Tribunal ref: FTC/114/2014

INCOME TAX — whether taxpayer carried on a trade — if so whether trade commercial — whether carried on with a view to profit — whether GAAP correctly applied — whether expenditure incurred wholly and exclusively for purposes of trade — First-tier Tribunal deciding all issues against taxpayer — whether findings should be upheld — yes — appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

PATRICK DEGORCE **Appellant**

- and -

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

Tribunal: Hon Mr Justice Hildyard
Judge Colin Bishopp

Sitting in public in London on 18 to 21 November 2014

Mr Jolyon Maugham, counsel, instructed by Reynolds Porter Chamberlain LLP, for the appellant

Mr Michael Gibbon QC and Mr Michael Jones, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the respondents

DECISION

Introduction

1. This is an appeal from a decision of the First-tier Tribunal ("the F-tT") (Judge Dean, as she now is, and Mrs Farquharson) released on 4 March 2013. The F-tT determined a reference made by the parties pursuant to s 28ZA of the Taxes Management Act 1970 ("TMA") of two questions which arose from an enquiry opened by the respondents, HMRC, into the appellant's, Mr Patrick Degorce's, income tax return for the year 2006-07. But for a continuing investigation into other matters not relevant to this appeal, that enquiry would have led to the closure of the enquiry by amendment of Mr Degorce's return so as to disallow his claim for loss relief of £20,151,186. That was the amount of the loss he said he had sustained as a sole trader in film distribution rights during that year. As nothing turns on precise figures we shall generally adopt round numbers in what follows.

2. The scheme that Mr Degorce had entered into was known as "the Goldcrest Film Scheme" or "the Goldcrest Pictures Scheme"; Goldcrest is the name of the group which promoted the scheme. It was undisputed that the scheme fell within the provisions of Part 7 of the Finance Act 2004 (which provide for the disclosure to HMRC of tax avoidance schemes and are known as the DoTAS provisions), and it was duly disclosed to HMRC. The essence of the reason given by HMRC for disallowing the claim, and the primary case they advanced before the F-tT and before us, is that the scheme did not work because Mr Degorce's activities did not amount to trading.

3. Mr Degorce was only one of twelve users of the scheme, all of whom have appealed against decisions made by HMRC in respect of their relevant income tax returns. Mr Degorce's appeal was selected as a suitable lead appeal and a direction was made in accordance with rule 18 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, designating it as the lead appeal while the other eleven have been designated as related appeals. Those appeals remain in the First-tier Tribunal.

4. The issue between the parties is encapsulated in the two questions referred to the F-tT, which were as follows:

   (a) Whether any Case I [of Schedule D] trade losses arose from the sole trader film distribution activity; and

   (b) If so, the amount allowable for tax purposes.

5. The parties agreed before the F-tT, and agree before us, that the referred questions break down into five primary issues:

   (a) whether, during the year ended 5 April 2007, Mr Degorce carried on a trade (the "trade issue");

   (b) whether, if the answer to (a) is yes, the trade was carried on on a commercial basis (the "commercial basis issue");

   (c) whether, if the answer to (a) is yes, the trade was carried on with a view to the realisation of profits or, in the alternative, whether

it was carried on so as to afford a reasonable expectation of profit (the "view to profits issue");

(d) whether the profits of the trade for the year of assessment 2006-07 were calculated in accordance with generally accepted accounting practice ("GAAP") (the "GAAP issue"); and

(e) whether Mr Degorce's expenditure on rights in two films, *Tropic Thunder* and *The Love Guru*, was wholly and exclusively laid out or expended for the purposes of the trade (the "expenditure issue").

6. HMRC add a supplementary issue, which arises if Mr Degorce succeeds on issues (a), (b) and (c), but fails on issue (d) (that is, the answer is "no"), namely what would the profits (or, more accurately, losses) have been had they been calculated in accordance with GAAP.

7. The F-tT determined the trade issue against Mr Degorce, and then went on to determine the remaining issues from the starting point that, although their findings of fact on the trade issue were correct, the conclusion to be drawn from them (contrary to what they had in fact concluded) was that he had been trading. They determined all of the remaining issues against him as well. They did not answer HMRC's supplementary question, but did express some views about the approach to it which should be adopted. It is now accepted that the F-tT's conclusion on the trade issue was determinative, and that their conclusions in respect of the other issues were not matters of decision. We are asked to adopt the same approach as the F-tT: that is, address the remaining issues should we agree with them on the trade issue; we shall of course need to deal with them as matters for determination should we disagree with the F-tT on the trade issue. We shall not, however, deal with HMRC's supplementary issue, since we do not consider we are equipped to do so in the context of an appeal.

8. Mr Degorce was represented before us by Mr Jolyon Maugham and HMRC by Mr Michael Gibbon QC leading Mr Michael Jones.

The scheme

9. The F-tT's decision sets out, at [38] to [70], a description of the complex series of transactions into which Mr Degorce and others entered on 5 April 2007, together with some information about the background to Mr Degorce's participation in the scheme. The F-tT's description of the facts is complicated by the fact that some of the transactions with which it deals related not only to Mr Degorce but also to other users of the scheme, a complication we think we can leave out of account, and the F-tT entered into rather more detail than we think is necessary for the purposes of this appeal. Their narration of the transactions is, however, not challenged and we can therefore summarise those of them which are relevant to this appeal fairly briefly, with some comments as we do so.

10. It was common ground that the Goldcrest group of companies is actively engaged in the film industry and has been involved in the production of numerous films, many of which have been commercially successful:

examples mentioned by the F-tT include *Gandhi*, *The Killing Fields*, *Chariots of Fire* and *Room with a View*. Various Goldcrest companies participated in the arrangements we describe below and we shall need to discriminate between them for some purposes, though generally we shall refer to them, whether individually or collectively, as "Goldcrest".

11. Mr Degorce is, or at the relevant time was, a hedge fund manager, enjoying substantial earnings. He was introduced to Goldcrest, and to the scheme, by HSBC Private Bank which, if he subscribed to the scheme, would receive an introducer's fee from Goldcrest. It was accepted by HMRC, though with some reservations to which we shall return, that Mr Degorce's advisers undertook some due diligence into Goldcrest on his behalf before he entered into the transactions. HSBC provided Mr Degorce with relevant and appropriate information about the scheme, including in particular the assumed, or intended, tax consequences of his entering into it. He was advised that the likelihood was that he would suffer a significant loss in his first accounting period which would, it was expected, entitle him to claim relief against the tax due on his income for the 2006–07 tax year, which was forecast to be about £19 million. Although, as the F-tT recorded at [120], Mr Degorce did not concede in his evidence that he knew this was a tax avoidance scheme which fell within the DoTAS provisions, he understood that it could be so regarded and he sought advice from HSBC on the issue accordingly. He also accepted that there was some pressure to conclude all of the agreements before the end of the 2006-07 tax year (it was only on 2 April that he was introduced to the scheme by HSBC, and all the agreements had been concluded by 5 April). Further, he acknowledged that, without the perceived tax advantage, it would not have been worth entering into the scheme.

12. The scheme required Mr Degorce to purchase and immediately assign intellectual property rights in certain films. The draft agreements produced a few days in advance of his entering into the scheme, and before he decided to do so, proceeded from the assumption that he was to buy rights in a film to be called *Star Trek XI*. It is not entirely clear from the F-tT's decision why those rights were initially proposed but then withdrawn, but it is apparent from the chronology set out at [112] and elsewhere in the decision that when he was instead offered rights in two other films, to be called *Tropic Thunder* and *The Love Guru*, he took advice before he agreed to purchase rights in those films and that there was some adjustment of the price to be paid for each film and some alteration of the territorial extent and duration of the rights he was to acquire. Although HMRC accepted that the advice was taken, and some changes in the price and the rights occurred before the agreements were finalised, they argued before the F-tT that the advice was not truly at arm's length, and the changes were little more than cosmetic. We will return to this argument in more detail later; at this stage we merely summarise what was said by the F-tT.

13. The advice given by HSBC seems to have been limited to the structure of the scheme and the results Mr Degorce might expect from entering into it. Some commercial information was provided by Goldcrest, which produced a "Financial Analysis and Valuation" in respect of each film, prepared by

reference to what Goldcrest considered to be comparable films. It was accepted by HMRC that Mr Degorce relied on them though, again, they questioned their true value. The further advice Mr Degorce obtained before agreeing to the change of films was provided by Mr Christopher Petzel, a media entrepreneur based in Los Angeles. It was undisputed that Mr Petzel has considerable experience in the film industry and that he was competent to give relevant advice, although again HMRC questioned the value of what he offered. He was asked to consider the potential of the films, and to do so in a very short timescale giving him limited opportunity for investigation. In substance, as the F-tT concluded, he was able to do little more than apply some hypotheses to earnings projections with which he was provided. HMRC also pointed out that he had formerly worked for the Goldcrest group and still had some connection with it; thus, they said, his advice was not wholly at arm's length.

14. Both of the films, in which well-known actors, producers and directors took part, were subsequently made and were released commercially. We understand that *Tropic Thunder* met with critical approval and a reasonable measure of commercial success, while *The Love Guru* was rather less successful, critically and commercially, and at the time of the hearing before the F-tT its gross earnings to date had fallen some way short of the cost of production.

15. The rights in the films were acquired by Mr Degorce, on 5 April 2007, from Goldcrest Film Rights Ltd ("GFilm") for a purchase price of about £20 million. GFilm had acquired the rights, on the same day and for a price of £3.7 million, from Upsticks Ltd ("Upsticks"), a BVI company of which a Guernsey company, PG Trustees, acquired control at Goldcrest's request. It is not apparent from the F-tT's decision what was the relationship between Goldcrest and PG Trustees, but it is clear that Upsticks was, in substance, a special purpose vehicle obtained in order that it could participate in the scheme. Upsticks acquired the rights which Mr Degorce and other users of the scheme were to buy from Grace Productions LLC, a company within the Paramount Pictures Corporation ("Paramount") group. Paramount was to (and did) produce and market the films. Upsticks financed the purchase by what appears to have been an entirely circular loan arrangement funded by Paramount or its subsidiaries but it does not seem that Mr Degorce was aware of the detail of the loan arrangement or the price paid by GFilm, or that, save in one respect to which we shall return, the detail is material to the issues we must determine.

16. Upsticks acquired rights in several films, and those rights were allotted to the various users of the Goldcrest scheme. It seems that the allotments were determined by Goldcrest and by reference to the amounts injected by each user of the scheme, though there may have been some opportunity for the users to exercise a measure of choice. It was also a feature of the arrangements that two users might take rights in the same film but in different territories. The rights acquired by Mr Degorce for each of the two films were also not identical—they differed in their territorial extent and duration—but essentially those he acquired entitled him to receive the bulk of the net profits (to the meaning of which we shall come) derived from the

exploitation of the films within the relevant territorial and temporal limits. The remainder (2%) was payable to Goldcrest Pictures Ltd ("GPictures"), which had entered into an agreement with Mr Degorce to provide him with certain advisory services, the consideration for which consisted of the 2% share plus an advance fee of £1.6 million.

