Neutral Citation: **[2023] UKUT 00073 (TCC)**

Case Number: UT/2021/000114-124, 126-127,129

UPPER TRIBUNAL
(Tax and Chancery Chamber)

Rolls Building, London

INCOME TAX – deferred remuneration tax whereby amounts reallocated pursuant to discretion decision to individual LLP members via corporate LLP member – whether amounts were partnership profits under s850 ITTOIA 2005 as HMRC argued – no (applying BlueCrest UT) - whether amounts taxable as miscellaneous income under s687 ITTOIA 2005 - yes – whether finding on discovery made – yes – FTT's refusal of appellants' application for redaction under Rule 14 UT Rules upheld –HMRC's and appellants' appeals dismissed

Heard on: 13 and 14 July 2022
Written submissions completed: 30 September 2022
Judgment date: 20 March 2023

Before

MR JUSTICE MELLOR
UPPER TRIBUNAL JUDGE SWAMI RAGHAVAN

Between

1. **HFFX LLP**
2. **STEPHAN ATKINS**
3. **YURI BEDNY**
4. **PAUL BEREZA**
5. **ALEXANDER GERKO**
6. **PHILIP HOWSON**
7. **RENAT KHABIBULLIN**
8. **JOSHUA LEAHY**
9. **JACOB METCALFE**
10. **ALEX MIGITA**
11. **DMITRY SHAKIN**
12. **ANDONIS SAKATIS**
13. **CHRISTOPHER SHUCKSMITH**
14. **EVGENY TANHILEVICH**

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellants: Kevin Prosser KC and David Yates KC, instructed by Macfarlanes LLP

For the Respondents: Thomas Chacko and James Kirby, Counsel, instructed by the General Counsel and Solicitor for His Majesty's Revenue and Customs

DECISION

Introduction

1. This appeal, and cross-appeal by HMRC, against a decision of a First-tier Tribunal (Tax Chamber) ("**FTT**") decision concerns the tax treatment of a deferred remuneration arrangement for individuals known as the Capital Allocation Plan ("**CAP**"). The individual appellants were involved with coding and developing programming for automated FX (foreign exchange) trading. They became members of the LLP appellant, HFFX LLP ("**HFFX**"), with the individual appellant, Alexander Gerko, as managing member. The LLP went on to deploy the automated trading to make significant profits. A proportion of profits was paid to the members upfront, the remainder was deferred using the CAP, pursuant to which, profits were allocated to a corporate member of the LLP who then had discretion to reallocate sums ("**Special Capital**") over the subsequent three-year period to the individual members (the individual appellants), taking account of Mr Gerko's recommendations.

2. According to the appellants, the tax consequences are that the individual is only taxed on the share allocated to them directly (instead of on a share of the partnership's profits which HMRC maintain represents their total reward). The share allocated to the corporate member is taxed at the lower corporation tax rates. When the Special Capital is transferred from the corporate member to the individual it is contended there is no income tax charge because it was a transfer of a capital asset.[1]

3. HMRC's case is that a charge to tax arises either on division of HFFX's profits under s850 Income Tax (Trading and Other Income) Act 2005 ("**ITTOIA 2005**") on the basis the individual members, not the corporate member, had the relevant and ultimate rights to share in the profits initially paid to the corporate member or, on receipt of distributions from the corporate member as miscellaneous income under s687 ITTOIA 2005, or else under the "sale of occupation income provisions" under s776 Income Tax Act 2007 ("**ITA 2007**")**.**

4. The FTT rejected HMRC's argument that the individuals were allocated the profits for the purposes of s850 ITTOIA when the profits were divided. The FTT also rejected HMRC's case that the allocations must be treated as made to the individual members by reason of the members acquiescing to profits (that would otherwise have gone to them) being allocated to the corporate member applying the reasoning and conclusions of the Supreme Court in *RFC 2012 plc (formerly the Rangers Football Club) v Advocate General for Scotland* [2017] 1 WLR 2767 and of the Privy Council in *Hadlee v CIR* [1993] STC 294. HMRC appeals those conclusions **(Issue 1- the s850 issue)**.

5. The FTT accepted HMRC's alternative argument that the income from the corporate member, was taxable as miscellaneous income under s687 ITA 2007, or else as sale of occupation income under s776 ITTOIA. The individual appellants appeal those decisions **(Issue 2a – the miscellaneous income issue** and **Issue 2b – the sale of occupation income issue)**.

6. The appeals to the FTT took the form of appeals against a number of closure notices / discovery assessments /discovery amendment. The global amount of tax at stake is approximately £22.5 million. A further issue before us concerns one of the discovery assessments made in respect of Mr Gerko (for 2012/13) where he argues the FTT was wrong to consider the discovery assessment valid because HMRC had not discharged the burden of showing a discovery had been made (**Issue 3 – the discovery assessment issue**).

[1] And no CGT liability (for the reasons explained in Statement of Practice D12) because it was a transfer in the share of the assets of a partnership.

7. The appellants' final ground of appeal is that the FTT wrongly rejected the appellants' application, under Rule 14 of the FTT Rules to redact commercially sensitive figures from the decision **(Issue 4 – the redaction issue).**

Background

8. The individual appellants are all members of HFFX LLP, a member of the investment management firm GSA Capital Partners LLP ("**GSACP**") which operated an investment management business ("**GSA**"). The individual members comprised a team who together researched and formulated high frequency foreign exchange trading strategies and they implemented those through the means of automatic-trading software. Mr Gerko led the team and was HFFX's "managing member". HFFX also had two corporate members. The first was the corporate member to which profits were allocated (as set out in the introduction above): GSA Member Ltd ("**GSAM**"), (this was referred to in HFFX's LLP Deed as the "Retention Member"). The second was GSA Capital Services Ltd ("**GSACS**") which was also the managing member of GSACP.

9. The individual members were, in addition to other remuneration, entitled to a share of GSACP profits calculated as a percentage of the profits generated by the "HFFX Trade Group" business conducted by GSA. The individuals could also benefit from deferred remuneration arrangements. The particular arrangement we are concerned with was known as the "Capital Allocation Plan" ("CAP"). (The other arrangement which warrants mention, because it is referred to in Mr Gerko's evidence and in the FTT's findings, involved the purchase of "Restricted Fund Shares"; in the end that was only relevant to US citizen members, in relation to whom the CAP arrangement would have resulted in adverse US tax consequences).

10. The steps in the CAP in outline were as follows:

> (1) Mr Gerko calculated a "Pre-Retention Amount" for each individual member of HFFX. In essence, this was an amount that Mr Gerko would have allocated to the member if there had been no deferral scheme.
>
> (2) Mr Gerko was required to allocate to GSAM at least 30% of Pre-Retention amount (Clause 10.3(D) of the LLP Deed). In practice the first £100,000 of each member's profit allocation was made in cash and 50% of the rest was deferred.
>
> (3) Mr Gerko was empowered (with GSACS's consent) to make recommendations to GSAM in prescribed form as to investment of profits paid to it, the contribution of proceeds of such investments to HFFX as Special Capital, and reallocation of Special Capital to other members.
>
> (4) Mr Gerko duly made recommendations. Those reflected the proportions deferred for the various individual members participating in the CAP.
>
> (5) GSAM duly invested profits paid to it and contributed sums as Special Capital. It then reallocated Special Capital to individual members.
>
> (6) Upon reallocation members could withdraw Special Capital. They argue no income tax was payable by them on withdrawal.

11. We refer below in more detail to the drafting of the LLP Deed and other documents, and to other facts the FTT found regarding the appellants' activities and appellants' purposes for entering into the transactions, when addressing the relevant grounds of appeal.

BlueCrest

12. In the course of the hearing, we drew to the parties' attention that another Upper Tribunal panel, who had heard an appeal in May 2022 on similar deferred remuneration arrangements, and in which the same points of law arose for consideration, would be likely to issue its decision before ours.

13. That decision, *BlueCrest Capital Management LP and others v HMRC* [2022] UKUT 00200 (TCC) was issued on 22 July 2022. Pursuant to agreed directions, the parties each provided written submissions in relation to the relevance of *BlueCrest* which culminated with the appellants' reply submissions filed on 30 September 2022.

14. The facts (see [2]) in *BlueCrest* concerned a similar deferral mechanism (the Partner Incentivisation Plan "**PIP**") in respect of partners in various entities (the "**Partnership**") operated by the BlueCrest alternative asset management business. A corporate partner was introduced to facilitate the PIP. The corporate partner was entitled to be considered for discretionary allocation of the profits of the Partnership, which if made, the corporate partner was then entitled to withdraw and use to acquire Special Capital which could then be used in acquiring investments in BlueCrest managed funds. The corporate partner awards of Special Capital to individual partners were based on recommendations made by a special committee of the Partnership and conditional on the partner having met certain conditions (if they had not then the corporate partner was entitled to forfeit the partner's PIP award). The Upper Tribunal in *BlueCrest* rejected HMRC's argument that the share allocated to the corporate partner could be treated as an allocation to the individual partner and also HMRC's case that the reasoning in *Rangers* and *Hadlee* could be applied so as to treat the allocations notionally made to the corporate partner as made to the individuals. (These arguments mirrored the arguments HMRC made to us under Issue 1 – see further below.)

15. As regards the precedential status of Upper Tribunal decisions the position is that while we are not bound as a matter of precedent (*HMRC v Raftopoulou* [2018] EWCA Civ 818 at [24]), this tribunal will normally follow an earlier decision of the tribunal, as a court of co-ordinate jurisdiction, unless satisfied that the Upper Tribunal decision was wrong. This was explained by the Upper Tribunal in *Leeds City Council v HMRC* [2014] UKUT 0350 (TCC) at [12].

16. Neither party seeks to persuade us we should depart from the points of law set out in *BlueCrest* although, as will be seen, there is disagreement on precisely what points of law should be taken from it and whether, according to the appellants, the facts in some crucial respects are materially the same.[2]

17. The appellants submit we should follow *BlueCrest* on that tribunal's interpretation of "profit-sharing arrangements" in s850 ITTOIA 2005. HMRC accepts that if we accept *BlueCrest* is right their appeal (Issue 1) must be dismissed. They reserve however the right to seek permission to appeal to the Court of Appeal on the issue and to contend there that *BlueCrest* is wrong.

18. Issue 1 (HMRC's cross appeal) thus falls away. It is relevant to note however that the Upper Tribunal in *BlueCrest* identified an error in the FTT's approach to statutory interpretation although it did not in the end affect the outcome there. We consider we need to briefly outline the implications of the legal analysis in *BlueCrest* as to a purposive interpretation of s850 ITTOIA to check whether it calls into question the FTT's reasoning in this case.

[2] The parties put this in terms of departing from *BlueCrest* on points of law if we are "convinced" that it is wrong by reference to *Gilchrist v HMRC* [2015] Ch 183 (that concerned the precedential effect of High Court decisions). We do not understand either party to be inviting us, to the extent there is any difference between being "convinced" a decision is wrong or being "satisfied" it is wrong, to be satisfied that the Upper Tribunal's decision was wrong.

