Neutral Citation Number: [2015] EWCA Civ 95 Case No: A3/2014/0643

IN THE COURT OF APPEAL
ON APPEAL FROM
THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

Date: 17 February 2015

Before:

THE CHANCELLOR OF THE HIGH COURT
LORD JUSTICE CHRISTOPHER CLARKE
AND
LORD JUSTICE VOS

BETWEEN

ECLIPSE FILM PARTNERS NO 35 LLP

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

- -
- -

Graham Aaronson QC and Jolyon Maugham (instructed by **Freshfields Bruckhaus Deringer LLP**) for the **Appellant**
Malcolm Gammie QC, Rajesh Pillai and Rebecca Murray (instructed by **General Counsel and Solicitor to Her Majesty's Revenue and Customs)** for the **Respondents**

Hearing dates: 13-15 January 2015
- -

APPROVED JUDGMENT

The Chancellor of the High Court (Sir Terence Etherton):

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

Introduction

2. This is an appeal by Eclipse Film Partners No 35 LLP ("Eclipse 35") from part of the decision of Mr Justice Sales in the Tax and Chancery Chamber of the Upper Tribunal ("the UT") dated 20 December 2012. The appeal is from his decision dismissing Eclipse 35's appeal from the finding of the First-tier Tribunal (Edward Sadler and John Walters QC) ("the FTT") that a closure notice issued by HM Customs Revenue & Customs dated 15 May 2009 correctly described Eclipse 35 as not carrying on a trade for the tax year ending 5 April 2007.

3. The proceedings raise a number of issues about the indicia of carrying on a trade in the context of tax legislation.

The issue

4. Members of Eclipse 35 borrowed money to contribute to its capital. They paid interest on the money borrowed. They may be able to claim tax relief in respect of that interest but only if Eclipse 35 was carrying on a trade and only if the borrowed money was used wholly for the purpose of that trade. That is the combined effect of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") s.863 and the Income and Corporation Taxes Act 1988 ("TA 1988") ss.353 and 362.

5. Although the closure notice (and so this appeal) relates to Eclipse 35 itself rather than the personal tax position of any of its members, what is important in practical terms is whether the members are entitled to tax relief in respect of interest on their borrowings. Accordingly, it is convenient to treat TA 1988 s.362(1) as the critical provision by way of background. That provides as follows so far as relevant:

> "Subject to sections 363 to 365, interest is eligible for relief under section 353 if it is interest on a loan to an individual to defray money applied –
>
> …
>
> (b) in contributing money to a partnership by way of capital or premium, or in advancing money to a partnership, where the money contributed or advanced is used wholly for the purposes of the trade, profession or vocation carried on by the partnership …"

6. Large sums are in issue. The members of Eclipse 35 ("the members") contributed a total of £840 million capital to Eclipse 35. They have paid a total of approximately £293 million in interest.

7. Eclipse 35's case is that in the relevant year of assessment it carried on the trade of acquiring and exploiting film rights. The case for the respondents, the Commissioners for Her Majesty's Revenue and Customs ("the Revenue"), is that Eclipse 35 has never carried on a trade but has merely organised a sophisticated financial model involving licensing and distribution rights in respect of two Disney films designed to give a series of pre-determined cash flows and with the ultimate object of giving rise to interest payments by the members (accelerated by prepayment) on borrowings for which they can claim tax relief to set against other income they have which is otherwise taxable.

8. The FTT decided that what Eclipse 35 actually did was not a trading transaction at all but rather it carried on the business of exploiting films not amounting to a trade, that is to say it carried on a "non trade business" of film exploitation within ITTOIA section 609.

9. If the FTT's decision is not overturned there will be very serious fiscal consequences for the members of Eclipse 35. They will be taxed on the income from the arrangements without any relief for the interest they have already paid.

The relevant transactions

10. Eclipse 35 and its members entered into a complex series of transactions in relation to the acquisition, distribution and marketing of film rights in relation to two films produced by the Disney group of companies, "Enchanted" and "Underdog" ("the Films").

11. Aside from Eclipse 35 and its members, the following were the principal parties involved.

Barclays Bank plc ("Barclays")	The issuer of a letter of credit securing the payment by the Distributor of certain sums due to Eclipse 35 under the film distribution arrangements; also the funder of Eagle.
Eagle Financial and Leasing Services (UK) Limited ("Eagle")	A wholly-owned subsidiary of Barclays, which made loans to the members and received, as security for such loans, the benefit of the letter of credit issued by Barclays.
Walt Disney Pictures ("Disney")	A US corporation and a member of the Disney group of companies which on 3 April 2007 as

	grantor entered into a licensing agreement with Eclipse 35 (as licensee) in relation to the Films.
WDPT Distribution VIII LLC ("the Distributor")	A US corporation and a member of the Disney group of companies which on 3 April 2007 as licensee entered into a distribution agreement with Eclipse 35 (as licensor) in relation to the distribution of the Films, and which procured the issue by Barclays of the letter of credit to secure its payment obligations to Eclipse 35 under the distribution agreement.
WDMSP Limited ("WDMSP")	A UK company which is a member of the Disney group of companies and which entered into an agreement with Eclipse 35 for the provision of marketing and advisory services in relation to the Films.
Future Films Limited ("Future")	A UK company which arranged the financing of films and also the production and distribution of films, which for a consultancy fee promoted Eclipse 35 and provided film advisory and other services to Eclipse 35.

12. Eclipse 35 was incorporated as a UK limited liability partnership on 3 October 2006. As the enumeration "35" indicates it was one of a number of Eclipse partnerships involved in film licensing transactions offering tax advantages for their members. Its partnership deed, which was executed on 13 March 2007, states that Eclipse 35 will carry on the business of the production, distribution, financing and exploitation of films, including the licensing and exploitation of film rights acquired from Disney.

13. On 3 October 2006 Eclipse 35 entered into a consultancy agreement with Future ("the Future consultancy agreement"), under which Future agreed to provide Eclipse 35 with a number of services relating to the selection, acquisition and exploitation of films and film rights. Eclipse 35 agreed to pay Future a fee based on a percentage of the partnership capital raised by Eclipse 35 and of the net proceeds from the exploitation of any film rights licensed by Eclipse 35.

14. On 3 April 2007, which was the date on which all the relevant principal documents took effect and was described in them as "Financial Close", Eclipse 35 had 289 members. All or most of the members are individuals liable to UK income tax, and for whom, if the relevant conditions are met, tax relief will be available for interest paid on borrowed money contributed by them to the partnership capital of Eclipse 35.

15. On 3 April 2007 Eclipse 35 entered into a licensing agreement with Disney ("the Licensing Agreement"), under which Disney granted Eclipse 35 a licence of specified rights to exploit and distribute the Films for a period of 20 years ("the Rights"). As consideration for the licence Eclipse 35 agreed to pay an aggregate licence fee of approximately £503 million and also a variable royalty. The licence fee was divided into 20 annual instalments. On 3 April 2007 Eclipse 35 paid Disney the entire aggregate amount of the licence fee as an advance against its obligations to pay the annual instalments.

16. Also on 3 April 2007 Eclipse 35 entered into an agreement with the Distributor ("the Distribution Agreement"), by which Eclipse 35 granted a sub-licence of the Rights to the Distributor for a period of 20 years. As consideration the Distributor agreed to pay Eclipse 35 specified sums annually over 20 years (called "Annual Ordinary Distributions") totalling approximately £1,022 million, variable distributions (which match the variable royalty Eclipse 35 must pay to Disney under the Licensing Agreement) and 40 per cent of "contingent receipts", being amounts payable under a complex formulation if gross receipts from the exploitation of the Films exceed a certain threshold after payment of prior charges ("the Contingent Receipts").

17. As security for its obligations to pay the Annual Ordinary Distributions to Eclipse 35, the Distributor provided a letter of credit issued by Barclays ("the Letter of Credit") to Eclipse 35 on 3 April 2007. Payments under the Letter of Credit directly correspond to the Annual Ordinary Distributions. Issue of the Letter of Credit relieved the Distributor from its payment obligations to Eclipse 35. On the same day the Distributor deposited approximately £497 million with Barclays and charged that sum to Barclays to secure the issue of the Letter of Credit and to fund Barclays in respect of its obligations under the Letter of Credit.

18. Eclipse 35 was financed by its Members. On 3 April 2007 they contributed capital to the partnership amounting in aggregate to £840 million. That contribution provided Eclipse 35 with the capital to pay the licence advance to Disney and certain other payments which Eclipse 35 made on that day. The members financed their capital contributions in part from their own resources but substantially by borrowing under a 20 year facility made available by Eagle. The members borrowed in total approximately £790 million from Eagle and contributed the balance of £50 million of capital from their own resources.

