[2015] UKUT 105 (TCC)
Appeal number: FTC/34 & 35/2015

First-tier Tribunal – Hearing of taxpayers appeals' – Allegations of dishonesty relating to evidence adduced by the taxpayers on a particular issue – Burden of proof – Whether necessary for HMRC to plead the allegations – Adjournment refused by the FTT, and case management directions given for future conduct of the hearing – Whether the FTT erred in law – Taxpayers' appeal against refusal of adjournment dismissed – HMRC's appeal against case management directions allowed

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

(1) INGENIOUS GAMES LLP
(2) INSIDE TRACK PRODUCTIONS LLP
(3) INGENIOUS FILM PARTNERS 2 LLP

Appellants

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: MR JUSTICE HENDERSON

Sitting in public at the Rolls Building, London EC4A 1NL on 23 and 24 February 2015

Mr Andrew Hochhauser QC, Mr David Milne QC, Mr Richard Vallat, Mr Edward Brown, Mr James Rivett and Mr Edward Waldegrave, instructed by Weil Gotshal & Manges, for the Appellants

Mr Malcolm Gammie QC, Miss Catherine Addy, Mr Jonathan Davey, Mr Michael Jones, Miss Ruth Hughes, Mr Imran Afzal, Mr Sam Chandler and Mr Nicholas Macklam, instructed by the General Counsel and Solicitor to HMRC, for the Respondents

Introduction

1. On Friday 20 February 2015 the Tax Chamber of the First-tier Tribunal (Judge Charles Hellier and Julian Stafford, "the FTT") released a written decision ("the Decision") giving their reasons for dismissing an application by the appellant LLPs ("the Appellants") for an adjournment of the trial then proceeding before the FTT for a period of at least one month. Both sides now appeal from the Decision to the Tax and Chancery Chamber of the Upper Tribunal, with permission granted by the FTT. Arrangements were made for the urgent hearing of the appeals on Monday 23 February. In the event, the argument lasted for a day and a half, concluding just before 1pm on 24 February when I reserved my decision.

2. The trial before the FTT had begun on 3 November 2014 and then continued over 28 sitting days until 15 December 2014, by when the oral evidence was nearly complete. There followed an adjournment of more than 2 months until Wednesday, 18 February 2015, for reasons which I will explain later in this decision. The intention was that the resumed hearing would last for about ten days, the first three of which would be available for completing the oral evidence and the rest of which would be devoted to the parties' closing submissions. The application to adjourn was formally made and heard on 19 February 2015 (day 30), having been presaged by a letter from the Appellants' solicitors, Weil, Gotshal and Manges, sent to the Solicitor's Office of the Respondents, HMRC, at 1.13pm on the previous day, which was the first day of the resumed hearing.

3. It can therefore be seen that the application for an adjournment was made at very short notice to HMRC, and at a very late stage of the proceedings. The justification for the application, according to the Appellants, lies in certain allegations made by HMRC in a lengthy document prepared and served by them on 2 February 2015 pursuant to directions given by the FTT when the trial was adjourned in December. The document was entitled "HMRC's Paper on the Evidence". It runs to 359 pages. Its general purpose was to review the evidence which had already been given, both oral and documentary, and to set out HMRC's submissions on it, including the findings of fact which in due course they would invite the FTT to make. It was understood that the document was not in final form, in the sense that it would probably need to be supplemented and/or amended in the light of the oral evidence still to be heard, but (subject to that) the document represented an important part of the written closing submissions that HMRC intended to place before the FTT during the second stage of the adjourned hearing. A similar document, entitled "The Appellants' Note of Evidence" and 190 pages in length, was served by the Appellants on the same day.

4. The passages in HMRC's Evidence Paper (as I shall call it) to which the Appellants took particular exception concerned a key document which had been prepared by the promoters of one of the Appellants, Ingenious Film Partners 2 LLP ("IFP2 LLP"), for use (in effect) as a prospectus to solicit external investment in the business which it had been formed to carry on. The basic nature of the business was to be the production of a "slate" of selected films, together with a number of non-production activities. The document was

called the IFP2 LLP Information Memorandum ("the IFP2 Information Memorandum"). Those principally responsible for its production were Mr Patrick McKenna, Mr Duncan Reid and Mr James Clayton, each of whom was a member of the LLP, and two of whom (Mr McKenna and Mr Reid) were also directors of the company which issued the document. Among other matters, the document included projections, based on various assumptions, of the trading losses and (subsequently) profits which the LLP was expected to make during the proposed five year term of its operations. The intention, as I understand it, was that the LLP would commence its business once a specified amount of external investment had been obtained.

5. Section 5.8 of HMRC's Evidence Paper was headed "The False Assumptions of the IFP2 Information Memorandum". It alleges a number of serious inaccuracies in that document, and also alleges in several places that Mr McKenna, Mr Reid and Mr Clayton either were or should have been aware of these inaccuracies. On a fair reading, it is reasonably clear (and the FTT found) that these passages were meant to include express allegations of dishonesty. (It should be noted, however, that an allegation in this form would not suffice to plead fraud, because it is not a clear and unequivocal allegation of actual knowledge: see Paragon Finance v D B Thakerar & Co [1991] 1 All ER 400 (CA) at 407c-e per Millett LJ). Thus, to take two sample passages at the beginning and end of the section, HMRC say (with my emphasis):

> "5.8.1 The IFP2 Information Memorandum … is a very important document in this case. Mr Milne QC put this document front and centre of his case in opening. The reason is that if the document is accurate it goes to prove that IFP2 was acting with a view to profit. However the document is inaccurate and *it contains inaccurate assumptions of which Mr McKenna, Mr Reid and Mr Clayton were or should have been fully aware*.
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> …
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> 5.8.26 The Information Memorandum, together with LS202, is an important document in the case, as it shows that on any realistic view IFP2 would be loss making. *It is not credible to believe that Ingenious believed its own propaganda*. The Information Memorandum in and of itself should cause the Tribunal to be sceptical indeed as to the credibility of the persons who stood behind it and sold it to the public."

6. The simple point taken by the Appellants is that these (and other) apparent allegations of dishonesty were never pleaded by HMRC, and were never put to the three individuals concerned in cross-examination. Accordingly, say the Appellants, it is not open to HMRC, at least as matters now stand, either to make these serious charges against them, or to invite the FTT to make findings in the terms alleged. As Peter Gibson LJ said in George Wimpey UK Ltd v V. I. Construction Ltd [2005] EWCA Civ 77, with the agreement of Sedley LJ and Blackburne J, at [31]:

> "It is trite law that dishonesty must be pleaded with full particulars and put to the person alleged to be dishonest (see, for example, the remarks of Lord Millett in Three Rivers District Council v Bank of England [2003] 2 AC 1 at paras 183-186 in a speech, which although dissenting in the result was fully in accord with the views of other members of the House of Lords on this point). This is an essential procedural safeguard on which the courts insist. It is not open to the court to infer dishonesty from facts which have not been pleaded. Nor is it open to the court to infer dishonesty from facts which have been pleaded but are consistent with honesty."

7. In these circumstances, one might perhaps have expected that the Appellants' protests would have been primarily directed to the intended use by HMRC of the offending passages in their forthcoming closing submissions, possibly coupled with an application that the relevant passages in HMRC's Evidence Paper should be struck out. However, that is not the course which the Appellants chose to adopt. Instead, by their written application issued on 19 February 2015, they asked for an adjournment to enable them to produce evidence to rebut the new allegations. After pointing out that, if the IFP2 Information Memorandum contained inaccurate assumptions of which Mr McKenna, Mr Reid and Mr Clayton were aware, each of them could potentially face censure or criminal proceedings under section 397(1) and (2) of the Financial Services and Markets Act 2000 (since replaced by section 89 of the Financial Services and Markets Act 2012), the application said this:

> "20. The Appellants deny the allegations advanced by HMRC for the first time in their Note on Evidence.
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> 21. Had the Appellants been put on notice of the allegations now advanced by HMRC at the proper time the Appellants would have been in a position to produce evidence with which to refute the allegations. Furthermore, the cross-examination of the Appellants' witnesses would not have proceeded on the false basis with which it appears to have been conducted.
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> 22. Given the serious nature of the allegations now advanced the only fair course is to adjourn these proceedings to enable the Appellants to identify that evidence and serve it on the Tribunal and HMRC. The Appellants consider that a period of one month from now should be a sufficient time in which to produce the evidence."

8. By framing the application in this way, the Appellants would seem to have conceded the logically anterior question whether it should be open to HMRC, at this late stage of the trial, to make the allegations of dishonesty at all. The FTT heard argument on the application from Mr Milne QC on behalf of the Appellants and Mr Gammie QC on behalf of HMRC. With commendable expedition, the FTT produced its ruling, in the form of the Decision, on the following day. Before examining it, however, I first need to fill in some more of the relevant background.