19. The Upper Tribunal in *BlueCrest* identified that the FTT in that case fell into error in adopting the Court of Appeal's approach in a case concerning statutory interpretation (subsequently rejected on appeal to the Supreme Court in *Rossendale BC v Hurstwood Properties (A) Ltd* [2021] 2 WLR 1125) by construing the phrase "the rights of the partners to share in the profits of the trade" narrowly and by reference only to the contractual rights conferred on the partners under the partnership deed whereas a broader inquiry was required ([64]).

20. In *BlueCrest*, the Upper Tribunal considered the rights under the PIP could not be treated as rights to share in the profits of the Partnership because: 1) the PIP was intended to solve a business issue [267 FTT *BlueCrest*[3]] and moreover s850 was simply about allocation, so the fact the corporate partner made no commercial or business contribution to profits was of no consequence; 2) there was no suggestion the relationship between the corporate partner and the others was a sham or that it held sums in a trust or fiduciary capacity: until it exercised its discretion to make a final PIP award the partner did not have a right or entitlement to it; 3) not all of the amounts allocated as profit share were used to fund an individual partner award - for instance if eligibility conditions were not met.

21. The Upper Tribunal explained (at [79]):

> "We consider that to bring the PIP within the profit-sharing arrangements of the Partnership would go beyond those limits in the present case. It would be necessary to fix the taxpayer, in this case the Partnership, with a contract to which its members did not agree. In our view, the correct contractual analysis is that the individual partner has no right to share in the profits of the Partnership at the time when allocations were made to the Corporate Partner and that the terms of the Partnership Deed which allocated those profits to the Corporate Partner must be respected. It is also our view that the contractual effect of the PIP and the way in which it was operated in practice do not change that position. When profits were allocated between the partners under the Partnership Deed, each individual partner had a legitimate expectation that his or her provisional PIP Award would be made final unless they failed to meet the eligibility conditions. Individual partners only had a right or entitlement to receive their PIP Awards once they were entitled to withdraw the Special Capital. Even adopting a purposive construction of section 850 of ITTOIA 2005, the PIP did not form part of the profit-sharing arrangements of the Partnership. We therefore dismiss Ground 1 of the PIP Appeals."

22. In the present case, the FTT rejected HMRC's argument that the profit-sharing arrangements of HFFX entitled the individual members to the amounts allocated to GSAM and held that s850 did not operate to include those amounts in the members' partnership profit shares ([146]). It also rejected HMRC's arguments on the applicability of *Rangers* and *Hadlee*. It does not appear HMRC ran a *Ramsay* argument along the lines it did in *BlueCrest*. The FTT did not therefore address that. It is clear in any case that the FTT did not err in looking purely at the partnership deed (see for instance in [140] the reference to LLP Deed or the "surrounding circumstances"). We consider therefore that the Upper Tribunal's statutory interpretation of s850 in *BlueCrest* does not indicate there is a similar error in the FTT's decision on Issue 1.

Grounds of appeal of HFFX and the individual appellants:

23. Having disposed of HMRC's appeal, we turn now to the remaining issues: the appeal made by HFFX and the individual member appellants.

[3] [2020] UKFTT 0298 (TC)

Issue 2 a) Miscellaneous income issue – s687 residual income

Law

24. Section 687(1) ITTOIA provides:

> "(1) Income tax is charged under this Chapter on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act."

25. The Upper Tribunal in *BlueCrest* provided helpful background to this provision, which included a summary of the principles established by another Upper Tribunal decision, *Kerrison v HMRC* [2019] UKUT 8 (TCC), as follows ([109]):

> "Before ITTOIA 2005 came into force, a residual charge to income tax arose under Schedule D Case VI on any annual profits or gains not falling under any other Case of Schedule D and not charged to tax under Schedules A, E and F. This residual charge to income tax is now found in section 687(1) of ITTOIA 2005 which was enacted as part of HMRC's Tax Law Rewrite Project. It is common ground that section 687(1) was intended to have the same scope as the earlier legislation and that the authorities relating to Schedule D Case VI (which go back many years) remain relevant to its interpretation. The principles to be derived from those earlier authorities were summarised in *Kerrison v HMRC* [2019] 4 WLR 8 at [68] where the Upper Tribunal stated that the receipt must meet the following requirements:
>
> (1) The receipts must have the nature of "annual profits". But that simply means that they must be capable of being "calculated in any one year". It does not mean that the income must recur every year.
>
> (2) The receipts must be of an income nature.
>
> (3) They must be analogous to some other head of charge under what was previously Schedule D. This is the *eiusdem generis* principle.
>
> (4) They must be the recipient's income.
>
> (5) They must involve a sufficient link between the source and the recipient."

Summary of parties' submissions and what the FTT decided

26. In *BlueCrest* the appellants' appeal engaged principles (2) (3) and (5) above. The Upper Tribunal there upheld the FTT's decision in HMRC's favour in relation to each.

27. In this appeal, the main area of dispute centres on principle (5) above – whether there was a sufficient link. In particular, the dispute is over what is meant by "a legal obligation to make the payment".

28. The FTT decided a source existed because, even if the members had no right to require reallocation "…any reallocation that [took] place [did] so in accordance with the provisions of the LLP Deed and by virtue of those rights. There [was] therefore a relevant relationship between the reallocation and the individual members' rights under the LLP Deed such that there is a source for the purposes of s687." ([169]). The FTT also considered the activities of the individual members, finding that the payments were made to reward them for their performance and to incentivise particular behaviour and that there was connection between those activities and the subsequent reallocation of Special Capital ([170] & [171]).

29. The FTT thus held a source existed for two reasons. The appellants challenge both these findings. We deal with them in turn but in essence the appellants' core argument is that, for both, there needs

to be a legal obligation on the payor to pay. As that was lacking in this case, it is argued the FTT was wrong to find that the requirement that there be a sufficient link between the source and payment was satisfied.

30. The Upper Tribunal in *BlueCrest* identified (at [124]) that an earlier Upper Tribunal case, *Spritebeam v HMRC* [2015] UKUT 75 (TCC), which we will look at in more detail below, stood for two propositions:

> (1) "the source of a particular payment may be a decision taken by a party on whom a discretion has been conferred by trust or contract"
>
> (2) "the required connection between the taxpayer and the source need not be limited to legal rights provided that there is a legal obligation to make the payment" (emphasis added).

31. The appellants submit we should follow *BlueCrest* in respect of the propositions above. The effect is that there must be a sufficient link between the source and the recipient. In the absence of a legal right to receive the payment, the connection must consist of a legal obligation to make the payment.

32. HMRC argue, by reference to the context of *BlueCrest*, that the concept of a legal obligation to make payment includes the effectively broader set of situations where payment is made pursuant to a legal obligation. In their submission, the key principle is not about whether someone can sue to enforce the payment but that the payor acts according to legal duties and not freely. This is so as to distinguish for instance payments by trustees on the one hand from gifts on the other. In stark contrast, the appellants argue *BlueCrest* is authority for the proposition that a legal obligation to act rationally in considering whether to make payment is not sufficient. Both parties therefore rely on *BlueCrest* but in diametrically opposed ways: the appellants to say their appeal should be upheld, HMRC to say the appeal should be dismissed.

Discussion

33. It is clear from [124] of *BlueCrest* (see at [30] above) that the Upper Tribunal in *BlueCrest* was not seeking to modify or depart from the propositions it extracted from *Spritebeam*. The key proposition of law under dispute is therefore not a new one established by the Upper Tribunal in *BlueCrest* but one derived from *Spritebeam.* The answer to the dispute between the parties thus concerns the meaning of the proposition regarding "legal obligation to pay" as understood in *Spritebeam.* It is to that decision we now turn.

34. As helpfully summarised in *BlueCrest UT* ([122]) *Spritebeam* concerned:

> "… a tax avoidance scheme which was intended to avoid tax credits arising under a loan relationship. Company A lent money to Company B but instead of Company B paying interest to Company A, Company B issued irredeemable preference shares equal in value to a commercial rate of interest on the loan to Company C."

35. The principal issue, as *BlueCrest UT* identified, was whether Company C's receipts were taxable at all given it had no enforceable right to receive payment under the loan arrangements. The Upper Tribunal in *Spritebeam* disagreed this was necessary.

36. The tribunal's review of the case-law in *Spritebeam* included *Cunard's Trustees v IRC* [1946] 1 All ER 159 (which concerned a power under the terms of a will to supplement income with capital to ensure the comfort and maintenance of the beneficiary). With regards to Lord Greene's statement there (cited in [66] of *Spritebeam*) that title to the income arose when the trustees exercise their

discretion in the beneficiary's favour and not before, the Upper Tribunal acknowledged, in the appellant's favour (the appellant was represented by Mr Prosser) that the passage:

> [67] At first blush…. supports Mr Prosser's requirement that the taxpayer must have an enforceable right to the property"

37. At [67], the Upper Tribunal noted however that Lord Greene went on to say:

> 'It was suggested, however, that [the Rule] does not extend to mere voluntary payments. But the payments here were not voluntary in any relevant sense; they were made in the exercise of a discretion conferred by the will out of a fund provided for the purpose by the testatrix. It is true that the trustees had an absolute discretion whether to make a payment or not; but the question whether they should do so is one which they were bound to take into their consideration. They could not refuse to consider whether the income of the estate was sufficient to give [the beneficiary] the required degree of comfort. The fact that, after examining that matter, they might come to the conclusion that it was sufficient … does not, in my opinion, give to a payment, if and when made, the character of a voluntary payment in any relevant sense.'

38. Later at [82], the Upper Tribunal referred back to this paragraph holding that:

> "Although, in *Cunard's Trustees* [1946] 1 All ER 159, 27 TC 122, the court was addressing the question whether the payments were or were not voluntary, what Lord Greene said (see para [67] above) was equally relevant to the question whether there was a connection between the recipient and a source."