19. The Eagle facility provided for a fixed rate of interest, and required the borrowing member to pre-pay the interest accruing over the first 10 years of the borrowing. That amounted in aggregate to approximately £293 million,

which the members paid on 3 April 2007. The borrowing by members from Eagle was secured by a charge by Eclipse 35 over the Letter of Credit.

20. Also on 3 April 2007, following the contribution by members of their capital, and pursuant to a provision to that effect in the partnership agreement, Eclipse 35 made a payment, which was expressed to be by way of loan on account of anticipated profits, to the members of an aggregate amount of approximately £293 million. That payment enabled members to make the prepayment of interest to Eagle.

21. Pursuant to the Future consultancy agreement Eclipse 35 paid Future a fee of approximately £44 million on 3 April 2007.

22. The payments made between the various parties on 3 April 2007, and the payments due over the 20 year term of the transactions, reflected cash flow statements produced from financial models devised by Future and used in the promotion of Eclipse 35 to potential investors.

23. Sales J in the UT helpfully summarised as follows the movement of funds (rounded to the nearest £1 million) on 3 April 2007 pursuant to the licensing and security documents mentioned above and also the arrangements between Barclays and Eagle (not mentioned above).

(1) Barclays paid Eagle £790 million by way of loan.

(2) Eagle paid the members in aggregate £790 million by way of loan.

(3) The members paid Eclipse 35 in aggregate £840 million by way of capital contributed to Eclipse 35, using the borrowings from Eagle of £790 million and £50 million from their own cash resources;

(4) Eclipse 35 paid:

(a) £503 million to Disney on account of the licence fees due under the Licensing Agreement;

(b) £44 million to Future as its fee due; and

(c) £293 million in aggregate to the members as loans against future income profits, pursuant to the partnership agreement.

(5) The members paid Eagle in aggregate £293 million by way of a prepayment of interest under their respective loan facility letters.

(6) Eagle paid Barclays £293 million by way of a prepayment of interest.

(7) The Distributor paid Barclays £497 million by way of deposit to induce Barclays to issue the Letter of Credit, and out of which Barclays was to be reimbursed for the payments it makes to Eclipse 35 under the Letter of Credit in place of the Annual Ordinary Distributions.

(8) Barclays paid the Distributor £293 million on account of the interest accruing on the deposit made in the deposit account which the Distributor holds with Barclays.

24. The FTT observed that in net terms on 3 April 2007 the sum of £497 million was circulated around the parties (assuming that within the Disney group there was some accommodation between Disney and the Distributor), and that £50 million was introduced by the members, and £44 million paid out to Future and £6 million paid out to Disney (the difference between the £503 million and the deposit of £497 million made by the Distributor with Barclays). The £6 million (called "the Studio Benefit") was in effect the financial payment for Disney's participation.

25. The FTT further observed that since, for each year of the 20 year terms of the licensing and distribution arrangements, the licence fee payable to Disney, the Annual Ordinary Distributions payable to Eclipse 35 and the consultancy fee paid to Future are fixed amounts, and since the variable distributions (if any) which are received by Eclipse 35 from the Distributor are exactly matched by the variable royalties which will then be paid by Eclipse 35 to Disney, it is possible to predict the minimum profits which will accrue to Eclipse 35 in each year, that is to say the profits without regard to any Contingent Receipts which might become payable. It is possible, therefore, to calculate that over the 20 year term Eclipse 35 will make an aggregate profit of approximately £474.4 million (viz. surplus Annual Ordinary Distributions over licence fees and consultancy fees).

26. It is also possible to calculate that over the 20 year term a total of £524.7 million will be paid by members by way of interest. When set against the profits of £474.4 million (disregarding the possibility of Contingent Receipts) there is an excess of interest of £50.3 million. The FTT observed that such excess interest equates to the aggregate of the amounts paid to Disney by way of Studio Benefit and to Future by way of consultancy fee, and may be regarded as funded by the capital contributed by Members from their own resources.

27. The FTT also noted that under the loan facilities with Eagle each member is required to repay the sum advanced by Eagle in accordance with a schedule of annual repayments and that, disregarding the prepayment of interest at Financial Close, the aggregate amount to be paid by the members in each year matches the Annual Ordinary Distributions receivable by Eclipse 35 for that year. Eclipse 35 assigned, by way of security for the advances made by Eagle, the right to the Annual Ordinary Distributions. As the FTT observed, in this way the members knew that, in cash terms, and assuming no default, all payments of interest and repayments of capital would be made to Eagle, and the profile of Annual Ordinary Distributions over the 20 year term was fixed to give this result.

28. The FTT observed that Financial Close was shortly before the end of the tax year and its significance would appear to be that, if the members paid the prepaid interest to Eagle just prior to the end of the tax year, they would be able claim tax relief in that tax year for such interest.

29. In addition to those principal transaction documents described above it is necessary to mention (among several further documents to which the FTT referred in their decision) the following three documents relevant to this appeal, all of which were entered into before 3 April 2007.

30. On 9 February 2007 Eclipse 35 entered into an agreement with the Disney group company WDMSP ("the Marketing Services Agreement"), in which WDMSP agreed, for a fixed fee plus a share of any Contingent Receipts from the Films, to act as Eclipse 35's exclusive agent in preparing marketing and release plans for the Films and supervising the Distributor in its implementation of those plans.

31. WDMSP agreed to procure the provision of services by "the Designees", specified employees of various Disney group distribution and marketing companies ("the Buena Vista companies"), and to secure the services of Salter Film Consultants Limited ("SFC") in order to assist WDMSP to carry out its obligations to Eclipse 35.

32. Eclipse 35 agreed to pay WDMSP at Financial Close a fixed fee of £28,000. That sum included £3,000 as a contribution towards the cost of WDMSP engaging Screen Capital International Corporation ("SCI") under the SCI Services Agreement (mentioned below) and Mr Stuart Salter as a consultant under the SFC Consultancy Agreement (also mentioned below). In addition, if for any year Eclipse 35 were entitled to Contingent Receipts, an additional fee equal to two per cent of Eclipse 35's share of Contingent Receipts would become payable.

33. On 1 March 2007 an agreement ("the SCI Services Agreement") was made between WDMSP, the Buena Vista companies, which were designated as "the Designee Provider", and SCI. SCI is a company based in Los Angeles, which was founded in 2001 by Mr David Molner, its managing director. Mr Molner's career in the film industry began in 1995 when he joined Paramount Pictures, where he eventually became Senior Vice President of worldwide corporate business development. In that position he had responsibilities for obtaining film finance from syndicated public and private limited partnerships, including negotiating the acquisition, financing and licensing of film rights. SCI specialises in structuring film and sports financing transactions and negotiating with the major US film studios on behalf of investors from the United States and Europe.

34. So far as relevant to Eclipse 35 and this appeal, in the SCI Services Agreement SCI agreed to assist the Designees by acting as a liaison between them and "the Consultant", namely Mr Salter of SFC and by assisting the Designees in preparing and providing to Eclipse 35 and the other Eclipse partnerships the reports which WDMSP was to provide under the Marketing Services Agreement mentioned below. For those services WDMSP was to pay SCI a fee of £3,000.

35. On 12 March 2007 there was novated to SFC an amended consultancy agreement between WDMSP and Mr Salter dated 23 March 2006 ("the SFC consultancy agreement"). It relates to all the Eclipse partnerships, including

Eclipse 35. Mr Salter's working life has been spent in the business of internationally marketing and distributing films. From 1991 until 2006 he worked for the Disney group in Paris and London, where he was an Executive Vice-President of Buena Vista International, which was at that time the trading division within the Disney group responsible for the cinema marketing and distribution of Disney films in all territories other than North America. Mr Salter's particular responsibilities were for the marketing and distribution of films in Europe, the Middle East and Africa.

36. So far as relevant to Eclipse 35 and this appeal, the SFC consultancy agreement recited that WDMSP wished to engage SFC as "Consultant" to oversee and facilitate the performance of the Designees. The Consultant agreed to provide WDMSP with certain services, including liaising with the Designees and SCI in relation to the preparation of marketing and release plans and the other services which WDMSP agreed to perform for Eclipse 35; assembling the work product of the Designees and SCI in connection with the preparation of the marketing and release plans and ensuring that such plans were in a form to be presented to WDMSP for consideration; if WDMSP approved the marketing and release plans, presenting the approved plans to Eclipse 35, Disney and the Distributor; from the information supplied by WDMSP, the Designees and SCI, tracking the performance of the Distributor in following the marketing and release plans, including identifying whether the Distributor has deviated materially from such plans; reporting to WDMSP on the performance of the Films (as informed by the Distributor); and generally providing written reports to WDMSP on matters relevant to the services WDMSP is to perform for Eclipse 35. The Consultant is to be remunerated at the rate of £700 per eight-hour day.

