UT Neutral citation number: **[2022] UKUT 00167 (TCC)**

UT (Tax & Chancery) Case Number: UT/2021/000074

Upper Tribunal
(Tax and Chancery Chamber)

Hearing dates: 10 to 11 May 2022
Rolls Building, London

Judgment given on 27 June 2022

Before

MR JUSTICE FANCOURT
UPPER TRIBUNAL JUDGE JONATHAN RICHARDS

Between

FOUNDATION PARTNERS (GP)

Appellant

and

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

Representation:

For the Appellant: James Rivett QC, Counsel, instructed by Greenwoods Legal LLP

For the Respondents: David Yates QC, Counsel, instructed by the General Counsel and Solicitor for Her Majesty's Revenue and Customs

DECISION

Introduction

1. The Appellant ("Foundation") is a general partnership. In its partnership tax return for 2008-09 it claimed a trading loss of £36,381,500. On completing their enquiries into that return, HMRC reduced the loss claimed to nil by a closure notice dated 13 May 2016. In a decision (the "Decision") of the First-tier Tribunal (Tax Chamber) (the "FTT") released on 26 January 2021, the FTT dismissed Foundation's appeal against that closure notice. Foundation now appeals to this Tribunal against the Decision with the permission of the FTT.

Background

2. In the remainder of this decision, references to numbers in square brackets are to paragraphs of the Decision unless we say otherwise.

3. Foundation was established on 9 July 2008. Its initial partners were Mr Tim Levy and Future Capital Partners (Management Services) Limited, which was a subsidiary of Future Capital Partners Limited ("FCP").

4. Both FCP and Mr Levy have a background in devising and promoting investments in film production which attracted tax reliefs. In 2007, Mr Levy realised that the tax-advantaged environment for film production was coming to an end. He was looking for ways to diversify his business by offering prospective investors the opportunity to invest in different asset classes, including real estate ([15]).

5. In 2007, Mr Levy met Mr John Kennedy at a trade event in Frankfurt. Mr Kennedy managed Boka Real Estate Managers Limited ("Boka"), a property investor. Mr Kennedy told Mr Levy about a project ("Project Adriatic") to construct a hotel, residential apartments (also referred to as "condominiums" in the Decision), and a trade fair in Budva, Montenegro. At that time, Project Adriatic took the form of an informal co-venture between Boka, a German fund manager ("Shedlin") and La Cite Development LLC ("La Cite"), a US real-estate and hotel developer ([17]).

6. Mr Levy thought that Project Adriatic, appropriately structured, might be a suitable investment for FCP's clients ([21] to [22]). To that end, the following agreements and transactions were entered into during the 2008-09 tax year:

> (1) Foundation was formed on 9 July 2008. Its role was to be the investment vehicle into which investors would subscribe. It took the form of a "tax transparent" partnership so that investors would be able to set sideways any trading loss realised by Foundation against those investors' own taxable income. On 16 December 2008, the initial corporate partner in Foundation was replaced by Foundation Design and Build Services (Jersey) Limited ("FDBS"), a Jersey incorporated company controlled by Mr Levy ([77]).
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> (2) On 27 November 2008, Boka, La Cite, Foundation and FCP entered into a "Teaming Agreement" which set out general terms under which Foundation would provide equity financing for Project Adriatic. Shedlin had by then withdrawn from the project and so was not party to the Teaming Agreement ([65] to [68]).
>
> (3) In February or March 2009, Foundation and FCP entered into a "Takeover Agreement" under which Foundation was given the right to use a "business concept" consisting of tax-efficient ways of raising finance from UK resident investors in return for a fee of 1.5% of the total capital that Foundation was able to raise. The Takeover Agreement was dated 9 July 2008, but the FTT found that it was signed in February or

March 2009 and backdated in order to give a better appearance of commerciality ([101] to [102]).

(4) Also, in February or March 2009, Foundation, Future Design and Build Services Limited ("Future Design"), a company controlled by Mr Levy, entered into a Partnership Consultancy Agreement which was expressed to require Future Design to provide building construction and design services to Foundation for a fee equal to 3.5% of total capital contributions to Foundation received from external investors plus 4% of future gross partnership income. Like the Takeover Agreement, the Partnership Consultancy Agreement was signed in February or March 2009 but backdated to make it appear as though it had been signed on 9 July 2008 ([101] and [105]).

(5) In February 2009, Boka Property Holding Services (Jersey) Limited ("BPHS") was formed. BPHS was controlled by Mr Levy. It was to play a central role in the cashflows that generated the loss that is in dispute in these proceedings. BPHS had a 50% subsidiary, Boka Adriatic Developments (Montenegro) Limited ("BAD"), and a wholly owned subsidiary, Integrated Property Contractor Services (Montenegro) Ltd d.o.o. ("IPCS"), a company incorporated in Montenegro ([28] to [30]).

(6) On 12 March 2009, BPHS entered into a "Master Agreement" with Polarisco Mix Limited ("Polarisco"). Polarisco was a member of the Atlas group, one of the largest businesses in Montenegro. The Master Agreement set out a mechanism under which BPHS could acquire the land necessary for the completion of Project Adriatic. Very broadly, that was to be achieved by a special purpose vehicle ("Lenley") obtaining the necessary land interests with BPHS acquiring the shares in Lenley ([114]).

(7) On 1 April 2009, Foundation and BAD entered into a "Principal Construction Contract" by which Foundation agreed to execute and complete the construction of Project Adriatic's hotel and residential apartments in return for a share of future revenue that the Partnership would receive from them ([121], [150]). In April 2009, the cost of constructing the hotel and residential apartments was estimated at around €100m ([131]).

(8) On 1 April 2009, Foundation and BAD entered into a "Services Contract" for the marketing of the hotel complex. No additional consideration was due under this contract beyond that payable under the Principal Construction Contract ([121], [150]).