39. Regarding the significance of the recipient being <u>able to enforce payment,</u> the conclusion the Upper Tribunal drew from the authorities was that [at (68)]:

> "… it is immaterial that the recipient cannot enforce payment; what matters is whether there is an obligation on the payer to pay. Thus in *Stedeford* there was no obligation on the governors to make any payment; they could have refrained at any time from making further payments, and neither the former headmaster nor anyone else could have compelled them to continue. <u>By contrast, in the trustee cases the beneficiaries, individually, could not enforce the payment of any particular sum to themselves; but the trustees were under an enforceable obligation to exercise their discretion and make a payment to one or more of the beneficiaries as circumstances required. In *Drummond*, for example, the payments were not voluntary payments in any relevant sense because the payments were made on the basis of the trustees' duties arising under the testamentary trust. In the present case, the right to payment may not have been enforceable by the Share Recipient but it was not voluntary either;</u> the Borrower was under a contractual duty to the Lender to allot and issue shares to the Share Recipient. Thus we conclude, in relation to issue (ii), that the shares were income in the Share Recipient's hands. (our emphasis added)

40. The Upper Tribunal in *Spritebeam* then went on to deal with the appellant's submission that a source was limited to a kind of property or activity and that <u>that</u> determined the necessary connection. If property, then the taxpayer had to have the legal right to enforce it. The Upper Tribunal rejected that as too narrow preferring the submissions of HMRC (who were represented by Mr Ghosh) as follows:

> [81] Mr Ghosh's argument was that it was the Share Recipient's status as a counterparty to an absolute obligation of the Borrower to pay interest on the Loan (an obligation satisfied by the issue of the shares) that is relevant. The validity of that contention was demonstrated, he said, by a comparison between *Drummond v Collins* [1915] AC 1011, 6 TC 525 and *Stedeford v Beloe* [1932] AC 388, 16 TC 505. In the former, the will

> which permitted the payment to be made also limited the class of persons who would be entitled to any payment made pursuant to it to the named beneficiaries. The beneficiaries therefore, by virtue of that status, were entitled to the payment, had a sufficient connection to the source, and were liable to tax on the income. By contrast, in the latter, the payment was made pursuant to the College statutes, under which only the College was a beneficiary. It could therefore not be said that the former headmaster was entitled to the payment by reference to that instrument. He had no identifiable source of the income beyond the College's generosity, but a voluntary payment of that kind was not taxable.
>
> [82] Here, the source of the Share Recipient's income was the Loan Agreement, in which it was the named beneficiary. It was entitled to receive the shares, by reason of its being so named, even if it did not have the capacity to enforce that entitlement itself: it was in a similar position to that of the beneficiaries in *Drummond v Collins* but not in an analogous position to that of the former headmaster. Although, in *Cunard's Trustees* [1946] 1 All ER 159, 27 TC 122, the court was addressing the question whether the payments were or were not voluntary, what Lord Greene said (see para [67] above) was equally relevant to the question whether there was a connection between the recipient and a source. The source in that case was 'the joint operation of the will and the exercise of their discretion by the trustees.' Once it was accepted (as the taxpayers had done in their skeleton argument) that the shares were derived from the Loan Agreement there was no need to enquire further: the source of the shares was identified, and sufficient.
>
> [83] On this issue we prefer Mr Ghosh's arguments. Although we accept Mr Prosser's argument that the categories of property and activities do demonstrate what constitutes a necessary connection, we are not persuaded that the test for necessary connection is limited to them. In short, Mr Prosser's test under this head is too narrow. It implies that 'possession' is to be equated with ownership, but we do not find anywhere in the authorities to which we were referred any support for the proposition that ownership is required. The beneficiaries in *Drummond v Collins* and *Cunard's Trustees* did not own the fund from which their income was derived, but they were nevertheless found to 'possess' (if that is the right word— as we have said, other terms have been used) a sufficient connection to the source.
>
> [84] We think, rather, that Mr Ghosh is correct to say that the required connection between taxpayer and source need not be limited to legal rights but can include the situation where the payment is made pursuant to any legal duty owed by the payer. That proposition is consistent with what was said by Lord Greene in the passage we have set out at para [67] above, in which the focus was on the payer's obligation to the recipient, and not on the recipient's ability to enforce it.

41. It is thus clear the focus is on the obligation on the payer. But reading the passages in context, although that requirement can be plainly satisfied when there is a contractual obligation on the payor to pay, it is just as plain the concept of an obligation on the payer may be broader. The requirement, as the Upper Tribunal in *Spritebeam* explained, is that "payment is made pursuant to any legal duty owed by the payer". That formulation provided the necessary means, as Mr Chacko submitted, of distinguishing trust payments from gifts. In the case of a contractual discretion, the legal duty referred to could take the form of fetters imposed on the discretion.

42. In the submissions Mr Prosser made in our case, he depicts the fact that a legal obligation on the payor was found in the cases referred to in *Spritebeam* which involved trusts, as arising from the fact that once the trustees exercised discretion that then created an obligation to make the payment which could therefore constitute a source of the income (referring to Lord Wrenbury's explanation in *Drummond* to that effect). However, as Mr Chacko pointed out, that is inconsistent with how the Upper Tribunal in *Spritebeam* viewed both *Drummond* and *Cunard's*. It can be seen from the passages at [67] and [68] of *Spritebeam* where the Upper Tribunal set out what it drew from the

authorities (and having had an argument put to it by Mr Prosser in similar terms regarding an obligation arising at the point a discretion had been exercised) that the Upper Tribunal obviously did not consider that sort of obligation relevant for the purposes of establishing a sufficient connection. Rather the obligation the Upper Tribunal had in mind concerned duties on the trustees that were already in place regarding how the discretion was to be exercised.

43. In his oral submissions, Mr Prosser also sought to explain the excerpt from Lord Greene's judgment dealing with the duties on the trustees to consider their discretion (at [67] of *Spritebeam*) as dealing with a different argument regarding the voluntary nature of the gift, but it is clear the Upper Tribunal in *Spritebeam* accepted HMRC's argument (given by Mr Ghosh) that what was said there was equally relevant to the question of connection (see [82] and [83] of *Spritebeam*).

44. We therefore reject the appellants' argument that *BlueCrest* is authority for discretionary fairness obligations not being sufficient to constitute a legal obligation on the payor (or putting it more accurately a payment made pursuant to a legal duty). On the contrary, in following *Spritebeam*, the proposition of law revealed is that discretionary fairness obligations may be sufficient to constitute the necessary legal obligation on the payor.

45. That is the point of law which we take away from *BlueCrest*. The fact that in *Spritebeam* there was in fact a contractual obligation does not detract from the breadth of the proposition *Spritebeam* extracted from the authorities. Similarly, the fact that in *BlueCrest* the Upper Tribunal considered there was a contractual obligation on the corporate partner to pay does not restrict the broader formulation of the point of law which it took from *Spritebeam*.

46. The fact that discretionary fairness obligations on the payor may be sufficient to distinguish s687 ITTOIA miscellaneous income cases from voluntary payments also disposes of the appellants' submission that their facts are indistinguishable from those in *Stedeford v Beloe* [1932] AC 388 (summarised in the extract from *Spritebeam* at [81], cited above). In *Stedeford* the governing body of a college granted a pension to a retired headmaster in circumstances where the headmaster was not a beneficiary and the college was not under any legal duty to consider a payment in his favour. The pension was not subject to the miscellaneous income charge. In contrast, if it is correct that there was a duty fairly to consider the appellants when GSAM decided to reallocate Special Capital (which is the next issue in dispute) then the payor, GSAM, did make the payment pursuant to a legal duty in the requisite sense.

47. The appellants argue there are very many material differences between the facts of *BlueCrest* and their case: (1) There was, on the facts of this case, no *de facto* expectation of the members receiving a CAP award, as there was in *BlueCrest* – here the members were never told or had any understanding that amounts would always be paid; there was the potential for multiple recommendations from more than one party who had more than one objective in mind. (2) The manner of operation of the CAP was different, for instance the recommendation process was informal and ultimately at the discretion of Mr Gerko, and with no clearly defined eligibility criteria. (3) The ultimate control GSA had over deferred remuneration meant there was no "automatic" award: GSACS had power to prevent reallocation by GSAM up to specified amounts, and GSACS's consent was required before Mr Gerko could make his recommendations to GSAM. There was no analogue to GSA/GSACP's role in *BlueCrest.* (4) Whereas in *BlueCrest* the corporate partner had no function other than to distribute Special Capital, it was intended that the corporate partner here, GSAM, could prefer the wishes of GSA and ignore any recommendations from Mr Gerko since under the purpose trust which held GSAM it was required to consider the interests of both GSA and HFFX. The risk of not receiving amounts was (and was always understood) to be genuine for HFFX members. In practice Special Capital was available to meet fines or other losses and costs regardless of the views of HFFX

members. It was impossible therefore to argue, so the appellants submit, that GSAM was under a legal obligation to pay the appellants unless forfeiture applied.

48. HMRC's position is that these points all amount to accepting (as the FTT did) that there was no guarantee the amounts initially recommended for individual members under the CAP would inevitably be reallocated to them, even if they did meet the relevant conditions to avoid forfeiture. HMRC do not dispute this but argue it does not undermine their case that there was a sufficient connection between the exercise of GSAM's discretion and the payments. The appellants also argue that a key distinction in the facts was that GSA was among the interested members. We would put this point in the same category as the other points the appellants make concerning the lack of certainty of payment from the individual appellant members' point of view.

49. For the reasons already discussed, we agree with HMRC that the factual differences are not material. It is the points of law from *BlueCrest* which we are to apply, and as explained above, we consider *BlueCrest's* recourse to *Spritebeam* draws out that it is sufficient that there is a legal obligation to exercise a discretion and a payment following that exercise. Any differences in lack of certainty would not detract from the payments in question being ones which were paid pursuant to a legal duty on the payor as elucidated by *Spritebeam* and its consideration of the relevant authorities.

50. Similarly, the appellants' argument that as GSAM was at no point under a legal obligation to reallocate Special Capital to the appellants, relying on there being a distinction between a decision to reallocate on the one hand (which they say gave rise to no legal right to a payment) and reallocation itself (which was what had legal effect), does not advance their case. The argument assumes the payor must be obliged to pay the amount to the recipient whereas what is relevant is whether the payment is made pursuant to a legal duty on the payor.

51. As we come on to below, the appellants' case is that there was no contractual right to a proper exercise of GSAM's discretion. Subject to a conclusion in the appellants' favour on that, we conclude that there was no error in the FTT being satisfied that the members' right to reallocation in accordance with the LLP Deed, once a discretion was exercised in their favour, could constitute a source and moreover that there was a sufficient link between the source and payment.

52. In reaching that conclusion, we do not need to rely on various of the other points HMRC raised which lacked merit for the reasons the appellants advanced:

> (1) HMRC place significance on the nuanced way the Upper Tribunal described the contractual obligation in *BlueCrest* (that there was a contractual obligation to give effect to members' expectations "in most cases" (at [72]) or "generally" (at [73]) arguing there was no suggestion that no tax arose in that minority of cases where there was no such obligation (consistent with the obligation being that of exercising a discretion and paying accordingly). We agree with the appellants that all those passages seek to reflect is that there were a minority of situations where, because of non-compliance with eligibility criteria or other reasons, members did not receive a payment (and accordingly no issue as receipt of miscellaneous income arose in the first place).
>
> (2) HMRC point to the appellants' reliance on the similarity of the appellants' facts with *BlueCrest* when running an argument before the FTT that there was a discovery for the purpose of a "staleness" of discovery assessment (no longer pursued in the light of the Supreme Court's decision in *HMRC v Tooth [2021] UKSC 17*). We agree with the appellants that is of no significance in circumstances where the FTT has, since that submission, made full findings of fact, both in *BlueCrest* and in the current appeal to which

recourse should be made, to the extent any comparison is required. The appellants are not constrained in arguing their facts are different, although for the reasons we have already discussed those differences do not undermine the significance of the point of law we take from *BlueCrest*.

Was there the requisite legal obligation in the circumstances of this case: issue of whether LLP deed conferred discretion, and if so whether subject to fair exercise implied term (under Supreme Court's decision in *Braganza* and related authorities)?

53. The appellants' position is that even if HMRC are correct that there is not a requirement for an enforceable legal obligation on the payor to pay the sum, and that it is sufficient that there is a legal obligation to exercise a discretion and a payment following that exercise (as we have concluded from the discussion above), then the FTT's conclusion is still wrong. This is because there is no further relevant obligation to be implied on the facts here: in the appellants' submission GSAM's absolute discretion was not a contractual one conferred by the LLP Deed (the deed simply recognised the discretion) and in any case the implied obligation would be inconsistent with the terms of the LLP Deed and the purposes of the CAP.