37. Finally, by way of background it is necessary to mention that the Licensing Agreement, the Distribution Agreement and the Marketing Services Agreement contained provisions intended to ensure that, in the event of any conflict between the interests of the Disney group and those of Eclipse 35, priority was to be given to the interests of the Disney Group. We will refer to those provisions in greater detail subsequently in this judgment but brief reference may be made to the following at this stage.

38. The Licensing Agreement provided that the licence of the Rights was subject to "the Prior Agreements". They are specified licence agreements between Disney and the Buena Vista companies dating from 1990 and also "any or all other licences or other agreements between [Disney] and any one or more of its Affiliates relating in whole or in part to the [Films] and/or any of the Rights existing as at the date of Financial Close".

39. In the Licensing Agreement Eclipse 35 acknowledged that Disney, WDMSP and other Disney parties to the transaction documents were part of the Disney group and may, in their sole discretion, enter into agreements or other arrangements with related companies in connection with the exploitation of the Rights and the Films and are under no obligation to offer the Rights to any unrelated third parties.

40. The Licensing Agreement automatically terminates, and all the Rights in the Films revert to Disney, on termination of the Distribution Agreement.

41. In the Distribution Agreement Eclipse 35 represented and warranted that, subject to the Prior Agreements, it had exclusively and exhaustively licensed the Rights to the Distributor and that during the 20 year term Eclipse 35 shall not be entitled to and shall not take any action with respect to any of the Rights or any of the Films except such actions as may be expressly provided for pursuant to the Distribution Agreement.

42. The Distribution Agreement provided that the Distributor shall be entitled to deviate from, amend or modify the marketing and release plans as WDMSP might approve in its sole and absolute discretion. It also provided that the Distributor shall be free to conduct itself without regard to the interests of Eclipse 35, subject only to the express terms of the Distribution Agreement.

43. In the Distribution Agreement Eclipse 35 acknowledged that the Distributor may have certain fiduciary and other duties to Disney group companies and their shareholders in relation to the Films and other Disney films and generally, which may compete or conflict with the Distributor's obligations to Eclipse 35, and that the Distributor can and will act in the best interests of the Disney group which may not be in the best interests of Eclipse 35, and any such action by the Distributor will not be a breach of any of the obligations owed by the Distributor to Eclipse 35 under the Distribution Agreement.

44. The Marketing Services Agreement provided that WDMSP's exclusive agency is irrevocable and is to continue until the Licensing Agreement is terminated. Eclipse 35 agreed not to terminate the appointment of WDMSP or direct how WDMSP is to perform its agency services other than as provided in the Marketing Services Agreement.

45. In the Marketing Services Agreement WDMSP acknowledged that WDMSP was a member of the Disney group and as such may have obligations and duties to Disney group companies in relation to the Films which may compete or conflict with its obligations to Eclipse 35, in which case WDMSP is entitled to act in the best interests of the Disney group even if that is not in the best interests of Eclipse 35.

The proceedings before the FTT and its material findings

46. The hearing before the FTT lasted some 14 days. They had extensive evidence. The documentary evidence, including witness statements and the documents exhibited to those statements, amounted to about 100 lever arch files. Eclipse 35 called four witnesses, including Mr Salter and Mr Molner. The Revenue called two expert witnesses. All the witnesses gave oral evidence and were cross-examined.

47. The FTT's impressive decision runs to 96 closely printed pages and 417 paragraphs. For the purposes of this appeal, it is sufficient to refer to the following parts of their decision.

48. The FTT rejected several of the Revenue's arguments.

49. The FTT did not accept the Revenue's argument that the effect of the contractual arrangements, properly interpreted, was that Eclipse 35 was not entitled to receive any meaningful Rights, and that such Rights as it acquired from Disney were immediately returned to the Disney group so that Disney effectively kept full control of the Rights, which it proceeded to exploit just as it would have done absent any involvement of Eclipse 35.

50. The FTT concluded (292, 304 and 305) that, having regard to the terms of the Licensing Agreement and the Distribution Agreement, the Licensing Agreement should be regarded as taking effect momentarily before the Distribution Agreement, and that, since the Rights granted by the Licensing Agreement were exclusive exploitation rights in respect of the Films across the range of entertainment media, and in virtually every country in the world, they were and are rights potentially of significant value.

51. The FTT did not accept the Revenue's arguments that the nature and value of the Rights were significantly depreciated by the Prior Agreements. The evidence was that Eclipse 35, through Mr Molner, had raised with Disney the question of the effect of the Prior Agreements and asked to see them, but this was refused. The refusal was not a surprise to Mr Molner since he understood them to deal with confidential matters. Disney's legal team confirmed orally that the Prior Agreements did not convey any rights. Mr Molner understood that Disney was not prepared to disclose them (having regard to their confidential nature) because they were commercially irrelevant rather than because they reserved out of the Rights a significant benefit for Disney which Disney wished to hide from Eclipse 35.

52. The FTT accepted (298-300) the submission of Eclipse 35 that it was probable that the Prior Agreements concerned matters of "routine housekeeping" within the Disney group and had no significant consequence for the licence of the Rights to Eclipse 35 and did not render the Rights valueless or materially depreciate their value.

53. The FTT did not accept the contention of the Revenue (208) that the amount and timing of the licence fees payable to Disney were determined solely by an arithmetic exercise in order to give the pattern of profit in Eclipse 35 which in turn correlated to the payment of interest by the members. The FTT accepted that the licence fees were, to an extent, determined by the cash flow which underlay the transaction, but concluded (222) that the amount of the licence fees :

> "also represents the likely value of the Rights licensed by Disney to Eclipse 35 or, at least, the value which the parties agreed to place on those Rights in the context of the overall deal which they struck after having regard to expert advice on the estimated financial performance of the Films."

54. The FTT found (319) that, looking at matters in the round, Eclipse 35 entered into the transaction knowing the likely value of the Rights it acquired, and

such value was taken into account in determining the consideration which it gave for the Rights.

55. On the issue of Contingent Receipts, which were described by the FTT (223) as in essence "super profits" and in which Eclipse 35 had a 40 per cent share under the Distribution Agreement, the FTT noted that there had been lengthy negotiations between SCI (for Eclipse) and Disney. It was a requirement of Disney that, for the purposes of calculating Contingent Receipts, the two Films should be regarded as one, that is to say their financial performance was "cross-collateralised". The consequence of having the Films "cross-collateralised" was to reduce the likelihood that Contingent Receipts would be payable: both Films would have to succeed.

56. The FTT recorded (227) that the advice of Salter Group LLC ("the Salter Group") (which was not a company connected with Mr Salter) to Eclipse 35 on 22 February 2007 was that a payment of Contingent Receipts was possible. If both Films, over the 20 year licence period, were to perform to the "best case" envisaged by Salter Group, Eclipse 35 would receive over that period Contingent Receipts of at least US$95 million. If "Enchanted" were to perform to the "best case" and "Underdog" to the "base case" envisaged by Salter Group, then Eclipse 35 would receive Contingent Receipts of between US$49 million and US$59 million. "Underdog" alone would generate Contingent Receipts only if it performed to Salter Group's "best case", and then the Contingent Receipts would be between US$4 million and US$5 million (disregarding the performance of "Enchanted").

57. The FTT said (312 and 313) that, although it now looks most unlikely that Eclipse 35 will receive Contingent Receipts, "it was reasonably expressed as a possibility" when Eclipse took the licence of the Rights and that further supported the conclusion that the licensed rights were of substance and value.

58. The FTT summarised those conclusions in paragraph 320 of their decision as follows:

> "Drawing all these matters together, therefore, we conclude that Eclipse 35 acquired the Rights by licence pursuant to the Licensing Agreement which it then subsequently proceeded to sub-licence to the Distributor pursuant to the Distribution Agreement. Neither the substance of the Rights nor their value was materially affected or depreciated by reason of the licence being granted subject to the Prior Agreements. The consideration which Eclipse 35 gave for the Rights reflected the likely value of the Rights. The Rights gave Eclipse 35, by reason of the Distribution Agreement, the entitlement to Contingent Receipts, and at the time the transaction was entered into a payment of Contingent Receipts, although speculative, was reasonably anticipated to be possible in the course of the twenty year term of the licence."

59. The FTT also rejected the Revenue's contention that the advances to the members did not give rise to any commercial risk. They concluded (232, 240

and 241) that it could not be ignored that Eagle could have recourse to the members. They said (241) that, although in April 2007 the risk of Barclays defaulting may have seemed remote almost beyond recognition, "subsequent events showed it to be at least within contemplation."

60. The FTT found (at 367) that, whilst (1) the cash flows resulting from the transactions can be said to be fundamental to Eclipse 35's participation in the arrangements it entered into, in that Eclipse 35 would not have entered into those arrangements if they did not result in those cash flows, and (2) Eclipse 35 accepts that tax relief for the interest paid on borrowings by the members was an objective on their part, it does not follow that the arrangements do not have the commercial purpose or effect which on their face they purport to have.

