable way of conducting its trade.

Cases on deductibility of damages, fines and penalties

26. The issue of whether a payment by way of damages, fines or penalties can be deducted has been considered by courts in this and other countries. We were referred to a number of authorities, all of which were considered by the FTT in the Decision. None of the cases to which we were referred concerned a situation exactly like the one in this case and our task, like the FTT before us, is to discern the principle that runs through the various cases and explains the different answers given by the courts.

27. The first case was *Strong and Company of Romsey Limited v Woodifield* 5 TC 215, a decision of the House of Lords from 1906. The appellant was a brewery company which owned and operated an inn. During a gale, a chimney of the inn fell and injured a guest. The company was required to pay costs and damages to the guest because the fall of the chimney was due to the negligence of the brewery's employees whose duty it was to maintain the premises in a safe condition. The company claimed a deduction for the costs and damages in computing its trading profits. The Inland Revenue contested the deduction on the ground that the amount was not wholly and exclusively for the purposes of the company's trade and assessed the company. The case eventually reached the House of Lords which held that the amount was not deductible.

28. Lord Loreburn decided that the amount was a loss not connected with or arising out of the company's trade and, applying what is now section 74(1)(e) ICTA, was not deductible. He held at p 219 that:

> "… it does not follow that if a loss was in some sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade or connected with something else quite as much as or even more than with the trade. I think only such losses can be deducted as are connected with it in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation, or fall on the trader in some character other than that of trader. The nature of the trade is to be considered."

In the particular case, Lord Loreburn held that the loss was not really incidental to the company's trade but fell on it in its character, not of a trader, but of a householder. Accordingly, the amount paid in respect of costs and damages was not deductible.

29. Lord Davey did not agree that the amount paid was a loss but reached the same conclusion as Lord Loreburn by applying what is now the wholly and exclusively rule in section 74(1)(a) ICTA. He found that the payment of costs and damages was not for the purpose of the trade. He held on page 220 that:

> "These words … appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade … It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade or is made out of the profits of the trade. It must be made for the purpose of earning the profits."

30. In *CIR v EC Warnes & Co Limited* (1919) 11 TC 227, the company was sued for a penalty under section 5 Customs (War Powers) Act 1915. The action was settled by consent on the agreement of the company to pay a reduced penalty. The company sought to deduct the penalty and its legal costs in computing its profits. The Inland Revenue issued assessments which were appealed. The General Commissioners held that the amounts were deductible. The Inland Revenue appealed to the High Court and the matter came before Rowlatt J who reversed the decision of the General Commissioners. Having referred to *Strong v Woodifield* , Rowlatt J held:

> "… it seems to me that a penal liability of this kind cannot be regarded as a loss connected with or arising out of a trade. I think that a loss connected with or arising out of a trade must, at any rate, amount to something in the nature of a loss which is contemplable, and in the nature of a commercial loss. I do not intend that to be an exhaustive definition, but I do not think it is possible to say that when a fine, which is what it comes to, has been inflicted upon a trading body, it can be said that it is 'a loss connected with or arising out of' the trade."

Although he dealt with the case by reference to whether there was a loss which fell within the statutory taxing provisions (under what is now section 74(1)(e)), his answer would clearly have been the same had he been dealing with what is now section 74(1)(a).

31. A penalty under section 5 of the Customs (War Powers) Act 1915 was also the subject of *CIR v Alexander von Glehn & Co Limited* (1920) 11 TC 232 which was heard in the High Court by Rowlatt J and then reached the Court of Appeal. The Special Commissioners had found that the penalty was incurred in the course of the company's trade and was incidental thereto. Accordingly, they decided that the penalty was deductible. Rowlatt J, following his decision in *Warnes*, allowed the appeal by the Inland Revenue.

32. The Court of Appeal, approving Rowlatt J's decision in *Warnes* and this case, found that the penalty was not deductible. In doing so, the Court of Appeal, as Lord Hoffmann noted at p 452 of *McKnight*, acknowledged that the expenditure was incurred in the course of the taxpayer's trade. Counsel for the company argued that

the penalty was deductible on, as Lord Sterndale MR recorded, “the broad principle that it does not matter whether the expense is incurred in consequence of an infraction of the law or whether it is a penalty for doing an illegal act, so long as it is something which reduces the amount which comes into the trader’s pocket as the result of his trading”. Lord Sterndale rejected that submission. He held, applying the remarks of Lord Davey in *Strong v Woodifield,* quoted above in [29], that the penalty was not money wholly and exclusively expended for the purposes of trade nor was it a loss connected with or arising out of a trade. He said at p 238 that:

> “[the company] committed a breach of the law, and for that breach of the law they were fined, and that does not seem to me to be a loss connected with the business, but it is a fine imposed upon the company personally, as far as a company can be a person, for a breach of the law which they had committed. It is perhaps a little difficult to put the distinction into very exact language but there seems to me to be a difference between a commercial loss in trading and a penalty imposed upon a person or a company for a breach of the law which they have committed in that trading.”