54. HMRC's support for the FTT's decision is based on GSAM's discretion whether to reallocate Special Capital being subject, in line with case-law principles (based on the Supreme Court's decision in *Braganza* and the authorities referred to there and which we refer to by way of shorthand, as the parties' submissions did, as the *Braganza* principle / *Braganza* obligation), to an implied term that it would exercise its discretion in good faith, rationally and for the purposes it had been given that discretion.

55. Before coming on to discuss those authorities on the terms to be implied into a contractual discretion it is helpful first to address the appellants' argument that there was no contractual discretion conferred by the LLP Deed, merely a recognition of GSAM's absolute discretion. It is convenient therefore at this point to set out the relevant wording in the LLP Deed in relation to reallocation of Special Capital, a helpful summary of which was provided in the appellants' skeleton which we have adopted with some minor modifications.

56. Clause 11.9 made provision in relation to "Special Capital". In particular, clause 11.9(A) provided that contributions of Special Capital:

> "shall be credited…to the relevant Member's Special Capital Account" and "Subject as hereinafter provided, the monies standing to the credit of a Special Capital Account…shall be held exclusively for the benefit of the relevant Member…and no other Member shall have any interest in such monies….save as specifically provided for in this Agreement or as agreed in writing with the relevant Member".

57. Clause 11.9(C) provided that any Member (this would include GSAM) who for the time being had Special Capital credited to his Special Capital Account:

> "may, in his sole and absolute discretion, decide that all or part of the interest of such Member in any Special Capital…should be reallocated to any other Member or Members…so that such other Member or Members will, following such reallocation, become beneficially entitled to the relevant part of such Special Capital" (appellants' emphasis added).

58. Clause 11.9(C) also provided, in relation to profits allocated to GSAM under clause 10.3(D):

> "Within 30 days of the making of an allocation of profit to [GSAM] under clause 10.3(D), the Managing Member may, with the prior consent of [GSACS], make recommendations in writing to [GSAM] in the form set out at Schedule 6 as to the investment of such profit (after meeting tax and other liabilities) in shares in the Funds, the contribution of the proceeds of such shares into the Partnership as Special Capital and the reallocation of such Special Capital to other Members. Following the making of such recommendations, the Managing Member may notify each Member of the fact that a recommendation has been made in respect of them in the form set out at Schedule 7. The Managing Member may make further or alternative recommendations to [GSAM] from time to time with the prior consent of [GSACS]. For the avoidance of doubt, [GSAM] shall be under no obligation to follow the recommendations of the Managing Member and shall have absolute discretion as to how it applies any profit allocations it receives from the Partnership." (appellants' emphasis added)."

59. Clause 11.9(D) provided that any Member who had any Special Capital credited to his Special Capital Account could, on giving 14 days' written notice to the Managing Member, withdraw all or part of such Special Capital. GSAM's above rights to reallocate and withdraw Special Capital were expressed to be subject to clause 11.9(B), which provided that, at any time prior to the reallocation under clause 11.9(C) of any Special Capital contributed by GSAM under clause 11.9(A), GSACS could determine in its discretion, acting in good faith, that GSAM could not, without GSACS's consent, withdraw or reallocate to any Member (other than GSACS) such Special Capital, or any part of it, up to the amount of certain liabilities incurred or likely to be incurred as a result of a breach of duty by a member of the HFFX Trader Group.

60. The appellants argue the words "may in his sole and absolute discretion, decide" in clause 11.9(C) did not confer a contractual discretion to which the *Braganza* principle applied: instead it merely recognised Members' legal power to assign their right over capital, the exercise of which was restricted in certain limited respects, namely by the requirement of consent in certain circumstances (clause 11.9(B)), the requirement that the Special Capital be held for at least 1 month (clause 11.9(C)) and the requirement that notice be given to the managing member (clause 11.9(C)).

61. HMRC submit the appellants are wrong to depict the provision as recognising the members' power to assign their rights over capital. It was clearly a discretion intended for the operation for the CAP. Under 11.9(C) whenever profit share was allocated to GSAM, Mr Gerko was empowered to make recommendations regarding the reallocation of capital and to notify members of that fact in the specified form.

62. We agree with HMRC that the clause clearly does confer a discretion rather than simply recognise one that already existed. This is evident from the drafting. The member only has a right to capital by virtue of the provisions in the LLP Deed. Clause 11, when setting out a member's beneficial entitlement, flags at 11.9(A) that that beneficial entitlement is subject to other provisions in the agreement which include the provisions setting out the nature of the members' discretion to reallocate and how that is circumscribed. The discretion appears in operative provisions of the LLP Deed rather than in recitals and is not prefaced with words such as "for the avoidance of doubt" which are used elsewhere in the document which one would expect if the LLP Deed provision in 11.9(C) was simply recognising what was already the case. It is also consistent with the approach the Court of Appeal took in *Horkulak* which we discuss below (see extract at [67]).

Braganza implied terms – Case law:

63. In *Braganza v BP Shipping Ltd and another* [2015] UKSC 17 the Supreme Court considered the situation where one party to a contract had power to exercise a discretion, or as in that case, to form

an opinion as to the relevant facts. The Court considered the principles surrounding whether terms should be implied regarding the manner of exercise of the fact-finding, and if terms were to be implied, the content of those. As to when such terms are to be implied Baroness Hale explained (at [18]):

> "Contractual terms in which one party to the contract is given the power to exercise a discretion, or to form an opinion as to relevant facts, are extremely common. It is not for the courts to rewrite the parties' bargain for them, still less to substitute themselves for the contractually agreed decision-maker. Nevertheless, the party who is charged with making decisions which affect the rights of both parties to the contract has a clear conflict of interest. That conflict is heightened where there is a significant imbalance of power between the contracting parties as there often will be in an employment contract. The courts have therefore sought to ensure that such contractual powers are not abused. They have done so by implying a term as to the manner in which such powers may be exercised, a term which may vary according to the terms of the contract and the context in which the decision-making power is given."

64. Regarding the content of the terms and the extent to which contractual implied terms should reflect judicial review principles, Baroness Hale said (at [30]) after surveying the authorities:

> "It is clear, however, that unless the court can imply a term that the outcome be objectively reasonable for example, a reasonable price or a reasonable term, the court will only imply a term that the decision-making process be lawful and rational in the public law sense, that the decision is made rationally (as well as in good faith) and consistently with its contractual purpose."

65. She continued at [31]:

> "But whatever term may be implied will depend on the terms and the context of the particular contract involved."

66. Mr Chacko submits the way in which these principles have been applied by the courts in the cases of discretionary bonuses is of particular relevance given the remuneration context to the CAP.

67. *Horkulak v Cantor Fitzgerald International* [2004] EWCA Civ 1287 was one such case. There the Court of Appeal upheld the trial judge implying a term that the employer's discretion was to be exercised properly. The clause under which an amount of discretionary bonus was payable was "… in the sole discretion of president of Cantor Fitzgerald Ltd Partnership" and there was also discretion from use of the word "may" as to the obligation to pay the bonus at all ([30]). HMRC also point out that the Court noted "the objective purpose of the bonus clause on the evidence….was plainly to motivate and reward the employee…and that the bonus was to be paid in anticipation of future loyalty": Potter LJ, who gave the court's judgment continued (at 46])

> "In such a case, as it seems to me, the provision is necessarily to be read as intended to have some contractual content, i.e. it is to be read as a contractual benefit to the employee, as opposed to being a mere declaration of the employer's right to pay a bonus if he wishes, a right which he enjoys regardless of contract."

68. In Mr Chacko's submission there was moreover no difficulty with applying the above approach of implying terms regarding the exercise of contractual discretion to contractual discretions outside the context of employment contracts. HMRC referred to the High Court's decision in *Tribe v Elborne Mitchell LLP* [2021] EWHC 1863 (Ch). There the claimant, a former partner in the law firm LLP disputed his profit share. The High Court agreed the contractual provision whereby profit was allocated by ordinary resolution on recommendations to be brought forward by the senior partner "to

be determined at [the senior partner's] discretion" was subject to the approach in *Braganza* albeit the court did not accept the standard of decision making was as rigorous as the claimant submitted. Similarly in *Reinhard v Ondra* [2015] EWHC 26 (Ch), where the claimant sought damages for underpayment of a discretionary bonus from a financial advice LLP the court applied the principles regarding the exercise of discretion set out *Horkulak*.

Application to context of LLPs?

69. Mr Prosser pointed out those decisions were not authority for terms being applied to LLPs as the position in those cases was agreed by the parties. That is certainly correct in relation to *Tribe* (see [76]). Although in *Reinhard* it was certainly common ground that the bonus provision was discretionary it is not so clear the application of the principles was common ground too. But in any case, the point does not advance the appellants' case because it is clear that the principles, as explained in *Braganza*, may operate more broadly so as to apply in the LLP context, without having to rely on *Tribe* and *Reinhard.*

70. In our view, it is plain that the factors expressed by the Supreme Court in *Braganza v BP Shipping Ltd and another* [2015] UKSC 17 to justify implication of terms regarding a discretion, (namely that the decision would affect the rights and obligations of both parties and that there was a conflict of interest) may operate in all sorts of contractual contexts. It is therefore not surprising that the application of the principles formed common ground in *Tribe.* We also note that a leading textbook on LLPs (Whittaker & Machell on The Law of Limited Liability Partnerships 5th Ed., 2021) states at 17.28 in relation to the situation "where parties agreed that one or more of them should have particular decision-making powers, which once exercised are binding on all the parties" and footnoting *Braganza* that:

> "…subject to any contrary indications in the relevant document, the law readily imposes an obligation that the power must be exercised in good faith. In an LLP context, there will, the authors suggest, generally be implied into the LLP agreement a requirement that a decision-making power must be exercised in good faith…"

71. Further reinforcement for our view that the principle may apply in an LLP context, is provided by the Upper Tribunal's decision in *BlueCrest.* There the Upper Tribunal implied a *Braganza* obligation into the Limited Liability Partnership Agreement at ([72(5)]) (that was the document the UT referred to as the "Partnership Deed"- see [37])).

Limitations to Braganza: appellants' argument that not applicable where discretion involves binary choice

72. Mr Prosser highlights that there are limits to when a *Braganza* obligation may be implied, which mean that the obligation would not in any event be implied to any discretion that arises on the facts here. He relies, in particular, on the Court of Appeal's decision in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd* [2013] EWCA Civ 200 for the proposition that implication is appropriate where the decision involves a choice between a range of different options, but not where the decision is binary. The context for that case was a contract between a health trust and a service provider. The contract set out rules regarding the Trust's decision to award "service failure points" by the provider and to make deductions from amounts otherwise due to the service

provider. After considering many of the authorities[4] on implication of terms (the majority of which were referred to in the Supreme Court's later decision in *Braganza*) Jackson LJ said at [83]:

> "An important feature of the above line of authorities is that in each case the discretion did not involve a simple decision whether or not to exercise an absolute contractual right. The discretion involved making an assessment or choosing from a range of options, taking into account the interests of both parties. In any contract under which one party is permitted to exercise such a discretion, there is an implied term. The precise formulation of that term has been variously expressed in the authorities. In essence, however, it is that the relevant party will not exercise its discretion in an arbitrary, capricious or irrational manner. Such a term is extremely difficult to exclude, although I would not say it is utterly impossible to do so. Certainly clause 1.1.5 of the conditions in the present case is not effective to exclude such a term, if it is otherwise to be implied."