61. Critically, however, the FTT rejected the contention of Eclipse 35 that, collaboratively with the Distributor, it was engaged in directing and supervising the marketing and release of the Films. WDMSP prepared on Eclipse 35's behalf an initial marketing and release plan for each of the Films. Once those plans had been agreed the role of WDMSP was to monitor the Distributor's exploitation of the Films in order to check whether the Distributor was proceeding in line with the plans, to question any variations proposed by the Distributor to the strategy laid out in them and to suggest any variations which WDMSP thought appropriate as matters unfolded following the release of the Films. The FTT observed (250) that, in view of the expertise within the Disney group as to the marketing and distribution of film rights, there was little by way of intervention by WDMSP in the marketing activities of the Distributor following the release of the Films.

62. The FTT held (343) that WDMSP cannot be regarded as an agent of Eclipse 35 despite WDMSP's apparent appointment as such in the Marketing Services Agreement. The FTT said that it is of the essence of a relationship of agency that the agent, when engaged on its principal's business, should act exclusively and in a fiduciary manner in the interests of the principal but that was not the case with WDMSP and Eclipse 35. In that respect, the FTT pointed out (344) and relied upon the express provision in the Marketing Services Agreement that any duties or obligations which WDMSP may have in its capacity as a Disney group member must prevail over the duties it would otherwise owe as agent to Eclipse 35.

63. The FTT also found (346) that neither Eclipse 35 nor WDMSP nor SCI had any capability whatsoever to be a part of any strategic or day-to-day planning for the marketing or release of the Films, or to monitor or supervise the Distributor's performance relative to any agreed plan. The FTT said that the capability to plan the marketing of the Films and to monitor or supervise the Distributor's performance resided within the Disney group, and in particular in the various Buena Vista distribution companies. They further held (348) that, whatever the contractual documents provided, there was not convincing evidence that what the documents provided for matched what happened in fact.

64. They said that Mr Salter, with his long experience, may have had such capability (although to achieve anything of significance he would have required substantial support). They also acknowledged that Mr Salter made specific recommendations to Eclipse 35 (which in turn WDMSP made to the Distributor) on one occasion and that he expressed his views less formally to the Distributor on another occasion. The FTT described those two occasions in paragraphs 251 and 252 of their decision. They found (352), however, that Mr Salter's role was limited to liaising between the Buena Vista companies and WDMSP.

65. The FTT said (349) that the Buena Vista companies would, regardless of the involvement of Eclipse 35, have used their vast resources and expertise to market and distribute the Films to the best of their considerable ability; and the Disney group had a direct interest in their so doing in order to maximise the variable distributions which flowed back to Disney as variable royalties, and to maximise also the likelihood of generating Contingent Receipts (60 per cent of which went to the Disney group). The FTT said that, in those circumstances, clear and convincing evidence was required that the Designees stepped out of their position as employees doing for their Buena Vista employer what they did on a daily basis and performed their duties instead for WDMSP. Appropriate evidence of that kind, however, was not made available to the FTT.

66. The FTT's conclusions on this part of the case were summarised in paragraphs 356 to 358 of their decision as follows:

> "356. …. we do not consider that Mr Salter's activities establish that Eclipse 35 was, even on a collaborative basis, engaged in directing and supervising the marketing and release of the Films. Eclipse 35 cannot be said to be directing and supervising matters in circumstances where the Distributor had already come to a conclusion as to what it should do.
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> 357. Finally, although there was undoubtedly a well-planned and well-executed regular flow of high quality and relevant information gathered by SCI and Mr Salter from the relevant Disney companies to WDMSP Ltd and Eclipse 35, with pertinent comment by Mr Salter, and although that information was considered at board meetings of WDMSP Ltd and by the Designated Members (that is, in effect, the executive Members) of Eclipse 35, that does not in itself establish the case which Eclipse 35 is asking us to accept.
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> 358. Whilst we can conclude that, through WDMSP Ltd, Eclipse 35 monitored the activities of the Distributor with regard to the marketing and release of the Films, and was kept fully aware of the activities in that regard which the Distributor undertook and of the financial performance of the Films, we are unable to conclude that Eclipse 35 had a part, or at least a meaningful part, in directing and supervising the marketing and release of the Films by the Distributor."

67. The FTT also considered (314) that, although a reasonable opinion had been expressed when the licence of the Rights was given that Contingent Receipts were possible, "the prospect of earning them was too remote to qualify as a basis or justification for entering upon a trading venture on any commercial level." The FTT mentioned, in that connection, the evidence of Mr Molner that no-one would be advised to invest in film rights by reference only to the prospect of what might be delivered by something like Contingent Receipts. The FTT said that was also shown by the financial illustrations given to potential investors when the arrangements were marketed, which disregarded any prospect of Contingent Receipts.

68. The FTT further held that, although the acquisition of the Rights by licence and sub-licence were not sham transactions, Eclipse 35 cannot be considered on any realistic or meaningful basis to have a customer or to offer to provide any goods or services by way of business. They pointed out that Eclipse 35 never received physical delivery of the physical manifestation or representation of the Films (since, under the terms of the Licensing Agreement, Disney was to provide physical delivery of the Films to Eclipse 35 by delivering the specified prints, negatives and other technical representations of the Films to a specified laboratory to be held for the account of the Distributor); the Licensing Agreement and the Distribution Agreement were co-terminous and were intended to be (and were) entered into concurrently and were interdependent; Eclipse 35 accepted that the Distributor may act in the best interests of the Disney group even if that may not be in the best interests of Eclipse 35; and, in relation to the marketing services arrangements, the capacity of strategic and day-to-day planning for the marketing and release of the Films was within the Disney group.

69. The FTT further agreed with the Revenue (301) that the fact that Eclipse 35 was prepared to take a licence of the Rights subject to the Prior Agreements without obtaining some formal reassurance from Disney as to the purpose, effect and possible significance of the Prior Agreements for the Rights granted indicated "a degree of indifference about the value of what was being acquired", which "[went] to the significance which Eclipse 35 attributed to this aspect of the transaction".

70. Having reviewed the evidence, the FTT referred to a number of authorities, including *Ransom v Higgs* [1974] 3 All ER 949, *Ensign Tankers (Leasing) Ltd. v Stokes* [1989] 1WLR 1222, *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684, *New Angel Court Ltd v Adam* [2004] STC 779, and *FA & AB Ltd v Lupton* [1972] AC 634.

71. The FTT also referred to a number of statutory provisions, including ITTOIA s. 609 (which provides for a charge to income tax on income from a business involving the exploitation of films or sound recordings where the activities carried on do not amount to a trade, that is to say a "non-trade business") and TA 1988 832(1), which defines trade as including "every trade, manufacture or concern in the nature of trade".

72. In the light of those authorities and statutory provisions, the FTT stated (398) that they considered that:

> "an element of speculation is a characteristic of the concept of trade – if a taxpayer is trading, what he does must, normally at any rate, be speculative in the sense that he takes a risk that the transaction(s) may not be as profitable as expected (or may indeed give rise to a loss)".

73. The FTT considered (401 to 403) that the element of risk was absent from the arrangements and activities of Eclipse 35 for the following reasons. Firstly, leaving aside the question of Contingent Receipts, the profit from the sub-licence of the Rights over a 20 year period, year by year, was determined at the outset and without any reference to the success or otherwise of the exploitation of the Rights. Eclipse 35 took the commercial risk that Barclays may not meet its liabilities under the Letter of Credit, but the FTT considered that such a risk was and is too remote to cause the pre-determined profit to be speculative in any relevant sense. Further, the FTT considered that such risk is not associated with the acquisition and exploitation of the Rights but rather with the solvency of Barclays "which is a factor as far removed from what Eclipse 35 actually did as the Members' financing arrangements".

74. Secondly, the FTT considered that the prospect of Eclipse 35 actually receiving any Contingent Receipts was "so remote as to make wholly unrealistic a conclusion that the entitlement to Contingent Receipts under the sub-licence of the rights in the Films gave the sub-licence the character of a trading transaction".

75. The FTT also said (405-409) that, although the licence and sub-licence of the Rights were not sham transactions, it was impossible to conclude that on any realistic or commercially meaningful basis Eclipse 35 has a customer or has offered to provide any goods or services by way of business for the same reasons as earlier stated.

76. The FTT held (410) that the conclusion that Eclipse 35 was not trading was further supported by the fact that the amount of the putative trading receipts of Eclipse 35 was affected by the extraneous factor of the financing arrangements of the members, reflected in the special feature of the pre-payment of ten years' interest. Our understanding of the meaning of the FTT on this aspect is that the profile of the Annual Ordinary Distributions payable to Eclipse 35 under the Distribution Agreement was influenced by the interest payable by the members, including their pre-payment of interest.