Background

9. The general background to the case was succinctly explained by the FTT in paragraphs 1 to 6 of the Decision, as follows:

> "1. This is a decision on an application made by the Appellant LLPs, Ingenious Games, ITP and IFP2, in an appeal made by the LLPs against closure notices issued to them by HMRC. The Appellants are members of a family of LLPs promoted by Ingenious Media Holdings Plc to persons who invest in the LLPs.
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> 2. If certain conditions are satisfied the LLPs are treated as partnerships for income tax purposes, and their investors as partners, taxable on their share of the profits and losses of the LLPs.
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> 3. Between them the LLPs were involved in the production of a large number of films and games. Many £100 ms were expended in these activities. The LLPs argue that, in the early years, these activities resulted in trading losses which their investors could in appropriate circumstances set against their other taxable income.
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> 4. We are told that the losses claimed by the family of LLPs amount in total to some £1,620 m, that the tax reclaimed by their investors amounts to £620 m, and that, with interest, the total amount at stake is some £1 bn. The Appellants say that some or all of that tax could be recovered by the Exchequer as and when the LLPs make taxable profits.
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> 5. It is common ground that the issues in the appeal are these:
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> (1) Were the LLPs carrying on a trade?
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> (2) Were they doing so "with a view to profit"?
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> (3) Did they incur expenditure equal to 100% of the budget of the film?
>
> (4) Was their expenditure incurred wholly and exclusively for the purposes of their trade?
>
> (5) Were their losses computed correctly as a matter of generally accepted accounting practice?
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> 6. The applications made by the Appellants arise principally in relation to the second of these questions and to [*the IFP2 Information Memorandum*] containing financial illustrations provided for potential investors in IFP2."

10. A fuller account of the background to the case, and its procedural history down to 8 October 2013 (when HMRC issued an application for further disclosure), may be found in the judgment which the Upper Tribunal (Sales J, as he then was) released on 7 February 2014, allowing HMRC's appeal from a decision of the FTT (Judge Sinfield) refusing to order the further disclosure sought by HMRC: see Revenue and Customs Commissioners v Ingenious Games LLP and Others [2014] UKUT 62 (TCC), [2014] STC 1416, at [1] to [45]. As Sales J said at [9], on any view this is major tax litigation.

11. The relevance of the second issue identified by the FTT is this. According to section 863(1) of the Income Tax (Trading & Other Income) Act 2005 ("ITTOIA 2005"), "if a limited liability partnership carries on a trade, profession or business *with a view to profit*" (my emphasis), then (in short) the LLP is treated as "transparent" for income tax purposes, and all its activities are treated as carried on in partnership by its members, and not by the LLP as such. Since an LLP, unlike an English partnership, has separate legal personality, it is only by virtue of this statutory deeming that the losses incurred by an LLP in carrying on its business can be treated for income tax purposes as losses of the members. Accordingly, it was essential, if the Ingenious film schemes were to generate allowable losses for the members, that the conditions of section 863(1) should be satisfied. If the relevant business was not carried on "with a view to profit", the conditions would not be satisfied, the LLP would be taxed as a corporate entity, and even if it incurred trading losses none of them would be allocated to the LLP's members.

12. HMRC's pleaded case on this issue, in their statement of case dated 14 June 2013 relating to the appeal of IFP2 LLP, is contained in paragraphs 66 to 69 under the heading "Transparency". After setting out section 863(1) of ITTOIA 2005, and referring to the corresponding provisions for corporation tax purposes, HMRC's position was pleaded as follows:

> "68. It is HMRC's case that the "with a view to profit" requirement was not satisfied. On the contrary, IFP2 entered into the agreements that it did with a view to generating losses and/or securing loss relief for the members. Ingenious and various Ingenious entities intended to profit from the arrangement through the fees they would earn through its implementation but IFP2's role in the arrangement was to attract individual contributions that would qualify for loss relief irrespective of the prospect for any profit.
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> 69. In consequence, IFP2 fell to be taxed as a corporate entity. Therefore, even if IFP2 was trading and incurred trading losses (both of which are denied) nonetheless the losses would not be allocated to IFP2's members."

13. In my view this section of HMRC's statement of case fully complied with rule 25(2) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (SI 2009/273) ("the FTT Rules"), which provides that:

> "A statement of case must –
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> (a) in an appeal, state the legislative provision under which the decision under appeal was made; and
>
> (b) set out the respondent's position in relation to the case."

It should be noted, however, that paragraph 68 said nothing about the IFP2 Information Memorandum, nor did it accuse any of those who had prepared it of dishonesty or carelessness. The principle reference to the IFP2 Information Memorandum was in paragraph 11 of the statement of case, where reference was made (without criticism) to the illustrative financial projections contained in it which showed a first year loss of £95.5 million, based on total capital contributions of £200 million of which £100 million would be contributed by the individual investors. A footnote explained that the individuals' contributions were substantially funded by loans from an Ingenious entity, and that the amount of the expected tax relief for an individual's share of the losses would be sufficient to fund the whole or a large proportion of his "net" contribution, i.e. the part of it not funded by borrowing.

14. In fairness to HMRC, I should make it clear that, in June 2013, they had no material available to them (so far as I am aware) to cast doubt on the accuracy of the financial projections contained in the IFP2 Information Memorandum, or the good faith of those who had prepared them. Furthermore, paragraphs 6 and 7 of the statement of case made it clear that HMRC were not yet in possession of all relevant documents relating to the appeal, and although the statement of case set out HMRC's current understanding of the position, paragraph 7 said:

> "this may change and HMRC reserves the right to make amendments. In any event the burden of proof is on IFP2 to establish the facts and that the tax treatment claimed by it was correct. Nothing in this [*statement of case*] should be construed as an admission either as to the facts or the consequences alleged by IFP2, as to which IFP2 is put to proof."

15. This passage reflects the fundamental principle, well known to tax lawyers but sometimes a cause of initial surprise to a lay person, that if an assessment to tax (or, nowadays, an amendment to a self-assessment return) is made within normal time limits, the burden of proof is on the appellant taxpayer to show that the assessment (or amendment) is incorrect: see section 50(6) of the Taxes Management Act 1970 and authorities such as Brady v Group Lotus Car Companies Plc [1987] STC 635 (CA) at 639j to 640c per Dillon LJ, 642c-d per Mustill LJ and 646g-647a per Balcombe LJ. As the decision in Brady shows, this is so even if the circumstances of the case are such that there either must, or may, have been some fraudulent conduct on the part of the taxpayer which is relevant to the tax liability. As Mustill LJ said at 644g:

> "The fact that the possibility of fraud is on one side of the case will of course require the tribunal to take particular care when weighing the evidence, given the seriousness of any finding

> which puts in question the honesty of a party to a civil suit (see *Hornal v Neuberger Products Ltd* [1957] 1 QB 247). At the same time, I cannot accept that this bears on the burden of proof."

16. I now turn to the topic of disclosure. It is convenient to begin with what the FTT say in paragraphs 7 and 8 of the Decision:

> "7. In 2013 there were discussions between the parties and directions hearings about documents for the hearing. A substantive hearing was scheduled for early 2014. Early versions of the directions for disclosure were in the normal default style of the tribunal requiring the listing and provision of documents on which a party relied. There were a vast number of potentially relevant documents; specimen transactions were agreed. HMRC sought disclosure of all documents relevant to these specimen transactions and other matters, effectively on a High Court/CPR basis. Following a decision of Sales J in the Upper Tribunal disclosure was ordered on this basis of a large range of documents. The disclosure request included documents relating to the estimated or projected profit and loss of films and games made by the LLPs. Following that decision a new hearing date was set for 12 November 2014.
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> 8. The number of documents disclosed as a result of this exercise was vast. We were told that there were some 750,000 pages in the electronic bundles."

17. The "normal default style" of disclosure referred to by the FTT reflects rule 27(2) of the FTT Rules, which provides that "subject to any direction to the contrary" within 42 days after delivery of the respondent's statement of case:

> "each party must send or deliver to the Tribunal and to each other party a list of documents –
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> (a) of which the party providing the list has possession, the right to possession, or the right to take copies; and
>
> (b) which the party providing the list intends to rely upon or produce in the proceedings."