(9) On 1 April 2009, Foundation and IPCS entered into a "Construction Sub-Contract" under which IPCS agreed to perform Foundation's obligations under the Principal Construction Contract in return for a fixed, non-repayable, sum of £37,762,650.76 ([121], [150]).

7. Mr Levy had hoped that Foundation would raise £25m from external investors. However, by 3 April 2009, it had raised just £10,888,750, £1,250,000 of which came from Mr Levy ([163], [188]). All those investors obtained partnership interests in Foundation in return for their investment and thereby acquired a right to share in profits and losses of Foundation ([23]). Mr Levy was Foundation's managing partner ([6]).

8. The following flows of funds took place on or around 3 April 2009, just before the end of the 2008-09 tax year ([189] to [191]):

(1) BPHS borrowed £30,266,250 from Barclays Bank plc ("Barclays") under a facility agreement repayable on the day of drawdown (the "Daylight Facility").

(2) FDBS borrowed £30,266,250 from BPHS which BPHS funded out of the principal amount of the Daylight Facility. £30,266,250 was credited to FDBS's account with Barclays.

(3) FDBS contributed £30,266,250 by way of partnership capital to Foundation and this sum was credited to Foundation's account with Barclays.

(4) IPCS invoiced Foundation for the £37,762,650.96 due to IPCS under the Construction Sub-Contract (see paragraph 6(9) above). Foundation paid this sum to IPCS in two separate tranches:

(a) Tranche 1 - £30,266,250 (funded out of the identical sum Foundation had just received from FDBS); and

(b) Tranche 2 - £7,496,400.96 (funded out of sums contributed to Foundation by investors).

(5) IPCS lent the sums it had received from Foundation to BPHS in two tranches, corresponding to those set out in sub-paragraph (4) above. £37,762,650.96 therefore passed into BPHS's account with Barclays in those two tranches.

(6) BPHS used the first tranche of the loan from IPCS (£30,266,250) to repay the Daylight Facility. The second tranche (£7,496,400.96) was at BPHS's general disposal.

9. A diagrammatic representation of the salient transactions and cash flows is set out in the Appendix to this decision. It can be seen from the cash flows that £30,266,250 passed in a circular loop starting with Barclays advancing that amount under the Daylight Facility on 3 April 2009 and ending with repayment of that facility on the day it was made. The FTT found ([147]) that, as a result of bank mandates and security arrangements entered into in connection with the Daylight Facility, BPHS, FDBS, Foundation and IPCS had no discretion as to how to apply the £30,266,250 that they received as part of that circular flow of funds with the result that it was pre-ordained that £30,266,250 would follow the circular path that we have just described.

10. The payment of £37,762,750.96 to IPCS was intended to generate a trading expense at the level of Foundation. Strictly, that trading expense did not arise as a consequence of the payment itself. Rather, it was expected that, in accordance with UK generally accepted accounting practice ("GAAP"), Foundation would be treated as acquiring an item of trading stock (its rights under the Construction Sub-Contract) in return for that payment, but the trading stock so acquired would be immediately impaired so as to result in an expense being recognised in Foundation's profit and loss account, with that expense being deductible for tax purposes. Except where precision as to the nature of the expense is necessary, we will, as a short-hand, refer to Foundation recognising an expense in connection with its payment to IPCS.

11. Foundation made some other payments in 2008-09 that are relevant in these proceedings. It paid FCP £605,325 pursuant to the Takeover Agreement and also paid FCP £1,412,425 in return for services provided pursuant to the Partnership Consultancy Agreement with Future Design. It was never explained why amounts due to Future Design were paid to FCP ([191(6)]).

12. The expenses to which we have referred above resulted in Foundation claiming an overall tax loss in its partnership return for 2008-09. The recognition of that loss was expected to have beneficial tax results for the members of Foundation who, it was hoped, would be able to set "sideways" their respective shares of the resulting tax loss against other taxable income that they had. Having opened an enquiry into Foundation's partnership tax return, HMRC issued a closure notice amending that return so as to deny the loss claimed which had the indirect effect of denying investors the opportunity to make claims for sideways loss relief.

13. Since the end of the 2008-09 tax year, there have been ongoing efforts to move the project forward. However, economic difficulties, issues surrounding the title to the relevant land and problems with obtaining planning permission have delayed construction. The design for the project was not approved until December 2019 by the relevant planning authority ([242]). Foundation accepts that, since October 2019, it has had no realistic prospect of sharing in any surplus profit from the development.

Relevant provisions of law

14. It was common ground between the parties before us that Foundation is entitled to a tax deduction for the expenses at issue in this appeal only if all of the following requirements are met:

(1) Foundation was, in the 2008-09 tax year, conducting a "trade" for tax purposes.

(2) That trade had actually commenced before the end of the 2008-09 tax year.

(3) The accounts of Foundation were correct as a matter of GAAP, such that they gave rise to the loss as claimed.

(4) Each relevant expense was incurred wholly and exclusively for the purposes of Foundation's trade.

(5) Each such expense was not capital in nature.

15. The issues set out in paragraphs 14(1) and 14(2) above are gateway conditions in the sense that, if Foundation had not commenced a "trade" by the end of the 2008-09 tax year, it was common ground that Foundation was entitled to no tax deduction for any of the expenses at issue, with the result that it could have obtained no trading loss and HMRC's closure notice would stand.

The Decision of the FTT

16. The Decision was long, running to over 150 pages. We will not, therefore, attempt to summarise the entirety of that Decision. Rather, in this section, we will simply highlight some findings and conclusions that were of central relevance and which set out the key battle ground between the parties in this appeal.

17. Although the FTT made findings that the Takeover Agreement and the Partnership Consultancy Agreement were backdated in an attempt to bolster the averred commerciality of Foundation ([101]), it found that none of the relevant contractual arrangements were a sham ([552]).