77. The FTT rejected (411) Eclipse 35's argument that the Licensing Agreement and the Distribution Agreement can be regarded as trading transactions on the analogy of a sale and leaseback transaction. They said that the purchase of an asset by a lessor on terms that it is leased back by a finance lease is properly to be regarded as a trading transaction, the essence of which is the provision of finance by the lessor. By contrast, Eclipse 35 does not claim to be carrying on a financial trade and in any case did not provide finance.

78. The FTT considered (412) that what Eclipse 35 actually did was not a trading transaction but nor was it a mere device to secure a fiscal advantage. They said (414) that the activities of Eclipse 35 viewed realistically amounted to a business involving the exploitation of films not amounting to a trade, that is to say a non-trade business within ITTOIA s. 609.

79. For those reasons the FTT dismissed Eclipse 35's appeal against the closure notice dated 15 May 2009.

The appeal to the UT

80. Sales J dismissed the appeal from the FTT on the trading issue. It was common ground, however, that in the light of the FTT's conclusions they ought to have allowed the appeal against the closure notice on the narrow basis that in the relevant period Eclipse 35 carried on a business with a view to profit. Sales J allowed the appeal against the closure notice and the FTT's decision on that narrow ground.

81. There was a Respondent's Notice in the Upper Tribunal in relation to the significance and effect of the Prior Agreements. The background to it was that, after the FTT's decision, the Revenue succeeded in obtaining copies of the Prior Agreements from Disney. It then became apparent that, contrary to the FTT's assumption, the Prior Agreements did not concern merely "routine housekeeping" matters but granted extensive distribution and other rights in respect of the Films to the Buena Vista companies. The Revenue contended that the effect of the Prior Agreements was that Eclipse 35 did not acquire from Disney any substantive distribution rights because those rights had already been granted to the Buena Vista companies.

82. The Prior Agreements and expert evidence on their proper interpretation were admitted in evidence on the hearing of the appeal. Sales J held that the FTT had mischaracterised the contractual effect of the Prior Agreements. He concluded that, in the light of their content and that the Licensing Agreement was made subject to them, the Rights granted to Eclipse 35 were and (unless and until the Prior Agreements are terminated) are limited to cinematic distribution rights in the USA and North America and television distribution rights. Sales J held, however, that the mischaracterisation did not have a significant impact on the analysis of the trading issue.

83. It is not necessary to recite and examine further Sales J's reasoning since the focus on this appeal is inevitably on the decision of the FTT, which was the fact finding body and from whose decision an appeal to the Upper Tribunal lay on a point of law only.

The appeal to the Court of Appeal

84. In its written Grounds of Appeal Eclipse 35 specified 11 grounds of appeal. Eclipse 35's main skeleton argument in support of the appeal advanced the eight "key steps" that it had identified before the UT as its main arguments. It then contended that 17 central findings of fact found by the FTT meant that the only proper conclusion open to the FTT was that Eclipse 35 was trading.

85. Mr Graham Aaronson QC, leading counsel for Eclipse 35, made extensive oral submissions. The following is not intended to be a comprehensive repetition of them but is a brief summary of his main points.

86. He submitted that Eclipse 35 engaged in genuine and sustained activity comprising four different elements: (1) identifying films which showed a good chance of generating income leading to Contingent Receipts; (2) negotiating the best possible margin of Contingent Receipts for Eclipse 35; (3) negotiating and setting up with Disney an unprecedented arrangement for the distribution of the Films; (4) monitoring and commenting on the way in which the exploitation of the Films was being carried out.

87. As to the choice of the Films, Mr Aaronson emphasised that the search was for franchise films which would carry the best prospect of obtaining Contingent Receipts. As the FTT explained (93(2)), "franchise" films are likely to have an enduring attraction and longevity and therefore best placed to earn maximised income over time with the best prospect for members of the Eclipse Partnerships of receiving Contingent Receipts. A "franchise film" is one which is based on an existing media property, so that in some way (subject matter, established and specific genre, characters) a potential audience already have a connection which is expected to draw them to the film: it may be a film based on a book, comic strip, or a television series, or as a sequel to an earlier film.

88. As to the negotiations over Contingent Receipts, Mr Aaronson emphasised that the entitlement to Contingent Receipts was heavily negotiated and was required to be approved by the President of Disney himself.

89. As to the arrangements for the distribution of the Films, Mr Aaronson emphasised that other film studios had refused to negotiate a comprehensive release and distribution plan and this was the first time Disney had agreed that such a plan should be prepared; the marketing services arrangements were the subject of detailed negotiation between Mr Molner, for the Eclipse partnerships, and the Disney group; and the plans were prepared by WDMSP with contributions from SCI and Mr Salter. Mr Aaronson emphasised the knowledge and experience of Mr Molner and Mr Salter in the film industry.

90. As to monitoring the implementation of the marketing and release plans, Mr Aaronson emphasised the findings of the FTT (249) that Mr Salter made regular reports to Eclipse 35 on the basis of information on marketing plans and matters supplied to SCI by the Designees; and, on the basis of those reports, Eclipse 35 instructed WDMSP to carry out the marketing plans, with WDMSP in turn instructing the Distributor and subsequently monitoring implementation of the plans. Mr Salter was in regular contact with his former colleagues at Buena Vista International, who acted for the Distributor in relation to the exploitation of the Films in the international markets. On one occasion (as found by the FTT at 251) Mr Salter made a specific recommendation to Eclipse 35 about marketing and distribution, which in turn WDMSP made to the Distributor. On another occasion (as found by the FTT at 252), Mr Salter recommended a marketing course of action with Buena

Vista International, which coincided with their view, and the Distributor proceeded in the way recommended.

91. Mr Aaronson emphasised the findings of fact in paragraphs 89 and 90 of the FTT's decision as to "negotiations" between Future, SCI and Disney. Paragraph 90 was as follows:

> "90. Matters which were the subject of particularly intensive negotiation included the following:
>
> (1) The value to be attributed to the film rights licensed and the amount of the fixed royalties paid by the Distributor;
>
> (2) The identity of the films, and the extent of the rights in such films, to be licensed;
>
> (3) The protection of Disney's rights in the films in the eventuality of the insolvency of the Eclipse partnership;
>
> (4) The marketing arrangements carried out through WDMSP Ltd, including the extent of WDMSP Ltd's role and its accountability to, respectively, the Eclipse partnership which engaged its services and Disney;
>
> (5) The amount of the Studio Benefit in the case of each tranche (which was reduced from 2.5 per cent envisaged in the Term Sheet to … 1.15 per cent in the case of Eclipse 35);
>
> (6) The terms on which the Contingent Receipts were to be ascertained, and the proportion of the Contingent Receipts to which the Eclipse partnerships were entitled; and
>
> (7) The extent of the rights which the Eclipse partnership had to audit the gross income receipts earned by the films in order to monitor any entitlement of the Eclipse partnership to Contingent Receipts."

92. In that context Mr Aaronson pointed out that the Eclipse 35 transaction differs from the prior Eclipse transactions in a number of respects, including that Eclipse 35 acquired the rights in two films (which were "cross-collateralised") rather than a single film and its share of Contingent Receipts was 40% rather than 34% as a *quid pro quo*.

93. Mr Aaronson emphasised the provisions in the Marketing Services Agreement which required WDMSP, as Eclipse 35's agent, to prepare marketing and release plans in relation to the Films; to oversee the conduct of the Distributor in implementing the plans; to report monthly to Eclipse 35 on the activities of the Distributor in implementing the plans and to hold review meetings periodically with Eclipse 35's management.

94. Mr Aaronson submitted that the FTT had made a number of significant errors in relation to the four areas of activity on which Eclipse 35 relies.

95. Mr Aaronson said that the FTT was wrong to attach the significance they did to the fact that no person would sensibly have invested in Eclipse 35 just to share in Contingent Receipts. What is important, he said, is that (as the FTT found) at the time the transaction was entered into it was reasonably believed there was a real possibility of obtaining Contingent Receipts if the Films were successful. He submitted on this aspect that, in deciding whether Eclipse 35 was carrying on a trade, what is critical is whether what was done by and on behalf of Eclipse 35 was *bona fide* and it does not matter whether it was speculative.

96. Mr Aaronson was critical of the FTT's statement (314) that the prospect of earning Contingent Receipts, although a possibility, was too remote to qualify as a basis or justification for entering upon a trading adventure on any commercial level. He said that the fortunes of Eclipse 35's business are obviously related to the performance of the Films, so the FTT could not possibly be saying they were not. He said that the FTT had minimised the importance of the Contingent Receipts to the point of extinction. He referred to the observation of the Judicial Committee in *IRC v Scottish Provident Institution* [2004] UKHL 52, [2004] 1 WLR 3172, at [23] that the composite effect of a tax scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectation of the parties, it might not work as planned.

97. So far as concerns the provisions in the Distribution Agreement preferring Disney's interests over those of Eclipse 35, Mr Aaronson said that those were simply standard provisions because, as a huge film studio, Disney would inevitably not permit a small entity like Eclipse 35 to prejudice its own plans.

