Neutral Citation: [2024] UKFTT 00084 (TC)

Case Number: TC09049

FIRST-TIER TRIBUNAL
TAX CHAMBER

Heard in person in London:

Appeal reference: TC/2020/00044-46; TC/2021/01877; 01878; TC/2020/00072; 00079; 00049 TC/2021/01893; 01918; 10926; 01979; 01989; 02003; 02023; 02043

LLP interests - payments made on their disposal taxed as income or capital – application of the profit sharing rules in ss850 and 850C ITTOIA- application of the miscellaneous income rule in s687 ITTOIA – application of the sale of occupational income provisions in Chapter 3 of Part 13 ITA 2007.
Deferral of profit – validity
What constituted the profit sharing arrangements of the partnership for s850 ITTOIA
Validity of discovery assessments under s29TMA; Validity of partnership amendments under s30B TMA; carelessness; hypothetical officer
Ability of HMRC to rely upon legal arguments not contained within their Statement of Case
Ability of HMRC to rely on evidence not addressed in their Statement of Case.

Heard on: 27 January to 7 February 2023 with written submissions dated 30 March 2023, 14 April 2023, 27 April 2023, 7 June 2023, 22 June 2023, 12 July 2023

Judgment date: 23 January 2024

Before

TRIBUNAL JUDGE BOWLER
MR JULIAN SIMS

Between

THE BOSTON CONSULTING GROUP UK LLP
MARK BENEDICT HOLDEN
AFONSO NASCIMENTO
PHILIP KRINKS
MICHAEL NIDDAM
THOMAS GARSIDE

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Sam Grodzinski KC and Ms Marika Lemos of Counsel, instructed by Freshfields Bruckhaus Deringer LLP

For the Respondents: Mr Rupert Baldry KC and Mr Thomas Chacko of Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. The Boston Consulting Group is a management consulting firm, which conducts its business in the UK through The Boston Consulting Group UK LLP ("the UK LLP"). These appeals principally concern the correct tax treatment of certain interests ("the Capital Interests") that were held by individual partners of the firm ("MDPs") in the five tax years from 2012/13 to 2016/17 (the "Relevant Period").

2. In essence, the Appellants' case is that payments received on disposal of the Capital Interests should be taxed on a capital gains tax basis. In contrast, HMRC say that the payments should be taxed as income under partnership profit sharing rules (including the mixed member partnership rules) under ss850–850C Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"); or as miscellaneous income under s687 ITTOIA; or as proceeds from the sale of occupational income under Chapter 3 of Part 13 Income Tax Act 2007 ("ITA").

3. There are two further separate issues concerning the deferral of a profit allocation and whether in fact allocation of profits of the UK LLP to the corporate partner, BCG Ltd, validly took place.

4. In addition, the Appellants have challenged the validity of various of the individuals' assessments on the basis that no discovery was made for a discovery assessment to be validly issued under s29 Taxes Management Act 1970 ("TMA"); and various of the partnership amendments on the basis that the amendments were not validly made under s30B TMA.

5. The individuals are lead appellants in the dispute affecting 63 MDPs.

6. The dispute has raised numerous substantive and procedural issues. After the hearing two relevant Upper Tribunal decisions in *HFFX LLP and ors v HMRC* [2023] UKUT 00073 and *Shinelock Limited v HMRC* [2023] UKUT 107 were published and the parties were invited to make written submissions about their implications which they accordingly did.

7. Shortly before issuance of this decision the Court of Appeal decision in the case of *HMRC v BlueCrest Capital Management LLP and ors* [2023] EWCA Civ 1481 was published. The parties agreed that they would not make any further submissions unless sought by us. We were satisfied that we did not need to seek further submissions as we considered that the Court of Appeal decision did not undermine our conclusions herein.

BACKGROUND AND PROCEDURE

8. On 17 and 19 January 2018, HMRC opened enquiries under s.9A TMA into the tax returns of two UK MDPs for the 2015/16 tax year, querying their treatment of their disposals of Capital Interests.