18. As Sales J explained in his disclosure decision, loc cit, at [25]:

> "This default rule makes considerable sense in the usual type of case, where HMRC will have used their extensive statutory powers of investigation at the stage of enquiry into a taxpayer's affairs and thus will have seen all relevant documents in the taxpayer's possession by the time an appeal is launched. In such a case, it would be disproportionate and unnecessary to require either the taxpayer or HMRC to list out and then allow

> inspection of all documents in their possession which are relevant to the appeal. The adoption of this type of formula in the Directions in the present appeals, however, created a problem. That is because, by reason of the agreed, limited approach to disclosure at the investigation stage, HMRC had not already seen or had a chance to inspect all the documents which might be relevant to determination of the issues arising on the appeal."

19. It was in this context that HMRC made their application for further disclosure of documents in specified categories on the normal CPR basis, i.e. including documents which would adversely affect the Appellants' own case or would support HMRC's case: see the description of standard disclosure in CPR 31.6. In reversing the decision of Judge Sinfield to refuse further disclosure on this basis, and not to adjourn the trial date then fixed for March 2014, Sales J said this:

> "62. In my view, the judge proceeded on an unfairly narrow view of the facts in para [15] of the decision, when he said that HMRC had the opportunity and the powers to require [*the Appellants*] to produce the documents "but decided not to do so". The full background, as explained above, shows that the restrictions on access to documents at the investigation stage were a matter of negotiation and agreement, rather than simply a unilateral decision of HMRC taken for their own reasons. The circumstances in which the Directions were made and the approach adopted by [*the Appellants*] to disclosure thereafter showed that the parties regarded the question of disclosure as something which should be kept under review and adjusted as the outline of the case developed. HMRC did not decide that [*the Appellants*] should make the averments they did in their Statements of Case; that was their choice, and HMRC were entitled to maintain that there was a need for additional disclosure once they saw how the appellants were putting their case.
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> 63. [*The Appellants*] do not suggest that they do not hold any further documents, beyond those inspected by HMRC during the investigation stage and any documents they propose to rely on themselves in the course of their appeals, which are relevant to the issues on the appeal. It is clear that they do hold other relevant documents. Moreover, it is entirely possible that there will be documents in that class which would be capable of undermining their case and/or of supporting HMRC's case on the appeal. Mr Milne made it clear that if further disclosure were ordered, his clients would wish to have liberty to adduce additional witness statements to address and explain the further documents to be produced.
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> …

> 67. In my judgment, the most important point on the present interlocutory appeal is that in order for the main appeal to be determined fairly and justly, in accordance with the overriding objective, HMRC should have an equal opportunity to review the further relevant documents held by [*the Appellants*] which they have not yet disclosed to HMRC and which they do not wish themselves to rely upon in the appeal. Put another way, it would be unfair and unjust for [*the Appellants*] to be able to suppress or keep from the view of HMRC and the FTT relevant documents which may be harmful to their case, as a consequence of the limitation on the extent of HMRC's inspection of documents during the investigatory stage as a result of a sensible co-operative approach to the conduct of the investigation which was agreed as being in the interests of both sides. Even allowing for some weight to be attached to the interest of avoiding delay by postponing the hearing of the appeal, scheduled for March 2014, the judge's decision was not compatible with a proper consideration of the issues in the appeal … In the particular circumstances of this case, I consider that the judge fell into error and reached a conclusion which was clearly wrong."

20. In the light of Sales J's decision, HMRC made a detailed disclosure request in February 2014. Paragraph 10 of schedule 2 (which dealt with IFP2) referred to a number of assertions made in IFP2's statement of case and the witness evidence, and sought disclosure of:

> "all documents not previously disclosed relating to the profits/losses, income, and estimates of and projections of income and profit/loss for every film said to have been produced by IFP2 and every non-production project with which IFP2 was involved."

This wording would arguably not have been wide enough to include the projections of future losses and profits contained in the IFP2 Information Memorandum, which related to the earlier stage when investors in IFP2 LLP were being sought. It is possible that other parts of the request in paragraph 10 would have been wide enough for that purpose, but the question is academic because the parties then agreed directions, incorporated in an order made by the FTT on 2 April 2014, which provided that the disclosure to be made pursuant to paragraph 10 of HMRC's request might be limited to:

> "(a) up to date participation statements for all films within all Ingenious Film partnerships;
>
> (b) representative projections (both third party and internal) for all films within Ingenious Film Partners 2 LLP;
>
> (c) in relation to the Lead Transactions (i) all participation statements and (ii) all sales and purchase invoices."

At the hearing before me Mr Andrew Hochhauser QC for the Appellants submitted, and Mr Gammie QC did not dispute, that this wording was on any view not wide enough to catch any projections of losses and profits which underpinned the IFP2 Information Memorandum.

21. A document which has assumed particular importance in the case is a spreadsheet (LS202) on which, as is now common ground, the financial illustrations in the IFP2 Information Memorandum were based. This spreadsheet was not disclosed by the Appellants as part of their initial disclosure, which indicates that it cannot have been a document on which they intended to rely: see rule 27(2)(b) of the FTT Rules, cited above. Nor, as I have explained, did it fall within the scope of the further disclosure agreed following the decision of the Upper Tribunal. The document was only disclosed by the Appellants on 5 September 2014, as part of a set of materials that had been provided to one of their experts prior to the delivery of his report in July 2014, but upon which the expert had placed no reliance in his report. No explanation of its nature or significance was given when the document was thus provided, nor were steps taken by the Appellants to include it in the electronic trial bundle. According to Mr Gammie, no fewer than 10,429 spreadsheets have been provided by the Appellants at various times, and nobody on HMRC's side appreciated the potential significance of the document until reference was made to it by Mr Milne in Mr McKenna's re-examination on day 7 of the trial. Mr Gammie had previously cross-examined Mr McKenna about the existence of calculations underlying the IFP2 Information Memorandum, and put to him a different document ("Ingenious Film Partners: Financial Model 10 (Upside)") which, unknown to Mr Gammie, in fact related to the immediately preceding LLP established by Ingenious.

22. It was in order to clear up this misconception, of which I assume Mr Milne himself had been equally unaware while the cross-examination of Mr McKenna was in progress, that during his re-examination on the following day Mr Milne put to him the spreadsheet LS202. There was then some discussion (to which I will have to return) about Mr McKenna's inability on the previous day to explain the cost of sales figures in the IFP2 Information Memorandum, and the possible "stain on his character" caused by suggestions put to Mr McKenna in cross-examination which arguably implied that the Memorandum was misleading. Mr McKenna referred to some "scribbles" that he had done at his kitchen table overnight, because he was so perturbed by the suggestions put to him. He said he had the scribbles with him, and would be happy to share them with HMRC. The matter was left on the basis that Mr Gammie expressly reserved the right to apply to recall Mr McKenna for further cross-examination on the spreadsheet LS202, and also (I infer) on the kitchen table calculations that Mr McKenna had prepared overnight.

23. Mr McKenna was in fact briefly recalled the following morning (day 8), when he said that he had no knowledge of documents underlying the IFP2 Information Memorandum, because he had not been involved in their preparation. Mr McKenna was also asked a few questions about his kitchen table calculations, but there was no time for the subject to be discussed with

him at any length because the next witness, Mr Clayton, was only available on that day and the tribunal had sat early to accommodate him. Accordingly matters were again left on the basis that Mr McKenna could, if necessary, be recalled on a future occasion to answer further questions. It is perhaps worth noting that Mr Gammie then made an application, which after hearing argument the FTT refused, that Mr Clayton and the other witnesses for the Appellants who had yet to give evidence should not be present at the hearing, or have access to the transcripts, before they entered the witness box.

24. Later on, Mr Reid was cross-examined on the assumptions and calculations which underlay the IFP2 Information Memorandum, by reference to the figures contained in spreadsheet LS202. In particular, he was asked why the figure for one of the assumptions used in the financial model which underlay the projections in the Memorandum was inconsistent with the assumption that Ingenious had used for the same variable in every other case. The significance of this point was that, if the underlying figures were calculated using the same assumption as Ingenious had made elsewhere, the projection would be transformed from one of overall profit to one of overall loss.