17. The total cost to Mr Degorce of the purchase price of the rights, the various fees he incurred (including the advance fee paid to GPictures) and some other expenses amounted to a little over £21 million. Of that total, he provided almost £5 million from his own resources, and he borrowed the remaining amount, expressed as US$34 million, from Goldcrest Funding Ltd ("GFunding"). HMRC pointed out to the F-tT that Mr Degorce handed over the amount he provided from his own resources before the change in the identity of the films in which he was to acquire rights, and before the price payable for the rights in each film had been finalised; we shall return to this point, too, at a later stage. It was a condition of the agreement with GFunding that the amount borrowed could be used only in the acquisition of the film rights, and that the money must be paid directly to GFilm: thus the amount borrowed never came into Mr Degorce's hands but remained within the Goldcrest group. The loan was secured on the rights acquired and it attracted interest at 8% pa on the outstanding balance but was on limited recourse terms. Mr Degorce was required to repay it, and pay the interest, only out of his share of the net profits, and his liability could not exceed a prescribed portion of the profit share he received. It was undisputed that he took legal advice in order that he could be confident of the extent of his personal exposure, that he secured a guarantee that the films would be completed on time and within budget, and that he obtained insurance cover against such risks as copyright infringement.

18. It was a pre-planned feature of the scheme that immediately after he acquired the rights—that is, also on 5 April 2007—Mr Degorce should enter into an agreement with Goldcrest Distribution Ltd ("GDistribution") by which he undertook to assign those rights to GDistribution in return for 100% of "Distribution Receipts" (to the meaning of which we also come shortly). The assignment, in respect of each film, was to become effective on the delivery of a "Laboratory Access Letter", which signified the practical completion of the film. Of Mr Degorce's receipts pursuant to this agreement, 2% was to be paid to GPictures to satisfy Mr Degorce's continuing obligations to that company, 55% to GFunding in order to service the loan and reduce the outstanding balance, and the remaining 43% to Mr Degorce. Although the agreement was unclear on this point, we were told that it was understood by the parties to the arrangements that once the loan was discharged Mr Degorce would become entitled to all but the 2% payable to GPictures.

19. We interpose that this was not an arrangement, such as that adopted in some other schemes, by which the user borrowed money and was guaranteed to receive back sufficient to service the loan while it was outstanding and to discharge it at a predetermined, or ascertainable, time; it was one in which, unless the films, or one of them, achieved significant success (certainly much more than they had achieved at the time of the hearing before the F-

tT) leading to the payment to the participant of a share of net profit, neither the loan nor any interest would ever become payable. The F-tT noted that the loan agreement made it possible for Mr Degorce to pay off the loan in advance if he wished, but dismissed his doing so as a real possibility since, in the absence of substantial returns, there was no conceivable advantage to him of early repayment. It was only if substantial returns materialised that Mr Degorce might decide to repay early, to avoid the interest charge.

20. HMRC argue that the only purpose of the loan was to disguise the fact that the nominal purchase price of the rights, the amount on which the claim for relief was based, exceeded their true value. It was, they say, for that reason that the borrowing arrangement into which Upsticks entered was also necessary: it made it possible to use enhanced values and for the money actually to change hands, while the reality was that the money did not leave a closed loop. This argument is relevant in particular to the expenditure issue, and we shall deal with it when we come to that issue.

21. Mr Gibbon drew our attention to two features of the arrangements which, he said, undermined the proposition that they had a commercial foundation. First, although (as he accepted) there was an understanding that Paramount would produce the films—which it did—there was no contractual provision compelling it to do so. Second, the agreement between Mr Degorce and GDistribution did not impose on GDistribution any obligation to exploit the rights—again, there was no more than an understanding or assumption. We observe ourselves that there was also no provision for the allocation to GDistribution of any share of the proceeds of any exploitation it did undertake, or for it to be rewarded in any other way. GDistribution did, nevertheless, enter into "Sub-Distribution Agreements" with Paramount, also on 5 April 2007, by which Paramount took an assignment of the rights assigned to GDistribution by Mr Degorce. The consideration in this case was a share (which varied over time on the occurrence of identified events) of "Defined Proceeds", meaning the gross receipts Paramount received from its exploitation of the assigned rights less certain amounts, representing expenses, which Paramount was permitted to retain.

22. The Distribution Receipts to which we have referred equalled the share of the Defined Proceeds to be received by GDistribution, which it was obliged to pass on in full to Mr Degorce, subject only to deduction of any taxes for which GDistribution was obliged to account. The amount GDistribution was required to pay to Mr Degorce represented his share of the net profit. By the time of the hearing before the F-tT, in May and June 2012, Mr Degorce had received no income at all from the rights because, although the films had earned some revenue, the amounts which Paramount was permitted to retain exceeded or equalled that revenue. Mr Degorce had therefore also paid nothing to GFunding or, apart from the initial fee, to GPictures.

23. At [17] the F-tT said this:

> "HMRC contended that the Scheme had three main drivers:
>
> (a) The primary goal as far as the individual participants were concerned was to generate income tax losses to shelter their taxable income for 2006-2007;

(b) In respect of Paramount, the Scheme represented a means by which it could sell a limited share in the distribution proceeds of its films for what it considered to be a reasonable price for such a share;

(c) As regards Goldcrest, the Scheme generated fee income from the individual participants."

24. Although they did not expressly say so, the F-tT seem to have treated that contention as a fair summary of the essential purpose of the scheme from the different participants' perspectives.

Mr Degorce's 2006-07 tax return

25. One of the services for which Mr Degorce's advisory agreement with GPictures provided was the preparation by accountants, now part of Mazars, of a valuation of the distribution rights he had acquired immediately after the various dealings with them that we have described—that is, at "close of business" on 5 April 2007. Like the F-tT, we shall refer to it as the "Mazars valuation". The individual valuations given were £380,487 for *Tropic Thunder* and £501,310 for *The Love Guru*, a total of £881,797. Those figures reflected what was described in the valuation as the "Present Value Calculation for the Whole Film (adjusted for risk factors)"; the covering letter by which a copy of the valuation was sent to Mr Degorce by Goldcrest added that "Mazars inform us that your valuation has been prepared using the appropriate accounting valuation methodologies". The F-tT recorded at [175] that the Mazars valuation assumed that only one in 20 films was successful, but did not explain why. It seems to have been an inference drawn from the adoption by Mazars of a discount factor of 95%.

26. Mr Maugham emphasised that it was not until some time after 5 April 2007 that Mr Degorce saw the valuation—in other words, he did not know at the time that he would be left with rights worth just under 4.5% of what he had paid for them—and he also pointed out (which is relevant to the subsidiary issues) that what Mazars had produced was an accounting, rather than commercial, valuation, and that it was provided for the purpose of preparing Mr Degorce's accounts for the year, and not as the basis for determining the price of a further disposal. Mr Gibbon agreed that Mr Degorce had not seen the valuation until June 2007, but was able to show us that Mr Degorce accepted as he gave evidence that he knew, at 5 April 2007, and even without the valuation, that only a small minority of films were successful and that his prospects of receiving a significant return on the money he had injected were therefore limited.

27. As we have said, the Mazars valuation was produced in order that Mr Degorce could adopt it for the purposes of his accounts and, consequently, his self-assessment return for the year 2006–07. He claimed loss relief for the difference between the aggregate of the purchase price he had paid for the rights and the various professional fees and costs he had incurred on the one hand, and the Mazars valuation of what he was left with, representing (in broad terms) the value of the potential income stream, on the other. The difference amounted to the sum of £20,151,186 we have mentioned. In fact,

the loss claimed exceeded his other income for that year and he sought to carry the balance forward.

28. The claim for relief was based on s 380(1) of the Income and Corporation Taxes Act 1988 ("ICTA"), which has since been re-written to the Income Tax Act 2007, but was in force at the relevant time. It allowed a taxpayer to set losses incurred in certain activities against income earned from other activities (hence the description "sideways relief"). So far as material, that subsection provided:

> "Where in any year of assessment any person sustains a loss in any trade, profession, vocation or employment carried on by him either solely or in partnership, he may … make a claim for relief from income tax on—
>
> (a) so much of his income for that year as is equal to the amount of the loss or, where it is less than that amount, the whole of that income; or
>
> (b) so much of his income for the last preceding year as is equal to that amount or, where it is less than that amount, the whole of that income;
>
> but relief shall not be given for the loss or the same part of the loss both under paragraph (a) and under paragraph (b) above."

29. The F-tT's decision also mentions the "early years" relief for which ICTA s 381 provided. It is, however, common ground that the conditions which must be met are, at least so far as this appeal is concerned, identical whether it is s 380 or s 381 which is in point, and for economy we shall therefore focus on s 380. It is accepted by HMRC that if all the conditions were satisfied Mr Degorce could set off the loss he had suffered against his other income.

30. The first condition is that identified by the opening words of the subsection: that the loss was sustained in a trade. Thus if s 380 was to be engaged at all Mr Degorce had to show that he had carried on a trade in film rights during the 2006-07 tax year (it being accepted that dealing in film rights cannot amount to a profession, vocation or employment). The meaning of "trade" was provided by ICTA s 832(1):

> "'trade' includes every trade, manufacture, adventure or concern in the nature of trade".

31. Although, as the further issues identified above indicate, there are other conditions which must be satisfied if the relief is to be available, they become relevant only once s 380(1) is engaged. It is for that reason that Mr Degorce's inability to persuade the F-tT that he had carried on a trade was determinative of his appeal.

32. An enquiry into the return was opened in accordance with TMA s 9A on 27 August 2008, and by a letter of 15 September 2009 HMRC notified Mr Degorce of their conclusion: that they were not satisfied that he had suffered any trading losses and the claim for relief must be disallowed. They could not close the enquiry for the reasons we have already given. Other users of the Goldcrest scheme received similar letters at about the same time. In some cases the enquiry was also closed, in others not.

The trade issue

33. Although the letter sent to Mr Degorce in September 2009 stated that its author did not agree that his activities gave rise to any Case I trading losses, it set out no detailed reasons for that conclusion. It is, however, not disputed that it was based primarily on HMRC's view that his purchase and assignment of the rights did not represent trading, but the acquisition of a potential income stream, and that in consequence any loss Mr Degorce had suffered was not a trading loss. As we have said, the F-tT agreed with that proposition. In later communications HMRC added the further arguments which are reflected in the additional issues we have identified above.

34. In *Ensign Tankers (Leasing) Ltd v Stokes* [1989] STC 705 Millett J said, at p 762, that "[w]hether a given transaction or series of transactions is in the nature of trade is a question of fact". We do not think that proposition is controversial and Mr Maugham did not argue otherwise. He recognised that s 11(1) of the Tribunals, Courts and Enforcement Act 2007 limits an appeal to this tribunal to an error of law but argued that, in reaching its conclusion that Mr Degorce had not been engaged in trade, the F-tT had reached some findings of fact which were irrational, in that they were contrary to or unsupported by the evidence, and that in some respects they had not made the necessary relevant findings at all. Those failings, he said, amounted to errors of law in the sense explained by the House of Lords in *Edwards v Bairstow* [1956] AC 14 and *Begum v Tower Hamlets LBC* [2003] 1 All ER, as developed in relation to the jurisdiction of this tribunal by observations of Lord Carnwath SCJ in *R (Jones) v First-tier Tribunal* [2013] All ER 625 at [41] to [47] (and since amplified by him, in observations with which the other members of the court agreed, in the more recent case of *Revenue and Customs Commissioners v Pendragon plc* [2015] UKSC 37, [2015] 1 WLR 2838). Mr Maugham also argued that, even if their conclusions could be supported if properly explained, the F-tT had failed in some respects to provide an explanation, itself a ground on which an appeal might be allowed, a proposition for which he relied on *Flannery v Halifax Estate Agencies Ltd* [2000] 1 WLR 377.