73. The relevant clause, in relation to which the question of whether it conferred a discretion so as to give rise to such implied term (clause 5.8), needed to be read along-side another document where it was acknowledged there were confusing inconsistencies. Jackson LJ considered there was only one sensible way to read the documents. His description of what the provision did noted the fact there were precise rules for determining how many service failure points the provider incurred and what deductions were due. The exercise was a matter of calculation in which there was only one right answer. While there was a procedure for challenging the calculation, once established as correct, it was provided that the trust "may" award the service failure point or may choose not to do so. Likewise, it could levy deductions or choose not to ([89](iii) –(vi)). Jackson LJ continued at [91]-[92]:

> "The discretion which is entrusted to the Trust in relation to service failure points and deductions in the present case is very different from the discretion which existed in the authorities discussed above. The Trust is a public authority delivering a vital service to vulnerable members of the public. It rightly demands high standards from all those with whom it contracts. There may, of course, be circumstances in which the Trust decides to award less than the full amount of service failure points or to deduct less than it is entitled to deduct from a monthly payment. Nevertheless the Trust could not be criticised if it awards the full number of service failure points or if it makes the full amount of any deduction which it is entitled to make. The discretion conferred by clause 5.8 simply permits the Trust to decide whether or not to exercise an absolute contractual right.
>
> 92. There is no justification for implying into clause 5.8 a term that the Trust will not act in an arbitrary, irrational or capricious manner. If the Trust awards more than the correct number of service failure points or deducts more than the correct amount from any monthly payment, then that is a breach of the express provisions of clause 5.8. There is no need for any implied term to regulate the operation of clause 5.8."

74. By way of further support, Mr Prosser referred to *UBS AG v Rose Capital Ventures Ltd v Ors* [2018] EWHC 3137 (Ch) which concerned whether a term should be implied into a mortgagor's decision under a contract to call in a loan early. Chief Master Marsh, after analysing the authorities which included *Braganza* and *Middlesex* noted (at [49](2)):

[4] *Abu Dhabi National Tanker Co v Product Star Shipping Ltd* [1993] 1 Lloyd's LR 397, *Horkulak v Cantor Fitzgerald International* [2004] EWCA Civ 1287, [2005] ICR 402, *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116.

> "The types of contractual decisions that are amenable to the implication of a *Braganza* term are decisions which affect the rights of both parties to the contract where the decision-maker has a clear conflict of interest. In one sense all decisions made under a contract affect both parties, but it is clear that Baroness Hale had in mind the type of decision where one party is given a role in the on-going performance of the contract; such as where an assessment has to be made. This can be contrasted with a unilateral right given to one party to act in a particular way, such as right to terminate a contract without cause."

75. Mr Prosser submits the relevant options given to GSAM were of the same binary character i.e. should Mr Gerko's recommendation to reallocate be followed or not? Should Special Capital be contributed or not?

76. Mr Chacko acknowledges terms were not implied in *Mid Essex* and *UBS v Rose* but points out the nature of the decision-making in those cases was very different from that here. He disagrees with the proposition that the decision making in this case was binary. We agree. GSAM's discretion did involve choosing between a range of different options: who to make reallocation to, and in what amount. GSAM's decision making role was much more akin (to adopt the point of distinction used in *UBS v Rose*) to one which involved ongoing performance of the contract rather than a unilateral right to act in a particular way.

77. We consider the situation here is distinguishable from the contract in *Mid Essex* where there was no need to imply the term, as Jackson LJ explained (at [92]), because the possibilities for the party acting arbitrarily, irrationally or capriciously (taking account of the system imposed by the contract) would have resulted in a breach of contract anyway. Here, if GSAM's decision was arbitrary, irrational or capricious, there would, without such term being implied, clearly be no breach of the terms of the contract. We come on to the argument immediately below to the effect that, GSAM, as owner of the amounts could do with it what it wanted including, if it wanted, acting arbitrarily, irrationally or capriciously (from the viewpoint of others). The situation in *UBS v Rose* was also distinguishable. We note that the Chief Master did not see a basis for implying a *Braganza* term because mortgage lending had built up its own protections in the form of a duty of good faith (see [55]).

Appellant's argument that no conflict of interest giving rise to Braganza *obligation because member dealing with their own property*

78. Mr Prosser also submits there is need to imply a *Braganza* rationality obligation here because there is no conflict of interest in any relevant sense. Where a member, in this case, GSAM, has withdrawn profits, the withdrawn profits are the member's own property to deal with it as it wishes. A member has no implied obligation as regards its own property. Other members may have views on what the member should do with the property but it makes no sense to talk of that as a conflict of interest which implies a *Braganza* obligation. Mr Prosser submits the function of the last part of clause 11.1(C) "*For the avoidance of doubt*…." is to make clear that (in case there were any doubt because of expectations as to how GSAM might deal with its own property) GSAM is in fact in no different position from any other member as respects its own property.

79. We reject this argument. As Mr Chacko identified, there was the necessary conflict of interest between GSAM and individuals who received reallocations: GSAM's interest lay in making the CAP work whereas that would sometimes mean depriving a member of the deferred amount. The imbalance of power between GSAM and the other individual members was similar to that of the employer in *Horkulak* and the senior partner in *Tribe*. The bonus sums in contention in a discretionary

bonus case such as *Horkulak* were equally the employer's own property yet a *Braganza* rationality obligation was nevertheless implied.

80. Mr Prosser acknowledged that if GSAM did not act in line with the individual members' expectations for reallocation there would be real consequences: dissatisfied members might choose to leave but he submitted that would be of no legal consequence. That is how arrangements which are not legally binding could work in practice – non-fulfilment of expectations could have adverse practical results but that did not turn the expectations into legal rights. We do not consider this depiction of the CAP arrangements stands in the way of implying a *Braganza* obligation. It could equally be said in a banker's discretionary bonus case that there was no need to imply a contractual term – the arrangement could be made to work by the employee walking away if not happy – yet a *Braganza* obligation was still implied.

Implied obligation excluded?

81. The appellants submit that in any case, any implied obligation does not arise or is excluded. If the contract conferred a discretion, it was clear this was in absolute terms: clause 11.9(C) uses the phrase the member "*may, in his sole and absolute discretion*". The drafting makes plain there is no obligation on GSAM to follow recommendations ("*For the avoidance of doubt, [GSAM] shall be under no obligation to follow the recommendations of the Managing Member and shall have absolute discretion as to how it applies any profit allocations it receives from the Partnership*").

82. While it was pointed out in *Mid Essex* that the implied obligation "was extremely difficult to exclude" (at [83] – see [72] above), Jackson LJ acknowledged exclusion was nevertheless possible. Mr Prosser also took us to para 17.32c) in Whittaker & Machell which explains:

> "It is open to the members to agree to exclude or limit the scope of the implied fetter and to agree expressly that the power is capable of being exercised free of any good faith or other restraint."

83. We reject the appellants' argument these features exclude the implication of a *Braganza* obligation. As Mr Chacko pointed out, describing the terms of a discretion as "sole" or "absolute" does not preclude the implication of terms. The discretion in *Horkulak* was a "sole" discretion accorded to the President of Cantor Fitzgerald. Nonetheless a *Braganza* type obligation was still implied.

84. While the discretion under Clause 11.9(C) of a member to reallocate Special Capital was described in terms of the member's "sole and absolute discretion", we do not consider that the use of the combination of both the terms "sole" and "absolute" materially affects the analysis that a *Braganza* obligation could nevertheless still be applied. Indeed, we note the Upper Tribunal in *BlueCrest* accepted a *Braganza* obligation was implied to a term regarding reallocation of the Special Capital there under the Partnership Deed (Clause 7.4(C)) which also referred to reallocation in the member's "sole and absolute" discretion (as explained at [38] and [72(3)] *BlueCrest UT*).

85. That GSAM was stated to be under no obligation to follow the recommendations is not in terms inconsistent with, or prohibitive of, fair consideration of such recommendations. It is, in principle, possible that GSAM could be under an obligation to consider those recommendations fairly but, in the end, decide not to follow them.

86. We conclude there was an implied *Braganza* obligation which was not excluded.

87. The FTT did not make any specific finding in its discussion of s687 regarding the implication of a *Braganza* obligation to a member's discretion to reallocate under clause 11.9(C). At [168] the FTT noted the LLP Deed provided GSAM with "absolute" discretion to reallocate some or all of their Special Capital. It noted reallocation took place in accordance with provisions of the LLP Deed and that by virtue of those rights "there [was] therefore a relevant relationship between the reallocation and the individual members' rights under the LLP Deed such that there [was] a source for the purposes of s687" ([169]).

88. There was some discussion however regarding *Braganza* earlier on in the FTT's decision in the context of HMRC's case that a right to be considered for future distribution was a right to share in profits under s850 ITTOIA. The appellants' submissions suggest the FTT decision was unclear on whether it considered there to be a *Braganza* obligation in relation to GSAM's discretion to reallocate Special Capital to other members under Clause 11.9(C). We note that at [129] the FTT made the point, that a *Braganza* obligation did not preclude GSAM acting otherwise than in line with the recommendations or that members could challenge a decision to distribute an amount out of line with the pre-retention amount calculation. This rather suggests the FTT considered there could be a *Braganza* obligation but its presence would not mean HMRC's s850 based case was right.

89. We consider that in order for the FTT's conclusion regarding sufficient connection for the purposes of s687 to have made sense, there needed to have been an implied *Braganza* obligation regarding the fair exercise of the discretion to reallocate Special Capital. However even if any doubt were resolved in the appellants' favour so as to assume that the FTT drew no conclusion regarding whether a *Braganza* obligation was to be implied we do not think it would make a difference to the appellants' appeal before us. To the extent the FTT considered there was no *Branganza* obligation with respect to reallocation, or it failed to make a finding on the point, then, if the decision were to be set aside for such error of law, and remade then it is clear from what we have said already regarding the context in which such obligations are implied, and that the relevant clause here did not, as suggested, entail a binary choice, that a *Braganza* obligation would be found.

90. This conclusion, which means HMRC's case that there is s687 charge on miscellaneous income is correct, is sufficient to dismiss the appellant's appeal. We will deal with the appellant's remaining arguments in recognition of the fact they were fully argued before us but will do so briefly as the issues are only relevant if we are wrong in our above analysis.

Alternative source of income: members' activities

91. After concluding that there was a relevant relationship between the reallocations and the individual members' rights under the LLP Deed, the FTT set out a further source with a sufficient connection to the payment as follows:

> "170. The background to the CAP should not be overlooked. It was described as a deferred bonus scheme. One of the reasons for the implementation of the CAP was to comply with FSA requirements for deferral of amounts derived by the individuals from their work. It was clear from the evidence, not least the fact that recommendations could be and were altered before reallocations were made, that the payments were made to reward individual members for their performance and to incentivise particular behaviour.
>
> 171. Although these were not allocations of profit, as established above, it is nevertheless clear that there is a connection between the activities of the individual members and the subsequent reallocation of Special Capital."