25. This aspect of Mr Reid's evidence is treated in some detail in paragraphs 5.8.23 to 5.8.25 of HMRC's Evidence Paper, from which I cite the following extracts:

> "5.8.23 True figures for P & A would have shown that Ingenious' assumptions put them in a loss making position. As was demonstrated in the cross-examination of Mr Reid, if only one sensible assumption is made about the proper P & A costs and put into LS202, upon which the Information Memorandum is based, it shows that IFP2 would be loss making. The costs of DVD sales is put in at 23% of DVD revenue … in the film income tab cells C27 and C54. That is far too low. The correct figure is 35% of DVD revenue and, as far as HMRC has been able to determine, this is the percentage used for all other purposes [*two examples are then given*]. Mr Reid readily agreed that he would expect the DVD costs to be in the region of 35% of DVD revenue … When one changes the figures from 23% to 35% the figures produced on the Film Production tab alter to show a loss … Mr Reid was unable to explain the fact that the DVD costs were far too low in the model.
>
> 5.8.24 The assumptions relating to non-production are even more egregious … Mr Reid agreed that Ingenious was proposing that it could make 72% of its profits on non-production activities, which were supposed to be low risk …, as opposed to 28% from production. The Financials Tab of LS202 indicated that Ingenious were expecting to obtain profit from its low risk activities in excess of the profit it was expecting on its high risk film production activities. If Ingenious could obtain high rates of return on low risk investments it is difficult to see why Ingenious would have

> bothered with the high risk activities at all. Mr Reid was wholly unable to explain this extreme oddity …
>
> 5.8.25 Even when one uses Ingenious' assumptions with one proper P & A assumption (of which Ingenious, in particular, Mr McKenna, Mr Reid and Mr Clayton would or certainly should have been aware) it shows that IFP2 would be loss making, as it indeed it has turned out to be. Indeed, the non-production forecasts … fail to withstand the most basic scrutiny."

26. A further issue arose during the course of the trial concerning the existence of a large number of notebooks which had not been disclosed. As counsel for HMRC explain in their skeleton argument for the present hearing, during Mr Clayton's oral evidence on 14 November 2014 (day 9) it became clear that there was additional relevant material, in the form of notebooks, which the Appellants had failed to disclose to HMRC. Mr Clayton has subsequently confirmed (when recalled to give further evidence on 20 February 2015) that he made use of his notebooks when preparing his first witness statement. The Appellants agreed to give further disclosure of notebook material during the course of the hearing, and duly did so in respect of Mr Clayton's notebooks and those of Mr Bower (another of the Appellants' witnesses). Further investigations by the Appellants then revealed that there was a significant amount of other notebook material which had not been disclosed and which related to several employees and former employees of Ingenious. Disclosure of this further material was ordered by the FTT on 12 December 2014, and it has resulted in the production of nearly 10,000 pages of notebook material, including significantly more for Mr Clayton and Mr Bower than had been disclosed before 12 December 2014. Because of the late disclosure of the notebooks, Mr Clayton and Mr Bower were required to return for further cross-examination, as was Mr McKenna, who was to answer further questions about his kitchen table calculations. These were the developments which led to the adjournment of the hearing from 15 December 2014 to 18 February 2015.

27. I should add that, although Mr Clayton returned for further cross-examination on 19 and 20 February 2015, questioning of him on the IFP2 Information Memorandum has been postponed pending the outcome of the present appeals. For the same reason, Mr McKenna has yet to give his further evidence.

Exchanges during the hearing relating to allegations of dishonesty

28. In paragraphs 17 to 23 of the Decision, the FTT refer to a number of occasions during the hearing when the question whether HMRC were alleging dishonesty has been raised. Since the Appellants place considerable reliance on these exchanges, I must set them out.

29. First, on day 1, there was an exchange between Mr Gammie and Mr Milne about reading together a sample composite set of film production agreements. Mr Gammie said he was not asserting that they were a sham, and accepted that HMRC were not saying that they were a sham "in a dishonest sense". It should

be stressed, however, that this exchange related to the contractual documents for the production of a film, and had nothing to do with the IFP2 Information Memorandum.

30. Secondly, on day 4, at the end of Mr Gammie's opening submissions, Mr Milne asked him to clarify for the record "that he is not actually asserting dishonesty at all". Mr Gammie replied: "No, I am not asserting dishonesty."

31. Thirdly, on day 6, Mr Gammie asked Mr McKenna in cross-examination, in relation to the IFP2 Information Memorandum:

> "Are you now telling us that you didn't bother to find out whether or not the information was correct and satisfy yourself that the figures being put forward to you were right or wrong?"

Mr McKenna replied that he would have relied on "a whole raft of people" informing him about the correctness of the financial material contained in the Memorandum, and that he had responsibility for overseeing the final document "in terms of making sure that we had something that was correct to the best of our ability".

32. Fourthly, on day 7, after the LS202 spreadsheet had been put to Mr McKenna in re-examination, Mr Milne asked Mr Gammie "to withdraw any inadvertent or otherwise suggestions that there is anything in the Information Memorandum that was misleading", to which Mr Gammie replied:

> "No, sir, I can't do that because Mr McKenna was unable to answer my questions on it, so I may need to ask a later witness as to how the cost of sales figure is arrived at."

33. Fifthly, on day 22, during Mr Reid's cross-examination, Mr Gammie said in the context of an intervention by Mr Milne:

> "As I am trying to demonstrate, the Information Memorandum were merely pretexts for what was really going on."

A little later on, Mr Milne said that this amounted to "a serious allegation of deliberate misleading", which led to the following exchange:

> "MR GAMMIE: Indeed, we will see how they might be carrying on some of their – we have already been into the games Information Memorandum and illustrated how that – you can reflect on Mr Reid's evidence as to what consideration they gave to that.
>
> MR MILNE: It's an allegation of dishonesty that my learned friend expressly disavowed in the first week.
>
> MR GAMMIE: No, no. Sham has nothing to do with dishonesty and –
>
> MR MILNE: It certainly does.

> MR GAMMIE: Well, it may be that – sir, we are just wasting time."

34. Finally, on day 25, during a procedural discussion, Mr Vallat for the Appellants referred to the exchange on day 22 which I have just quoted, and continued:

> "On that particular point, sir, that was not the express disavowal of any allegation of dishonesty that one might have liked. This isn't time wasting, it is very important that we know whether or not we are faced with any unpleaded allegations of fraud, sham, deliberate misrepresentation or any other similar form of dishonesty against the Appellants.
>
> It should be easy to give that information. Nothing is pleaded, no application has been made to amend the pleadings and my learned friends are well aware of their obligations in this respect so I would ask them now to give that confirmation. Right now."

The Chairman then intervened to say that it would also be very difficult, if not impossible, for the FTT "to find a form of dishonesty without that having been put to the witnesses involved".

35. After some further discussion about timetabling, and the notes on evidence that the parties were going to prepare, the Chairman asked Mr Davey (for HMRC) whether he wanted to respond to Mr Vallat's point about dishonesty. Mr Davey gave what appears to me a rather discursive answer, saying that HMRC had not pleaded sham, but "there are a range of principles in play to cover the situation where on occasion substance comes away from form". He then gave two examples, and continued:

> "I would also say that the evidence hasn't closed so how one characterises that evidence is still an open question. And moreover, I would say – and this is particular to the Tribunal in a way which is slightly different from litigation in the High Court. In the end this Tribunal has a duty to take an unblinkered view of what it sees before it, even in fact if a party doesn't plead a point. They have to decide in the end what they think is right."

36. The Chairman then said it was his understanding of the principles applied in the Upper Tribunal that they were precluded from finding dishonesty unless it had been properly put, and reference was made to two cases: Customs and Excise Commissioners v Pegasus Birds Ltd [2004] EWCA Civ 1015, [2004] STC 1509 and Okolo v Revenue and Customs Commissioners [2012] UKUT 416 (TCC), [2013] STC 906 ("Okolo"). Mr Davey repeated that the Tribunal would need to take an unblinkered view of the evidence, to which Mr Vallat retorted:

> "Sir, if I may, what Mr Davey should and could say is whether or not they are alleging any dishonesty in the sense of fraud, dishonesty, sham, deliberate misrepresentation, anything of that sort. They haven't pleaded it but they have come close to it in their cross-examination in a way that is not fair, frankly. Are they going to suggest that to you in their note or in their submissions or not? It is a simple question."

37. An exchange ensued between Mr Davey and the Chairman, in which the Chairman said he had no recollection of any allegation of dishonesty having been put to any of the witnesses. Mr Davey agreed, and the exchange concluded as follows:

> "THE CHAIRMAN: Yes. I've not heard that sort of allegation and I assume I haven't misheard as far as you know.
>
> MR DAVEY: I don't think you have, sir.
>
> THE CHAIRMAN: Right. So therefore I think that is the answer to your question, Mr Vallat. I haven't heard an allegation of dishonesty of the nature you describe.
>
> MR VALLAT: Sir, if we are being told that we have to take Mr Davey's answers as an assurance that no allegation of dishonesty is going to be made, then we are happy with that.
>
> THE CHAIRMAN: If they turn around later and make an allegation of dishonesty then there is the question of whether we can find dishonesty and that brings Okolo back into it –
>
> MR VALLAT: Yes, and then we're into all sorts of things.
>
> THE CHAIRMAN: All sorts of things, yes, and we know the answer to that."