Findings as to a lack of commerciality

18. The FTT decided that Foundation was not carrying on a trade in 2008-09. At the heart of that conclusion were findings as to the lack of commerciality in Foundation's operations. Some examples of the FTT's findings in this regard are set out below.

19. All of the contracts providing for payments by Foundation which contributed to Foundation's claimed trading loss were entered into with entities controlled, or substantially controlled, by Mr Levy. Mr Levy was the managing partner of Foundation. The Takeover Agreement was entered into with FCP and the Partnership Consultancy Agreement was entered into with Future Design, both controlled by Mr Levy. The Construction Sub-Contract was with IPCS, also wholly controlled by Mr Levy. The Principal Construction Contract and Services Contract were entered into with BAD which was a 50% subsidiary of BPHS. However, the FTT found ([402]) that BAD entered into both of these contracts as agent for BPHS, so therefore these contracts too were entered into between entities controlled by Mr Levy.

20. The FTT found at [401] that the Principal Construction Contract and the Construction Sub-Contract were not concluded on arm's length terms and were "wholly uncommercial". Mr Levy confirmed to the FTT that none of the partners in Foundation (except himself) had any role in the negotiation of any of the agreements to which Foundation was a party [109]. Accordingly, these contracts were negotiated with Mr Levy acting on behalf of both counterparties.

21. Under the Principal Construction Contract, Foundation had contracted with BAD to construct an 18,000 square metre five star internationally branded hotel and 22,000 square metres of condominium apartments, together with associated parking and external works. The consideration was a payment by BAD of: (i) for a period of 30 years, 22% of the revenue generated from the Anticipated Hotel Management Contract (an anticipated future contract with a not yet known hotel operator), starting from a year after formal opening; and (ii) 90% of the net profits derived from the sale of the apartments, or 90% of the net lease or rental income (if the apartments were not sold) ([121]). Foundation sub-contracted all of its obligations under the Principal Construction Contract to IPCS. The consideration paid to IPCS was a "fixed lump sum payment" of £37,762,650.96 (excluding VAT) which was payable up-front and "not subject to adjustment for any reason whatsoever" ([121]).

22. On 1 April 2009, when the Principal Construction Contract was executed, BPHS did not have any interest in the land on which the hotel and condominiums were to be built ([392]). Nor did BPHS have the necessary funding in place to be able to buy all the shares in Lenley that was to hold the land. Accordingly, on 1 April 2009, Foundation, IPCS, and BAD (as agent for BPHS), all of which were controlled by Mr Levy, contracted with each other to build a luxury hotel and condominium apartments on land which none of the companies owned and on which they had no right to build.

23. Foundation was taking a significant risk on the construction project. It retained the contractual obligation to build the hotels and condominiums pursuant to the Principal Construction Contract, at an expected cost in the region of €100m. It had subcontracted those obligations to IPCS pursuant to the Construction Sub-Contract. However, IPCS had no resources to enable it to perform its obligations as it lent all of the £37,762,650.96 that it received from Foundation to BPHS. Despite IPCS's lack of resources with which to perform its obligations, Foundation was not entitled to any refund of the sums that it had paid up front to IPCS even on termination for a bona fide reason ([129]). The FTT found that the only reason why the consideration payable under the Construction Sub-Contract was paid up front on a non-refundable basis was to provide justification for Foundation to be able to recognise an impairment loss in respect of the Construction Sub-Contract, and so trigger a tax loss that could be utilised by its investors by way of sideways relief ([409]).

24. The FTT concluded, at [416], that no business of a commercial character would have entered into an agreement to construct a hotel and apartment complex, believing it would cost €100m to construct, but having raised only circa £10m of financing, and without any commitments from other parties to contribute to the costs. The FTT also found that no commercially driven business would sub-contract those construction obligations to a sub-contractor for a fixed consideration of circa £37m which was not repayable or refundable, knowing that the sub-contractor would immediately pay away the overwhelming majority of that consideration (as part of the circular flow of funds starting with the Daylight Facility) and would have no money left actually to construct anything ([416]).

25. The prospective location of Project Adriatic was in a seismic zone and the land in question was sandy. It had originally been envisaged that InterContinental Hotel Group would be the hotel operator and they had specified that they would require a 17-storey hotel building. Yet, the local development planning provisions only allowed buildings of 11 storeys to be built in Budva generally, and buildings of only five storeys on Project Adriatic's beachside location ([539]). Foundation had ordered a geotechnical report to consider, among other things, the foundation that the building would require

in light of these concerns, but Foundation did not wait to receive this report before entering into the relevant contracts ([539]).

26. In the event, the geotechnical report noted, among other things, that constructing a building over 13 storeys might not be possible due to the high seismic zoning without significant additional costs. The report recommended that no commitment be made in respect of the project until confirmation was received that at least 11 storeys would be permitted, and further engineering analysis had been undertaken. Of course, by the time this report had been received by Foundation, the relevant contracts had already been signed ([152], [154]). The FTT found that the only reason why the Principal Construction Contract and the Construction Sub-Contract were signed on 1 April 2009 was to ensure that the investors accrued their purported trading loss in the 2008-09 tax year. The FTT found that a commercially motivated business would have deferred entering into these agreements until after it had received additional information, even if that meant pushing execution into the 2009-10 tax year ([390]).

27. There were also peculiar elements of the Partnership Consultancy Agreement, entered into between Foundation and Future Design. It was originally envisaged that this would contain a liquidated damages provision, by which Foundation would be entitled to compensation if Project Adriatic did not proceed ([89]). Mr Levy testified that he had no recollection of why this was eventually dropped from the final agreement ([108]). The liquidated damages provision would have given Foundation some protection if Project Adriatic did not proceed, but neither Foundation nor its partners expressed any concern when the protection was omitted from the final documents ([396]).