98. He said that the view expressed by the FTT (346-349) that nothing was done in relation to the marketing and release of the Films which Disney would not ordinarily have done is inconsistent with the express finding (247) that this was the first occasion on which Disney had agreed to commission a comprehensive marketing plan.

99. Mr Aaronson criticised the observation of the FTT (349) that the FTT's view might have been different if someone from the Disney group had given evidence that Eclipse 35's efforts had made a contribution and a difference. He said that cannot be the proper test. He submitted that the true and proper test is whether there were genuine attempts to generate Contingent Receipts.

100. He further argued that, even if it were true that the Disney group would have done exactly the same in any event, that would be irrelevant. He said that what mattered was that Mr Molner and Mr Salter were engaged to achieve as effective an exploitation of the Films as could be devised and to check that the marketing and release plans were followed.

101. Mr Aaronson criticised the FTT for drawing an inference adverse to Eclipse 35 for failing to secure some formal re-assurance in relation to the "Prior Agreements". He said that it is absolutely standard practice for there to be intra-group arrangements such as were contained in the Prior Agreements.

102. Mr Aaronson criticised the FTT for their reasoning (398 to 403) that speculation is a characteristic of the concept of trade and their finding that the transaction entered into by Eclipse 35 did not have that characteristic. He said that speculation is not an essential characteristic of trade.

103. Mr Aaronson criticised the FTT's imposition of a "customer" test and their finding (404 to 408) that Eclipse 35 did not have a discernable customer. He submitted that it plainly had a customer, namely the Distributor.

104. He also criticised the FTT's observation (411) that "a trade of acquiring and exploiting film rights would… usually involve the retention by the trader of some residual film rights having commercial reality". Mr Aaronson said that there was no reason for that to be so.

105. Mr Aaronson submitted that the FTT were wrong to attach significance to the fact that (as provided in the Licensing Agreement) the prints, negatives and other technical representations of the Films were never delivered to Eclipse 35 but were delivered to a laboratory for the account of the Distributor. He said that it was entirely understandable that a studio like Disney would not want to deliver its films into the hands of private investor partners.

106. Mr Aaronson's "default" argument was the simple proposition that the activity of entering into a licence and sub-licence was in itself a trading activity regardless of any other facts and matters. He referred in that context to *Pearn v Miller* [1927] 11 TC 610, *Johnston v Heath* [1970] 3 All ER 915, *Ransom v Higgs* [1974] 3 All ER 949 and *Ensign Tankers (Leasing) Ltd v Stokes* [1989] 1 WLR 1222 (Millett J), [1992] 1 AC 655 (HL). He criticised the FTT's comments (411) distinguishing finance leasing since, as he submitted, the FTT were mistaken as to the essence of financing leasing and, in any event, it was never contended that the transaction in the present case involved a finance lease: financing leasing was merely advanced by way of analogy.

107. Mr Jolyon Maugham, Eclipse 35's junior counsel, added submissions of his own as to the circumstances in which it would or would not be appropriate to remit to the FTT if they had made one or more errors of law as set out in paragraphs 9 to 46 of Eclipse 35's skeleton.

108. By a Respondent's Notice the Revenue relies on additional grounds to support the decision of the FTT and of the UT that Eclipse 35 was not trading: in particular, the Revenue contends, as it did before the UT, that the existence and content of the Prior Agreements mean that Eclipse 35 acquired no substantive rights to the Films and the Prior Agreements deprived the Rights of any real value.

Legal principles

109. We begin our analysis with the following observations on the relevant legal principles. As Mr Aaronson observed at the outset of his submissions, tax on profit from carrying on a trade has been a feature of our tax legislation for some 200 years. In the present case, we are concerned with the proper

meaning and application of "trade" in ITTOIA 2005 ss. 5 and 863(1) and TA 1988 s. 362(1)(b), which are the applicable provisions for the tax year in issue.

110. There is no special rule for interpreting tax legislation. *Ramsay (WT) Ltd v IRC* [1982] AC 300 marked the end of an unduly literal interpretative approach to tax statutes and a formalistic insistence on examining steps in a composite scheme separately. As Lord Nicholls, giving the judgment of the Judicial Committee, said in *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL, [2005] 1 AC 684 at [32], the essence of the new approach was to give the statutory provision a purposive interpretation 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. This brought the interpretation of tax statutes into line with general principles of statutory interpretation and required notice to be taken of the reality of the transaction in issue. As the Judicial Committee observed in the *Barclays Mercantile Business Finance* case at [35] that approach has led the court in cases such as *Inland Revenue v Burmah Oil Co Ltd* [1982] SC (HL) 114 , *Furniss v Dawson* [1984] AC 474 and *Carreras Group Ltd v Stamp Commissioner* [2004] STC 1377 to decide that elements which have been inserted into a transaction without any business or commercial purpose did not prevent the composite transaction from falling within a charge to tax or, as the case may be, bring it within an exemption from tax. To that list of cases may be added *IRC v Scottish Provident Institution* [2004] UKHL 52, [2004] WLR 3172. The effect of the *Ramsay* case and the modern approach was elegantly summarised by Ribeiro PJ in the following statement (approved by the Appellate Committee in the *Barclays Mercantile Business Finance* case) in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, para 35:

> "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."

111. The concepts of an "unblinkered approach to the analysis of the facts" and a "realistic approach to the transaction" derive at least in part from the speeches in *Ransom v Higgs*. There, Lord Morris said (at 960c) that "[i]n considering whether a person 'carried on' a trade it seems to me to be essential to discover and examine what exactly it was that the person did", and Lord Reid (at 955h) specifically examined what Mr Higgs had himself done. It is necessary to stand back and look at the whole picture and, having particular regard to what the taxpayer actually did, ask whether it constituted a trade.

112. The Income Tax Acts have never defined trade or trading further than to provide that (in the words of TA 1988 s. 832(1) which was applicable to the relevant tax year) trade includes every trade, manufacture, adventure or concern in the nature of trade. As an ordinary word in the English language "trade" has or has had a variety of meanings or shades of meaning. Its

meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation, depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular factual characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles. To that extent the conclusion is one of fact, or, more accurately, it is an inference of fact from the primary facts found by the fact-finding tribunal.

113. It follows that the conclusion of the tribunal of fact as to whether the activity is or is not a trade can only be successfully challenged as a matter of law if the tribunal made an error of principle or if the only reasonable conclusion on the primary facts found is inconsistent with the tribunal's conclusion. These propositions are well established in the case law*:* *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). An appeal from the FTT is on a point of law only: Tribunals, Courts and Enforcement Act 2007 s.11.

114. In *Marson v Morton* at pages 1348-1349 Sir Nicholas Browne-Wilkinson V-C set out a list of matters which have been regarded as a badge of trading in reported cases. He emphasised, however, that the list was not a comprehensive statement of all relevant matters nor was any one of them decisive in all cases. He said that the most they can do is to provide common sense guidance to the conclusion which is appropriate; and that in each case it is necessary to stand back and look at the whole picture and, having regard to the words of the statute, ask whether this was an adventure in the nature of trade. It is not necessary to set out Sir Nicholas Browne-Wilkinson's list here because neither side argued its case by reference to the list. The cases by reference to which the list was compiled are not sufficiently analogous to the facts of the present case to make the list of value in these proceedings.

115. In *Ransom v Higgs* Lord Reid said (at 955) that the word "trade" 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. Lord Wilberforce said (at 964) that normally trade involves the exchange of goods or services for reward and pre-supposes a customer. Those references to the normal feature of a "customer" in trading activity must be treated with care. In that case the taxpayer played a role in putting together a scheme involving transactions between trustees, a number of companies and his wife. He was not personally a party to any of the transactions. The Revenue claimed that he was liable to income tax on the ground that the part he had played in implementing the scheme constituted an adventure in the nature of trade within the Income Tax Act 1952 s. 526(1). He was held not liable. The important point being made by Lord Reid and Lord Wilberforce was that the taxpayer had no counter-party. As Lord Wilberforce explained (at 964f)

"trade must be bilateral – you must trade with someone". Lord Cross said (at 974):

> "A man cannot be trading or engaged in an adventure in the nature of trade unless there is someone with whom he is trading – someone to whom he supplies something such as goods or services for some return. Here there was no one with whom Mr Higgs can fairly be said to have "traded" … Mr Higgs … simply told the parties concerned to carry out the transaction which the scheme which he had adopted required them to carry out."

116. Undoubtedly trading activity involves a counter-party of some description. We do not find it helpful, however, in a complex transaction such as the one with which we are concerned to seek to identify whether that counter-party is or is not properly characterised as a "customer", as that word is used in ordinary speech.

117. Finally, on legal principles, it is elementary that the mere fact that a taxpayer enters into a transaction or conducts some other activity with a view to obtaining a tax advantage is not of itself determinative of whether the taxpayer is carrying on a trade: *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655, 677 (Lord Templeman).