33. Warrington LJ, whilst accepting that the expenditure arose in the course of the trade, also rejected the company’s submissions. He held at p 241 that:

> “[the penalty] is not a loss connected with or arising out of the trade. It is a sum which the people conducting the trade have had to pay because in conducting it they have so acted as to render themselves liable to this penalty. It is not a commercial loss, and I think when the Act is talking about a loss connected with or arising out of such trade it means a commercial loss connected with or arising out of the trade.”

34. Warrington LJ also referred to the remarks of Lord Davey in *Strong v Woodifield* before concluding that:

> “Now it cannot be said that the disbursement in the present case is made in any way for the purpose of the trade or for the purpose of earning the profits of the trade. The disbursement is made … because the individual who is conducting the trade has … been guilty of an infraction of the law.”

35. Scrutton LJ again referred to Lord Davey’s remarks and concluded as follows at page 244:

> “Were these fines made or paid for the purpose of earning the profits? The answer seems to me to be obvious, that they were not, they were unfortunate incidents which followed after the profits had been earned.”

Scrutton LJ declined to decide whether compensation paid in civil proceedings was deductible but acknowledged that, on the language that he had used, questions might arise as to the deductibility of damages in civil proceedings (a matter on which more light is thrown by Lord Hoffmann in *McKnight* at p 452).

36. The deductibility of damages in such proceedings was considered by the High Court of Australia in *The Herald and Weekly Times Ltd v The Federal Commissioner for Taxation* (1932) 48 CLR 113. The case concerned the deductibility of costs incurred by a newspaper in contesting claims by persons defamed in the paper and of amounts paid, either before or after judgment, as damages for defamation. The relevant statute prohibited the deduction of expenses which were not wholly and exclusively laid out or expended for the production of assessable, ie taxable, income. By a majority, the Court held that the costs were wholly and exclusively laid out or expended for the production of assessable income.

37. In a joint judgment, Gavan Duffy CJ and Dixon J held at page 119:

> "The question whether money is expended in and for the production of assessable income cannot be determined by considering only the immediate reason for making a payment and ignoring the purpose with which the liability was incurred. … The inclusion of the alleged defamatory matter is the cause of the expenditure. … The money was spent to answer the claims, and whether it was expended wholly and exclusively for the production of income, must depend upon the manner in which the claims were incurred. When it appears that the inclusion in the newspaper of matter alleged by claimants to be defamatory is a regular and almost unavoidable incident of publishing it, so that the claims directly flow from acts done for no other purpose than earning revenue, acts forming the essence of the business, no valid reason remains for denying that the money was wholly and exclusively expended for the production of assessable income."

38. The judges stated that the distinction between that case and *Strong v Woodifield* was the degree of connection between the trade or business carried on and the cause of the liability for damages. They also distinguished *Warnes* and *von Glehn* as follows at page 120:

> "The penalty is imposed as a punishment of the offender considered as a responsible person owing obedience to the law. Its nature severs it from the expenses of trading. It is inflicted on the offender as a personal deterrent, and it is not incurred by him in his character of trader."

39. Another of the majority, Rich J, noted that publication was the common source of income and liability so the necessary connection between carrying on the business and the liability which caused the expenditure was made out. The final member of the majority, McTiernan J, held at page 127 that:

> "It should, I think, have been concluded upon the finding that the expenditure was an unavoidable consequence of carrying on the business of printing and publishing the appellant's newspaper that the money in question was wholly and exclusively laid out or expended by the appellant to get its income. Indeed it would follow from his Honor's [Mann J in the Court below] finding that the only condition that could have freed the appellant from the expenditure in question was that it ceased to carry on the business of printing and publishing a

> newspaper. The money, it is true, was paid out after publication. But the publication of printed matter was at once the act which produced the income and generated the liability which the moneys were expended to discharge. The amount of the liability was not fixed until after publication, but it was part of the true cost of publication. It was wholly and exclusively expended to print and publish the newspaper."