38. My reading of this final exchange is that Mr Davey was driven to concede that no express allegations of dishonesty had been put to any of the witnesses, and that the answer to Mr Vallat's question was "No".

The Decision of the FTT

39. I can now turn to the Decision, picking it up at paragraph 24 where the section headed "Discussion" begins. The FTT reminded themselves that the appeal related to the LLPs, and was not an appeal by the three individuals whose honesty might be in issue. The FTT then found, as I have already said, that the relevant passages in section 5.8 of HMRC's Evidence Paper included an express allegation of dishonesty. They continued:

> "28. There is no allegation in HMRC's skeleton argument that any of the three individuals were dishonest, reckless or negligent in relation to the Information Memorandum. But a

> particularly important spreadsheet (LS202) on which the financial illustrations in the Information Memorandum were based was not made available to HMRC before the hearing was in full flood.
>
> 29. Our view of the exchanges during the hearing related above is this: (i) HMRC did not allege any form of dishonesty; (ii) HMRC left the door open to the possibility that they might argue that there had been some dishonesty but did not put the point squarely; (iii) the Appellants and the three individuals would have known that HMRC had not alleged that any of the three individuals had been dishonest, but would also have known that HMRC might try to do so at a later stage.
>
> 30. These exchanges and other parts of the cross-examination of the three individuals make clear however that HMRC were suggesting negligent or reckless inaccuracies in the Information Memorandum.
>
> 31. Thus the passages in section 5.8 of [*HMRC's Evidence Paper*] would have been an unwelcome and late notification of the allegation of dishonesty, but may not have been wholly unexpected. There would not however have been surprise in relation to any allegation of carelessness."

40. I would make these comments on the paragraphs which I have just quoted. First, the reference to the spreadsheet LS202 not having been made available to HMRC "before the hearing was in full flood" is not strictly accurate. It was first made available on 5 September 2014, but its significance was not appreciated by HMRC until it was put to Mr McKenna in re-examination. Secondly, the FTT were in my view entitled to assess the overall effect of the relevant exchanges during the hearing, and the cross-examination to date of the three individuals, in the way which they did. Their assessment reflects a degree of ambivalence which seems to me to characterise much of HMRC's approach to the question of dishonesty on the part of the three individuals throughout the hearing. Thirdly, the FTT drew a distinction between allegations of dishonesty on the one hand, and allegations of negligence or recklessness as to inaccuracies in the IFP2 Information Memorandum, on the other hand. This has the potential to be a little misleading, because the established common law definition of fraud draws a distinction between recklessness whether a false representation is true or false (which, if established, amounts to fraud), and mere carelessness (which does not): see, for example, Chitty on Contracts, 31st edition, vol. I, para 6-047, citing the well-known definition of fraud by Lord Herschell in Derry v Peek (1889) 14 App. Cas. 337 at 374.

41. In the next section of the Decision (paragraphs 32 to 39), the FTT considered the relevance of the IFP2 Information Memorandum. They concluded that it would not be necessary for them to make a finding of dishonesty (by which they meant permitting the IFP2 Information Memorandum to be promulgated knowing that the financial illustrations were misleading: see paragraph 32) in

order to determine the appeals. I confess that I find some of the reasoning in this part of the Decision difficult to follow, but I will not prolong this decision by examining it because it seems to me to be of only marginal relevance to the issues which I now have to decide. Of course it is not necessary for the FTT to make any findings of dishonesty, whether in relation to the IFP2 Information Memorandum or otherwise, in order to decide whether the business of IFP2 LLP was carried on with a view to profit. On the other hand, if it were the case that the Memorandum was dishonestly prepared so as to show an expectation of eventual profit when the application of standard assumptions would have shown an overall loss, that would obviously be a highly material piece of evidence for the FTT to consider in relation to the issue. If the promoters of the venture themselves expected it to trade at an overall loss over the relevant period, but represented the contrary in a document which was shown to potential investors, and which was in due course likely to be disclosed to HMRC, this could help to ground an inference that the real purpose of the business was to generate tax losses and it was never genuinely carried on with a view to profit.

42. The next three paragraphs of the Decision, under the sub-heading "Dishonesty", are in my view of central importance. They read as follows:

> "40. Our initial view of the evidence (and it has not all been heard) is that we would not find it shown that the three individuals had been dishonest.
>
> 41. It is clear to us that we cannot find a witness to have been dishonest in relation to statements made in the past unless the allegation is plainly made and put to him with the evidence supporting the allegation and in a manner which gives him a fair chance to rebut it. Unless those criteria were satisfied we would not make a finding of dishonesty.
>
> 42. Even if those criteria were satisfied we would consider making such a finding only if relevant to the matters we have to decide."

43. These paragraphs show that the FTT had well in mind the standard requirements of fairness and natural justice which must be satisfied if a tribunal or other body performing a judicial function is to be entitled to make a finding of dishonesty. Rightly, no criticism was made of these paragraphs by either side in their written or oral submissions on the present appeals.

44. The final substantive section of the Decision, headed "Striking a balance", runs from paragraphs 43 to 60. The section begins as follows:

> "43. These are appeals of the LLPs not the three individuals. The primary question is whether the order sought is just and fair, and that depends in large measure on whether dismissing the application would unfairly prejudice the Appellants, and on whether allowing it would unfairly prejudice HMRC.

> 44. There has been some unnecessary delay on both sides.
>
> 45. HMRC should have made clear that they wished to allege dishonesty or carelessness by Day 28 [*i.e. 15 December 2014, when the hearing was adjourned*]. HMRC should have known that not making their position clear as soon as possible would elicit a late request that the allegations be put to the witnesses and that they have an opportunity to defend them. Had they done so before Christmas the Appellants would have had plenty of time to search for documents relevant to the issue and to make this application in good time.
>
> 46. The Appellants must have know that HMRC were trembling on the brink of these allegations. They knew of the allegations when the Note of Evidence was served two weeks before Day 29. They must have had time to start any search.
>
> 47. We accept that the search for relevant documents was a vast exercise which in the case of emails and electronically held documents required the selection of names or topics for search and that it may not have been appreciated that the search criteria would not have thrown up all the documents relating to the illustrations in the Information Memorandum. But we also accept that taken in the context of the issues in the appeal the disclosure directed should have included documents relating to these issues.
>
> 48. These issues therefore do not weigh heavily in one direction or the other."

45. The FTT then commented, in paragraph 49, that they did not at present consider that a finding of carelessness would be relevant to determination of the question whether the business was carried on with a view to profit. I find this comment puzzling, for the same reasons that I find parts of paragraphs 32 to 39 of the Decision difficult to follow. Again, however, I do not think it is a matter I need to pursue.

46. The FTT continued:

> "50. Injustice to the three individuals may be avoided if the tribunal makes no finding of dishonesty, or if the allegation is squarely put to them and they are given a fair opportunity to reply. The grounds of any allegation are already known: they are spelled out in the Note of Evidence.
>
> 51. It does not seem to us that we should make a finding of dishonesty of any of the three individuals unless the allegation is put to them fairly and squarely with an opportunity to reply. If the absence of all the documents they might possibly be able to rely on means that they are unable fairly to reply, we should not make such a finding. We therefore ask whether dismissing

the application and applying this approach would prejudice either party.

52. It does not seem to us that this approach would prejudice HMRC. To find dishonesty the tribunal must find that the LLPs believed something different from what they said in the Information Memorandum. But, on the view of the meaning of "with a view to profit" in which dishonesty is relevant, all that it needed for HMRC to demolish the evidential value of the Information Memorandum is a finding that the directing individuals were not shown to have an expectation of profit. That finding is different from and can be made without a finding of dishonesty.

53. Nor would it prejudice the Appellants. The onus of proof is on the Appellants. If they offer the Information Memorandum as evidence of the relevant expectation of the partner investors, dishonesty and inaccuracy are irrelevant. If it is offered on the basis that the expectation is taken as that of the LLP's directing minds as evidence of the expectation of those minds, the tribunal may make findings as to their views at any particular time without needing to make a finding that one or more of the three individuals did not believe what was said in the Information Memorandum.

54. We do not think that in the light of Mr Milne's reliance on the Information Memorandum, their original disclosure obligation, and at this stage in the proceedings the Appellants are unfairly prejudiced by being denied the opportunity to adduce further evidence in relation to an allegation which the tribunal does not need to adjudicate."