Conclusion as to the absence of trade

28. Mr Levy's evidence was that investors' ability to obtain sideways loss relief was intended to provide them with a level of commercial protection against what was a risky commercial endeavour. However, the FTT did not believe that, describing Mr Levy's explanation as "window dressing" that was intended to misdirect HMRC as to the true description of the transaction ([365] and [380]). The FTT concluded that obtaining a loss that could be set sideways would have been the primary attraction of Project Adriatic from the perspective of investors ([379]) and that the reason why Foundation entered into the Principal Construction Contract and the Construction Sub-Contract on 1 April 2009 was so that investors could obtain sideways loss relief ([394]).

29. At [526], the FTT recorded HMRC's submission, based on the judgment of the House of Lords in *FA & AB Ltd v Lupton* 47 TC 580 ("*Lupton*"), that Foundation's activities in the 2008-09 tax year could not amount to a trade because, they were "so distorted by tax considerations" as to "break down as a credible trading proposition". At [551], the FTT accepted this submission and, in using words identical to those that HMRC had used when making their submissions based on *Lupton*, the FTT demonstrated that it considered the principle set out in *Lupton* to apply on the facts of this case.

30. There were, therefore, two broad reasons for the FTT's decision that Foundation was not conducting a trade in the 2008-09 tax year:

> (1) First, what the FTT described as the "artificiality and utter lack of any commerciality in the contracts concluded by Foundation" ([550]) meant that Foundation's operations did not have the "commercial character" identified in *Ransom v Higgs* (1974) 50 TC 1 necessary for a trade.
>
> (2) The principle in *Lupton* applied as the relevant arrangements were so distorted by tax considerations that they broke down as credible trading propositions ([551]).

31. The FTT characterised Foundation's activities as a partial financing of the Project Adriatic construction project and held that the Principal Construction Contract could only be construed as a cost contribution arrangement (i.e. a financing arrangement ([553])).

32. At [558] to [559], the FTT determined that even if, contrary to its conclusions, Foundation was carrying on a trade, that trade had not commenced on or before 5 April 2009. It based that conclusion on the "considerable uncertainties" prior to 5 April 2009 as to whether the necessary construction work could be completed successfully.

33. The FTT's findings as to the absence of a trade in 2008-09 meant that Foundation's appeal would necessarily fail since the existence of a trade in 2008-09 was a "gateway" condition in the sense we have described in paragraph 15. However, the FTT went on to make findings as to whether, if Foundation were carrying on a trade, (i) its accounts were prepared in accordance with GAAP; (ii) various expenses were incurred "wholly and exclusively" for the purposes of that trade; and (iii) expenses for which Foundation claimed a deduction were capital in nature.

Findings as to the accounting treatment

34. The accounting treatment was relevant to Foundation's claim to be entitled to claim a deduction for the impairment in its rights under the Construction Sub-Contract. If, applying GAAP, no expense would be recognised for that impairment, then it was common ground that the expense that Foundation did recognise in its partnership accounts would not be deductible for tax purposes.

35. The appropriate accounting treatment under GAAP was disputed and the FTT had expert evidence from Ms Chew for Foundation and from Mr Bach for HMRC. The FTT was critical of both experts' evidence and was especially trenchant in its criticism of Mr Bach ([445]). At [581], the FTT concluded that no impairment event had occurred on or prior to 3 April 2009 (the date of Foundation's balance sheet) and, in the absence of such an impairment, no impairment loss should, under GAAP, have been recognised in Foundation's accounts. At [582], it went on to make other findings as to the correct accounting treatment under GAAP which we need not summarise, though we note that both parties appeared to be agreed that these further findings were inconsistent with the opinions of both experts.

Findings as to "wholly and exclusively"

36. We quite understand why the FTT made additional findings on this issue. They were, at least in part, findings of fact which could assist a superior court or tribunal to remake the Decision if it contained an error of law. There was, however, a conceptual difficulty in making such additional findings. If, contrary to the FTT's conclusion, Foundation was carrying on a trade of some description the question whether expenses were incurred "wholly and exclusively" for the purposes of that trade would depend on the nature of the trade being conducted. Having concluded that Foundation was not carrying on a trade, the FTT understandably made no findings as to the character of any trade being conducted. Yet, if Foundation was trading, there were at least two possible formulations of the nature of its trade. One possibility was that its trade was "property development" involving the construction and realisation of a hotel and condominiums. Another possibility was that it was carrying on some kind of "financial" trade that involved the financing of Project Adriatic, a possibility emerging from the FTT's findings that we have summarised in paragraph 31 above. The FTT did not say expressly what kind of trade it had in mind when performing its counterfactual analysis of whether sums were incurred "wholly and exclusively" for the purposes of a trade.

37. The FTT found at [572] that the £37,762,650.96 paid to IPCS under the terms of the Construction Sub-Contract was not incurred "wholly and exclusively" for the purposes of any trade. It concluded at [571] that the purpose of £30,266,250 of the payment was to inflate investors' entitlement to

sideways loss relief. It concluded that the balance of the payment could not be treated as deductible because it was not possible to split the payment into different elements and identify some part of the payment that was untainted by duality of purpose.

Findings as to the capital nature of payments

38. The FTT also went on to make findings as to whether payments that Foundation made were of an income or capital nature, which also proceeded by assuming that Foundation was, contrary to the FTT's conclusion, carrying on a trade in 2008-09.

39. At [562], the FTT concluded that the amount paid to FCP under the Takeover Agreement was capital in nature because it was paid in return for the right to use a tax structure and business concept.

40. At [563], the FTT decided that the amount paid to Future Design under the Partnership Consultancy Agreement was capital in nature because it was paid as consideration for the Future Group's work in finding prospective investors and persuading them to invest capital.

41. At [578], the FTT found that the £37,762,650.96 paid to IPCS under the Construction Sub-Contract was capital in nature noting that it was a "single lump sum paid to generate an income stream for Foundation".