40. In *Fairrie v Hall* (1947) 28 TC 200 (1947), a sugar broker, Mr Fairrie, was found to have maliciously libelled a commercial rival and ordered to pay damages and costs. In a case of malicious libel, a jury was entitled to impose penal damages although the judge, sitting alone, confined the damages to £550 with costs of £3,025. Mr Fairrie sought to deduct the amount of damages and costs from his sugar broking profits. The Special Commissioners held that the amount had not been wholly and exclusively laid out for the purposes of Mr Fairrie's trade or business nor was it a loss arising out of the trade or business. Mr Fairrie appealed to the High Court where Macnaghten J dealt with the question of deductibility mainly by considering whether the expense was a loss not connected with or arising out of Mr Fairrie's trade or profession. He acknowledged that the expense was a loss and that the desire to increase his own profits by defaming a rival meant that there was, in that sense, some connection with his trade. Having cited the passage from the speech of Lord Loreburn in *Strong v Woodifield* quoted in [28], he held at page 206 that:

> "The loss fell upon the Appellant in this case in the character of a calumniator of a rival sugar broker. It was only remotely connected with his trade as a sugar broker.
>
> The case seems to me to be plain beyond all possible doubt, and ... it would indeed be preposterous if the Appellant were allowed to deduct these sums and thus be enabled to share ... [the loss] with the public revenue …
>
> …
>
> I … think that it is not possible to say that damages for a malicious libel published by a sugar broker can be said to be a loss connected with or arising out of his trade …"

41. *Robinson v CIR* [1965] NZLR 246 is a New Zealand case. Mr Robinson was a barrister and a solicitor who was fined by the Disciplinary Committee of the New Zealand Law Society. Mr Robinson claimed a deduction for the fine from his taxable income. The New Zealand Revenue assessed Mr Robinson who appealed. In the Supreme Court of New Zealand, Tompkins J held that the fine was not a loss exclusively incurred in the production of income and was, therefore, not deductible. Tompkins J reviewed a number of cases including *Strong v Woodifield, Warnes, von Glehn* and *Herald and Weekly Times* before stating, at page 249, that:

> "It is clear in my opinion that fines and penalties levied on a taxpayer by the Courts for breaches by him of the law are not deductible items."

42. Tompkins J then considered whether the fine levied on Mr Robinson was so similar to a penalty imposed by a Court as to preclude its deduction. He noted that the Disciplinary Committee was established by statutory authority and had statutory powers, including the power to fine; and also that Mr Robinson was compelled to

submit to the rules of the Law Society because otherwise he could not practise as a lawyer. Tompkins J said that "the only difference between these fines and those imposed by the Courts is that the former are inflicted by a specially created statutory tribunal". Tompkins J held, at page 250, that:

> "In my opinion there is no distinction in principle between the claim to be entitled to deduct from assessable income a fine imposed by the Disciplinary Committee and a fine imposed by a Court. ... It is inflicted on the offender as a penal liability; it is a fine imposed on the offender for professional misconduct; it is inflicted on the offender as a personal deterrent and a punishment.
>
> … It is a personal penalty imposed as a personal deterrent and punishment and not a loss incurred in the legal business."

43. Judge Hellier said at [21] that the reasoning in *Robinson* looked to the policy of the legislation imposing the penalty to assess whether it was designed to punish the person or his business. If the penalty was intended to punish the trader personally then the penalty was not incurred in the production of assessable income. We do not agree with Judge Hellier's characterisation of the reasoning in *Robinson* on this point. In *Robinson*, no reference was made to the policy of the legislation under which the fine was imposed. It seems to us that Tompkins J was looking at what conduct led to the fines in determining whether the fines were a loss exclusively incurred in the production of income. This is clear from a passage at the end of the judgment where Tompkins J stated:

> "Here it seems to me that the fines totalling £500 are certainly a loss in the sense that the appellant has had to pay the fines. They are, of course, incurred during the time that the income was being produced. … But is it fairly incidental to the carrying on of the appellant's profession that he should be guilty of professional misconduct so as to render him liable to fines? I think not. They are a punishment imposed on him personally rather than a loss suffered in the practice of his profession."

The reference to "fairly incidental" echoes Lord Loreburn's phrase "really incidental" in *Strong v Woodifield* which was cited in *Robinson*. Tompkins J considered that professional misconduct was not really incidental to Mr Robinson's professional activities and so fines paid as a result of such misconduct were not losses exclusively incurred in the production of income. The reference to the fines being a punishment imposed on Mr Robinson personally echoes Lord Sterndale's words in *von Glehn*, also cited in *Robinson*. The fact that the fines punished Mr Robinson personally was not the policy behind the penalty or the reason that the fine was not deductible but rather the consequence of the fine not being a loss suffered in the practice of his profession, as Tompkins J held.