35. Mr Gibbon accepted that there were some obscurities and infelicities in the F-tT's decision but, he said, they did not come close to satisfying the stringent test which must be met before we could interfere. Moreover, he said, it was plain, obscurities and infelicities notwithstanding, that the F-tT came to the right conclusion, and that there was ample evidence to support that conclusion.

The F-tT's decision

36. The F-tT heard Mr Degorce's appeal over seven days. They had a significant volume of documentation as well as the oral evidence and statements of Mr Degorce and Mr Petzel, and the oral evidence and reports of three expert witnesses, all accountants, two of whom dealt with the accounting treatment of the transactions while the third gave evidence about valuation. After the oral evidence had concluded, Mr Degorce's representatives presented the F-tT with a lengthy document setting out

suggested findings of fact, from which the F-tT seem to have drawn although they did not mention it.

37. Although the question whether a person is or has been trading is one of fact, there is a good deal of learning on the manner in which the question should be approached, and before turning to the detail of the evidence the F-tT embarked on an analysis of the leading authorities on the topic. They first considered the observation of Lord Reid in *Ransom v Higgs* [1974] STC 539 at 545 that the term "is commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services", together with that of Lord Morris of Borth-y-Gest, at p 550, that "In considering whether a person 'carried on' a trade it seems to me to be essential to discover and to examine what exactly it was that the person did". In that case there was, as here, a pre-planned series of transactions undertaken in a short space of time.

38. It is convenient to refer at this point to passages in the speech of Lord Wilberforce, in the same case, to which we were additionally taken. At p 554 he said:

> "Trade has for centuries been, and still is, part of the national way of life; everyone is supposed to know what 'trade' means; so Parliament, which wrote it into the law of income tax in 1799, has wisely abstained from defining it and has left it to the courts to say what it does or does not include.…
>
> 'Trade' cannot be precisely defined, but certain characteristics can be identified which trade normally has. Equally some indicia can be found which prevent a profit from being regarded as the profit of a trade. Sometimes the question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, of organisation, even of intention, and in such cases it is for the fact finding body to decide on the evidence whether a line is passed.…
>
> Trade involves, normally, the exchange of goods, or of services, for reward … there must be something which the trade offers to provide by way of business. Trade, moreover, presupposes a customer (to this too there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral—you must trade with someone.…"

39. The F-tT then set out a lengthy passage from the judgment of Millett J in *Ensign Tankers*. The case was eventually to reach the House of Lords (we shall refer to the speech of Lord Templeman later) but it was accepted by the House of Lords that what Millett J said represented an accurate statement of the law. In that case, too, the taxpayer claimed loss relief for expenditure on rights to exploit films.

40. We do not, we think, need to repeat the entirety of the extract from Millett J's judgment quoted by the F-tT but we should set out some passages, at pp 762-3 of the report, as follows:

> "… The production of a film, or the completion of an uncompleted film …, in each case with a view to its distribution and exploitation for profit, are all typical (though highly speculative) commercial transactions in the nature of trade …

> In order to constitute a transaction in the nature of trade, the transaction in question must possess not only the outward badges of trade but also a genuine commercial purpose.
>
> If the transaction is of a commercial nature and has a genuine commercial purpose, the presence of a collateral or ulterior purpose to obtain a tax advantage does not 'denature' what is essentially a commercial transaction. If, however, the *sole* purpose of the transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose …
>
> The purpose or object of the transaction must not be confused with the motive of the taxpayer in entering into it. The question is not why he was trading, but whether he was trading. If the sole purpose of a transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose. But it is perfectly possible to predicate a situation in which a taxpayer whose sole motive is the desire to obtain a fiscal advantage invests or becomes a sleeping partner with others in an ordinary trading activity carried on by them for a commercial purpose and with a view of profit …
>
> The test is an objective one …
>
> In considering the purpose of a transaction, its component parts must not be regarded separately but the transaction must be viewed as a whole. That part of the transaction which is alleged to constitute trading must not be viewed in isolation, but in the context of all the surrounding circumstances. But this must mean all *relevant* surrounding circumstances; that is to say, those which are capable of throwing light on the true nature of the transaction and of those aspects of it which are alleged to demonstrate a commercial purpose." [original emphasis]

41. The fourth of those paragraphs echoes an observation of Lord Morris of Borth-y-Gest in *Lupton v FA & AB Ltd* [1972] AC 634, an observation to which the F-tT also referred. At p 647 Lord Morris said that

> "It is manifest that some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction. The result will be not that a trading transaction with unusual features is revealed but that there is an arrangement or scheme which cannot fairly be regarded as being a transaction [in the nature of trade]."

42. The F-tT then set out a passage from the judgment of Sir Nicholas Browne-Wilkinson V-C in the *Ensign Tankers* case when it reached the Court of Appeal. Mr Maugham argues that the F-tT were wrong to rely, as they had, upon this passage, as it included some observations which were later disapproved by the House of Lords; indeed, the F-tT did not refer to the speeches in the House of Lords ([1992] 1 AC 655) at all. The passage of the Vice-Chancellor's judgment which they set out, reported at [1991] STC 136 at p 147, is:

> "if the [Special] commissioners find as a fact that the *sole* object of the transaction was fiscal advantage, that finding can in law only lead to one conclusion, *viz* that it was not a trading transaction … if the commissioners find as a fact only that the paramount intention was fiscal advantage … the commissioners have to weigh the paramount fiscal

> intention against the non-fiscal elements and decide as a question of fact whether in essence the transaction constitutes trading for commercial purposes."

43. In the House of Lords ([1992] 1 AC 655 at p 677) Lord Templeman, who gave the leading speech, said, immediately after quoting that passage:

> "I do not consider that the commissioners or the courts are competent or obliged to decide whether there was a sole object or paramount intention nor to weigh fiscal intentions against non-fiscal elements. The task of the commissioners is to find the facts and to apply the law, subject to correction by the courts if they misapply the law. The facts are undisputed and the law is clear. [The taxpayer] expended capital of $3¼m for the purpose of producing and exploiting a commercial film. The production and exploitation of a film is a trading activity. The expenditure of capital for the purpose of producing and exploiting a commercial film is a trading purpose. By section 41 of the [Finance Act 1971] capital expenditure for a trading purpose generates a first year allowance. The section is not concerned with the purpose of the transaction but with the purpose of the expenditure. It is true that [the taxpayer] only engaged in the film trade for the fiscal purpose of obtaining a first year allowance but that does not alter the purpose of the expenditure. The principles of *Ramsay* and subsequent authorities do not apply to the expenditure of $3¼m because that was real and not magical expenditure by [the taxpayer]."

44. The reference to *Ramsay* is, of course, to the well-known case of *W T Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300. It is, perhaps, worth mentioning in connection with that extract from Lord Templeman's speech that he did not suggest that what Lord Morris had said in *Lupton* no longer represented the law. Thus the distinction to be drawn, as these authorities show, is between the transaction which has the character of trading even though it may be motivated by tax considerations, and the transaction which, on proper analysis, is a tax-driven device which does not amount to trading at all.

45. The F-tT then examined the "badges of trade" to which Millett J referred in the extract from his judgment in *Ensign Tankers* we have set out above. They were identified from the authorities by Sir Nicholas Browne-Wilkinson V-C, sitting in the Chancery Division, in *Marson v Morton* [1986] STC 463 at p 470. He prefaced them by observing that

> "… the question whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case … The most that I have been able to detect from the reading of the authorities is that there are certain features or badges which may point to one conclusion rather than another … I would emphasise that the factors I am going to refer to are in no sense a comprehensive list of all relevant matters, nor is any one of them so far as I can see decisive in all cases."

46. He then proceeded to describe nine badges, to which we shall come shortly, before repeating his warning (at p 471):

> "I emphasise again that the matters I have mentioned are not a comprehensive list and no single item is in any way decisive. I believe that in order to reach a proper factual assessment in each case it is

necessary to stand back, having looked at those matters, and look at the whole picture and ask the question—and for this purpose it is no bad thing to go back to the words of the statute—was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?"

47. Despite those warnings, the nine badges the Vice-Chancellor identified have been quoted with approval and applied on many occasions. The parties accepted before us that they were a useful guide, albeit to be used with care. As they formed a central feature of Mr Maugham's arguments we need to set them out in full:

> "(1) That the transaction in question was a one-off transaction. Although a one-off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.
>
> (2) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.
>
> (3) The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realisation …? For example, a large bulk of whisky or toilet paper is essentially a subject matter of trade, not of enjoyment.
>
> (4) In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature?
>
> (5) What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.
>
> (6) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? For example, the purchase of second-hand machinery which was repaired or improved before resale. If there was such work done, that is again a pointer towards the transaction being in the nature of trade.
>
> (7) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? If it was broken down it is again some indication that it was a trading transaction, the purchase being with a view to resale at profit by doing something in relation to the object bought.
>
> (8) What were the purchaser's intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer towards a pure investment as opposed to a trading deal. On the other hand, if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some

indication against concluding that the transaction was by way of investment rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.

(9) Did the item purchased either provide enjoyment for the purchaser (for example, a picture) or pride of possession or produce income pending resale? If it did, then that may indicate an intention to buy either for personal satisfaction or to invest for income yield, rather than do a deal purely for the purpose of making a profit on the turn.…"

48. After setting out the same extract from the judgment the F-tT said, at [80]:

"In taking into account the principles derived from authorities set out above and others to which we were referred, our approach to the issue as to whether or not the Appellant was trading was as follows:

(1) To consider the badges of trade, bearing in mind that such features, where present, are not necessarily determinative of the issue;

(2) We bore in mind that even where an ulterior (even paramount) motive to obtain a tax advantage is present, this does not automatically 'denature' a commercial transaction;

(3) To determine the question of trade as a matter of law and thereafter consider whether, on the facts, a trade existed;

(4) The test is an objective one;

(5) That the transaction must be analysed as a whole and viewed in the context of its surrounding circumstances where that context assists in determining the true nature of the transaction;

(6) To ask ourselves 'What did Mr Degorce actually do?'"

49. The F-tT proceeded to deal with the badges one by one. Some of their conclusions are not controversial: that intellectual property rights and income streams are items capable in principle of forming the subject matter of a trade (badge 3—[88]); and that the rights were re-sold as they stood (badges 6 and 7—[93] and 94]). Their other findings about the badges are, however, challenged by Mr Maugham, and we need to describe what the F-tT said about them in more detail.

50. They dealt with the first two badges—repetition and relation to Mr Degorce's other activities—together. They accepted the obvious point that dealing in film rights is unrelated to hedge fund management, and went on to consider whether Mr Degorce could show a pattern of dealing in film rights of which these transactions were only one example or whether, as HMRC contended, the transactions should properly be regarded as a single, one-off venture. The F-tT's conclusion on that point was put in this way, at [99]:

"We found as a fact that there was no element of repetition in [the] Appellant's transaction. We had no detailed evidence before us relating to Mr Degorce's activities either pre or post 2006-2007. As regards those pre 2006-2007, there was no evidence to support the assertion on behalf of the Appellant that there existed a 'deemed film trade' nor has any binding finding been made by a Court or Tribunal in that regard. Similarly, whilst we accepted that the Appellant had

> been involved in activities similar to that before us after the relevant period (2006-2007), we noted that those activities were subject of an enquiry by HMRC and again, no determination has been made on the issue of trade. In our view, it would be unsafe to accept the Appellant's assertions in the absence of any detailed examination of the evidence and consequently [we] found that we must deal with the transaction as a one-off transaction."