Grounds of appeal

42. The FTT therefore decided all of the issues that we have summarised in paragraph 14 above against Foundation. With the permission of the FTT, Foundation appeals against the FTT's decision on all of those issues.

43. For reasons that will become clear, we do not need to address all of Foundation's grounds of appeal. Our focus will therefore be on Foundation's challenges on the "trading" issue, namely whether the FTT erred in law in finding that Foundation was not carrying on a trade.

The "trading" issue - discussion

The nature of Foundation's challenge

44. Foundation does not seek to challenge the FTT's primary factual findings that underpinned its findings as to a lack of commerciality. Nor does it seek to argue that having made those primary findings, it was unreasonable for the FTT to make the evaluative conclusion as to an absence of "commerciality". Rather, Foundation seeks to establish that, even given the FTT's unchallenged findings as to a lack of commerciality, the FTT was not entitled to conclude that Foundation was not carrying on a trade in 2008-09 for all or any of the following reasons:

> (1) The FTT impermissibly ignored the reality of the contracts to which Foundation was party, which it held were not shams. Those contracts provided for Foundation to obtain real commercial benefits and be subject to real commercial obligations. If proper regard was had to the reality of those contracts, the FTT could not fairly have described them as either having an investment character - that of acquiring a guaranteed income stream - or as being artificial. The FTT's findings as to a lack of commerciality simply involved it identifying difficulties with the benefit of hindsight. They could not alter the inherent "trading" nature of the activities given their type and scale.
>
> (2) The FTT failed to have regard to activities that IPCS was to perform under the Construction Sub-Contract, which were "trading" in nature. Those activities, being

performed by subcontractors on behalf of Foundation, should have counted in Foundation's favour when determining the extent to which it was carrying on a trade.

(3) Even if Foundation was, as the FTT found, involved in the provision of finance for Project Adriatic, the only reasonable conclusion available to the FTT was that the financing transaction was in the nature of a trade.

45. Those challenges are, as Mr Rivett QC acknowledged in his oral submissions, challenges to the FTT's evaluative findings as to the existence or otherwise of a trade in 2008-09. As such, Foundation must meet the hurdle identified in *Edwards v Bairstow* [1956] AC 14 of establishing that the FTT misdirected itself in law, ignored relevant considerations, took into account irrelevant considerations or reached a conclusion that no reasonable tribunal could reach, before this Tribunal is entitled to interfere with the FTT's conclusions.

Applicable legal principles

46. We did not understand there to be a significant disagreement between the parties as to the following principles relevant to determining whether Foundation's activities in 2008-09 amounted to a trade or not:

(1) The relevant question is only whether Foundation was carrying on a "trade" in 2008-09. Foundation is a general partnership, not a limited liability partnership ("LLP") formed under the Limited Liability Partnerships Act 2000. Therefore, unlike an LLP, Foundation does not need to satisfy the requirement of s863(1) of the Income Tax (Trading and Other Income) Act 2005 of carrying on a trade "with a view to profit". Moreover, this appeal is concerned with the loss claimed in Foundation's partnership return for 2008-09 and not with claims by partners to set their proportionate share of that loss "sideways" against other income. While it would be necessary for partners surrendering their share of losses to establish that Foundation's trade was carried on "on a commercial basis" and "with a view to the realisation of profits" (see sections 66(1) and 66(2) of the Income Tax Act 2007), these statutory provisions do not apply for the purposes of determining whether Foundation was carrying on a trade.

(2) In order to determine whether Foundation was carrying on a trade in 2008-09, the FTT was required to evaluate the activities that Foundation actually carried on.

(3) It is a question of law whether a particular factual characteristic is capable of being an indication of trading activity. It is a question of law whether Foundation's activities are capable of amounting to a trade. Whether Foundation's activities actually amounted to a trade depends upon an evaluation of the facts against the background of applicable legal principles.

47. Given the multifactorial nature of the factual examination, it is not possible to provide an exhaustive definition that will determine conclusively whether a particular activity amounts to a trade or not. However, a flavour of the nature of the test can be found from the speech of Lord Reid in *Ransom v Higgs* in which he said:

> The Income Tax Acts have never defined trade or trading farther than to provide that trade includes every trade, manufacture, adventure or concern in the nature of trade. Leaving aside obsolete or rare usage [trade] is sometimes used to denote any mercantile operation but is commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services. The contexts in which the word "trade" has been used in the Income Tax Acts appear to me to indicate that operations of that kind are what the legislature had primarily in mind.

48. In a similar vein, the issue can sometimes usefully be approached by considering whether those activities have the characteristics of an "investment" as distinct from a "trade". That distinction is not one of pure law and involves instead a high-level summary of relevant aspects of the multifactorial assessment. So, for example, in *Eclipse Film Partners No 35 LLP v HMRC* [2015] EWCA Civ 95 ("*Eclipse*"), the Court of Appeal declined to interfere with the FTT's conclusions that the taxpayer had, in effect, laid out £503m that would be repaid with interest, that the possibility of obtaining further contingent receipts by reference to the profitability of films was in real and practical terms insignificant and the taxpayer's activities were therefore of an investment, rather than of a trading character.

49. Another issue relevant to this appeal is the extent to which Foundation's fiscal motives are relevant in determining the extent to which its activities were of a trading character. The classic statement of the law on this issue is found in the judgment of Megarry J in the High Court in *Lupton*, which was approved in the judgment of the House of Lords:

> If on analysis it is found that the greater part of the transaction consists of elements for which there is some trading purpose or explanation (whether ordinary or extraordinary), then the presence of what I may call "fiscal elements", inserted solely or mainly for the purpose of producing a fiscal benefit, may not suffice to deprive the transaction of its trading status. The question is whether, viewed as a whole, the transaction is one which can fairly be regarded as a trading transaction. If it is, then it will not be denatured merely because it was entered into with motives of reaping a fiscal advantage. Neither fiscal elements nor fiscal motives will prevent what in substance is a trading transaction from ranking as such. On the other hand, if the greater part of the transaction is explicable only on fiscal grounds, the mere presence of elements of trading will not suffice to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an artificial structure, remote from trading and fashioned so as to secure a tax advantage, the mere presence in that structure of certain elements which by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure.