44. Another case that concerned a claim to deduct fines imposed following disciplinary proceedings was *McKnight*. Mr Sheppard, a stockbroker, was the subject of disciplinary hearings conducted by committees of the Stock Exchange Council in relation to alleged breaches of the rules and regulations of the Stock Exchange. Mr Sheppard was fined and he also incurred legal expenses in connection with the

proceedings. At the time, the Stock Exchange was not regulated by statute and, unlike *Robinson*, the fine did not arise under statutory powers. Mr Sheppard's claim to deduct the expenses and the fines in computing his liability to tax was refused by the Inland Revenue.

45. On appeal, the Special Commissioner (Mr Theodore Wallace) in a decision reported at [1996] STC (SCD) 103, allowed Mr Sheppard's appeal in respect of the legal expenses but not the fines on the ground that the fines were a loss not connected with or arising out of the trade. The Inland Revenue appealed the decision that the legal costs were deductible and Mr Sheppard appealed against the conclusion that the fines were not deductible.

46. In the High Court, Lightman J held that neither the fines nor the legal expenses were deductible on the ground that they were not sufficiently connected with the carrying on of the trade. At pages 440-441, Lightman J held that, in order for a disbursement or expense to qualify as deductible, it must be an incident (or cost) of carrying on of the trade in question. If, however, the risk and liability arise outside (and not as an incident of) the conduct of the trader's normal profit-earning activities, the expenditure will not qualify for deduction. Lightman J held that:

> "… if the trader has deliberately undertaken a course of conduct outside the ordinary course of the conduct of his trade and thereby incurs or is occasioned liabilities or expenditure, the payment in satisfaction of those liabilities and the expenditure are not deductible. Thus libel damages and legal expenses will not be deductible if the libel is malicious, for it is not part of the trade of a newspaper to publish malicious libels (consider *Fairrie v Hall (Inspector of Taxes)* (1947) 28 TC 200); nor will damages for fraud be deductible, for it is 'no part of its trading to be fraudulent and deceitful' (see *Golder v Great Boulder* (1952) 33 TC 75 at 93 per Donovan J). A statutory penalty (whether or not technically criminal) exigible for breach of the law and the costs of unsuccessfully defending proceedings for recovery of the penalty are likewise not deductible. For a deductible expenditure must be occasioned by carrying on the trade in a lawful way, and if occasioned by carrying on in an unlawful way (whether or not involving moral obloquy) the expenditure is not deductible (see *IRC v Alexander von Glehn & Co Ltd* [1920] 2 KB 553, 12 TC 232). A penalty imposed to punish for a breach of the law and to deter breaches is not an ordinary incident of the business (see *Herald & Weekly Times Ltd v Federal Comr of Taxation* (1932) 48 CLR 113 at 120)."

47. Lightman J concluded that both the fines and the legal expenses in contesting them were not deductible because Mr Sheppard had been found guilty of serious misconduct contrary to the rules of the Stock Exchange. Such conduct was outside the ordinary, proper and lawful conduct of his trade and, in such circumstances, the fines and expenses were not deductible disbursements or expenses.

48. Mr Sheppard appealed in relation to the legal expenses but did not appeal against the High Court's decision in relation to the fines. The Court of Appeal held that Lightman J had been wrong to apply a two-stage test, namely, was the expenditure wholly and exclusively incurred for the purposes of the trade and, if so,

was it also sufficiently connected with the carrying on and earning of profits in the trade. The Court of Appeal held that there was a single test under what is now section 74(1)(a), namely whether the disbursements or expenses were wholly and exclusively laid out or expended for the purposes of the trade or profession. The Court said that the second requirement suggested by the judge was only an aid to deciding whether the first had been satisfied or not. The Court of Appeal allowed Mr Sheppard's appeal and restored the Special Commissioner's decision in relation to the legal expenses. The Inland Revenue appealed to the House of Lords.

49. In the House of Lords, the only question in *McKnight* was whether the legal expenses were "disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade" under what is now section 74(1)(a) ICTA. It is to be noted that as a matter of fact the taxpayer had only one purpose in paying the cost, namely to preserve the trade; and this was so even though the taxpayer was not unconcerned about his own reputation: see the discussion at p 450. It is against that background that the question was addressed. In answering it, Lord Hoffmann, who gave the only speech, considered why the Court of Appeal had held that the fine in *von Glehn* was not deductible. In the context of a submission that the legal expenses could not be regarded as "for the purposes of the trade" because they arose from the taxpayer's own misconduct which was behaviour outside the proper scope of his trade, Lord Hoffmann gave an analysis of *von Glehn.* He said that he had no doubt that the decision in *von Glehn* was correct but he found the reasoning difficult. Lord Hoffmann observed, at page 452:

> "But there would have been no … illogicality in treating the penalty in *von Glehn* as a trading expense. It was, as the Court of Appeal accepted, incurred in the course of the company's trade. There must therefore have been something in the nature of the expense which prevented it from being deductible. I think with great respect that the Court of Appeal had difficulty in identifying exactly what this was because they were looking in the wrong place. They hoped to find the answer in the broad general principles of what counts as an allowable deduction. But the reason in my opinion is much more specific and relates to the particular character of a fine or penalty. Its purpose is to punish the taxpayer and a court may easily conclude that the legislative policy would be diluted if the taxpayer were allowed to share the burden with the rest of the community by a deduction for the purposes of tax. This, I think, is what Lord Sterndale meant when he said that the fine was imposed 'upon the company personally'.
>
> By parity of reasoning, I think that the Special Commissioner and the Judge were quite right in not allowing the fines to be deducted. "

50. Having considered whether the fines were deductible, Lord Hoffmann went on to consider the deductibility of the legal expenses, at page 452, as follows:

> "It does not follow, however, that the costs were not deductible. Once it is appreciated that, in a case like this, non-deductibility depends upon the nature of the expenditure and the specific policy of the rule under which it became payable, it can be seen that the relevant considerations may be quite different. This explains the divergent answers given by the courts in

> the various cases on fines, penalties, damages and costs to which your Lordships were referred. So, for example, in *The Herald and Weekly Times Ltd v Federal Commissioner of Taxation* the High Court of Australia decided that damages for defamation payable by a newspaper company were a deductible expense. This seems to me correct: as Gavan Duffy CJ and Dixon J said in their joint judgment such claims against a newspaper are a 'regular and almost unavoidable incident of publishing it' and the damages are compensatory rather than punitive. There would seem no reason of policy why a rule which allows recovery of damages by plaintiffs defamed in the course of carrying on the business should prohibit deduction of those damages as an expense. In *von Glehn*, Scrutton LJ expressed some anxiety lest the broad principles he thought he was applying should exclude the deductibility of civil damages for negligence. But the relevant principles are in fact a great deal more specific and can accommodate both *von Glehn* and *The Herald and Weekly Times Ltd v Federal Commissioner of Taxation* without inconsistency."

Discussion

51. Before considering whether the penalty was not allowable as a deduction by McLaren under the rules in section 74(1)(a) or (e) ICTA, it is necessary to determine what McLaren's trade was or, more specifically, whether it included cheating.

52. Judge Hellier held, at [98], that "McLaren's trade is 'trying to make money from the design and racing of Formula One cars'". He rejected the idea that McLaren's trade was participation in Formula One racing subject to any rules imposed in the Concorde Agreement (and although he did not say so, could only have said the same in relation to other rules governing the sport, such as the ISC). Judge Hellier then held that:

> "I do not regard any contractual prohibition in Mr Coughlan's contract as conclusive of McLaren's trade. In my view, the profit making activity carried on by McLaren was not limited to acting within the confines of the Concorde Agreement and could include 'cheating'. That activity was its trade."

53. Judge Hellier did, however, decide, at [103] of the Decision, that the activities which gave rise to the penalty were not a *normal or ordinary* part of McLaren's trade. But held, at [104], that they were activities "so closely associated with the mainstream of McLaren's trade that I cannot say they were not part of it".

54. His reasons for holding that cheating was included among the activities of McLaren's trade were that

> (1) it was an ordinary part of McLaren's activities to seek information on its competitors' designs and strategy;
>
> (2) employing other teams' employees, and correspondingly taking steps to ensure that the damage which could result as the result of an employee defecting, were part of that activity;
>
> (3) Renault did the same; and

(4) the WMSC held that McLaren, by the activities of its employees, had obtained a sporting advantage, namely an advantage in the activity that gave rise to its income.

We examine each of these reasons in turn.

55. As to the first reason, it was undoubtedly an ordinary part of McLaren's activities to seek information on its competitors' designs and strategy. This was explicitly acknowledged in the September WMSC Decision which stated:

> "Formula One teams have great interest in each other's technology and go to considerable lengths (within the rules) to study each other's designs and innovations through direct observation, photographic evidence and other means."

56. It is clear from that passage that obtaining information about competitors was one of the activities carried out by a Formula One team but there were limits placed on the way in which that activity could be carried out by the rules in the Concorde Agreement and the ISC. The June and September WMSC Decisions show that the governing body, which included representatives of the Formula One teams, did not regard deliberately acting outside the rules (or cheating, as it is more commonly called in sport) as acceptable or normal behaviour in the competition. The fact that it was an ordinary part of McLaren's activities to seek information does not, in our view, support the conclusion that a deliberate flouting of the relevant rules under the ISC or a deliberate breach of the Concorde Agreement is to be seen as an activity in the course of the trade.