92. The appellants accept there was a factual connection between the work the individual appellants did and the Special Capital reallocated to them, and the appellants had a *de facto* expectation of receiving payment. They submit however that the FTT erred in law because the relevant case-law on the miscellaneous income charge requires that there be a binding legal obligation to make the payment in return for the activities. That was lacking in this case. The appellants rely on *Manduca v HMRC* [2015] UKUT 262 [34]-[35], *Brocklesby v Merricks* (1934) 18 TC 576 at 582-583 and *Spritebeam* [84] (see above at [40]).

93. The Upper Tribunal in *BlueCrest* helpfully summarised the background facts of *Manduca* as follows:

> "…the taxpayer and a colleague set up a hedge fund. They transferred the fund to a new fund manager and the taxpayer and his colleague became its employees. They entered into a separate bonus agreement under which they were paid a bonus for the transfer of their fund. They were then made redundant and brought a claim against their new employer. They settled the claim on terms that they received compensation for the failure to pay the bonus. An issue arose as to the correct tax treatment of the compensation to be paid under the settlement. It was common ground that the compensation should have the same tax treatment as the bonus. But HMRC also took the view that the payments fell within Case VI of Schedule D whereas the taxpayer contended that the bonus was in the nature of the capital sum subject to capital gains tax"

94. The FTT in *Manduca* rejected the taxpayer's case the sum was capital. Before the Upper Tribunal, the taxpayer sought to raise a new point (in relation to which it was denied permission, which was described as another ground for dismissal of the appeal- see [43]) that the bonus could not fall within the miscellaneous income charge because it was not *ejusdem generis* with the cases in Schedule D (see *Kerrison* principle 3 above at [25]). Rose J (as she then was) rejected that argument finding that *Brocklesby* (which the appellants here also rely on) and another case "show that once it is established that the payment was an income receipt rather than a capital receipt and that it was paid pursuant to a binding contract in return for some kind of service then there is no need to go further to inquire into the extent of the services in fact provided". She also considered it clear that the bonus was to pay for services which were *ejusdem generis* the other cases ([36]).

95. *Brocklesby* concerned a payment made to an architect by a client in relation to disposal of the client's estate. The client had originally bought the estate through the architect introducing the client to the former estate owner. On appeal from the first instance tribunal to the High Court, Finlay J noted the Revenue's argument that the sum was chargeable under Case VI would not work because there was no agreement that the appellant was to receive remuneration for the agreement (pg 582). However, the Case VI assessment was upheld at first instance not on that basis but on the basis the architect had rendered services. Finlay J upheld the assessment on that basis. It did not matter the architect had done very little by way of providing services – he was paid the sum because he had an enforceable right to get it because he had a got a contract in respect of which he was entitled to remuneration.

96. HMRC argue that where, as on the facts here there is a clear quid pro quo, there is no requirement for an enforceable contract. It is enough if in the words of *Manduca* there is income "paid pursuant to a binding contract in return for some kind of service" ([35]). Here, the Special Capital awards were paid pursuant to the LLP Deed (they were paid in the form indicated in Schedule 7 and 11.9(C)- the expected service and reward were also specified). They were also paid as the FTT found at [170] to reward individuals for performance and incentivise particular behaviour.

97. HMRC also submit further support for their argument can be found in *BlueCrest* at [117]

> 117. *Manduca* shows that if a payment is made to an employee as a reward for services it is taxable under Case VI even if it is not paid pursuant to a contract for employment. In the present case the payment was a reward for services. Although we have found that individual partners did not have the right to receive PIP Awards as part of the profit-sharing arrangements of the Partnership, this does not prevent those awards falling within Case VI. The FTT found that the PIP was intended to reward individual partners for their contribution to the success of the Partnership, because of the services they provided and to incentivise them for the future. In our judgment, the FTT was also entitled to find that these services were eiusdem generis with the services listed within the other Cases in Schedule D.

98. The appellants say this extract is of no assistance as it was concerned with the question of whether the payment was capital or revenue, which does not arise in this case. They also refer to [124] of *BlueCrest* (see above [30]) to emphasise the importance of there being a legal obligation to pay for s687 purposes.

99. We see force in HMRC's submission that the authorities the appellants rely on do not establish that a payment for services cannot fall into s687 unless the payment is enforceable as a matter of legal obligation. If there is a legal obligation, as there was in *Brocklesby* and *Manduca* that will clearly be sufficient but neither case rules out the possibility of a payment arising from there being a quid pro quo in relation to provisions of services that does not amount to a legally enforceable obligation. In both *Brocklesby* and *Manduca* the issue which arose was as to the extent and nature of the services provided, not the enforceability of the obligation. We consider that *BlueCrest* [117] supports the proposition a broader view may be taken. What the Upper Tribunal said there was not restricted to the capital/revenue question but was addressing what the Upper Tribunal earlier identified as the "real issue" (see [114]) namely the *ejusdem generis* issue. As for the summary of the propositions from *Spritebeam* in *BlueCrest* [124], that does not assist the appellants for the reasons we have already discussed: read in context, even assuming the requirement in respect of sufficient connection does not vary depending on the nature of the source, then insisting there be an enforceable obligation to pay on the payor wrongly takes too narrow a view.

100. If it became necessary to decide this issue, it is difficult to see why we should not follow the same approach the Upper Tribunal in *BlueCrest* took and agree that the members' activities could provide a source for the payments. In *BlueCrest* the Upper Tribunal found the payment was a reward for services. It did not matter individual partners lacked the right to receive awards. They were paid for services they rendered in terms of work carried out but also in not leaving. The payments were clearly not gratuitous being paid in line with the framework of the LLP agreement and schedules.

101. The appellants also argue that the source was the activities which they carried on in a trade, the income from which was allocated to, and fully taxed in hands of members including GSAM. We agree with HMRC's submission that this analysis is misconceived. The fact the individual partner receives profits as an HFFX partner does not mean that where a third party (in this case GSAM) rewards the partner for continuing to act the reward escapes charge. The individual member's income is being supplemented by another person. That is typically taxable on the recipient as income and the position is no different because the person supplementing the income is a member of the same LLP as the recipient.

Issue 2 b): Sale of Occupation Income

102. HMRC's alternative case is that even if there were no charge under the miscellaneous income provisions, the reallocations of Special Capital were chargeable to tax under Chapter 4 of Part 13 of ITA 2007 (sale of occupation income rules).

103. In brief, the rules provide for a charge to income tax where transactions are effected or arrangements made to exploit the earning capacity of an individual in an occupation, and the main object or one of the main objects of the transactions or arrangements is the avoidance or reduction of liability to income tax, and Conditions A to C are met.

104. Condition A is that the individual carries on an occupation in the UK (where "occupation" is defined in s774 ITA as referring to "activities of a kind undertaken in a profession…"). Condition B is that the transactions/arrangements are made to exploit the individual's earning capacity in the occupation by putting another person in a position to enjoy all or part of the income or receipts derived from the individual's activities in the occupation. Condition C is that as part of, or in connection with or in consequence of, the transactions or arrangements a "capital amount" is obtained by the individual for the individual or another person. (The term "capital amount" is specifically defined to mean "an amount in money or money's worth which does not fall to be included in a calculation of income for purposes of the Tax Acts otherwise than as a result of the Chapter).

105. It is common ground that the establishment and operation of the CAP were "arrangements" for the purposes of these provisions. It is also common ground that Condition C above was met. In relation to Condition B (that the arrangements put GSAM in a position to enjoy income arising from the individual appellants' activities in their alleged occupations), the appellants sought to raise as a new point of law which was not argued before the FTT that this Condition was not satisfied. This was on the basis that when GSAM was allocated the share of profits, this represented its own income, not that of the individual members. Following the Upper Tribunal's decision in *BlueCrest* the appellants acknowledge that the Upper Tribunal's reasoning (at [134]-[136]) (that s777(3) ITA 2007 applied to the allocation of profits to the corporate partner there pursuant to the PIP) would apply equally to the allocation of profits to GSAM pursuant to the CAP. While the appellants consider *BlueCrest's* reasoning on this point to be wrong, they do not pursue the point before us but reserve the right to argue it on appeal. This is on the basis that they consider that, realistically, it will be difficult to convince us the Upper Tribunal in *BlueCrest* was wrong.

106. The focus of the appellants' appeal before us is on two points which we will address in turn:

> (1) Whether Condition A was met; in particular whether the FTT misunderstood the appellants' unchallenged evidence regarding its activities and whether, in concluding the appellants' activities amount to a profession, the FTT made findings which amounted to *Edwards v Bairstow* errors of law.
>
> (2) Whether the FTT erred in law in finding that the main object or one of the main objects of the arrangements was the avoidance or reduction of liability to income tax.

Condition A: occupation issue – were the appellants' activities a "profession"?

107. Section 774 ITA defines "occupation" as follows:

> "In this Chapter references to an occupation, in relation to an individual, are references to any activities of a kind undertaken in a profession or vocation, regardless of whether the individual—
>
> (a) is carrying on a profession or vocation on the individual's own account, or

(b) is an employee or office-holder."

108. The FTT referred to various propositions regarding the interpretation of the term "profession" which the appellants accept accord with the correct test. In particular, the FTT noted from Scrutton LJ's judgment in *CIR v Maxse* (1919) 12 TC 41 that the arrangements for the production or sale of commodities amounted to a trade rather than a profession and the court in *Christopher Barker & Sons v IRC* [1919] 2 KB 222 (at pg228) noted that "the exercise of commercial knowledge in connection with the sale of commodities in the market" is not a profession (FTT [185][186]).

109. However, the appellants argue the FTT wrongly rejected the appellants' submission that by their devising and implementing of models for dealing in foreign exchange instruments, the appellants' activities amounted to making arrangements for, or the exercise of commercial knowledge in, the buying and selling of commodities. The FTT reasoning for that (at [212]), was:

> "It was clear from the evidence of the individual members that their activities in respect of HFFX were the design and development of software-based trading strategies. Their titles (whilst not conclusive) support this: the team consisted [sc.] of researchers and developers, not commodity traders or market advisers. They had none of the infrastructure required for such buying and selling. The evidence provided was that all of the infrastructure and functions relating to the foreign exchange transactions was provided by GSA and that trading in foreign exchange financial instruments was undertaken by GSA."

110. The appellants make a number of criticisms of the reasoning. It is submitted the FTT erred as follows:

(1) In basing its conclusion on the activities being "the design and development of software-based strategies", the FTT wrongly overlooked that the buying and selling were fully automated by computer. It failed to recognise the appellants not only designed and developed strategies but also implemented the strategies thus making arrangements for buying and selling.

(2) In giving weight to the job titles "researchers" and "developers", where there was already ample evidence on the nature of the activities and the context in which those were undertaken.

(3) In basing its conclusion on its view that the appellants had none of the infrastructure for buying and selling and that all infrastructure was provided for by GSA. Whether someone provided infrastructure or not was irrelevant to whether a person was making arrangements for buying and selling. The finding was, in any case, inconsistent with the evidence. For instance, Mr Gerko's evidence had explained GSA's infrastructure was poor, and the appellants had effectively "started from nothing".

111. In our view, none of these criticisms are well-founded and none amount to an error of law in the FTT's decision. They, in essence, amount to a challenge to the weight the FTT accorded, or omitted to accord, to various features. That sort of challenge cannot constitute an error of law unless the FTT was perverse in the sense of taking an approach that was not one reasonably open to it.