51. The F-tT added the rider, at [101], that a finding that this was a one-off venture "does not prevent it from being regarded as an adventure in the nature of trade".

52. The F-tT's discussion of the fourth badge, that is whether the transaction was typical of trade, was rather limited. They referred to the dicta in *Ransom v Higgs* which we have set out above, and briefly recorded Mr Degorce's arguments (to which we shall come in more detail later), before setting out their own conclusion at [106]:

> "We accepted the submission of HMRC, relying on *Ransom*, that the Appellant did not intend to sell the potential income stream and therefore, in the absence of a customer, the transaction cannot be viewed as having been carried through in a way typical of trade."

53. The F-tT recorded that there was a borrowing (badge 5), and mentioned, at [91], HMRC's argument that, at five years to redemption, it was a medium-term loan. We interpose that although it is correct that the repayment date was stated to be five years from drawdown of the loan, the description of this as a term loan is artificial when in reality the obligation to repay was wholly dependent on the receipt of a share of net profit. At [107] the F-tT said that they did not consider that five years was short-term, but did not go on to identify the significance of that conclusion. We deduce, however, from what else they said that the conclusion led them to reject an argument, albeit unstated in the decision, that his obtaining a short-term loan was consistent with the proposition that Mr Degorce was trading.

54. The F-tT also dealt with the eighth and ninth badges together. After a short summary of the parties' arguments they set out their conclusions:

> "[109] As to whether the purchaser intended to sell at the time of purchase; if the transactions are viewed, as urged by the Appellant, as a sale and subsequent resale of the Rights, it points to trade. However, in our view, to ignore the role of the income stream as part of the composite transaction would not reflect the reality of the situation which, properly viewed following analysis of the documents and from a realistic perspective the transactions were a composite whereby Mr Degorce made payment of a lump sum in return for the potential income stream and there was no evidence upon which we could be satisfied that there was any intention to sell at the time of purchase.
>
> [110] We agreed with the submission on behalf of the Appellant that only through the sale of the Rights could income be produced; the Appellant only held the asset for a very short period, during which he had no power to interfere with it or use it to obtain income and was obliged to immediately assign the rights as part of the overall transaction. That said, the purchase and assignment was executed simultaneously and we could not ignore the potential income stream

> which formed part of the transaction and which was, in reality, the asset acquired by the Appellant and which provided no income for the Appellant. Looking at the reality of the whole picture, we found that the asset was indicative of non-trading activity."

55. The F-tT then embarked on an analysis of the evidence in order to answer the question they had posed for themselves, namely what it was that Mr Degorce had done. Mr Maugham attacks substantial parts of the analysis; it is more convenient to deal with his attack as we examine his submissions. We should, however, record at this stage the conclusions the F-tT drew, which appear at [156]:

> "… when we looked at what Mr Degorce did, he purchased film rights for £20,299,495, which he then sold on the same day at a loss of £19,417,698 (not taking into account professional fees/finance charges). In our view, this cannot be viewed as a purchase and subsequent sale of an asset; the transactions were inextricably linked and there was no regard to the true value of the Rights. When we asked ourselves 'what was Mr Degorce trading' we concluded that his activities were, in reality, focussed on the close of the financial year and that his activity was limited to obtaining fixed receipts as proscribed [*sic*] by the Agreement signed which cannot be deemed as 'trade'. We concluded from the evidence that the asset purchased was irrelevant for the purpose of the scheme; the sole requirement was a lump sum figure which was initially paid for *Star Trek*, and thereafter matched for *Love Guru* and *Tropic Thunder*, in return for the potential income stream. We concluded that this was not an adventure in the nature of trade."

56. The F-tT also dealt with HMRC's argument, based on what Lord Morris said in *Lupton v FA & AB Ltd* and quoted at para 41 above, that the transactions were so affected by fiscal considerations that what might otherwise have been a trading transaction had been "denatured". They recorded the submissions for Mr Degorce (made by Mr Jonathan Peacock QC, who led Mr Maugham before the F-tT) based upon the further observation by Lord Morris in the same case ([1972] AC 634 at 647):

> "… once it is accepted, as it must be, that motive does not and cannot alter or transform the essential and factual nature of a transaction it must follow that it is the transaction itself and its form and content which are to be examined and considered. If the motive or hope of later obtaining a tax benefit is left out of account, the purchase of shares by a dealer in shares and their later sale must unambiguously be classed as a trading transaction."

57. However, the F-tT preferred HMRC's case on this point. Their conclusions appear at [163]:

> "In reaching our conclusions, we did not unduly focus on the scheme as a whole, but rather the specific activities of Mr Degorce. Viewed realistically, we found that this was a scheme designed and planned to take place over the course of a very short period of time. In our view, Mr Degorce's only activity was to participate in a scheme suggested to him (other than on the advice of his tax advisor) without any real understanding of it. He did not negotiate in the sense that, in our view, would be expected in a normal commercial trading transaction, nor

> was he responsible for selling. No service was provided by him, nor did he seek out or deal with a customer. We concluded that the sole purpose of the scheme, and therefore the sole purpose of Mr Degorce's participation therein was to shelter his taxable income. In those circumstances we found that the transaction was so affected by fiscal consideration that 'it affects not just the shape or structure of the transaction, but its commerciality' so that, in Lord Morris' words 'the shape and character of the transaction is no longer that of a trading transaction.' (per Millett J in *Ensign Tankers*)."

58. The F-tT's reasons for concluding that the transactions into which Mr Degorce entered did not amount to a trade can, we think, be summarised in this way. First, they were satisfied that there was no element of repetition which might support the conclusion that the transactions represented the continuation or extension of an existing trade or the start of a trade to be continued in later years. Second, they found it significant that the purchase and the assignment were executed simultaneously; and, they said, a purchase of film rights for (in round figures) £20 million followed by their immediate sale at a loss of £19 million could not be viewed as the purchase and independent sale of an asset. The conclusion to be drawn from that factor was that the transactions were inextricably linked and were entered into without regard to the true value of the rights. Third, the F-tT concluded that the evidence showed that it was immaterial what asset Mr Degorce acquired: realistically viewed, the transactions amounted to nothing more than the payment of a lump sum in return for a potential income stream which he did not intend to sell, and they were undertaken as a means of generating tax relief. It was the combination of those three core factors which led to the conclusion at [156] that the transactions did not amount to an adventure in the nature of trade; but, for good measure, any trade there might have been was "denatured" by the fact that the sole purpose of the scheme, and therefore the sole purpose of Mr Degorce's participation therein, was to shelter his taxable income, so that the "shape and character of the transaction was not in reality that of a trading transaction".

Mr Degorce's arguments

59. Permission to appeal to this tribunal was granted by the F-tT on various grounds. Mr Maugham says that they resolve into three categories: misdirections of law; the irrational or absent findings of fact to which we referred at para 34 above; and the F-tT's failure to give adequate reasons for their conclusions. However, he says, the grounds cannot be wholly segregated in that way, since there are four particular errors which extend over several of the issues. These are, to use Mr Maugham's own description, a *Ramsay* error, a repetition error, a relevant facts error and a valuation error. In this part of our judgment (in paragraphs 60 to 80 below) we record Mr Maugham's arguments in that regard.

60. The *Ramsay* error, as Mr Maugham put it, lay in the F-tT's apparent, though not overtly stated, assumption that the various agreements made up a composite transaction by which Mr Degorce purchased an income stream. So much could be derived from various comments throughout their decision, most particularly at [247]:

> "We concluded that the Appellant acquired the rights to a future income stream as part of a series of transactions designed to achieve this commercial outcome. As such, he acquired an intangible fixed asset with a life of 60 years, which does not have the substance of a trading stock item … we did not consider that the original purchase and assignment of the rights should be viewed separately but as a part of a series of transactions designed to achieve an overall commercial effect."

61. The approach adopted by the F-tT is surprising, Mr Maugham says, because it did not even mention *Ramsay* or any of the later judgments making up a significant line of authority about the proper approach to contractual relationships such as that in issue here. That approach was most neatly expressed, and the correct question to ask identified, by Ribeiro PJ (in a passage approved on countless subsequent occasions) in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46:

> "… the driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction viewed realistically."

62. How that proposition should be put into practice was explained by the House of Lords, in a unanimous opinion, in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684 ("*BMBF*"), one of the cases in which the observation of Ribeiro PJ was approved, and the case now generally regarded as the leading authority on this topic. At [32] the House said:

> "The essence of the new [*ie* post-*Ramsay*] approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311, 320, para 8: 'The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case.'"

63. The F-tT failed, says Mr Maugham, to undertake that analysis. This was not a merely inconsequential point, since it infected the F-tT's approach to the application of the relevant statutory provisions to the facts and undermined their decision. The F-tT should not have treated Mr Degorce's purchase of the rights, followed by an immediate sale, as the acquisition of an intangible fixed asset, but instead should have considered whether two linked transactions of that kind are inimical to trading. Had they asked that

question, while bearing in mind the badges of trade, they would have been bound to conclude that the answer was "no".

64. That error of approach led the F-tT into the error of disregarding the fact that Mr Degorce's purchase and sale were no more than two steps in a series of transactions to most of which he was not a party at all, and over which he had no control of any kind. There were real transactions between Paramount group companies and Goldcrest companies which created real rights and obligations; against that background it was impossible to conclude, as the F-tT had done at [163], that:

> "the sole purpose of the scheme, and therefore the sole purpose of Mr Degorce's participation therein, was to shelter his taxable income."

65. Mr Maugham submits that although the F-tT prefaced that finding with the observation that they were required to consider what Mr Degorce did, rather than focus on the scheme as a whole, it is apparent from the manner in which their finding is phrased that they disregarded their own warning, and simply looked at their perception of the scheme as a tax avoidance device rather than at the role which Mr Degorce played. The error, Mr Maugham says, stemmed from the F-tT's misunderstanding of what was said by the House of Lords in *Ensign Tankers*. In particular, the F-tT paid heed to the conclusion of the Court of Appeal in that case that motive was central to the question whether a person was trading, despite the fact that it was reversed by the House of Lords, and despite the fact that in the later case of *New Angel Court Ltd v Adam* [2004] STC 779 the Court of Appeal itself accepted that motive was not the test. The F-tT's findings of fact on the trade issue are accordingly tainted by their incorrect perception, at [156] and [163], that motive was a relevant consideration: thus the F-tT had focused not on the correct test, namely what Mr Degorce did, but on why he did it.

66. Mr Maugham further submits that the F-tT also fell into a serious error in their examination of the evidence relating to Mr Degorce's activities in other years. The first of the badges of trade identified by the Vice-Chancellor in *Marson v Morton* was based on the distinction between the one-off transaction and a pattern of repeated similar transactions. The F-tT wrongly concluded, first, that this was to be regarded as a one-off transaction and, from that incorrect conclusion, proceeded to make the further error of treating the fact (as they found) that it was a one-off transaction as an indication that it did not amount to trading. That they did so was surprising; they appeared to have focussed on the statement by the Vice-Chancellor in *Marson v Morton*, at p 470, that "the lack of repetition is a pointer which indicates there might not here be a trade" while ignoring, even though they quoted it and despite the rider at [101], his further observation that "as far as I can see there is only one point which as a matter of law is clear, namely that a single, one-off transaction can be an adventure in the nature of trade".