50. Mr Yates QC for HMRC submitted, in reliance on the speech of Lord Simon in the House of Lords in *Lupton*, that were following such an analysis the matter is equivocal one can look at the "paramount object" of the structure. It is unnecessary for us to consider that submission further because the FTT did not consider that the matter was equivocal, as the fiscal advantage was the only true object.

51. There was a dispute between the parties as to some more detailed propositions of law. We will deal with such disputes in the analysis of the parties' competing submissions that follows.

Whether the FTT impermissibly ignored the reality of the contracts to which Foundation was party or the "type and scale" of its activities

52. Foundation places much emphasis on the FTT's finding at [552] that none of the relevant contractual arrangements were shams. Accordingly, Foundation had a real obligation, pursuant to the Principal Construction Contract, to provide services, and it had a real right to receive services pursuant to the Construction Sub-Contract. Foundation both supplied and received services under these contracts. Foundation notes that, in *Brain Disorders Research Limited Partnership v HMRC* [2018] EWCA Civ 2348 at paragraph [32] Patten LJ stressed that any analysis of whether a person is trading or not has to be performed by reference to the actual transactions effected. As Patten LJ put it:

> Although the *Ramsay* approach to construction has undoubtedly involved the courts in looking at the commercial realities of the transaction and ignoring financial components

> of a scheme which are circular or have no purpose other than to produce a tax loss in order to identify whether and, if so, which parts of the transaction engage the relevant tax provisions, it does not enable the courts to fix the taxpayer with a contract which under the scheme it does not have. The actual transactions remain the same.

53. In our judgment, Foundation's argument that the FTT "ignored" the reality of the contracts faced a fundamental difficulty from which it never recovered. Having made an express finding, at [552], that the contracts were real and not shams, there is an obvious difficulty with the proposition that the FTT "ignored" that finding in its analysis. Indeed, it is difficult to see what more the FTT could have done to demonstrate that it had the reality of the contracts firmly in mind other than make a finding of the kind set out at [552]. What the FTT then proceeded to do was consider the substance of the transactional arrangements as a whole, so far as they affected Foundation. It would have been wrong to focus narrowly on the terms of the Principal Construction Contract and the Construction Sub-Contract. The whole picture needs to be considered.

54. Foundation argues that a clear instance of the FTT ignoring the actual agreements is to be found at [553] to [555], where the FTT concluded that the Principal Construction Contract was, in effect, a "cost contribution arrangement – in other words a financing" and that the Teaming Agreement set out the "real deal" agreed between the co-venturers.

55. We do not accept that argument. Having found that the agreements were not shams at [552], the FTT did not ignore that finding in the paragraphs immediately following. Rather, as the FTT made clear in [552] itself, the FTT was considering what label to attach to the agreement. Of course, the question whether Foundation was trading could not be determined merely by a consideration of labels. However, it was permissible for the FTT to consider how the transactions could be described in substance and what they really amounted to as an aid to deciding whether they were of a trading nature or not. Precisely the same approach was followed in *Eclipse* where it was appropriate to consider, at a high level, whether the taxpayer's transactions amounted to little more than an investment of £503m at interest (see paragraph 48 above).

56. Read in the context of the Decision as a whole, the FTT was reflecting on its conclusions on commerciality at [553] to [555]. It had expressed its primary conclusion at [550] and [551] on the basis of the "artificiality and utter lack of commerciality in the contracts concluded by Foundation". The agreements to which Foundation was party were all entered into between parties under the direct or indirect control of Mr Levy. Those agreements set out real construction and other obligations but were completely uncommercial. By contrast, the Teaming Agreement was entered into with independent third parties (Boka and La Cite) and described Foundation's role in the project as involving the provision of finance. The FTT was not ignoring the reality of the suite of agreements to which Foundation was party. However, in view of the lack of commerciality of those agreements, the FTT was not prepared to label them as "construction and development contracts", a label that would suggest that they had a normal level of commerciality about them but preferred to label them as aspects of a financing of Project Adriatic, which was the description of Foundation's role set out in the Teaming Agreement. The FTT was entitled to that view since the suite of contracts involving Foundation did result in £7,496,400.96 (the balance of the funds available to Foundation that were not deployed in the circular funding loop starting with the Daylight Facility) being available for deployment in Project Adriatic. In any event, the FTT's conclusions as to whether Foundation's activities were appropriately described as "financing" or as "property development" were not material to its overall decision since, however, the arrangements were described, the FTT based its conclusion on the absence of commerciality and the applicability of the principle in *Lupton*.

57. More generally, Foundation argues that the FTT's findings on the absence of commerciality themselves demonstrated a failure to have regard to the reality of the Principal Construction Contract

and the Construction Sub-Contract. It was argued that the FTT was simply making findings, with the benefit of hindsight, about undoubted commercial flaws in the bargain that Foundation had struck. However, Foundation argued, this could not alter the "trading" nature of its activities since even the most commercial of trading ventures frequently fail for reasons both inside and outside the control of their protagonists.

58. We reject that argument. In making its findings as to commerciality, the FTT took Foundation's rights and obligations pursuant to its contracts as the starting point, demonstrating that it had the reality of those rights and obligations firmly in mind. On any fair reading of the Decision, the FTT was not simply deciding that the transactions were unwise or overly optimistic whether with, or without, the benefit of hindsight. The FTT's conclusion was more fundamental. It decided that the transactions were so lacking in ordinary commerciality that no reasonable trader would enter into them. No challenge has been made, and none could be made, to that evaluative conclusion which was firmly rooted in features of the contracts, and the parties' actual behaviours, that we have summarised in paragraphs 18 to 27 above.