47. Pausing at this point, it seems to me that a number of different themes are combined, not always in complete harmony, in the above passage. First, paragraphs 50 and 51 essentially repeat the procedural safeguards on which the FTT had already directed themselves, in my view impeccably, in paragraph 41. Secondly, paragraph 53 makes the important point that the burden of proof is on the Appellants, and it is they, not HMRC, who are seeking to rely on the IFP2 Information Memorandum. Thirdly, the FTT repeat the (obvious) point that it is not necessary to make a finding of dishonesty in order to conclude that the business of the LLP was not carried on with a view to profit. Fourthly, however, the FTT then seem to rely on this point as a reason for saying (in paragraph 54) that there would be no unfair prejudice to the Appellants in refusing them the opportunity to adduce further evidence. With respect, this seems to me to overlook the equally obvious point that dishonesty in the preparation of the Memorandum, if established, would be highly relevant to determination of the issue. Accordingly, if any finding of dishonesty is to be made, the procedural safeguards set out in paragraphs 41 and 51 cannot be whittled down. I am sure the FTT did not mean to suggest that this would be the case, but read in isolation paragraph 54 might be thought to carry such an implication.

48. The remaining paragraphs of this section read as follows (I have corrected a few typographical errors in them attributable to the speed with which the Decision was produced):

> "55. The remaining consideration appears to us to be balancing any residual unfairness to the three individuals and the effect of the delay which would be caused by granting the application.
>
> 56. In the context of an appeal by the LLPs we do not regard the interests of the three individuals as particularly weighty. They will be entitled to have put to them any allegation of dishonesty HMRC wish to make, they will know the grounds for such an allegation, and will not be found dishonest unless they have a fair chance to rebut it, although they may not be able to adduce all the evidence they would wish to adduce were this an action brought against them.
>
> 57. The Appellants request an adjournment of a month. The disclosed documents would have to be considered by HMRC. It would in our view be very unlikely that a date could be found for a reconvened hearing before June 2015. Further disclosure is also likely to lengthen an already long hearing as both parties may wish to rely on it or put it to witnesses. Delay and distance from the evidence prejudices the ability to remember and will further delay a decision and increase costs.
>
> 58. Taking these considerations together we find the balance lies on the side of dismissing the application.
>
> 59. It seems to us that if HMRC choose to put the allegation of dishonesty … to any of the three individuals, the Appellants should be permitted to adduce such additional evidence as they have found to date. They might not have discovered all the evidence relevant to the issues, but merely identified evidence they wish to rely upon (although they should disclose anything relevant they have found); further it might be only some of the evidence which should have been disclosed pursuant to the directions made after Sales J's decision. But permitting its admission on the one hand might permit the tribunal to make a finding of dishonesty – if that is what HMRC press upon the tribunal (*pace* our conclusion above) – and on the other provides a measure of fairness to the three individuals. Such evidence should however be limited to evidence relating to what the individuals believed.
>
> 60. If HMRC choose not to put the allegation of dishonesty then there is no compelling reason for the additional material to be admitted. Even if the allegation is put and the evidence admitted it may be insufficient for us to make a finding of dishonesty."

49. The FTT therefore refused the one month adjournment requested by the Appellants, but held that if HMRC elected to put allegations of dishonesty to any of the three individuals, the Appellants "should be permitted to adduce such additional evidence as they have found to date". I have to say it is far from clear to me what kinds of additional evidence the FTT here had in mind. Were they referring only to documentary evidence, or did they envisage that oral evidence from persons other than the three individuals might also be adduced? The second sentence of paragraph 59 seems to envisage a wide liberty to adduce "evidence relevant to the issues", but the final sentence limits such evidence to "evidence relating to what the individuals believed". The paragraph also appears to contemplate the production of documentary evidence even if it should already have been disclosed. In the light of these (and other) uncertainties, I have considerable doubt whether the solution propounded by the FTT could work in practice, at any rate without giving rise to a lot of argument and the likelihood of one or more adjournments of a similar length to the one they had already refused.

50. Be that as it may, the FTT then summarised their conclusions as follows:

> "61. We dismiss the applications.
>
> 62. We will not take into consideration any allegation of dishonesty against the three individuals unless it is put squarely to them and they have a fair chance to reply.
>
> 63. If HMRC choose to put allegations of dishonesty (as defined in para 32 above) to any of the three individuals the Appellants through the three individuals may adduce such additional evidence as described above and [*as*] they collected before Thursday 19 February in defence of any such assertion."

The FTT then granted permission to appeal to both sides, being "persuaded that both parties have arguable cases that we erred in law in our decision" (paragraph 65).

The legal framework

51. An appeal from the First-tier Tribunal to the Upper Tribunal lies only on a point of law: section 11 of the Tribunals, Courts and Enforcement Act 2007 ("the 2007 Act"). Section 12 then sets out what the Upper Tribunal may do if it finds that the making of the decision under appeal involved the making of an error on a point of law:

> "(2) The Upper Tribunal –
>
> (a) may (but need not) set aside the decision of the First-tier Tribunal, and
>
> (b) if it does, must either –

(i) remit the case to the First-tier Tribunal with directions for its reconsideration, or

(ii) re-make the decision.

…

(4) In acting under sub-section (2)(b)(ii), the Upper Tribunal –

(a) may make any decision which the First-tier Tribunal could make if the First-tier Tribunal were re-making the decision, and

(b) may make such findings of fact as it considers appropriate."

52. Where, as in the present case, the appeal is from a case-management decision, the proper approach for the Upper Tribunal to adopt was conveniently stated by Sales J in the disclosure appeal at [56], in terms with which I respectfully agree:

> "The Upper Tribunal should not interfere with case management decisions of the FTT when it has applied the correct principles and has taken into account matters which should be taken into account and left out of account matters which are irrelevant, unless the Upper Tribunal is satisfied that the decision is so plainly wrong that it must be regarded as outside the generous ambit of discretion entrusted to the FTT: *Fattal v Walbrook Trustees (Jersey) Ltd* [2008] EWCA Civ 427 at [33], [2008] All ER (D) 109 (May) at [33]; *Revenue and Customs Comrs v Atlantic Electronics Ltd* [2013] EWCA Civ 651 at [18], [2013] STC 1632 at [18]. The Upper Tribunal should exercise extreme caution before allowing appeals from the FTT on case management decisions: *Goldman Sachs International v Revenue and Customs Comrs* … [2009] UKUT 290 (TCC) at [23] – [24], [2010] STC 763 at [23] – [24]."

53. In the Goldman Sachs case, Norris J said at [25] that he did not consider there to be any substantial difference between "reviewing" and "remaking" the decision of the FTT:

> "because, in remaking the decision, the decision of the judge of the First-tier Tribunal is to be accorded respect. That judge was a judge appointed for his specialist knowledge; that judge was one who daily deals with cases of the type under appeal and who, in making an assessment, can draw upon a depth of practical experience in the conduct of such cases."

The position of the parties

54. As I have said, the application which the Appellants made to the FTT was for an adjournment to enable evidence to be obtained in order to rebut the allegations of dishonesty in HMRC's Evidence Paper. The application did not explicitly challenge HMRC's right to make the allegations in the first place. On the contrary, it was implicit in the relief sought that, in principle, the allegations could properly be made, so long as there was an adequate opportunity to respond to them.

55. In the interval between the release of the Decision on Friday, 20 February and the start of the hearing of the appeals on Monday, 23 February, however, the Appellants' case underwent a radical transformation. New counsel (Mr Hochhauser QC and Mr Edward Brown) were brought in to reinforce the existing team headed by Mr Milne QC, and amended grounds of appeal were prepared. The amended grounds withdraw the request for an adjournment, and replace it with two contentions pleaded in the alternative.

56. The first contention is that the FTT erred in law in permitting unpleaded allegations to be made. The alleged errors are set out in detail in paragraph 35 of the Appellants' skeleton argument (which, rather confusingly, also does double duty as part of their amended grounds of appeal). On this basis, the Upper Tribunal is asked to quash the Decision and to rule that (a) HMRC's Evidence Paper be redacted, as set out in an Appendix which the Appellants said they were still in the course of preparing, and (b) HMRC could not make the allegations of dishonesty or any other serious and unpleaded allegations.

57. The alternative contention was that there should be an adjournment for the matter to be properly pleaded and the subject of further submissions in due course (with the usual costs consequences in respect of any amendment, if permitted).

58. For their part, HMRC oppose the relief sought by the Appellants in both its original and its amended form. By their own notice of appeal, they contend that the FTT erred in law in giving the directions contained in paragraphs 59 and 63 of the Decision, on the basis that the directions were plainly wrong having regard to the relevant procedural history and the substance of the appeals.

59. The alleged errors of law upon which the Appellants rely (as set out in paragraph 35 of their skeleton argument) are in summary as follows:

    1) The FTT were wrong to consider it somehow relevant that HMRC's statement of case had been produced before disclosure. That is normally the case, and that is why rule 5(3)(c) of the FTT Rules enables a party to apply to amend.