67. Mr Maugham points out that there was, in fact, extensive evidence before the F-tT of Mr Degorce's activities in the acquisition and disposal of film rights both before and after 2006-07. HMRC themselves had referred in their statement of case to his participation in similar transactions on three

occasions. The evidence showed that he had, in addition to this transaction, purchased interests in films in 2005-06, as a member of two LLPs; that from February 2007 he had been engaged in extensive discussions with Mr Petzel about possible purchases of film rights; that he had actively researched the market over a significant period; and that he had purchased rights in several films later in 2007, in 2008 and in 2009. Thus this was merely one of a series of similar transactions by which Mr Degorce had acquired rights in films, some of which had been successful while others had not; he knew that they were transactions of a speculative nature but a trade is no less a trade for being speculative. On the contrary; as Sales J said in *Eclipse Film Partners (No 35) LLP v Revenue and Customs Commissioners* [2014] STC 1114 at [78], the speculative character of a transaction may be "strongly indicative" of trading. If one were to examine his position for the tax years 2005-06, 2006-07 and 2007-08 together, it would become clear that while his income from other activities amounted to about £44 million, Mr Degorce had spent as much as £74 million on film rights. If his purpose was solely to shelter his income from tax he had gone too far by £30 million. The difference between his taxable income and his expense is, says Mr Maugham, far more consistent with his being an active trader in film rights than with his having no purpose other than tax avoidance.

68. Mr Maugham submits that had the F-tT properly considered that evidence, together with what the Vice-Chancellor said in *Marson v Morton*, they would have been driven to conclude, at the least, that what Mr Degorce did was capable of amounting to trade. They should then have gone on to decide whether, as a matter of fact, it did amount to trade. Instead, they simply treated the purchase and sale as component parts of a different, composite, transaction and failed to consider properly what was their true nature. That was a consequence of their failure to consider critical facts, many of which were unchallenged. That failure led in turn to the F-tT's making findings of fact which could not be supported.

69. As to this, the evidence the F-tT failed to take into account included that relating to the advice Mr Degorce took, to his understanding that he could withdraw from the transaction if his lawyers advised against it, to his decision not to rely on the information provided by Goldcrest but to seek a valuation from Mr Petzel, and to the fact of negotiations about the precise nature of the rights to be acquired and the price to be paid. They also ignored the evidence that Mr Degorce had been discussing with HSBC, since March 2007, the possibility that he might set up a film business, with staff, that he had sought advice from Mr Petzel about film investment in a general sense, both before and after these transactions took place, that his later purchases were made in order to broaden his portfolio, with the aim of spreading his risk while improving his prospects of making a positive return, that he had in fact achieved returns on some of the films in which he had acquired rights, that there had been serious negotiations about the price to be paid for the rights in other films, that on one occasion he had refused to invest in a substitute film but had demanded (and received) a return of his money, and that he had sought advice from recognised industry experts rather than from lawyers and others unversed in the film industry. Those,

says Mr Maugham, were all indications that Mr Degorce was engaged in a serious trading venture of which this transaction was merely a part.

70. Instead, the F-tT found that some of the advice he received was not wholly independent and that he had not taken any steps to ensure that he did receive independent advice, that he had not received any advice at all on the deal structure, that the nature of the assets in which he was trading was unimportant to him, that there was no evidence that he contemplated withdrawing when he was told that *Star Trek* was no longer available when in fact it was clear that withdrawal was a real possibility, that Mr Petzel's input was of little value, that there was no true negotiation of either prices or rights, and that there was no evidence of how he assessed commerciality or could be satisfied that the price he paid for the rights was commercial. All of those findings, says Mr Maugham, are contrary to the evidence or unsupported by it. The consequence of their incorrect findings on these points was that the F-tT's approach to the main question before them, namely whether Mr Degorce was trading, was fatally undermined.

71. Although Mr Maugham depicted as being the F-tT's worst error their application of the first and second of the badges of trade, because they had wholly misunderstood the test of repetition, he submits that they had also fallen into error in their application of some of the other badges. They were right to accept, in respect of the third, that film rights were capable of being the subject of trading activity, but wrong in concluding at [106], in respect of the fourth, that because there was no intention on Mr Degorce's part that the income stream should be sold and no customer for it, "the transaction cannot be viewed as having been carried through in a way typical of trade". The F-tT had asked themselves the wrong question; had they asked the right question, and examined not the income stream but Mr Degorce's dealings in film rights and the evidence relating to those transactions, they would have been driven to conclude that film rights are typically exploited through a distribution agreement, just as they had been exploited here. Their conclusion could not be reconciled with the decision of the Court of Appeal to the contrary in *Revenue and Customs Commissioners v Micro Fusion 2004-1 LLP* [2010] STC 1541.

72. We interpose that we do not accept that argument. The relevant statutory provision in that case was s 42 of the Finance (No 2) Act 1992, which used the phrase "trade or business"; accordingly the criteria to be considered were different. We do not, therefore, find the case of any assistance.

73. Mr Maugham contends that the F-tT also asked themselves the wrong question about the finance (the fifth badge), by looking at whether it was short-term or long-term, when the real question was whether there was borrowing (an indication of trading) or not (an indication of a purchase for personal reasons or as an investment). Mr Maugham emphasises, as a further indication that what Mr Degorce did was in the nature of trade, the point we have already made that, unlike other schemes of a similar basic structure, the Goldcrest scheme did not provide for its users a guaranteed income stream designed to pay off the borrowing or simply return the capital paid out. Everything Mr Degorce was to receive was, Mr Maugham

points out, entirely dependent on the success of the films—if they were unsuccessful, or only moderately successful, as in this case, he would receive nothing as all the proceeds were taken by the production studio. It was only when a film was truly successful that the production studio's prior claim became satisfied and there was a surplus for a person in Mr Degorce's position. Mr Maugham offers the example of the well-known film *Twilight*, which Mr Degorce had helped to finance, and which had produced considerable profits in which Mr Degorce had shared to the extent of nearly £20 million.

74. The purchase of rights and their sale, or exchange, for an income stream is, Mr Maugham says, clearly a trading transaction; it was an error of the F-tT to elide the steps so as to conclude that all Mr Degorce did was purchase an income stream. It does not matter that the purchase and sale were parts of a composite transaction, that they were interdependent in that neither would have occurred without the other, or that they had been organised in advance. The reality was that, despite stating that it was what they intended to do, the F-tT had failed to examine what Mr Degorce did, and instead had simply looked at the start and end points, without regard to what took place in between.

75. The taxpayer in *Ensign Tankers*, too, had entered into an avoidance scheme which required it to purchase, from the producer, certain rights in a film which the producer was to make. It then (as here, on the same day) assigned the rights it had acquired to two distribution companies which were wholly-owned subsidiaries of the producer. The Inland Revenue argued, as HMRC do here, that the taxpayer was not trading. Lord Templeman, as the extract from his speech set out at para 43 above demonstrates, was well aware that the taxpayer entered into the scheme as a means of generating a first-year allowance greater than the actual expenditure; but he nevertheless found, as had Millett J, that the taxpayer was trading. The F-tT did not refer to what Lord Templeman said, and simply disregarded the similarity between the two cases.

76. Mr Maugham accepts that the F-tT were right to find, at [108], that the fact that the rights were disposed of as they were acquired and in one lot (the sixth and seventh badges) pointed away from trading, but their conclusion at [109] (see para 54 above) in respect of the eighth badge was, he says, fundamentally flawed. The conclusion set out in that paragraph, that the transactions should be regarded as a single, composite, whole, he says, again revealed the F-tT's failure to consider what had been said by the House of Lords in *Ensign Tankers*. It was also a finding which ignored the sentence in the Vice-Chancellor's description of the eighth badge, in *Marson v Morton*, at p 471, that "if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment".

77. What the F-tT said of the ninth badge at [110] (also set out at para 54 above), says Mr Maugham, was equally wrong in that it did not reflect the evidence to the effect that, even though he had received no return from the rights at the time of the hearing before the F-tT, Mr Degorce had an

expectation of receipts in the future. It ignored the fact that the exploitation of film rights was speculative, sometimes producing a return (as in the case of *Twilight*) and sometimes not. In addition, the concluding sentence was a *non sequitur*; it does not follow from the fact that no income had resulted that there was no trade. This was a clear and typical example of the inadequate reasoning of which the F-tT were guilty. It was only one of several examples, says Mr Maugham, of the F-tT's making, or appearing to make, findings of fact only then to draw inferences, or reach conclusions, which did not follow from those facts.

78. Mr Maugham contends that the F-tT had also misunderstood the significance of the Mazars valuation. They had failed to recognise that it was intended to, and did, provide no more than a GAAP valuation but had instead treated it as if it represented a measured economic value assessment, one which might be relied on in the context of an onward sale. Mr Degorce's evidence showed that he recognised the limited utility of the valuation. This error was more relevant to the commercial basis and view to profits issues, but it also affected the F-tT's approach to the trade issue, since their mistaken understanding of the significance of the valuation led them to the unwarranted conclusion that Mr Degorce was unconcerned about the value, and therefore the nature, of what he was acquiring. The F-tT had also emphasised the Mazars valuation while ignoring the evidence that Mr Petzel had estimated a value for the rights greater than the price paid.

79. Mr Maugham submits that the F-tT were also wrong to accept HMRC's proposition that even if there was a trade it was "denatured" (see para 56 above). They had disregarded what Lord Morris said in *Lupton v FA & AB* and had, incorrectly, looked at Mr Degorce's state of mind rather than at the character of the transactions into which he entered. It is the purpose of the transaction, and not the purpose of the participant, which must be considered.

80. The trade issue resolved into only one question, namely whether Mr Degorce was trading, and that had to be determined on purely objective grounds, by reference to what was done and not why it was done. The authorities clearly showed that the facts found by the F-tT could properly lead them to only one conclusion, that Mr Degorce was trading. Thus although the finding that he was not trading was one of fact, it was based on a misunderstanding and was a conclusion with which it was open to us to interfere.

HMRC's arguments

81. Mr Gibbon's arguments on behalf of HMRC began by his referring us to a further observation, not set out above, of Millett J in *Ensign Tankers*, at p 761:

> "Whether a given transaction or series of transactions is in the nature of trade is a question of fact for the commissioners. An appeal from their decision can succeed only if they have misdirected themselves in law or if the only true and reasonable conclusion from the facts found by them is contrary to their determination."