59. Those findings as to the absence of "commerciality" were plainly of some relevance to the question of whether Foundation was trading, not least because the concept of "commerciality" features in the description of what constitutes a trade set out in the extract from *Ransom v Higgs* that we have quoted in paragraph 47 above. Therefore, Foundation's true argument is that the FTT gave too much weight to a relevant consideration (commerciality) in performing its multi-factorial assessment. It is trite law that it is for the primary fact-finding tribunal to decide how much weight to give to relevant factors in performing a multi-factorial evaluation and there is no error of law in the FTT's decision that the absence of commerciality was a factor of considerable weight.

60. There is a further reason why this Tribunal should not interfere with the conclusion the FTT reached following its multi-factorial evaluation. At [551], the FTT made a further evaluative finding to the effect that the arrangements to which Foundation was party were "so distorted by tax considerations, that they break down as a credible trading proposition". That was clearly a finding as to the applicability of the principle set out in *Lupton* since it echoed the submissions that HMRC had made on *Lupton* summarised at [526]. The paragraph betrays no misunderstanding of *Lupton*. Moreover, having found that the arrangements to which Foundation was party were "uncommercial from the 'get go'" ([547]) and that the uncommerciality arose from arrangements designed to provide investors with sideways loss relief, there was a rational basis for the FTT's conclusion that the principle in *Lupton* applied.

61. Foundation seeks to escape from this conclusion by arguing that, whatever reservations the FTT may have had about the circular cash flows funded out of the Daylight Facility, there was a core trading activity since, putting those cash flows to one side, Foundation had actually spent £7,496,400.96 under the Construction Sub-Contract for purposes connected with property development. As Mr Rivett QC put it in his oral submissions, even if Foundation was not "trading as to £37m", the only reasonable conclusion available to the FTT was that Foundation was "trading as to £7m".

62. In support of that argument, Foundation reasoned by analogy with judgments in *Ensign Tankers (Leasing) Limited v Stokes* [1989] STC 705 ("*Ensign*"). *Ensign* concerned a tax planning arrangement with some similarities to that undertaken by Foundation. A partnership spent $3.25m that was genuinely employed in activities that included the acquisition and exploitation of a film. The partnership obtained a further $9.75m by means of limited recourse funding with the overall purpose of the arrangement being to provide investors in the partnership with capital allowances by reference to $13m of expenditure and not just the $3.25m that they had invested. In the High Court, Millett J

reversed the finding of the Special Commissioners that the partnership was not carrying on a trade. The House of Lords did not disturb that conclusion when the case came to them (see the report at [1992] STC 226) and in his speech, Lord Jauncey explained why the principle in *Lupton* did not apply.

63. At 762d to 764c of his judgment, Millett J set out a number of propositions relevant when considering whether activities having some tax motivation should be regarded as trading, including:

> (1) If a 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" that commercial transaction.
>
> (2) The question is not whether tax purposes predominate over commercial purposes; the question is whether the transaction can fairly be described as being in the nature of a trade. The question is not why the taxpayer is trading, but whether it is trading.
>
> (3) If the purpose or object of a transaction is to make a profit, it does not cease to be a commercial transaction merely because the taxpayer concerned has obtained finance from others who are more interested in obtaining a tax advantage.

64. Foundation argues that these principles apply in its case. The only reasonable conclusion available to the FTT was that the £7,496,400.96 was deployed in a venture that was inherently of a trading character and the presence of other arrangements designed to enhance investors' entitlement to loss relief does not alter that.

65. We reject that argument for two reasons. First, we do not accept that there is any such thing as an activity that is "inherently trading". We quite accept that an activity consisting of property development will frequently, or usually, constitute a trade. However, where this is the case, it is not because the activities can, as a shorthand, be described as "property development". Rather, it is because the activities actually undertaken amount to a trade. As Sir Andrew Morritt C put it at [148] of his judgment in *Eclipse*:

> 148. We turn finally to the other way in which Mr Aaronson put Eclipse 35's case, namely that the acquisition of the licence to the Rights and the sub-licensing of them for consideration and with a view to profit constituted inherently and as a matter of law carrying on a trade. We do not agree, and we do not consider that the cases relied upon by Mr Aaronson justify his submission. We have summarised above the general principles and approach in this type of case, namely that what is necessary is an evaluation of the precise facts against the background of the meaning of the statute.

66. Henderson LJ made a similar point at [59] of his judgment in *Samarkand Film Partnership No 3 and others v HMRC* [2017] EWCA Civ 77 ("*Samarkand*"):

> 59…. At the most basic level, it is now clear from Eclipse, if it was not clear before, that the question whether what the taxpayer actually did constitutes a trade has to be answered by standing back and looking at the whole picture: see [111]. Although it is a matter of law whether a particular activity is capable of constituting a trade, whether or not it does so in any given case "depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles": see [112]. It follows that it can never be appropriate to extract certain elements from the overall picture and treat them, viewed in isolation, as determinative of the issue. But that, in essence, is what Mr Furness is inviting us to do, when he says that the purchase and leaseback (or onward lease) of a film are inherently trading activities. There is no dispute that such activities are capable of forming part of a trade, and in many contexts the only reasonable conclusion would be that they did form part of a trade. But when the whole picture is

> examined, the conclusion will not necessarily be the same. The exercise which the FTT has to undertake is one of multi-factorial evaluation, and their conclusion can only be challenged as erroneous in point of law on Edwards v Bairstow grounds: see Eclipse at [113]

67. Second, the FTT evidently found that the facts it was considering were very different from those present in *Ensign*. It may well be that, in *Ensign*, there was a core commercial activity, of acquiring and exploiting films, that was supplemented by avoidance arrangements designed artificially to boost the amount of capital allowances to which investors were entitled. However, in this case, the FTT made express findings that there was no core commercial activity at all. The entirety of the arrangements to which Foundation was party were "uncommercial from the 'get go'". Foundation cannot come close to disturbing that finding simply by pointing to the fact that Foundation made a payment of £7,496,400.96 that IPCS was able to deploy as it saw fit. It is not permissible simply to single out one relevant factor, identify it as a trump card, and argue that it demonstrates that the FTT's evaluative conclusion was wrong: the FTT's task was to examine all relevant circumstances. As Lewison LJ memorably put it in *Fage v Chobani* [2014] EWCA Civ 5 such an approach impermissibly invites this appellate tribunal to go "island hopping" in a "sea of evidence."