Discussion

118. Mr Aaronson's submissions were carefully reasoned but we would nevertheless dismiss this appeal.

119. Mr Aaronson's argument fell into two broad parts. The first is that, on the basis of the contractual documents and the primary facts as to what was actually done by and on behalf of Eclipse 35, a finding that Eclipse 35 was trading is the only possible legally correct outcome, or, in the language of the case law, the only reasonable conclusion on the facts The second is that the acquisition of film rights and the sub-licensing of those rights for profit are inherently and as a matter of law carrying on a trade.

120. As to the first part of Mr Aaronson's argument, the elements on which he relied can be broadly and simply summarised as follows. The FTT found that the contractual documents governing the licensing and sub-licensing of the Film Rights and the marketing and release of the Rights were not shams. The FTT found that they gave Eclipse 35 a real and valuable interest in the Rights. The FTT found that Eclipse 35 was advised that there was a real possibility of the Films generating over the 20 year term Contingent Receipts which, on a best case basis, could amount to as much as $95 million. The FTT found and recorded in their decision a number of activities by and on behalf of Eclipse 35, all of which were directed to securing for Eclipse 35 as great an amount of Contingent Receipts as possible.

121. Those activities included the negotiation of the contractual terms relating to Contingent Rights; the preparation by WDMSP, on behalf of Eclipse 35, and

with input from Mr Salter, of an initial marketing and release plan for each of the Films (which Disney had apparently never commissioned for any previous films); instructions to WDMSP to carry out the marketing plans; instructions by WDMSP to the Distributor to implement the plans; and the monitoring of the implementation of the plans. The latter included two particular occasions on which Mr Salter made proposals with regard to the marketing of the Films. There was no finding by the FTT that any of those activities were not genuine.

122. Eclipse 35's case is that the combination of those matters must as a matter of law lead to the conclusion that Eclipse 35 was carrying on a trade.

123. We do not agree. Our reasons can be stated quite briefly. The proper characterisation of the business of Eclipse 35 depends upon the totality of its activity and enterprise. Stripping the business down to its essential elements, the transactions on which Eclipse 35 was engaged had two aspects. One aspect was that a payment by Eclipse 35 of £503 million would be repaid with interest over a 20 year term and would produce a profit unrelated to the success or otherwise of the exploitation of the Rights sub-licensed. That aspect had the character of an investment. Mr Aaronson did not argue to the contrary.

124. The second aspect was the possibility of Eclipse 35 obtaining a share of Contingent Receipts and the activity on the part of Eclipse 35 to secure such a share. The FTT considered that this second aspect was in real and practical terms insufficiently significant in the context of Eclipse 35's business as a whole to lead to a proper characterisation of Eclipse 35's business as one of trade within the meaning of the tax legislation. In our judgment, that was a conclusion which the FTT were entitled to reach and, indeed, with which we agree.

125. The view of the FTT on this point is encapsulated in paragraph 402 of their decision when they said that "the prospect of Eclipse 35 actually receiving any Contingent Receipts … was … so remote as to make wholly unrealistic a conclusion that the entitlement to Contingent Receipts under the sub-licence of the rights in the Films gave the sub-licence the character of a trading transaction". That mirrored the language they had used in paragraph 314 of their decision.

126. That language, viewed in isolation, might appear inconsistent with the evidence and indeed the findings of the FTT that the Rights acquired and sub-licensed by Eclipse 35 had a real value; there was a real possibility that they would generate Contingent Receipts; the relevant contractual documents, most particularly the Licensing Services Agreement, the Distribution Agreement and the Marketing Services Agreement, were not shams; there were intensive negotiations by Eclipse over them; and various steps were taken by or on behalf of Eclipse 35 in relation to the marketing and release of the Films directed to improving the prospect that marketing of the Films would be successful and so heighten the likelihood of them generating Contingent Receipts.

127. Mr Aaronson submitted that there was (in our language) a "disconnect" between the findings of fact of the FTT in relation to those and other matters in the earlier parts of the decision and the FTT's analysis and conclusions from paragraph 368 onward. It led him to suggest that the FTT may have changed their minds in the course of writing their decision or that there had been what he described as judicial "reverse engineering", that is to say moulding reasoning and analysis to fit an intuitive or pre-determined outcome.

128. We reject that criticism. It is elementary that the FTT's decision must be read as a whole in order to arrive at a fair understanding of the FTT's meaning and intent. It seems to us plain what was meant by the FTT in paragraph 402 and what was the basis for their conclusion that the possibility of obtaining a share of Contingent Receipts was not such as to lead to the proper characterisation of the business of Eclipse 35 as trade.

129. In both paragraphs 314 and 402 the FTT referred to the evidence given by Mr Molner, Eclipse 35's own witness, that no-one would be advised to invest in film rights by reference to the prospect of obtaining a share of Contingent Receipts. That, they said, was borne out by the financial illustrations given to potential investors when the arrangements were marketed. Those illustrations disregarded the prospect of Contingent Receipts in presenting an internal rate of return which was considered by Future to render the investment attractive even if an investor did not wish to borrow part of the capital intended to be contributed.

130. As alluded to in the last sentence of paragraph 406 of the FTT's decision, the contractual documents themselves contained important provisions which so radically preferred the interests of Disney over Eclipse 35 and so severely curtailed the legal obligations of the Distributor and WDMSP to Eclipse 35 as to add acute legal conditions to the prospect of Eclipse 35 receiving a share of Contingent Receipts.

131. Clause 2(f) of the Licensing Agreement restricted Eclipse 35 from sub-licensing the Film rights otherwise than in accordance with the Distribution Agreement. By clause 20(b) of the Licensing Agreement Eclipse 35 acknowledged that Disney (including WDMSP) had a free hand to enter into agreements and other arrangements with Disney-related parties in connection with the Film rights and their exploitation and was under no obligation to offer exploitation rights to any non-Disney entities.

132. By clause 2(d) of the Distribution Agreement Eclipse 35 represented and warranted that it had granted the Distributor an exclusive and exhaustive licence of the Film rights and that it could not take any action in respect of those rights unless expressly provided for in the Distribution Agreement itself. By clause 4(a) of the Distribution Agreement Eclipse 35 acknowledged and agreed that the Distributor should be entitled to deviate from and amend or modify the marketing and release plans in any way it might choose in its absolute discretion. Clause 4(b) provided that the Distributor should be free to conduct itself, and its obligations under the Distribution Agreement, without regard to the interests of Eclipse 35, subject only to the express terms of the Distribution Agreement. In clause 20(c) Eclipse 35 acknowledged that it

might have obligations to Disney, its affiliates and their shareholders in relation to the Films and other Disney films and generally which might conflict with the Distributor's obligations to Eclipse 35 under the Distribution Agreement, and in the event of any such conflict, the Distributor could and would act in the best interests of Disney and its affiliates; and such conduct of the Distributor should not be a breach of the Distribution Agreement or of any other contractual obligations owed by the Distributor to Eclipse 35. Paragraph 3.2 of Appendix A to Schedule 1 of Exhibit C to the Distribution Agreement provided that the Distributor has no obligation to distribute any of the Films and, if it does so, it has no obligation to maximise accountable receipts; and Eclipse 35 acknowledged that the Distributor had not made any representations with respect to the likelihood or amount of Contingent Receipts, if any, which might be derived from distribution of any of the Films. Paragraph 3.3 provided that, as between the Distributor and Eclipse 35, the Distributor has exclusive and perpetual control of the distribution, marketing, advertising, publicising, exploitation, sale or other disposition of the Films and might distribute, or withhold or withdraw any of the Films from distribution at its sole discretion with respect to one or more territories or media; and the Distributor might distribute the Films with other pictures whether or not the Distributor has any interest in such other pictures. Paragraph 3.3G contained provisions similar to clause 20(b) of the Licensing Agreement. Appendix A to Schedule 2 of Exhibit C of the Distribution Agreement contains similar provisions.

133. The Marketing Services Agreement recited that Eclipse 35 wished irrevocably to appoint WDMSP as its exclusive agent to provide the services specified in the Agreement. Clause 2.1.3 contains similar provisions to clause 20(b) of the Licensing Agreement. Clause 13.1 provided that the Distributor had agreed to exploit the film rights substantially in accordance with the marketing and release plans subject to such amendments as may be permitted pursuant to the Distribution Agreement or as WDMSP might approve in its absolute discretion.