57. As to the second reason, Judge Hellier failed to distinguish between employing another teams' employees, which is allowed and unobjectionable, and improperly using the products of unauthorised disclosure by a competitor's current or former employees. The possibility that an employee of another team might be employed lends no support to the view that deliberate cheating is properly to be seen as an activity in the course of the trade once it is recognised that it would not be proper for such an employee to use confidential information for the benefit of his new employer.

58. As to the third reason, the fact that Renault also obtained confidential information in breach of the rules does not legitimise McLaren's actions and amounts to no more than a justification of "they were all at it".

59. As to the fourth reason, namely that McLaren obtained a sporting advantage by the misuse of Ferrari's confidential information, this ignores the fact that the confidential information and consequent sporting advantage were improperly obtained and, for that reason, any advantage was liable to be (and, indeed, was) cancelled by the loss of points and the penalty. Further, McLaren could have been excluded from the following season's championship which would have destroyed McLaren, as its counsel admitted at the disciplinary meeting of the WMSC in September 2007. If Judge Hellier was simply saying, as it appears he was, that an attempt to obtain a sporting advantage by cheating (which would only succeed if the cheat was not found out) was an activity in the course of the trade, that is no more than an assertion of the conclusion which this fourth reason seeks to support.

60. We prefer the opinion of Mr Dee on this point at [127] where he said that:

> "No part of their trade could encompass what their employees or agents had done in view of the WMSC findings."

61. In our view, a deliberate activity which is contrary to contractual obligations and the rules and regulations governing the conduct of the trade, which is not an unavoidable consequence of carrying on a trade and which could lead to the destruction of the trade is not an activity carried on in the course of that trade. We consider that, on the facts as found by the FTT, Judge Hellier should have concluded that the activities which gave rise to the penalty were not part of McLaren's trade.

62. The fact that the cheating activities carried out by McLaren were not carried out in the course of its trade does not dispose of the issue in this appeal. Although we have dealt with the question whether cheating activities can form part of the trade in deference to Judge Hellier, we must record that Mr Alun James, who appeared for McLaren, submitted that it had never been argued that cheating was within the scope of McLaren's trade. Rather, his submission was that McLaren's trade was the design, manufacture and racing of motor cars. It employed designers and engineers as part of that. Part of the designers' job was to obtain information about rivals' cars but they had to do so within the rules. It was an occupational hazard that employees might sometimes overstep the mark and act outside the scope of their employment just as, we remark, newspapers might libel individuals as in *The Herald and Weekly Times Ltd*. McLaren was vicariously liable for the actions of its employees but that liability arose in the course of McLaren's trade because it related to the actions of its employees.

63. We do not agree with that line of argument. In our view, the liability of an employer for the acts of its employee and what activities fall within the scope of the employer's trade are two different and largely unrelated issues. It cannot be said that simply because an employer incurs liability as the result of the acts of an employee, the liability is incurred in the course of the employer's trade. We consider that, on the facts of this case, wrongfully obtaining and using confidential information belonging to a rival team, which McLaren accepts and the Tribunal held, was not a normal or ordinary activity in the course of its trade, does not become such an activity simply because it is carried out by an employee. In this case, it is clear that Mr Coughlan's conduct was not within the proper scope of his employment even if the conduct occurred while he was employed: nor was it within the scope of the activities of the trade to do what Mr Coughlan did.

64. But this does not mean that the payment of the penalty is not deductible. The statutory question is not whether the payment was brought about as the result of an activity in the course of the trade, but whether the payment was "wholly and exclusively laid out for the purposes of the trade". It is said on behalf of McLaren that the payment was wholly and exclusively for the purposes of the trade. In this context, it is to be noted that the Concorde Agreement was entered into by McLaren in the furtherance of its trade; payment properly made under that Agreement might therefore be said to be seen as being made wholly and exclusively for the purposes of

the trade. In any case, the payment of the penalty had to be made, otherwise, in practice, McLaren would have been excluded from the F1 championship altogether.