The "sub-contractor" argument

68. Foundation argues that the FTT erred in law by failing to identify that the activities carried on by IPCS as contractors under the terms of the Construction Sub-Contract should have been attributed to Foundation for the purposes of assessing whether Foundation was carrying on a trade.

69. Although Mr Rivett referred to the law of agency in his written skeleton argument, we did not understand his argument to depend on the proposition that IPCS (or indeed any "sub-sub-contractors" that IPCS appointed) was Foundation's agent. Rather, the essence of Foundation's argument was that activities carried out by IPCS or sub-sub-contractors were (i) trading in nature and (ii) should be attributed to Foundation and treated as Foundation's own activities.

70. We reject that argument for two essential reasons:

> (1) It relies on the proposition that the activities of IPCS and sub-sub-contractors can be described as "inherently trading". That proposition is not correct in the light of the judgments of the Court of Appeal in *Eclipse* and *Samarkand* that we have quoted in paragraphs 65 and 66 above. What Foundation had was a contractual right to require IPCS to comply with the Construction Sub-Contract; what, if anything, that amounted to depended on an appraisal of all the circumstances in which the transactional documents were entered into.
>
> (2) Even assuming, without deciding, that Foundation should be treated as carrying on activities undertaken by IPCS and the sub-sub-contractors, those activities could necessarily only be those specified in the Construction Sub-Contract. Yet that agreement was, as the FTT found, entirely uncommercial. The FTT's point was not that trading-type activities to be undertaken by IPCS and sub-sub-contractors did not "count" in determining whether Foundation was trading. Its point, rather, was that the Construction Sub-Contract, like the other agreements to which Foundation was party, was completely uncommercial. Neither the terms of the Construction Sub-Contract nor any activities actually undertaken by IPCS or sub-sub-contractors in accordance with the terms of that contract added anything in terms of trade or commercial substance to the analysis.

Whether the FTT should have found that any "financing" activity amounted to a trade

71. Foundation argues that, even if its activities could be described as a "financing" of Project Adriatic, the FTT was bound to conclude that such an activity amounted to a trade. Any "financing" would involve Foundation providing funding to BAD in consideration of a right to share in future revenue derived from the hotel and condominiums. That, it argues, "involved the laying out of funds for an uncertain reward of a type which is intrinsically a trading activity".

72. We reject that argument. First, as we have explained, Foundation's activities cannot be described as "intrinsically trading" for reasons given by the Court of Appeal in *Eclipse* and *Samarkand*. Second, it does not matter whether Foundation's activities are described in summary as a "financing" or (as Foundation prefers) as "property development". However characterised, the FTT found that those activities were totally uncommercial and that the principle in *Lupton* applied to prevent them amounting to a trade. The FTT was entitled to conclude from those findings that, however described, Foundation's activities were not of a trading character.

Conclusion and disposition

73. For the reasons that we have given, Foundation's appeal on the trading issue fails, essentially because there is no valid *Edwards v Bairstow* challenge to the FTT's evaluation of its undisputed factual conclusions. The FTT was entitled to conclude that Foundation's activities as carried out in 2008-09 did not answer to the definition of a "trade".

74. In those circumstances, there is no need for us to address Foundation's challenge to the FTT's conclusion as to the commencement of a trade. Once it is established that any activities Foundation was carrying out in 2008-09 did not amount to a trade, there is no point in considering when that non-existent trade could be treated as having commenced.

75. Nor is there any need to address Foundation's other grounds of appeal:

> (1) The question whether payments that Foundation made were incurred wholly and exclusively for the purposes of a trade does not arise since Foundation was not carrying on a trade. Nor, for reasons that we have mentioned in paragraph 36 above, is it straightforward to consider this ground of appeal on a "counterfactual" basis that proceeded on the assumption that, contrary to the FTT's conclusion, Foundation was trading in 2008-09.
>
> (2) The question of whether payments are of a capital nature also does not arise in the absence of a trade. Moreover, this issue also cannot be addressed on a "counterfactual" basis since, whether a payment is capital in nature will depend on the precise nature of the relevant trade.
>
> (3) Conceptually, we could have addressed the FTT's factual findings on GAAP as an abstract question, not dependent on the characteristics of any particular trade. The absence of a trade, however, means that the accounting treatment is not a live issue since, however Foundation's loss is quantified as a matter of GAAP, it cannot constitute a trading loss for tax purposes. It is clear that the FTT was not assisted as it should have been by the expert evidence but, since we have not ourselves heard the evidence, we do not consider we are any better placed to address the difficult issues of GAAP raised in this appeal. Therefore, we say only that if we had concluded that the FTT had erred in law in deciding that Foundation was not carrying on a trade in 2008-09, we would have invited the parties to make submissions as to the terms on which there should be a remittal of accounting issues back to the FTT.

76. For the reasons we have given, Foundation's appeal is dismissed.

Signed on Original

MR JUSTICE FANCOURT
JUDGE JONATHAN RICHARDS

RELEASE DATE: 28 June 2022

APPENDIX – DIAGRAMMATIC REPRESENTATION OF TRANSACTION