134. In addition to all of those provisions conferring a very wide discretion on Disney and its group companies, including the Distributor and WDMSP, as to how and indeed whether at all to market the Films, the Licensing Agreement and the Distribution Agreement were expressly made subject to the rights conferred by the Prior Agreements on various Buena Vista companies or other Disney-related entities. Disney did not allow Eclipse 35 to see the Prior Agreements and did not disclose their contents. The FTT agreed with Eclipse 35 that the Prior Agreements, and the grant of the Rights in the Licensing Agreement subject to the Prior Agreements, probably did not make the licensed rights valueless or materially depreciate their value. They noted in paragraph 301 of their decision, however, that it was significant that Eclipse 35 was prepared to take a licence of the Rights subject to the Prior Agreements without obtaining some level of satisfaction from Disney beyond, at best, an un-minuted oral remark as to their purpose and effect and possible significance for the Rights granted. The FTT were entitled to conclude, as they did in paragraphs 301, that this speaks of a degree of indifference about the value of what was acquired.

135. In addition to those matters is the fact that the WDMSP carried out its functions for Eclipse 35 using Disney employees seconded from Disney group companies, notably the Buena Vista companies. The FTT found in paragraph 349 that, regardless of the involvement of Eclipse 35, the Buena Vista companies would have used their vast resources and expertise to market and distribute the Films to the best of their considerable ability. They found in paragraph 351 that, even before the involvement of Eclipse 35, it was probable that Disney would have engaged in a sophisticated preparatory process. None of those findings is undermined by the FTT's acknowledgment that Disney had never before prepared a comprehensive marketing and release plan or that the marketing services arrangements were the subject of detailed negotiation or that the marketing and release plans had some input from Mr Salter.

136. It is true that Mr Salter was engaged by WDMSP as a consultant, and Eclipse 35 relies on two occasions when Mr Salter made suggestions about the marketing of the Films. As the FTT noted in paragraph 338 of their decision, however, Mr Salter's activities under his consultancy agreement did not require him to take an executive part in the marketing and distribution of the Films. His role was to receive information from, or the work product of, others (such as the Buena Vista employees seconded to WDMSP) and to pass that on to WDMSP and generally to act as a liaison between WDMSP, Eclipse 35 and the Buena Vista companies.

137. In the circumstances the statement of the FTT in paragraph 349 of their decision that witness evidence from one of the Buena Vista staff would have shed light on the commercial reality of the arrangements provided for in the network of contractual documents is understandable and was justified.

138. Mr Aaronson made various submissions on the burden of proof, suggesting that the FTT may have misunderstood or misapplied the burden, which he accepted lay on Eclipse 35, of establishing that its business was one of trade. There is simply no proper basis for any such suggestion. After analysing the mass of written and oral evidence adduced over some three weeks the FTT concluded on the facts, and was perfectly justified in concluding, that, reducing the transactions to their core and notwithstanding some contribution by SCI and Mr Salter, the substantial reality was that Disney produced the Films; let the rights in them to Eclipse 35, and immediately took them back again; Disney personnel created marketing plans and implemented them; and they reported back to Eclipse 35 what Disney was doing.

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

140. The FTT's conclusion on the facts was not inconsistent with their finding that the contractual documents were not shams. "Sham" has a technical and well-

known meaning: see Diplock LJ in *Snook v. London & West Riding Investments* Ltd [1967] 2 QB 786, where he defined a sham as:

> "acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual rights and obligations (if any) which the parties intend to create."

141. The reality of the transaction is something quite different. It requires a detailed factual investigation of what actually happened and what the taxpayer actually did. That is what the FTT undertook.

142. Mr Aaronson submitted that the FTT made several significant errors of law on the way to their conclusion, and those errors fatally undermine that conclusion.

143. Mr Aaronson criticised the FTT's statement in paragraph 403 that the transactions entered into by Eclipse did not have the speculative aspect which the FTT would expect to see in trading transactions. He submitted that they were wrong to view speculation as a critical ingredient of trade. In *Johnston v Heath* [1970] 3 All ER 915 at 922 Goff J said that he was far from persuaded that an adventure in the nature of trade in this context necessarily connotes that there must be risk. We agree that carrying on a trade does not necessarily require that there must be risk. It is apparent, however, from paragraph 398 of their decision that the FTT's view was that speculation is an indication of trade, not that it is essential. That is a perfectly legitimate approach.

144. Mr Aaronson criticised the FTT's attempt in paragraphs 404 to 409 of their decision to discern whether Eclipse 35 had any customer and their conclusion that it did not. Mr Aaronson submitted that, in that respect, the FTT misunderstood Lord Wilberforce's comment in *Ransom v Higgs* quoted in paragraph 399 of the FTT's decision. He submitted that Eclipse 35 plainly did have a customer: the Distributor, to whom the Film rights were sub-licensed.

145. It is true that the FTT did not expressly acknowledge that there can be trading in rights and choses in action as well as goods and services. We also agree, as stated above, that Lord Wilberforce's comment must be understood in the context of a case where the taxpayer had no counter-party at all. The FTT was focusing in paragraphs 404 to 409 on what Eclipse 35 was offering by way of business to the Disney parties. Their substantive conclusion was that on a realistic view of the facts, Eclipse 35 did not offer to provide any commercially meaningful goods or services to the Disney parties by way of business. The FTT's approach to the identification of a customer did not distract them from this important exercise.

146. The whole analytical exercise undertaken by the FTT was, as we have said, to discern whether what would otherwise have been simply the business of acquiring an investment from Disney by Eclipse 35 was more appropriately characterised as a trade or an adventure in the nature of a trade by reason of the right to Contingent Receipts and the steps taken to acquire a share in them.

For that purpose, the FTT was rightly examining the reality of what was actually agreed and done by Eclipse 35. That is what the FTT were doing in paragraphs 405 to 407, looking at the terms of the contractual documents and the persons who were actually responsible for the marketing of the Films (on both of which we have commented above). In expressing the view in paragraph 409 that "on any realistic view of the facts – that is, on any commercially meaningful basis" Eclipse 35 had no customer and did not offer to provide any goods or services by way of business, the FTT were really doing little more than stating a conclusion already reached that, stripped to its essentials, the relationship between Disney and all its related entities, on the one hand, and Eclipse 35, on the other hand, was one in which Eclipse 35 acquired an investment rather than carried on a trade.

147. Finally, on this part of Mr Aaronson's submissions, we referred above to his criticism of the FTT's observation in paragraph 406 of their decision that the fact that Eclipse was never to receive actual physical delivery of the physical manifestation or representation of the Films was relevant to the question of the nature of Eclipse 35's business. That observation, however, was made in the context of analysing the provisions of the relevant contracts. We have already explained why the FTT were fully justified in taking into account the general contractual emphasis on preferring the interests of the Disney group over those of Eclipse 35 and conferring a wide discretion on the Disney group in relation to marketing while commensurately circumscribing the rights of Eclipse 35.

148. We turn finally to the other way in which Mr Aaronson put Eclipse 35's case, namely that the acquisition of the licence to the Rights and the sub-licensing of them for consideration and with a view to profit constituted inherently and as a matter of law carrying on a trade. We do not agree and we do not consider that the cases relied upon by Mr Aaronson justify his submission. We have summarised above the general principles and approach in this type of case, namely that what is necessary is an evaluation of the precise facts against the background of the meaning of the statute. The facts in the cases relied upon by Eclipse 35 were very different from those of the present case. In *Pearn v Miller* the taxpayer bought on mortgage five tenanted properties over a five year period. He repaired them and sold two of them to the tenants. Rowlatt J remitted to the Commissioners to determine whether what the taxpayer did was a trade or an adventure or concern in the nature of trade. In *Johnston v Heath* Goff J held that the taxpayer was engaged in an adventure in the nature of a trade where he entered into a contract to purchase land having already contracted to sell it to someone else.

149. In *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655 the House of Lords held that a partnership between the taxpayer and others and the subsidiary of an American film production company to produce and exploit a film then in the course of production by the production company was carrying on a trade. The substance of its activity was to expend US$3.25 million towards the commercial exploitation of the film in which they had a 25 per cent interest. Millett J said at first instance ([1989] 1 WLR 1222 at 1232):

> "The production of a film, or the completion of an uncompleted film or, I might add, the purchase of a completed 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."

150. In the House of Lords Lord Templeman said (at 677) that "[t]he production and exploitation of a film is a trading activity".

151. By contrast with that case, Eclipse 35 did not pay for the production of the Films and the FTT concluded that the reality was that it did not make a significant contribution towards their exploitation.

152. At the trial in the FTT Eclipse sought to make an analogy with finance leases. The FTT rejected any such analogy. Mr Aaronson did not take up the point to any significant extent in his oral submissions before us.

153. It is not necessary in the circumstances to address the Respondent's Notice, on which we received in any event very few oral submissions.

154. Finally, we should mention that both the FTT and Sales J in the UT referred to ITTOIA s. 609 in the course of their decisions but we took the view that we would not be assisted by any submissions on that section and discouraged them. We therefore did not receive full argument on that section. We should not be taken as endorsing anything said below about that section, including in particular the approach of the UT in paragraphs 96-100 of its decision.

Conclusion

155. For those reasons we dismiss this appeal.