    2) The FTT were wrong to suggest that it was open to HMRC to "leave the door open" to an allegation of dishonesty, and that the Appellants should be taken as knowing that the door had been "left open". As a

matter of basic procedural fairness and natural justice, it is not possible to "leave the door open" or allow a party to "tremble on the brink". If dishonesty is to be pursued, that requires an application to amend. If HMRC were to make such an application, it would be opposed; and if permission to amend were granted, the decision would be amenable to review on appeal.

3) The FTT were wrong to consider that HMRC's Evidence Paper provided a sufficient basis for the allegations. Apart from the fact that the allegations were not properly particularised, the Evidence Paper was the wrong place for them to be made and it should be redacted accordingly.

4) It is the duty of the FTT, sitting in public in a high profile case, to prevent unheralded allegations being made in the final stages of a trial, particularly in such a casual manner.

5) If the FTT were correct in their conclusion that it is not necessary to make a finding of dishonesty in order to determine the appeals, the dishonesty allegation is irrelevant and should not be permitted by way of amendment.

6) The FTT were wrong to conclude that, because the three individuals are not formally the Appellants, their "interests" were properly regarded as "not particularly weighty".

60. In view of the radical change in the Appellants' case, Mr Gammie for HMRC took a preliminary point. He argued that no error of law could possibly be shown in the decision of the FTT to refuse an adjournment, because the basis upon which the Appellants sought the adjournment had been abandoned. It is true that the Appellants do still ask for an adjournment, in the alternative, as part of their second amended contention, but the purpose of such an adjournment (to enable HMRC to make an application to amend) is different from the purpose of the adjournment as originally sought, and was never considered by the FTT. For these reasons, submitted Mr Gammie, the Appellants' appeal must fail *in limine*.

61. I am unable to accept this submission. In my judgment it looks at the question too narrowly. By virtue of section 11 of the 2007 Act, the Appellants have the right to appeal from the Decision if it is erroneous in point of law. That right is not removed merely because they have changed their mind about the relief which they wish to obtain. Furthermore, there is a wider public interest in play (namely the interest of the general body of taxpayers that the tax system should operate correctly, in matters of both substance and procedure) which tells strongly in favour of allowing an appeal to proceed, if an error of law might thereby be corrected. There is of course a separate question whether an appellant should be allowed to rely on grounds different from those which were argued below, but that is essentially a question of procedural fairness to be decided in accordance with the overriding objective. Mr Gammie did not argue that the Appellants should be refused permission to rely on their new grounds, if his preliminary objection failed. For these reasons, I am satisfied

that I can and should consider the merits of the Appellants' appeal on the amended grounds now relied upon.

Is it necessary for HMRC to plead dishonesty?

62. At the heart of the Appellants' amended case is the proposition that it is not open to HMRC to put allegations of dishonesty (or other serious forms of misconduct) to their witnesses, or to invite the FTT to make adverse findings of fact on such a basis, unless the relevant allegations have been pleaded with full particularity and the Appellants have been given a proper opportunity to respond to them.

63. In cases where the burden of proof lies on HMRC to establish fraud or dishonesty, these principles undoubtedly apply in the same way as they would in ordinary civil litigation. Examples include cases where HMRC wished to make assessments to income tax outside normal time limits on the ground (before 1989) of fraud or wilful default under section 36 of the Taxes Management Act 1970, or (in the modern world) where, relying on principles developed by the Court of Justice of the European Union, they wish to deny a VAT-registered trader his otherwise incontrovertible right to deduct input tax because of his alleged participation in, or connection with, "missing trader" (or MTIC) fraud.

64. The present case, however, is not of that nature. It is common ground that the burden of proof lies on the Appellants to displace the closure notices issued to them by HMRC within normal time limits, and (in particular) to establish that the businesses of the relevant LLPs were carried on with a view to profit. This issue, as I have explained, is properly pleaded in HMRC's statement of case. No burden lies on HMRC to establish that the businesses were *not* carried on with a view to profit. It is for the Appellants to adduce such evidence as they think fit with a view to discharging the burden which throughout lies on them.

65. The IFP2 Information Memorandum is one of the pieces of documentary evidence relied upon by the Appellants as supporting their case on this issue. HMRC were under no obligation to accept it at face value, when it was disclosed to them, and they were fully entitled to cross-examine the witnesses for the Appellants who had been involved in its preparation in order to test its reliability and examine the assumptions on which it was based. HMRC were not obliged to give advance notice of the lines of questioning which they intended to pursue with the witnesses, and still less were they obliged to plead a positive case of dishonesty in preparation of the Memorandum before putting questions to the witnesses which, depending on how they were answered, might in due course provide a foundation for the FTT to draw such a conclusion. The obligations which lay on HMRC were in my judgment of a different nature. First, as a matter of professional duty, counsel may not put questions to a witness suggesting fraud or dishonesty unless they have clear instructions to do so, and have reasonably credible material to establish an arguable case of fraud. Secondly, as the FTT rightly recognised, it is not open to the tribunal to make a finding of dishonesty in relation to a witness unless (at least) the allegation has been put to him fairly and squarely in cross-

examination, together with the evidence supporting the allegation, and the witness has been given a fair opportunity to respond to it. Important though these obligations are, they are quite different from, and do not entail, a prior requirement to plead the fraud or misconduct which is put to the witness. If it were otherwise, a party would be obliged to serve an amended statement of case before attempting to expose a witness as dishonest in cross-examination, and the element of surprise which can be a potent weapon in helping to expose the truth would no longer be available.

66. In the light of these distinctions, it becomes clear, to my mind, that the requests made by the Appellants at various stages of the trial for HMRC to state whether they were alleging fraud, and the Appellants' primary ground of appeal that the FTT "erred in permitting unpleaded allegations to be made", are misconceived. The real questions, as it seems to me, are:

    a) whether it is now too late for HMRC to put the relevant allegations to the three individuals; and

    b) if it is not too late, whether it will in due course be open to the FTT to make findings of fraud or dishonesty in relation to the preparation and promulgation of the IFP2 Information Memorandum.

67. As to the second question, the FTT has said, and I see no reason to disagree, that on the evidence as it now stands they could not make any such findings. Apart from anything else, the allegations have not been put fairly and squarely to the witnesses, nor have they been given an opportunity to rebut them. It is therefore a legitimate criticism of HMRC's Evidence Paper that it invites the FTT to draw inferences, and reach conclusions, which are not at present open to them. But the evidence is not yet complete, and when the Evidence Paper was prepared both Mr Clayton and Mr McKenna were due to give further evidence at the resumed hearing. If HMRC are permitted to put the relevant allegations to them, the position may yet be reached where the FTT can properly make findings of fact on them.

Is it now too late for HMRC to put the allegations of dishonesty to the three individuals?

68. The FTT clearly considered that HMRC should still be permitted to put the allegations of dishonesty to the three individuals, despite their previous failure to do so and despite the exchanges during the course of the hearing which I have summarised above. This conclusion was one which turned on the FTT's assessment of what fairness and justice require, in the light of the history of the case and the conduct of the parties to date. It is a discretionary assessment of the kind with which an appellate tribunal cannot interfere, unless an error of law (in the sense explained in paragraph 52 above) is demonstrated. Furthermore, even if the FTT did err in law, the Upper Tribunal should in my judgment still accord as much weight as it properly can to the FTT's assessment. They have been hearing the case for over five weeks, and they are the body charged by Parliament with its determination. Inevitably, the

Decision, produced under great time pressure, cannot contain a complete record of all the factors which they took into consideration and how they balanced them.

69. In my judgment the Appellants have been unable to demonstrate any error of law in the FTT's conclusion on this point. For the reasons which I have already given, the Appellants' overarching contention that the FTT were thereby "permitting unpleaded allegations to be made" is in my view based on a misconception about where the burden of proof lies on the issue of "with a view to profit", and a failure to distinguish between the position of a party who is obliged to advance a positive case on an issue, on the one hand, and a party who merely wishes to test, and if possible discredit, the evidence relied upon by his opponent, on the other hand.

70. With these distinctions in mind, it seems to me that the more detailed errors of law alleged by the Appellants in paragraph 35 of their skeleton argument/amended grounds of appeal either fall away, or go to the different questions of what counsel may properly put to a witness in cross-examination, and the conditions which have to be satisfied before a tribunal can properly reach a conclusion of dishonesty. As to those questions, I would observe, first, that the Appellants do not allege that any of the questions already put by counsel for HMRC to the witnesses were improper, including in particular Mr Gammie's cross-examination of Mr Reid on the LS202 spreadsheet; and, secondly, that the FTT were clearly well aware of the constraints on a finding of dishonesty.