82. The hurdle an appellant must overcome if he is to succeed is therefore high. The difficulty facing an appellant was emphasised by Lord Millett, as he had by then become, in *Begum v Tower Hamlets LBC*, at [99], where he indicated that a finding of fact could be successfully challenged only if it was "perverse or irrational; or there was no evidence to support it". Similarly, the task before an appellant wishing to show that the first instance judge's reasons are inadequate is heavy. The leading authority is generally considered to be *English v Emery Reimbold & Strick Ltd* [2002] EWCA Civ 605, [2002] 1 WLR 2409 in which (among others) *Flannery v Halifax Estate Agencies Ltd*, on which Mr Maugham relies, was considered. The material passage is as follows:

> "[19] … if the appellate process is to work satisfactorily, the judgment must enable the appellate court to understand why the judge reached his decision. This does not mean that every factor which weighed with the judge in his appraisal of the evidence has to be identified and explained. But the issues the resolution of which were vital to the judge's conclusion should be identified and the manner in which he resolved them explained. It is not possible to provide a template for this process. It need not involve a lengthy judgment. It does require the judge to identify and record those matters which were critical to his decision. If the critical issue was one of fact, in may be enough to say that one witness was preferred to another because the one manifestly had a clearer recollection of the material facts or the other gave answers which demonstrated that his recollection could not be relied upon.…
>
> [21] … The essential requirement is that the terms of the judgment should enable the parties and any appellate tribunal readily to analyse the reasoning that was essential to the judge's decision."

83. Mr Gibbon stresses the importance of bearing in mind, when considering that guidance, that the adequacy of the reasons is to be judged from the perspective of the parties and the appellate tribunal, and not that of the first-time reader: see *Harris v CDMR Purfleet Ltd* [2009] EWCA Civ 1645, at [21], per Smith LJ.

84. The essential question is whether there was material on which the F-tT could properly reach their conclusions. If there was, that is enough; the fact that there might have been other material which pointed a different way is irrelevant. The proposition that what Lord Carnwath said in *R (Jones) v First-tier Tribunal* has altered the long-understood limitations on what an appellate tribunal might do was rejected in clear terms by Sales J in *Eclipse Film Partners (No 35)* at [43], as confirmed and emphasised by the Court of Appeal in that case (in the following way ([2015] EWCA Civ 95, [2015] STC 1429at [113]):

> "…the conclusion of the tribunal of fact as to whether the activity is or is not a trade can only be successfully challenged as a matter of law if the tribunal made an error of principle or if the only reasonable conclusion on the primary facts found is inconsistent with the tribunal's conclusion. These propositions are well established in the case law*: Edwards v Bairstow* [1956] AC 14, 29-32 (Viscount Simonds), 33, 36, 38-39 (Lord Radcliffe); *Ransom v Higgs* [1974] 3

All ER 949, 955 (Lord Reid), 964 (Lord Wilberforce), 970-971 (Lord Simon); *Marson v Morton* [1986] 1 WLR 1343, 1348 (Sir Nicholas Browne-Wilkinson V-C)."

85. Mr Maugham appears to be arguing that although the F-tT identified the correct tests (the *Marson v Morton* badges) to be applied in determining whether or not Mr Degorce's activities amounted to trade, they then proceeded to apply them incorrectly. The criticism is misplaced. The first complaint is that the F-tT had regarded the transactions as a composite whole. But that is not a legitimate complaint; as the words in parenthesis in the judgment of the House of Lords in *BMBF* show (see para 62 above), it is sometimes necessary to consider "the overall effect of a number of elements intended to operate together", and that is what the F-tT did in reaching the conclusion that the overall effect of these transactions was that Mr Degorce bought a potential income stream. There was nothing before the F-tT which undermined that conclusion. The purchase and subsequent sale of film rights in return for a share of an income stream might in some circumstances amount to trading in film rights, but in other circumstances it might amount to a composite transaction for the purchase of an income stream. The F-tT's conclusion that in this case the transaction was of the latter rather than the former character could not be assailed.

86. Mr Maugham's attack on the detail of the F-tT's findings of fact is misconceived. There was evidence before them about the advice Mr Degorce had obtained from which they could properly draw the conclusions they had drawn, which were effectively that the advice was of little value and of little concern to Mr Degorce. His own oral evidence on the topic, as the F-tT commented several times, was vague, and it was plain that in the time available, which extended to, at most, three days, he could not have obtained, considered and acted upon truly independent and informed advice. Mr Petzel, too, had said in his oral evidence that he had been provided with a limited amount of information from which it was difficult to provide meaningful advice. There was also evidence before the F-tT to the effect that Mr Degorce's prime concern was the tax relief, and that the arrangements were no more than the means of securing it—thus it was a legitimate inference that details such as the identity of the films in which he was acquiring rights and the scale of the returns which might realistically be expected were of secondary importance to him.

87. Contrary to Mr Maugham's argument, there was no evidence before the F-tT that Mr Degorce contemplated withdrawing from the scheme when *Star Trek* was replaced. It may be that he could have done so, but he did not suggest at any point that he had considered the possibility. The attack on the finding that Mr Degorce did not negotiate misrepresented what the F-tT found, which was (see [163]) that he "did not negotiate in the sense that, in our view, would be expected in a normal commercial trading transaction", a finding consistent with the evidence that there was a substitution of films with no adjustment in the aggregate price, and then an adjustment in the price of one film, after Mr Degorce had committed himself, made unilaterally by Goldcrest. It was for these reasons that the F-tT's conclusion that Mr Degorce cannot have been satisfied that he was paying a fair

commercial price for the rights was also unassailable. Mr Petzel's evidence that he could not provide considered valuations in the time, and on the information, available to him was alone sufficient to justify that conclusion.

88. Mr Gibbon did not accept that the F-tT had misdirected themselves about motive. They had correctly recorded at [80] that the test of whether something is a trade "is an objective one", and although it was correct that they had quoted a passage from the judgment of the Court of Appeal in *Ensign Tankers* it was not a passage which put motive at the forefront of the test, and there was nothing in their decision to suggest that the F-tT had done so.

89. Mr Maugham's argument based on Mr Degorce's claimed repetition of trading in film rights has to be considered against the background of the question to be asked in this case, which is not whether Mr Degorce was trading in film rights in a general sense, but whether the transactions into which he entered in the tax year 2006-07 amounted to trading. It is conspicuous that in his tax return for 2006-07 Mr Degorce stated that his trading activity began on 2 April 2007, the date on which he committed himself to the scheme. It is true that he had been a member of two partnerships in 2005-06, and that those partnerships had undertaken transactions relating to intellectual property rights in films, but even if (which HMRC dispute) the partnerships were trading, being a member of a partnership and undertaking trade on one's own account are quite different things, and the F-tT were entitled to take the view that what Mr Degorce did in 2006-07 did not represent the continuation of an existing trading activity. What is perhaps more important still is that there was no repetition within this scheme; once the rights had been bought and assigned, anything which might have been regarded as a trading activity ceased.

90. Mr Gibbon concluded with the argument that the essential question before the F-tT required them to make a choice between two clear alternatives: whether Mr Degorce was trading, on the one hand, or purchasing an income stream, on the other. They decided, having heard and read the evidence, that it was the latter. Mr Degorce's attacks on that conclusion could be seen, when one stood back from them, to be no more than an attempt to persuade this tribunal to re-make their findings, which is not a permissible course.

Discussion

91. We begin with a few observations about the nature of this tribunal's jurisdiction. The limitations on what an appellate tribunal may ordinarily do when faced with a challenge to the findings of fact of a first-instance tribunal have been stated many times. One recent example is the *Eclipse Film Partners* case to which Mr Gibbon referred us. More recent still is the review and succinct explanation of the earlier authorities provided by Lewison LJ in *Fage UK Ltd v Chobani UK Ltd* [2014] EWCA Civ 5 at [114]:

> "Appellate courts have been repeatedly warned, by recent cases at the highest level, not to interfere with findings of fact by trial judges, unless compelled to do so. This applies not only to findings of primary

> fact, but also the evaluation of those facts and to inferences to be drawn from them."

92. As we have said, Lord Carnwath has made comments about the special role of the Upper Tribunal in the (now) not so new tribunal system, in *Jones* and in *Pendragon*; in the latter case he was expressing the unanimous view of the Court. We do not, however, read his comments as an indication that the Upper Tribunal has some special exemption from the restrictions to which Lewison LJ referred. Rather, he was saying that, in the interpretation of a statutory scheme in respect of which the jurisdiction has been conferred on a Chamber of the First-tier Tribunal, or in a matter which governs the exercise of that Chamber's jurisdiction in multiple cases, it is part of the Upper Tribunal's function to provide guidance; and if, in order to do so effectively, it is necessary for it to reconsider the First-tier Tribunal's findings of fact, in a case in which it has the relevant evidence available to it, it should adopt that course. The Upper Tribunal's jurisdiction is, of course, not engaged at all if no error of law is identified; it is only then, as Lord Carnwath indicated in *Pendragon* at [47], that it has the power to set aside the First-tier Tribunal's decision and re-make it, including the power to make its own findings of fact. That is a long way from saying that the Upper Tribunal may simply disregard the normal restriction on interference by an appellate tribunal with findings of fact.

93. We do not, moreover, consider that the trade issue as it arises in this case gives rise to matters of principle on which it is appropriate for this tribunal to offer guidance. The question whether a person is carrying on a trade is, as we have indicated, essentially a question of fact and, as Sales J pointed out in *Eclipse Film Partners*, at [47], there is already copious guidance at the highest level, to which it would be presumptuous of us to seek to add, on the approach which must be adopted. The task for us, therefore, is the more mundane one of enquiring whether the F-tT in this case correctly applied the guidance in determining the facts and evaluating them. It is pertinent to mention, even if only by way of reminder, that the question is not whether we, hearing and reading the same evidence, might have come to a different conclusion, but whether there was evidence before the F-tT sufficient to support their conclusions.

94. We recognise that there are, as Mr Maugham argues and Mr Gibbon accepts, various parts of the F-tT's decision which can be criticised, and we have ourselves found their reasoning difficult to follow in some respects. In particular, we are willing to agree with Mr Maugham that what the F-tT said at [99] (quoted at para 50 above) reveals an error of approach: one cannot disregard evidence of similar activities because the tax consequences of those activities are under investigation. The tax consequences of a transaction do not determine its character; rather, it is the character of the transaction which determines its tax consequences.

95. However, it is not enough simply to attack the approach. Mr Maugham must in addition demonstrate that, had the F-tT approached this part of the evidence correctly, their doing so would, or at least might, have affected the outcome. Mr Maugham's argument seems to elevate the first badge of trade from an indicator, something which may tend to support one conclusion

rather than another, into a discrete test. As we understand what the Vice-Chancellor said, this badge, by distinguishing between a one-off transaction on the one hand and repeated transactions of a similar character on the other, is aimed at identifying, respectively, the person who engages in one purchase and sale with no intention of entering into a course of trading and the person whose objective is to trade in the commodity over the longer term. Repetition therefore points to the greater likelihood that the person concerned falls into the latter category; but it does not answer the question whether the activity, repeated or not, is capable of amounting to a trading activity. If, on proper analysis, the transactions into which Mr Degorce entered led to the acquisition of an income stream the fact of repetition does not convert what he did into something else.

96. The core question is whether there was material before the F-tT from which they could properly conclude that Mr Degorce was not trading in film rights, but that he merely acquired a contingent, or potential, income stream. The F-tT's approach, when shorn of detail, was to undertake the task they had set themselves, namely examine what Mr Degorce did, in entering into a set of pre-arranged contracts which were designed to, and did, follow one another in a very quick sequence. It was, in particular, clear before he entered into the first of the transactions that at the end of them, minutes later, he would be left only with the income stream. No other outcome was possible: the whole set of contracts assumed (simplifying a little) that a Paramount company would sell rights to a Goldcrest company, which would sell them to the user, in this case Mr Degorce, who would do nothing with them but assign them to another Goldcrest company which would in turn assign them back to a different Paramount company. Once the start button was pressed, all the transactions fell into place automatically, with only one possible result.