65. We do not consider that these points resolve the matter in favour of McLaren. The WMSC imposed the penalty because it held McLaren to be responsible for the conduct of its then senior designer, Mr Coughlan, who disseminated the information within the McLaren team. Mr Coughlan's conduct was not in the course of McLaren's trade and was not in the furtherance of that trade. Although we accept that one reason why McLaren paid the penalty was in order to avoid the far worse consequence of being excluded from the World Championship, which might have destroyed the business, it was not paid for that purpose alone. The penalty was also paid because McLaren, through its employees, had engaged in conduct that was not in the course of its trade and incurred a liability to the penalty as a result. In our view, although the payment may have had to be made a matter of commercial necessity, it had, at least as one of its purposes, the satisfaction of a legal obligation – a contractual obligation being the analysis adopted by Judge Hellier – arising as a result of activities which were not in the course of McLaren's trade. The penalty was a disbursement or expense but it was not money wholly and exclusively laid out or expended for the purposes of McLaren's trade. Accordingly, the penalty was not an allowable deduction for computing the amount of McLaren's profits to be charged to corporation tax. Even if it can be argued that the penalty was unenforceable as a matter of law, the conclusion that it was in fact unenforceable is far from clear and may well be wrong in the context of the ISC. The payment of the penalty was at least the satisfaction of a possible liability and would therefore have had a dual purpose.

66. On the alternative view (which we do not favour) that the penalty is not a disbursement or expense within section 74(1)(a) but is a loss within section 74(1)(e), it will be apparent from our discussion that we consider that the penalty did not arise out of McLaren's trade and nor was it connected with the trade. Mr Coughlan's activities were not in the course of McLaren's trade and the fact that he may have rendered McLaren liable to the penalty does not result in the penalty being a loss connected or arising out of the trade.

67. Our conclusion on this point is sufficient to dispose of the appeal in favour of HMRC but even if we are wrong and the penalty was paid wholly and exclusively for the purposes of McLaren's trade, we consider that it would not be deductible for reasons similar to those given by Lord Hoffmann in *McKnight.*

68. In considering the Court of Appeal decision in *von Glehn*, Lord Hoffmann considered that the Court had been looking in the wrong place (broad general principles of what counts as an allowable deduction) for the reason why the expense was prevented from being deductible. The reason related to the particular character of the fine or penalty. We have quoted the relevant passage at [49] above. On the facts of that case, the fine arose under a statutory provision. The purpose was to punish the taxpayer; the court could easily conclude that the legislative policy (*ie* of the provision under which the fine arose) would be diluted if the burden of the fine could be shared with rest of the community. But that is not to say that legislative, or any other, policy must be under threat of dilution before a penalty can be seen as non-

deductible; rather, the dilution of the legislative policy is a (strong) example of a special circumstance in the nature of the expense which made it non-deductible.

69. It was by parity of reasoning that Lord Hoffmann considered the Special Commissioner and the Judge to be correct in not allowing the fines to be deducted in *McKnight*. The fines, it is to be remembered, arose under the rules of the Stock Exchange and not under a statutory scheme. The parity of reasoning was, presumably, that the rules under which Mr McKnight was fined, like the statutory provision in *von Glehn*, were based on a policy of punishing a person for the way in which he had acted in the course of the trade. To allow a tax deduction would dilute that policy. Dilution of the policy which was to be found in *von Glehn* and *McKnight* justified the conclusion that the nature of the expense prevented it from being deductible. The policy in *McKnight* was not, of course, a legislative policy, but was the policy behind a voluntary scheme regulating the conduct of brokers participating in the Stock Exchange.

70. Mr James submitted that the penalty in the present case was not a punishment but was simply intended to address any sporting advantage that McLaren had obtained by reason of its employee's conduct. We do not accept this submission. The FIA was unable to calculate the sporting advantage that McLaren had gained but the employee's conduct led to McLaren losing all the points awarded to it in the 2007 World Championship as well as paying the penalty. That meant that McLaren lost more than the major part of any sporting advantage, namely the points which it had gained, because it had to pay the penalty in addition to losing all of its points. The size of the penalty, the fact that it exceeded the value of the championship points taken from McLaren and the fact that it was an alternative to exclusion from the World Championship in the future all lead to the conclusion that the penalty was intended to punish McLaren. That last factor is important: it could hardly be maintained that exclusion from the championship would be other than a punishment; the payment of a large fine to avoid that punishment can only be seen, we consider, as acceptance of an alternative punishment. That view is not undermined by the fact that the FIA calculated the penalty to be proportionate to the resources of McLaren. In our view, the only conclusion that the FTT could have reached, on the facts as found by them, was that the £32 million penalty was intended to punish McLaren.

71. We therefore agree with Mr Dee (in disagreeing with Judge Hellier) at [124] of the Decision (showing, incidentally, that McLaren itself saw the penalty as a punishment):

> "As a result the WMSC clearly intended to punish McLaren, and from McLaren's own submissions regarding sanctions, ejection from the championship that year was a distinct possibility. To avoid this McLaren were prepared to go to great lengths of contrition. In the words of [the team principal of McLaren] 'If there is a punishment let it fit the crime'."