(1) In placing the weight it did on the design and development aspects of the appellants' activities it cannot be said the FTT's approach was unreasonable. The FTT was clearly aware that buying and selling were automated; it recorded the appellant's submission that trades were carried out using automated systems at [187] but clearly, as it was entitled to, did not consider that a material feature of the circumstances. Mr Prosser referred us to a number of passages in the evidence of the appellants' witnesses suggesting that the FTT's

earlier summary of the evidence ought to have given a much fuller account of the individual appellants' activities. We disagree; the FTT did not need to summarise all the evidence. To the extent it did, it was sufficient for it to refer in its reasoning to the evidence it considered relevant. Its summary of Mr Gerko's evidence included a reference to implementing, as well as creating high frequency trading strategies ([18]).

(2) The job titles were plainly part of the relevant overall factual circumstances and the FTT was entitled to give them such weight as it reasonably saw fit. The significance the FTT drew from the titles was their consistency with the appellants' activities. The appellants take issue with the FTT omitting to mention Mr Gerko's job title: Head of HFFX Trading. However, the FTT set out details of his academic background in maths and economics, his role, and the changing balance between his research and management activities (at [18]). It was open to the FTT to consider that Mr Gerko's title was not reflective of his activities in the same way as the other titles.

(3) We disagree with the submission that the question of who provides infrastructure is irrelevant to the question of whether the person is making arrangements for buying and selling. Although not determinative, and the FTT did not suggest that it was, it is clearly part of the overall picture of factual circumstances. There was sufficient evidence which pointed towards GSA providing the infrastructure to mean it was open to the FTT to reach that finding. As Mr Chacko's submissions pointed out, elsewhere in his evidence Mr Gerko had explained his move to the successor firm to HFFX, (XTX) was because they "…needed [their] own infrastructure rather than relying on GSA". The trades were executed in GSA's name and with its funds.

112. The Upper Tribunal in *BlueCrest* also considered the meaning of the word "profession" in Condition A. It noted (at [132]), that the word "profession" is an ordinary English word. The appellants did not take issue with that in their post-hearing submissions. The Upper Tribunal went on to quote Lord Reid's discussion in *Brutus v Cozens* [1973] AC 854 that the meaning of ordinary English words is a question of fact and that if it is alleged the tribunal has erred "The question would normally be whether their decision was unreasonable in the sense that no tribunal acquainted with the ordinary use of language could reasonably reach that decision". The Upper Tribunal considered the FTT in that case was entitled to consider that Condition A was satisfied on the basis that a reasonable person would have understood the term "profession" to include the activities of the appellants in that case.

113. Even if there were any error of law in the way the FTT approached the evidence, in terms of its relevance or weight, and the decision fell to be remade, we would have no hesitation, despite the evidence Mr Prosser took us to in the witness statements and the excerpts from cross-examination in the transcripts, in concluding the activities of the appellants in using their research and software development skills to design, develop and implement high frequency trading strategies, would amount to activities of a kind undertaken in a "profession".

Sale of Occupation Income: Tax avoidance purpose?

114. Under s773(2)(b) ITA, the sales of occupation income provisions only apply if "the main object or one of the main objects of the transactions or arrangements is the avoidance or reduction of liability to income tax".

115. Whether there is such a main object is a question which turns on the evidence before the FTT. The appellants are accordingly correct to point out that the Upper Tribunal's decision in *BlueCrest* upholding the FTT's decision that the main object test was satisfied is not relevant in this case.

116. The FTT considered, ([240]-[241]) in relation to both GSA and Mr Gerko, that each had a main object of reducing a liability to tax. The appellants' ground is that the FTT made precisely the type of error that Lord Upjohn warned against in his observations in *IRC v Brebner* [1967] 2 AC 18 that:

> "the fact that there are two ways of carrying [a genuine commercial transaction] out — one by paying the maximum amount of tax, the other by paying no, or much less, tax — it would be quite wrong, as a necessary consequence, to draw the inference that, in adopting the latter course, one of the main objects is, for the purposes of the section, avoidance of tax. No commercial man in his senses is going to carry out a commercial transaction except upon the footing of paying the smallest amount of tax that he can…"

117. The analogue to the alternative way of carrying out a transaction in issue here was described earlier by the FTT when it set out Mr Gerko's evidence regarding an alternative remuneration deferral mechanism: the restricted fund shares mechanism. Mr Gerko was told by his lawyers there would be tax charge that would take up the whole of the initial payment under that mechanism and that all other amounts would be deferred and at risk. He explained that GSA had refused to allow the mechanism to be used other than by US taxpayers (as they would be subject to an excessive tax burden under the CAP) ([30]-[31]). He suggested that tax was only a factor to the extent he had been advised that the alternative mechanism created a deeply unfair tax position by creating a tax charge on amounts never received. The problem was not the amount of tax but the timing ([37]).

118. The FTT also noted the evidence of Philip Howson (one of the individual appellant members). Mr Gerko had explained to Mr Howson that there would be tax benefits to using the CAP and that the amounts would be subject to corporation tax rather than income tax ([59]).

119. The FTT set out at [241] (where AG is Mr Gerko):

> "I consider that it is clear from AG's evidence that he had a main object of reducing a tax liability in agreeing to the CAP, as he considered that the alternative restricted fund shares arrangements carried an "unfair tax position" and also believed that there would be tax savings to the use of the CAP. Whilst he also had other objects in agreeing to the CAP, I consider that it was clear from his evidence that the tax position was an important part of that decision as he emphatically contrasted the tax position that would arise from the alternative deferral arrangements that were under consideration and also explained the tax benefits of the arrangements to [Mr Howson]. I do not consider that it is credible that he was not interested in a potential tax saving of more than 40% on very substantial earnings."

120. At [244] the FTT explained:

> "the FSA changes with regard to variable remuneration meant that some form of restructuring of remuneration arrangements would have had to take place, and that no alternative structures to the CAP appear to have been considered, other than the retention of the restricted funds mechanism for US nationals as a consequence of the US tax consequences arising from the use of the CAP".

121. At [245] although it did not quote the extract from *Brebner* we have referred to above, the FTT effectively summarised the same proposition as follows:

> "245. It is also clear that taxpayers are not required to select the worst possible tax position when considering how to structure their affairs and that, as such, it may be that in choosing between two or more viable commercial structures, an option with a non-adverse tax charge may be able to be taken without there being a main benefit [sic] of obtaining a reduction in a tax liability.

122. However, the concern did not arise here, the FTT explained, because it considered (at [246]):

> "that the steps involved in the arrangements were intended to lead to a significant tax reduction for the individual members; this was not a by-product of choosing one structure over another, nor was this submitted to be the only possible structure available".

123. The appellants' case is that conclusions regarding GSA's and Mr Gerko's objects were based solely on the (admitted) facts that i) GSA and Mr Gerko believed that the CAP avoided the unfair tax position of the restricted fund shares mechanism and ii) that this was important. The FTT made precisely the error of inference warned against in *Brebner* because those facts were equally consistent with CAP being a tax-efficient means to a commercial end rather than tax saving being an object in own right.

124. The FTT also erred in being satisfied that an intention to lead to a significant tax reduction amounted to an object. The FTT's reasoning regarding a significant tax reduction not being a by-product, but intended, did not mean seeking to reduce tax was an object.

Discussion

125. As emphasised in the passage immediately following Lord Upjohn's observation in *Brebner* cited above:

> "the question whether in fact one of the main objects was to avoid tax is one for the [first-instance tribunal] to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence".

126. In agreement with Mr Chacko, we consider the basis which the appellants advance for challenging the FTT's conclusion is too narrow in that it focusses on one aspect of the evidence, the timing issue of the alternative mechanism resulting in an upfront tax charge, when there was in fact another important aspect namely the reduction in tax charge from 50% on income to 28% corporate tax. Thus, in respect of Mr Gerko the FTT found he explained to Mr Howson "there would be tax benefits to using the CAP" (and that such benefits must have been important in Mr Gerko's view to draw them to the attention of others) [231], [241]. In respect of GSA, the FTT also had regard to GSA's belief that the CAP "should thus lead to a significant reduction in the overall tax suffered by the members". The FTT found these words indicated tax reduction was an intended result of the arrangements not an inevitable consequence [237]. It also found the arrangements included use of a purpose trust for "inter alia, fiscal reasons" [239]. The FTT did not consider Mr Gerko's evidence that he was not interested in the potential tax saving on very substantial earnings to be credible ([241]).

127. These findings demonstrated that the FTT found GSA to have a wider set of tax reduction/avoidance objects than merely preferring CAP to restricted fund shares. In circumstances where, as Mr Chacko submitted, Mr Gerko knew about the tax benefit, was interested in it, and that it was important to him, it was perfectly open to the FTT to say tax reduction was one of the main purposes of the arrangements.

128. As regards the FTT's reference to "intention", while on the face of it that displays an error, when the paragraph is read, as it must be, with the surrounding context of [245] and [246], and the clear opposition of [246] to [245] (set out above at [121] and [122]), it is plain the FTT considered that tax reduction was not simply an intention but an object.

129. We would accordingly, if we were wrong on the miscellaneous income issue, dismiss the appellant's appeal in relation to the sale of occupation income issue.

Issue 3: discovery assessment? – whether finding on discovery made

130. This issue is only applicable in respect of Mr Gerko and in relation to 2012/13. He submits the FTT erred in law by upholding the validity of the discovery assessment. In summary, a discovery assessment is an assessment an HMRC officer makes pursuant to s29 Taxes Management Act ("**TMA**") where one of the conditions is that the officer making the assessment discovers an insufficiency in tax. As is well-established, the question is whether the officer who is deciding to make a discovery assessment subjectively made a discovery that there has been an under-assessment of tax (*HMRC v Tooth* [2021] UKSC 17 at [79]*).* It is recognised that the burden falls on HMRC to prove the discovery but that this is not an especially difficult burden to meet.

131. Mr Yates, for the appellant accepted the FTT correctly identified the issue the appellant raised (at [277]). This was that HMRC had failed to prove their case on discovery. They had not pled their case on the issue and had not provided any evidence from the officers who made the discovery assessment for the assessment on Mr Gerko. In accordance with *Burgess & Anor v HMRC* [2015] UKUT 578 (TCC) the FTT therefore had to find the assessment to be invalid.

132. It is necessary to note, in order to put the FTT's reasoning in context, that before the FTT, the appellant also argued the assessment was invalid because it was "stale". In other words it was arguing that there was too long a period between any discovery being made and the time the assessment was made. The Supreme Court decision in *Tooth*, which was handed down after the FTT's decision, confirmed however that no such concept of staleness existed. Accordingly, that issue is not an issue the appellant pursues.

133. Regarding the making of the discovery, the FTT recorded from HMRC's evidence at [298] that:

> "After reviewing the additional correspondence, Officer Frusher concluded that the 2012/13 self-assessments of the individual members were insufficient and so raised discovery assessments for 2012/13 on 31 March 2017."

134. This reflected the evidence Ms Frusher gave in her statement at paragraph 25:

> "Whilst the meeting and the additional information provided was helpful, it ultimately did not revise my view of the nature of the Capital Allocation Plan. After reviewing the additional correspondence, I considered whether the 2012/13 self-assessments were sufficient and concluded that they were not. Consequently, I raised discovery assessments for 2012/13 for the relevant Individuals on 31 March 2017."