97. It was not an arrangement which left Mr Degorce with the freedom to retain the rights, assign them elsewhere for cash, or assign part of the rights while retaining the remainder. Not only he but all of the other participants in the Goldcrest scheme—that is, the Goldcrest and Paramount companies—entered into the series of transactions knowing that they could have only one outcome, which in Mr Degorce's case was the right to a potential income stream. Once one focuses on the core question it becomes clear that even if the F-tT were wrong in one or more of the lesser findings they made on the way to their overall conclusion, that overall conclusion was supported by the evidence. It does not matter, in answering the core question, whether Mr Degorce did or did not take advice, or did or did not negotiate, since advice and negotiation do not transform the purchase of an asset, as an income stream is, into a trading activity. They were not included by the Vice-Chancellor in his list of the badges of trade and in our view rightly so. They are as likely, perhaps even more likely, to feature in a person's decision to buy an asset as they are in his decision whether or not to trade in a particular commodity.

98. It is true that the overall exercise was speculative, in the sense that it was unknown whether, and if so to what extent, Mr Degorce would receive income from the exploitation of the rights; but there was no element of

speculation in the transactions themselves, which were undertaken on a pre-determined basis with, as we have said, a pre-determined outcome.

99. We do not accept Mr Maugham's argument that the facts of this case are materially indistinguishable from those of *Ensign Tankers*. There is certainly a similarity in as much as the agreements in each case were all entered into on the same day, and that they related to the exploitation of films, but there are in other respects material differences. In particular, Ensign Tankers did not merely buy and immediately dispose of rights, but contributed to the financing of the production of the films, as one of the members of a partnership. In our judgment, if a comparison is to be made with another case, the better comparison is with *Eclipse Film Partners* in which the taxpayers, investors in partnerships which acquired rights in films and then assigned them in exchange for an income stream, were found not to have been trading, a finding upheld by the Court of Appeal: see [2015] EWCA Civ 95, [2015] STC 1429.

100. At para 38 above we quoted the observations of Lord Wilberforce in *Ransom v Higgs* about the meaning of trade, and in particular his statement that "everyone is supposed to know what 'trade' means". That remark, as we see it, suggests that "trade" is a concept which can, at least in the ordinary case, be readily recognised by a non-lawyer unversed in the authorities. The badges identified by the Vice-Chancellor are a useful aid, and in a border-line case may tip the balance; but as a general rule a trading transaction should be recognisable as such without close analysis of its detail. It does not seem to us that the informed observer, standing back from the detail, would necessarily conclude that what Mr Degorce did amounted to a trading activity or, to align the proposition more closely to the question before us, that it could be said that the informed observer's conclusion that this was not trading could be regarded as perverse.

101. Thus although, as we have agreed, some criticism of the detail of the F-tT's decision is justified, we can see no sufficient basis for overturning their overall conclusion that, looking at both the reality of the whole picture ([110]) comprising the series of transactions of the character they described, and at what Mr Degorce actually did and obtained under the scheme, this was not an adventure in the nature of trade (see [111] and [156]).

102. Before concluding the discussion of the trade issue we need to deal with the disagreement between the parties about the F-tT's approach to Mr Degorce's purpose in participating in the scheme, it being Mr Maugham's submission that the F-tT, in their whole approach and in their finding of fact on the trade issue, placed an impermissible, or impermissibly heavy, reliance on the question why Mr Degorce did what he did, whereas the real question was what he did.

103. We think it may assist in explaining why we do not think this submission avails Mr Degorce for us to highlight two points at the outset. First, the F-tT were careful to make clear that their consideration of whether the transaction was "denatured" by Mr Degorce's purpose in participating in it was in the context of HMRC's alternative submission if the F-tT found against them on the first (whether Mr Degorce's activities were capable of

amounting to trade). In other words, the F-tT addressed this aspect in case they were incorrect in their findings on the first issue (see [162] and [163]). Secondly, it seems to us that Mr Maugham may himself have fallen prey to, and possibly wrongly be ascribing to the F-tT, a confusion between Mr Degorce's fiscal motives (which of themselves are irrelevant) and the way that the fiscal objectives of the scheme affected its shape and character (which, as we read their decision, the F-tT held also caused it no longer to be a trading transaction because it lacked any commercial, as distinct from fiscal, purpose).

104. The first point needs little elaboration: in paras [162] and [163] the F-tT expressly stated the context in which they turned to consider the "denaturing" point. The second point is more debatable, not least because although the distinction between motive and purpose is often stressed, it can be elusive, and the language used by the F-tT and what Mr Gibbon described as their "compressed" reasoning may have added to the confusion. However, in our view, what the F-tT concluded was that the fiscal objectives had so affected "the shape and character" of the transaction as to deprive it of the essential quality of commerciality. The F-tT did not cite the passage, but as Millett J (as he then was) put it in *Ensign Tankers* at first instance, [1989] STC 705 at page 764, in considering the speech of Lord Morris in *FA & AB Ltd v Lupton*, a transaction may be so fundamentally affected that

> "it is in truth a mere device to secure a fiscal advantage, albeit one given the trappings normally associated with trading transactions."

105. We do not consider that the approach of the F-tT in relation to this alternative argument can be said to be wrong; and in any event, even if the F-tT were confused and did take motive into account at this second stage, we do not consider that error to be such as to undermine the F-tT's conclusion. Put shortly, we do not detect that the F-tT took motive into account in their earlier conclusion that what Mr Degorce did was not trading; they brought it into account only on the hypothesis that he was trading.

106. We also reject Mr Maugham's argument that it is relevant that other participants in the arrangements, particularly the Paramount companies, had ordinary commercial reasons for entering into them. The F-tT appear to have accepted, at [17] (see para 23 above), that the argument was factually correct. However, as Millett J also indicated in *Ensign Tankers*, the reasons why others might enter into such transactions are not material; the taxpayer whose purpose is solely to secure a fiscal advantage may enter into transactions which, from his perspective, do not amount to trading even though, from the perspective of other participants, they do.

107. We therefore dismiss the appeal on the trade issue. For the reasons we have given, that conclusion is determinative.

108. However, since we are requested to do so, and in deference to the argument addressed to us, we now turn to deal, relatively briefly, with the other issues identified above.

The commercial basis issue and the view to profits issue

109. Although they identified them as separate issues at the beginning of their decision and, at [177], they recorded the argument advanced for Mr Degorce that there were two discrete questions, we think it fair to say, as Mr Maugham does before us, that the F-tT did not develop the point and instead dealt with the two questions together, at [164] to [201]. Mr Maugham argues that they were wrong to treat them as aspects of the same argument, as they are conceptually distinct, a point to which we shall return. However, although the F-tT did not explain their elision, it is a reasonable assumption that they dealt with the two issues together because of the terms in which the relevant legislation was written. That legislation was contained in ICTA s 384(1), which added further conditions to be satisfied if relief was to be available in accordance with s 380. It provided that:

> "... a loss shall not be available for relief under section 380 unless, for the year of assessment in which the loss is claimed to have been sustained, the trade was being carried on on a commercial basis and with a view to the realisation of profits in the trade or, where the carrying on of the trade formed part of a larger undertaking, in the undertaking as a whole."

110. We should perhaps add for completeness the clarification provided by sub-s 384(9):

> "Where at any time a trade is carried on so as to afford a reasonable expectation of profit, it shall be treated for the purposes of subsection (1) above as being carried on at that time with a view to the realisation of profits."

111. Both of the parties relied, before the F-tT and before us, on the well-known observation of Robert Walker J in *Wannell v Rothwell* [1996] STC 450 on the meaning of "a commercial basis". At p 461 he said:

> "… it was suggested that the best guide is to view 'commercial' as the antithesis of 'uncommercial', and I do find that a useful approach. A trade may be conducted in an uncommercial way either because the terms of trade are uncommercial (for instance, the hobby market-gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable costs of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby art gallery or antique shop where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante."

112. The F-tT's decision deals first with HMRC's submissions on these two issues, the essence of which was that the transactions into which Mr Degorce entered on 5 April 2007 were plainly uncommercial: he paid £20.3 million to GFilm for rights which GFilm had just bought for £3.7 million, and assigned them on the same day for consideration (the income stream) worth only £882,000. By the time of the hearing before the F-tT he had received no return at all. The transactions could not be said to have a commercial character; rather, they were driven by the availability, or hoped-

for availability, of the tax relief without which (as Mr Degorce himself accepted) they made no economic sense. The valuation Mr Petzel had provided was based on figures provided by Goldcrest to which Mr Petzel made little more than arbitrary adjustments to arrive at a range of possibilities. Such price negotiation as there was amounted to nothing more than the re-allocation of the money Mr Degorce paid, since he paid exactly the same for *Tropic Thunder* and *The Love Guru* as he had originally agreed to pay for *Star Trek XI*; the driver was not the true value of the rights but the amount of tax relief Mr Degorce wished to generate. It was also apparent from his oral evidence, said HMRC, that Mr Degorce did not fully understand, nor care about, the detail of the agreements into which he had entered.

113. At [172] and [173] the F-tT recorded HMRC's submissions to the effect that the legislative requirement was that regard must be had only to trade within the relevant tax year; thus even if it were to be found (contrary to HMRC's case) that Mr Degorce had traded in film rights in other years, it was irrelevant to the question before the F-tT. In any event, his trade, if that is what it was, in other years had also been unprofitable; although *Twilight*, in which Mr Degorce acquired rights in a different tax year, had made an apparent profit, that was so only if the tax consequences of Mr Degorce's acquisition of those rights were taken into account.

114. If it was correct (HMRC's arguments continued) to take *Tropic Thunder* and *The Love Guru* in isolation, it became apparent that there was no realistic basis on which Mr Degorce could have had a reasonable expectation of profit. The Mazars valuation proceeded from the position (although Mr Degorce did not accept it to be correct), that films had only one chance in 20 of success; and this was borne out by the fact that neither of these films had achieved any economic return for him. In reality, said HMRC, he had entered into the transactions with no expectation or even hope of profit, but only for the intended tax advantage.

115. The F-tT also mentioned the arguments advanced for Mr Degorce, which overlapped to some extent with those advanced in respect of the trade issue. In summary, they were that the evidence showed that he had entered into the transactions in a commercial fashion, that is after obtaining and acting upon advice; that what it was necessary to consider was what Mr Degorce, rather than any other party to the transactions, did; that the fact that the tax consequences for him of the transactions were a factor affecting his decision to enter into them did not undermine their commerciality; and that, contrary to HMRC's arguments, he had in fact made significant profits from the rights he had acquired in *Twilight* and had realistic hopes of doing so from another film, *Eagle Eye*, and the fact that these films might have generated no return for him was irrelevant.

116. The F-tT began their consideration of this issue by citing with approval the observation of a differently-constituted First-tier Tribunal in *Samarkand Film Partnership No 3 v Revenue and Customs Commissioners* [2011] UKFTT 610 (TC), [2012] SFTD 1 at [247] that a distinction is to be drawn between the commerciality of a person investing in (as in that case) a

partnership and the commerciality of the trade undertaken by the partnership.