Did the FTT err in law in refusing the adjournment sought?

71. On the footing that it should still in principle be open to HMRC to put allegations of dishonesty to the three individuals, did the FTT err in law in refusing the adjournment requested by the Appellants? In my judgment this was a conclusion to which they were plainly entitled to come, as appears to be implicitly recognised in the Appellants' abandonment of the basis on which the adjournment was originally sought. It would in my view have been quite inappropriate (and, arguably, so unreasonable as to amount to an error of law) if the FTT had granted a lengthy adjournment for the Appellants to prepare evidence, and make unspecified further disclosure, in relation to allegations of dishonesty which had not yet been put to the witnesses concerned, but had merely been advanced (prematurely, on the evidence as it then stood) in HMRC's Evidence Paper.

72. As to the alternative basis on which the Appellants now ask for an adjournment, namely "for the matter to be properly pleaded and the subject of further submissions", I would reject the argument if what is envisaged is a formal application by HMRC for permission to amend their statement of case. As I have explained, I do not consider that HMRC are under any formal obligation to plead a positive case of dishonesty in relation to the IFP2 Information Memorandum, nor do they need permission to put allegations of this nature to the witnesses. On the other hand, the question of an adjournment may still arise in the context of HMRC's cross-appeal, if I were

to take the view that the FTT erred in law in giving the case management directions set out in paragraphs 59, 60 and 63 of the Decision. In that event, it might still be appropriate to order an adjournment, but the primary basis for doing so would lie in the powers conferred on the Upper Tribunal by section 12 of the 2007 Act, even if an alternative basis could if necessary be found in the Appellants' amended grounds of appeal against the original refusal of an adjournment.

HMRC's cross-appeal

73. I can take this quite shortly, because neither side has attempted to defend the case management directions proposed by the FTT, and (as I have already indicated) I fear that they would in any event be unworkable in practice. The directions appear to envisage that as soon as an allegation of dishonesty is put to one of the three individuals, the Appellants should then "be permitted to adduce such additional evidence as they ha[d] found to date", i.e. by Thursday, 19 February 2015. To my mind, there are at least two major flaws in this proposal. First, it is not possible to say in advance what the appropriate response should be to the putting of the allegation. Much would depend on how the witness answered the relevant questions, and it is only at that stage that the FTT would be in a position to decide whether fairness and justice to the witness and the Appellants required an adjournment, and if so on what terms. Secondly, I can see no principled basis for confining the additional evidence which may be adduced to evidence collected before 19 February 2015. On the one hand, it is potentially unfair to confine the scope of such evidence to that collected before the cut off date, when no allegations of dishonesty had even been put to the witnesses. This point gains added force, in my judgment, from the exchanges between Mr Davey and the Chairman on day 25: see paragraphs 35 to 38 above. On the other hand, the direction has the potential to be over-generous to the Appellants, in that it apparently gives *carte blanche* to them to adduce further documentary evidence even if it should have been disclosed long ago pursuant to the orders for disclosure already made in the course of the proceedings. Finally, the proposed directions appear to contemplate that this procedure may have to be repeated on a number of occasions, as and when any allegation of dishonesty is put to any of the three individuals. That would, with respect, be a recipe for procedural chaos, and might result in several adjournments for a total period considerably in excess of the one month originally requested by the Appellants.

74. For these reasons, I am satisfied that the FTT erred in law in the directions which they gave for the future conduct of the hearing. In those circumstances, it is clear to me that I should set aside the relevant part of the Decision pursuant to section 12(2)(a) of the 2007 Act. I then have a choice whether to remit the case to the FTT with directions for its reconsideration, or to re-make the decision myself. Mr Hochhauser submitted, and I did not understand Mr Gammie to disagree, that I should if possible adopt the latter course, so that the parties would know where they stood before the hearing resumes before the FTT. I agree that it would be desirable for me to give such directions or guidance as I think I properly can, while bearing firmly in mind the late stage

in the trial at which these issues have arisen, the primary role of the FTT, the feel for the case which they have gained over the last four months, and my own very limited and recent involvement in the matter.

The way forward

75. The present position is in my judgment unsatisfactory in a number of respects. HMRC have made apparent accusations of dishonesty in their Evidence Paper for which, on the evidence as it now stands, there is no proper foundation. On the other hand, the evidence is not yet complete, and two of the three individuals (Mr Clayton and Mr McKenna) were still scheduled to give further evidence at the time when HMRC's Evidence Paper was prepared. Mr McKenna, in particular, was due to be questioned on his kitchen table calculations which, as I understand it, related directly to the assumptions underpinning the IFP2 Information Memorandum. Mr Reid was not scheduled to give further evidence, but his cross-examination by Mr Gammie, especially in relation to the LS202 spreadsheet, had arguably provided an entirely proper foundation on which an allegation of dishonesty or carelessness might have been put to him, but for whatever reason this was not done.

76. There has also been a recurrent theme of assurances given to the FTT, sometimes in apparently unqualified terms, to the effect that HMRC were not alleging fraud or dishonesty against anybody. While it is true, if I am right in my analysis of the law, that HMRC were under no obligation to plead a positive case of fraud or dishonesty in relation to the IFP2 Information Memorandum, it is in my view regrettable that the distinctions which I have sought to articulate in this decision do not seem to have been put clearly, if at all, to the FTT. Instead, and I am sure unintentionally, the impression given to a neutral observer by some of HMRC's exchanges with the FTT could be one of ambivalence, even at times evasiveness, and a willingness to wound but not to strike, in an area where openness and clarity should be at a premium unless HMRC had some good reason for wishing to spring a surprise on an unsuspecting witness.

77. How, then, should matters now proceed?

78. In the first place, I see no reason to interfere with the FTT's overall assessment that the balance of fairness and justice comes down in favour of permitting HMRC to put allegations of dishonesty, or other discreditable conduct, to the relevant witnesses. Mr Reid will therefore have to be recalled for this purpose, unless of course HMRC decide that they do not wish to make any such allegations against him.

79. Secondly, however, I consider that before putting any such allegations to the three individuals, HMRC should first be required to clarify their position by producing a document explaining the general nature of the allegations which they wish to put, the witnesses to whom they wish to put them, and the relevance of the allegations to the pleaded issues. I emphasise that this document would not be a formal statement of case, but it should contain

sufficient particularity to give the Appellants and their witnesses a clear indication of the nature of the case that will be put to them, and of the material that is said to justify it. Since the material needed for preparation of this document should already have been considered and analysed by HMRC when preparing their Evidence Paper, I would not at present propose to allow more than a short period of one to two weeks for its preparation.

80. Thirdly, I think that the Appellants should then have a reasonable opportunity to consider whether they wish to adduce any further witness or documentary evidence in response to the allegations. I emphasise that this is not intended to give them an opportunity to broaden the ambit of the case, or to make extensive disclosure of documents which should already have been disclosed pursuant to existing disclosure orders. Any evidence should be strictly responsive to the allegations contained in HMRC's document, and its objective should be to ensure that the FTT will in due course be able to deal with and rule upon the allegations fairly. The period which I would provisionally allow for this exercise is four weeks from the date when HMRC's document is served on the Appellants. Any disputes about the relevance, extent or admissibility of the material produced by the Appellants will have to be resolved by the FTT in due course.

81. Finally, when these steps have been taken, and the parties have had a reasonable time to digest the relevant material, the main hearing should resume. I envisage that further evidence will then be given by the three individuals, but limited to the matters raised in HMRC's document, Mr McKenna's kitchen table calculations, and any other matters which the FTT may permit to be raised. If the Appellants have filed responsive witness statements from any other witnesses, and been granted permission to rely on them, those witnesses too will be heard. The case can then proceed to final submissions, in accordance with such timetable as the FTT may direct.

82. It is unfortunate, but in my judgment both unavoidable and in accordance with the overriding objective in rule 2 of the FTT Rules, that these directions will entail a further substantial delay in the completion of the hearing. In a case where less was at stake, this might have been a good reason for refusing HMRC permission to put the allegations to the witnesses at such a late stage of the trial. But this is not an ordinary case, and its outcome will be of the greatest importance both to the parties and to the general body of taxpayers.

Conclusion

83. For the reasons which I have given, the Appellants' appeal will be dismissed, but HMRC's cross-appeal will be allowed on the terms which I have indicated. I hope that the parties will now be able to agree directions to give effect to my decision within a short period of time. In the event of disagreement I will be available to resolve any outstanding matters, either on paper or (if necessary) at a short further hearing.

MR JUSTICE HENDERSON

TRIBUNAL JUDGE:

RELEASE DATE: 05 MARCH 2015