135. Mr Yates points to the fact that while HMRC's evidence was from Ms Frusher, the officer whose name appeared on the assessment was Sundri Felix and that Ms Frusher did not give any evidence about delegating the issuing of the assessment to Ms Felix. It is submitted the FTT failed to address the discovery question and made no determination of the issue. HMRC highlight the issue regarding the different officer name was only raised after the evidence had closed and that Ms Frusher was not cross-examined on the point.

136. We agree with Mr Chacko's submissions that Ms Frusher's evidence, given on behalf of HMRC, was sufficient to prove 1) she had made a discovery and 2) that she had made the assessment.

137. In the absence of any challenge regarding whether someone else had made the assessment, we consider it was open to the FTT to accept that evidence despite someone else's name appearing on

the assessment letter of the same date. The date of that letter (31 March), the same date Ms Frusher says she made the particular assessment, is entirely consistent with Ms Frusher delegating the sending of the actual letter to another officer (which is endorsed by s113(IB) TMA[5] and in the case-law (*Burford v Durkin* [1991] STC 7)). Where one officer gives evidence they have made the assessment, but a different officer's name appears on the letter in which the assessment is sent, and there is no inconsistency with the legal framework regarding the issue by one officer of an assessment a different officer has made, there is no presumption that the evidence must set out that the issue of the assessment which the first officer had made was delegated to another officer.

138. The focus of the FTT's discussion was understandably, in dealing with the appellant's arguments as to staleness, on whether any discovery had been made earlier. But it is clear the FTT accepted, as it was entitled to, Ms Frusher's evidence that she made a discovery, and that she made the assessment. Although it is true the FTT did not make an explicit finding in its discussion section, it is impossible to see its decision, that a valid discovery assessment was made, as indicating any reservation on its part regarding Ms Frusher's evidence, that it was she who made the assessment despite the assessment being issued by another officer. In our view, the evidence HMRC advanced was enough to meet the burden on it. We also consider that the appellant derives no help from *Burgess* which concerned the situation where HMRC advances no case at all on the elements it needed to prove.

Issue 4: Rule 14 application - The redaction issue

139. This issue concerns the FTT's refusal of an application the appellants made to redact certain figures from the FTT decision under Rule 14 of the FTT Rules[6]. The appellants argued the figures were confidential between the appellants (no appellant knew how much the others were getting and discovering that would seriously impact relationships between team members) and commercially sensitive (it would enable competitors to poach staff, exploiting disparities between members and indicate baseline amounts they would need to offer).

140. It is common ground the FTT was right to consider the approach outlined in *Unwired Planet International Ltd v Huawei Technologies Co Ltd (No. 3)* [2017] EWHC 3083 (Pat) where it was said "redactions will require powerful reasons, supported by cogent evidence addressing the details". The decision of the High Court (Birss J) set out a number of factors that would be relevant including: i) the nature of the information and ii) the effect of the publication of the information. On that second factor, Birss J explained:

> "This will be a critical factor. If publication would be truly against the public interest then no doubt the information should be redacted. If publication would destroy the subject matter of the proceedings – such as a technical trade secret – then redaction may be justified. The effect on competition and competitiveness could be a factor but will need to [be] examined critically."

141. The list of factors continued with: iii) the nature of the proceedings and iv) the relationship between the information in issue and the judgment as a whole. On that fourth factor, Birss J said:

> "Obviously judges do not deliberately insert irrelevant information into judgments but not every word of a judgment is as important as every other word. It may be that some

[5] Section 113(IB) provides: "Where … officer of the Board [has] in accordance with section 29 of this Act … decided to make assessment to tax, and [has] taken all other decisions needed for arriving at the amount of the assessment, they may entrust to some other officer of the Board responsibility for completing the assessing procedure, whether by means involving the use of a computer or otherwise, including responsibility for serving notice of the assessment on the person liable for tax."

[6] The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009

> sensitive information can be redacted without seriously undermining the public's understanding of the reasons."

142. The final factor v) concerned the relationship between the person seeking to restrain publication of the information and the proceedings themselves, in relation to which the following example was given:

> "…a patentee seeking damages for patent infringement on a lost profit basis knows that they will have to disclose their profit margin in the proceedings and that those proceedings are public. A third party whose only relationship with the case is that they are a party to a contract disclosed by one of the parties to the litigation is in a different position."

143. The FTT refused the appellants' redaction application at [334] in the following terms:

> "Having considered the arguments of the parties, I consider that the Appendix should not be redacted. I do not agree that the "powerful reasons [and] evidence" required for redaction as noted in Unwired Planet are present: in particular, the information is question is now several years out of date and the Appellants should have known that the information would need to be disclosed in public proceedings. The fact that some of the Appellants may not have received all of the information to date is irrelevant, as I agree that they would be entitled to receive the information if they requested it."

144. On behalf of the appellants, Mr Yates argued the FTT erred in law as follows:

> (1) The fact the information was several years out of date did not mean it would not still benefit the successor partnership's competitors.
>
> (2) The numbers were not fully required to understand the decision (illustrated by the fact they appear in an appendix).
>
> (3) The FTT was also wrong to consider that the appellant ought to have known that the information would need to be disclosed in public proceedings. That begged the very question in issue. The appellants took active steps in the hearing to ensure the figures were not disclosed.
>
> (4) The disclosure of figures was random depending on whether HMRC were to seek a variation of the original figures they had sought.

Discussion

145. Before addressing the appellant's particular arguments, it is relevant, as HMRC identified, to acknowledge that the decision on Rule 14 was an exercise of case management discretion, albeit that it was a discretion where there is authority giving guidance on the cogency of evidence required, and the factors that will be relevant to consider. There is no dispute the FTT identified the right test.

146. For the reasons which we set out below we do not consider the appellant's arguments demonstrate the FTT went wrong as a matter of principle, or that it reached a decision that was plainly wrong. We will address the points raised in turn.

147. The basis for the concern raised regarding poaching of staff from competitors was dealt with in Mr Gerko's evidence. The FTT considered Mr Gerko's evidence but it was not bound to accept it. The effect on competition and competitiveness is identified in *Unwired Planet* factor ii) as potentially relevant but needs to be examined "critically". In our view, the need to examine the evidence

critically reflects that principles of open justice are by their nature ones which involve matters of public interest which go beyond the particular parties' respective individual interests (so, even if the other party agreed to the redaction that would not necessarily absolve the need of the tribunal to carefully consider whether redaction was justified).

148. The FTT's critical evaluation was that the information was several years out of date. That was a view we consider was open to the FTT to hold on the evidence. Mr Gerko's evidence was that if the Special Capital information were published it would "provide competitors with the opportunity to exploit apparent disparities between members, while also giving an indication of base-line amounts that they would need to offer when making any approach". Mr Gerko's evidence made the point that profitability for the years 2010 to 2016 could be broadly derived, but it did not explain, in terms, how knowing that would better enable a competitor to poach staff some five years later in 2021. Given the bonus reallocations were performance related, and variable, there was no reason on the face of it to think a member's performance would be considered like for like across a longer period and in relation to a different successor partnership.

149. While it is said in addition that the FTT did not deal with the confidentiality as between the team members, it clearly did: it accepted HMRC's argument the appellants were entitled to access the information through the lawyers if they wanted (at [334]). It was therefore saying the information was not confidential between them.

150. Turning to the question of whether the relevant numbers sought to be redacted were necessary to understand the decision, the subject matter of the appeal was whether amendments should be confirmed or varied. It is not unreasonable, in our view, to consider that the extent to which amendments were being varied was something which was required in order to properly understand what the tribunal was doing. That is a legitimate factor to take into account (per note iii) of *Unwired Planet*). We would add the factor has particular resonance where the subject matter of the case concerns tax for the reasons Henderson J (as he then was) explained in *HMRC v Banerjee (No. 2)* [2009] EWHC 1229 (Ch)[7] at [35]:

> "in tax cases the public interest generally requires the precise facts relevant to the decision to be a matter of public record, and not to be more or less heavily veiled by a process of redaction or anonymisation. The inevitable degree of intrusion into the taxpayer's privacy which this involves is, in all normal circumstances, the price which has to be paid for the resolution of tax disputes through a system of open justice rather than by administrative fiat."

151. Contrary to the appellants' argument that the FTT ought not to have considered that the appellants should have known their figures would be disclosed, we consider it was open to the FTT to make that point. The point was in essence entirely consistent with the way the factor was explained in *Unwired Planet*: in the course of the particular litigation, in this case tax litigation, disclosure of figures relevant to an understanding of what a tribunal was doing with the closure notice and assessments before it would normally be expected to be made public. That did not beg the question, just as Birss J's commentary on the factor he highlighted did not beg the question (in that in his example it might equally be the case that the patent litigant would also be making efforts to redact by making an application but it's doing so would not alter the analysis).

152. The point that the disclosure of figures was random insofar as it depended on whether HMRC had made an error in its original assessment figures does not take matters further. The figures are not really random but are predicated on the assumption that where an assessment is varied the tribunal

[7] Quoted by the FTT in *A v HMRC* [2012] UKFTT 541 at [13]

needs to state what the variation is whereas that is not necessary where the amendment is simply confirmed. However, once the view is taken that open justice requires disclosure of the figures, then that does not make it any less right not to disclose but simply means the decision ought sensibly to include everyone's amendment figures whether the amendments are confirmed or varied.

153. Mr Yates made the point that the public will know that large sums of money are involved, and there is no objection to HMRC's proposal (as indicated in the FTT's record of HMRC's submissions at [333]), that a global figure of tax payable as a result of the decision be included. However that only serves to highlight that if a redaction were made there might be a perception, as highlighted by the FTT President Judge Bishopp's reasoning in *Mr A v HMRC* (see extract at [331] of FTT Decision) that the tribunal was not treating appellants where large sums of money were at stake similarly to cases involving smaller sums. While that point concerned hearings in private, the wider point regarding the tax system being operated even-handedly would apply just as much in relation to inroads into open justice created by redaction.

154. We are not therefore satisfied the appellants have identified an error of law in the FTT's refusal of the appellants' redaction application. The appellants' appeal against that refusal is accordingly dismissed.

155. Pending resolution of any permission to appeal application on this point, the redaction kept in place by the FTT pending this appeal should remain in force so as to avoid undermining the purpose of any onward appeal from our decision on this point.

156. The appellants are directed to notify the FTT if no permission to appeal application challenging our decision to uphold the FTT's refusal is made by the appellants within the relevant one month time limit, in order that the FTT may then publish an unredacted version of the appendix to its decision.

Decision

157. In conclusion:

(1) HMRC's appeal in relation to Issue 1 is dismissed.

(2) The appellants' appeal in relation to Issue 2a is dismissed (with the result a decision on Issue 2b is not necessary, but we find against the appellants on that issue in any event).

(3) On Issue 3, Mr Gerko's appeal against the discovery assessment for 2012/13 is dismissed.

(4) On Issue 4, the appellants' appeal against the FTT's decision to refuse their application for redaction is dismissed.

MR JUSTICE MELLOR
JUDGE SWAMI RAGHAVAN
UPPER TRIBUNAL JUDGES

RELEASE DATE: 21 March 2023