117. They then went on to adopt the same approach to the assessment of commerciality as the tribunal in *Samarkand 3*, as it was explained in the following extract from the *Samarkand 3* decision:

> "[253] It seems to us that the serious interest in a profit is at the root of commerciality. Christmas is commercialised when it is used for profit. The hobby art gallery is not run with a serious eye to making money; nor is the loss making market garden.
>
> [254] But a serious interest in profit does not to our mind mean simply an interest in an excess of receipts over expenditure especially where longer term cashflows are involved. In those cases the well known and well understood technique of discounting future cashflows to derive their present value would be used to evaluate the project or investment…
>
> [256] It seems to us that if an entity enters into a transaction which has a negative net present value the transaction cannot be described as commercial unless there are other collateral benefits expected or hoped for which are expected to outweigh the negative effect of the transaction. If you buy an asset for £10 and exchange it for something worth £7 that is not a commercial transaction unless you have a collateral hope for at least £3 profit elsewhere."

118. There was no challenge to that part of the decision on Samarkand 3's appeal to this tribunal (see [2015] UKUT 0211 (TCC)), but para [256] was quoted in its decision with evident approval.

119. In adopting the *Samarkand 3* approach the F-tT went on to examine what Mr Degorce had paid and had received in return. They found, in that process, that the loan was effectively, if not non-recourse (as at one point the F-tT inconsistently described it), then at most, on its true construction, limited recourse (a conclusion not challenged before us), that the possibility that Mr Degorce would choose to pre-pay it was so remote as to be fanciful, and that the structure of the agreements was such that Mr Degorce could never become entitled to more than 15% of what was earned from exploitation of the rights. They then set out the results of that examination at [196]:

> "In our view, taking into account the figure at which the Appellant purchased and then re-sold the rights in the same day, combined with the limitations contained within the documents as to the monies to which the Appellant was thereafter entitled, there was little likelihood that the Appellant would obtain significant receipts, such as would either recoup the loss made on the sale price of the rights or would provide the Appellant with any real expectation of making a return."

120. Mr Maugham takes issue with that conclusion; the F-tT, he says, misunderstood the valuation evidence. He takes greater issue still, as it is (he says) another instance of what he describes as the repetition error, with what the F-tT said at [197]:

> "We did not find the Appellant's reliance on his receipts from *Twilight* assisted him; an appendix annexed to HMRC's written closing submissions showed that even where the film was a worldwide success, the returns made by Mr Degorce were only profitable on a post-tax basis. In our view, whilst the tax benefits were no doubt a sensible consideration from Mr Degorce's perspective in deciding whether to enter into the scheme, such allowances cannot be decisive of the issue of whether the trade was carried on on a commercial basis."

121. At [198] the F-tT drew those conclusions together:

> "We did not accept that the price paid for the rights was intended by Mr Degorce to be a reasonable and commercial price; having looked at his activities in purchasing and assigning the rights, we could find no basis upon which Mr Degorce could be satisfied that the price paid was commercial; there was no detailed independent valuation prior to Mr Degorce signing the agreements and making payment nor was such a matter within his own knowledge. When viewed against the loss at which the rights were sold, for which again there was no independent assessment, we concluded that the entire focus of the transaction was on the potential tax relief and that this was not a trade that was carried on on a commercial basis."

122. They then added that they rejected Mr Degorce's evidence that he had assessed the commerciality of the transactions and, although they did not go so far as to find that he was indifferent to profit, they said in clear terms at [201] that the trade was not commercial and that Mr Degorce could have had no reasonable expectation of earning any profit.

123. We have mentioned above Mr Maugham's argument that there is a conceptual distinction between "commerciality" and "with a view to profits". The distinction is, we think, in many cases a fine one; and it is difficult to imagine the circumstances in which a trade might be carried on on a commercial basis yet without the aim of making a profit. The reverse, however, is not the case; one can imagine, with Robert Walker J in *Wannell v Rothwell*, the antique dealer who makes (or sets out to make) a profit on each individual sale, yet does not run his business on commercial lines.

124. We do not, however, think that the distinction Mr Maugham seeks to draw adds anything in this case. The statutory test has two elements, as the wording of s 384(1) shows, both of which must be met. The very fact that the distinction, such as it is, is fine carries with it the consequence that factors which are relevant to one are likely to be relevant to the other. We do not see any material fault in the F-tT's having dealt with these two issues together. At [199] they said:

> "… Mr Degorce accepted in his oral evidence … that he only cared about the 'commerciality of those movies and how much I will have to pay' yet there was no evidence of any in depth analysis as to how he assessed 'commerciality' or how this was balanced against the amount he paid. Added to the limitations in what Mr Degorce could expect and the lack of any evidence that Mr Degorce ever queried or took the time to fully understand the potential receipts or the timeframe within which he could expect to make a profit, we concluded that this was

> not the attitude or actions of a person carrying on a trade on a commercial basis with a serious view to profit."

125. It is apparent from that passage that the F-tT had well in mind the two-element test, and that they had concluded that neither element was satisfied.

126. In our judgment that conclusion, too, is unassailable in this tribunal. The F-tT had the considerable advantage of hearing the oral evidence of, in particular, Mr Degorce himself. They were in a far better position than we are to determine whether he entered into the transactions with an eye to profit to which the tax advantage was no more than an incidental benefit or, instead, entered into transactions which (he understood) would confer the tax advantage and might result in an incidental profit. Mr Maugham has been unable to identify to our satisfaction any reason why their conclusion that it was the latter was inconsistent with or unsupported by the evidence, and this attack on the F-tT's findings must also be dismissed.

The GAAP issue

127. Although the F-tT dealt with a number of accounting issues, Mr Maugham attacks now only one finding, relating to the presentation in Mr Degorce's accounts of the asset (the right to future sums, or income stream) and the loan. Two of the accountants who gave evidence—Mr John Graydon for Mr Degorce and Mr Richard Cannon for HMRC—dealt with this issue which, in view of the F-tT's other conclusions, was of only peripheral importance. It goes to the measure of the relief to which Mr Degorce would have been entitled had his remaining arguments succeeded.

128. The F-tT's conclusion is set out at [239]:

> "We preferred the arguments of Mr Cannon. In our opinion the financial accounts of the Appellant at 5 April 2007 do not show a true and fair view of his state of affairs and have not been produced in accordance with UK GAAP. The asset and loan should have been presented as a linked presentation in the Balance Sheet. We also preferred his evidence for the reason that he had tested his opinion with an alternative approach which resulted in the same accounting treatment."

129. Mr Maugham's argument is that the conclusion is perverse, and not supported by adequate reasons. FRS5 (the relevant accounting standard) is, he says, prescriptive and exclusive about the circumstances in which a "linked presentation" is appropriate. It provides that it may be adopted only when "there is no provision whatsoever whereby the entity may … keep the item on repayment of the finance". Here, however, Mr Degorce was entitled to keep the rights on repayment of the finance; accordingly it was not a possible finding that a linked presentation was required. In addition, it was not enough for the F-tT to say that they preferred one witness to the other without more. They had explained at [248] why, on another point, they preferred Mr Graydon: "we have, in respect of the valuation issue, preferred the evidence of Mr Graydon on the basis that, in our view, his role as head of the Film Team within an accountancy and advisory firm attaches weight to his evidence within this specialised area"; yet on this occasion had offered no reasons at all for their preference of Mr Cannon.

130. Mr Gibbon's response is that this, too, is a finding of fact made by the F-tT after hearing the experts on both sides, and it is one with which we should be prepared to interfere only on the clearest of grounds. Moreover, it was not merely an accounting point; it was dependent in addition on the F-tT's interpretation of the loan agreement and its conclusion that it provided for a limited recourse (or non-recourse) loan; Mr Graydon's primary evidence was based on his view that it was a full recourse loan, but he had agreed as he gave evidence that if he was wrong on that point he would have to reconsider.

131. We are compelled to agree with Mr Maugham that the F-tT might have explained their reasoning on this point more clearly. However, the failing is largely one of presentation: the conclusion is found at [239] while the reasoning which led to it is at [257] and [258], and not linked back to the conclusion. From the perspective of a reader coming to the decision without any knowledge of the case, the link between the reasons and the conclusion will be obscure; but as Smith LJ explained in *Harris v CDMR Purfleet*, that is not the test. We do not accept that the parties can reasonably claim to have been unable to work out why the F-tT reached the decision they did. Moreover, we agree with Mr Gibbon that, in the light of Mr Graydon's concession about the interpretation of the loan agreement, the conclusion was one which was open to the F-tT and which cannot be challenged in this tribunal.

The expenditure issue

132. The statutory requirement which gives rise to this issue is to be found in s 34(1)(a) of the Income Tax (Trading and Other Income) Act 2005:

> "In calculating the profits of a trade, no deduction is allowed for—
>
> (a) expenses not incurred wholly and exclusively for the purposes of the trade …"

133. Although, at [273], the F-tT made it clear that they were satisfied that Mr Degorce's expenditure "was not wholly and exclusively laid out or expended for the purposes of the trade", their reasoning is not so clearly expressed. It appears at [258]:

> "The loan in this case was paid directly from GFunding to GPictures (of which the Appellant was aware) and we concluded that the loan was a limited recourse loan. In the words of Lord Walker there was no 'economic activity' produced by the loan until the potential income stream came into effect. As such, we accepted HMRC's submission that the money went into a loop to enable the Appellant to 'indulge in a tax avoidance scheme' and that, irrespective of whether the terms were fully commercial or not, there was not, in reality, an incurring of expenditure of the borrowed money in the acquisition of the rights."

134. Mr Maugham challenges that reasoning by arguing that it does not follow from the fact that the acquisition was in part funded by a limited recourse borrowing that the borrowed money was not expended on the rights. He points to the fact that, in other years, Mr Degorce had borrowed money for the same purpose and had received income which had been used in order to

repay the borrowings. The F-tT's conclusion, he says, is another manifestation of their failure to take into account the fact that this was only one of a series of ventures in the film industry which Mr Degorce had undertaken, and it was coloured by their incorrect perception, as [258] reveals, that this was a tax avoidance scheme dressed up as trading. They had addressed the question from the wrong perspective.

135. Mr Gibbon's response is that while, in a purely formal sense, the loan was made to Mr Degorce for the purpose of acquiring the rights, the reality was that the loan was no more than a device designed to produce a higher asset cost that could then be written down in his accounts in order to produce the hoped-for tax loss. Unless the films were spectacularly successful the loan was no more than an illusion, a proposition borne out by the fact that both loans—by Paramount to Upsticks and by GFunding to Mr Degorce—were effected by money simply travelling in a closed loop back to its starting point. The purpose in Mr Degorce's case was to do as was done in *Ensign Tankers*, namely to inflate the real expenditure to a much larger sum by what was no more than an artificial device.

136. In our judgment, Mr Gibbon is correct on this issue, and for the reasons he gave. As in *Ensign Tankers*, there was real expenditure on the rights, and there was artificial expenditure, effected by means of what were essentially self-cancelling transactions. The result, again as in *Ensign Tankers*, is that relief is available (or would be available if the other requirements were met) for the real expenditure, but not for the amount by which the real expenditure has been artificially inflated. Thus on this point too we agree with the F-tT.

Disposition

137. For the reasons we have given the appeal is dismissed.

Mr Justice Hildyard

Colin Bishopp
Upper Tribunal Judge

Release date 24 August 2015