72. In our view, and by further parity of reasoning along the same lines as that of Lord Hoffmann in *McKnight*, we consider that the penalty in the present case is not deductible. One of the purposes of the ISC is to ensure that the sport is conducted

fairly and one of the sanctions available to achieve that policy is the imposition of penalties. Even if the penalty in the present case is to be viewed as simply a contractual matter between the FIA and the F1 competitors, we consider that the ISC demonstrates a clear policy to punish their contravention and for reasons just given, we consider that the actual penalty was indeed a punishment. As in *McKnight*, the penalty was intended to punish McLaren personally within the meaning of what Lord Sterndale MR said in *von Glehn*. The penalty was not "money wholly and exclusively laid out for the purposes of the trade" and nor was it a loss "connected with or arising out of the trade".

73. However, we do not think that it is right to regard the penalty as simply a contractual matter in that way. The FIA has, it seems to us, a regulatory function over motor sport and F1 in particular: and even in relation to F1 it is a regulatory function which goes beyond the mere enforcement of contractual arrangements between the FIA and participating teams. As to this, see [51] and [52] of the Decision, noting the separation of the FIA's commercial activities and its regulatory functions. In any case, spectators, and perhaps gamblers, have an interest in seeing that the sport is conducted fairly, just as such persons have an interest in seeing that champion cyclists do not take illicit performance enhancing drugs and that footballers do not fix matches. Further, the fine imposed in the present case did not accrue for the benefit of the F1 teams but was instead to be utilised in more general ways for the benefit of the sport. These factors reinforce us in our view that the penalty was neither "money wholly and exclusively laid out for the purposes of the trade" nor a loss "connected with or arising out of the trade".

74. Our conclusion is consistent with the decision in *Fairrie v Hall*. Although this case was not cited by Lord Hoffmann, it was referred to in argument. There is nothing in Lord Hoffmann's speech to suggest that he thought it was wrongly decided. Indeed, it is an example of the divergent answers to which he refers at p 452H. Thus, damages for malicious libel (which could have been visited with an award of penal damages) were not deductible, in contrast with damages for the sort of libel discussed in *The Herald and Weekly Times Ltd* which were an almost unavoidable incident of carrying on business.

75. Judge Hellier took a very different approach, perceiving a requirement for there to be a dilution of some policy, a requirement which he saw as introducing a high hurdle to be passed for non-deductibility. He considered that a dilution policy might be relevant where there is a serious public concern to be protected. And he went on at [43] of the Decision to set out the principles which he considered should be applied. His conclusion was that there must be a serious public interest in the conduct before the dilution policy can apply to deny deduction of a penalty or fine that would otherwise be deductible. We do not detect in the cases any requirement for a serious public interest in the conduct before the dilution policy can apply. In that context, Judge Hellier referred to the statement of the Special Commissioner in *McKnight* that he could see no difference between a statutory civil penalty, as in *von Glehn*, and "a fine imposed by a professional body for a breach of its rules, particularly where those rules were designed to protect the investing public". But we do not consider that the

Special Commissioner was imposing any public interest condition in making his comment and, even if he was doing so, we would not agree.

76. Further, as we have already pointed out, Lord Hoffmann did not seek to make any distinction between fines or penalties imposed by statute or other legislative authority and those that arose under other arrangements, such as the rules and regulations of the Stock Exchange. There is no reference in section 74(1)(a) or (e) ICTA or in *McKnight* or any of the other cases discussed above to a requirement for serious public interest. We reject the conclusion that a fine or penalty imposed to punish a taxpayer would only be non-deductible if deduction would be contrary to a serious public interest in the conduct that gave rise to the fine or penalty.

Conclusions

77. We consider that, on the facts as found by the FTT, the FTT should have concluded that the activities which gave rise to the penalty were not carried out in the course of McLaren's trade. Deductibility of the penalty cannot therefore be justified as an expense of carrying out an activity in the course of the trade. The penalty is not deductible on the basis that its payment was necessary to preserve McLaren's trade since that was not its sole purpose. Accordingly, the penalty was not wholly and exclusively laid out or expended for the purposes of McLaren's trade and was not an allowable deduction for tax. Even if the sole purpose of the payment had been to preserve McLaren's trade, it still would not satisfy the statutory requirement because the nature of the payment was such as to prevent its deductibility, namely that it was designed to punish McLaren for an egregious breach of the ISC.

Disposition

78. For the reasons set out above, we allow HMRC's appeal.

Mr Justice Warren

Chamber President

Greg Sinfield

Judge of the Upper Tribunal

Release date: 17 June 2014