9. On 23 February 2018:

(1) A discovery amendment was issued under s.30B TMA to UK LLP in relation to the 2013/14 tax year; and

(2) Discovery assessments were also issued under s.29 TMA to 38 UK MDPs, including Mark Benedict Holden, in relation to the 2013/14 tax year. The covering letter to one lead Appellant stated that the HMRC officer considered it unlikely that entrepreneurs' relief was available on disposal of the Capital Interests and that "the amounts included on your CGT pages in respect of the disposal of your Capital Interest Scheme awards should have been subject to income tax".

10. On 8 March 2019:

(1) Discovery assessments were issued under s.29 TMA in relation to the 2012/13 tax year to four other UK MDPs including one of the individual appellants, and

(2) Discovery assessments were also issued under s.29 TMA in relation to the 2013/14 tax year to five other UK MDPs including two of the individual Appellants.

11. On 29 March 2019 discovery amendments were issued under s 30B TMA to UK LLP in relation to the 2012/13 and 2014/15 tax years.

12. On 26 March 2021:

(1) Discovery amendments were issued under s.30B TMA to UK LLP in relation to the 2015/16 and 2016/17 tax years.

(2) On the same date, discovery assessments were also issued to 63 MDPs in relation to the 2014/15, 2015/16 and 2016/17 tax years

13. By the discovery amendments issued to the UK LLP, HMRC sought to re-allocate profits of BCG Ltd to the UK MDPs on the basis of HMRC's view that profits were being diverted from the UK MDPs to BCG Ltd in respect of the "Capital Interest plan arrangements implemented". The discovery amendments purported to amend the amount of UK LLP profits allocated to BCG Ltd, as follows:

14.

Tax year	Profit allocated to BCG Ltd by UK LLP	Revised BCG Ltd's profit share
2012/13	£42,376,848	£25,971,274
2013/14	£22,317,086	[Not specified]
2014/15	£29,841,003	£1,065,124
2015/16	£17,504,385	£0
2016/17	£29,783,247	£0

The assessments / amendments under appeal

15. The assessments and amendments under appeal comprise:

(1) a series of "discovery assessments", raised by HMRC against the individual (lead) Appellants under section 29 of the Taxes Management Act 1970 (TMA). Some of the discovery assessments relate to profit allocation under the rules applicable to the taxation of partnerships contained in sections 850-850C ITTOIA and some relate to the tax treatment of disposals of the Capital Interests; and

(2) a series of "discovery amendments", raised by HMRC against UK LLP in respect of its partnership tax return under section 30B TMA, in respect of each year within the Relevant Period.

16. The UK LLP was issued amendments to its returns for each year 2012/13- 2016/2017. In the case of the individual Appellants the appealed assessments have been issued in relation to varying tax years. In the case of both assessments/amendments issued to the UK LLP and the individual Appellants certain of them are only validly issued if HMRC can show that the

"extended time limits" in section 36 TMA are available in respect of such assessments / amendments.

17. The table below sets out the dates that each of the assessments / amendments under appeal were issued:

18.

Financial year	2012 / 13	2013 / 14	2014 / 15	2015 / 16	2016 / 17
UK LLP	29/03/19*	23/02/18	29/03/19	26/03/21*	26/03/21
P Krinks	08/03/19*				
B Holden		23/02/18	26/03/21*	26/03/21*	26/03/21
A Nascimento		08/03/19*			
T Garside			26/03/21*	26/03/21*	26/03/21
M Niddam				26/03/21*	26/03/21

19. Those assessments / amendments marked with an asterisk in the above table were issued by HMRC outside of the ordinary time limit for raising such assessments, pursuant to section 34 TMA. Accordingly, HMRC has raised each of those assessments / amendments on the basis that (in HMRC's view) the "extended time limits" in section 36 TMA are available in respect of such assessments / amendments.

GROUNDS OF APPEAL

20. LLP Appeals

(1) Profits of the UK LLP were allocated in accordance with its "profit sharing arrangements" as defined in s.850 Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") in each of the relevant tax years. No adjustment needs to be made to the allocation of profit to the members of the UK LLP for any of the relevant tax years. (It is in any event not open to HMRC to seek to defend amounts charged by the Discovery Amendment made in relation to the tax year 2012/13 relying on matters which were not the subject of the Discovery Amendment for that tax year); and

(2) No adjustment is required to be made under the mixed member rules ("MMRs"), in particular s.850C ITTOIA, in respect of the tax years 2014/15, 2015/16 and 2016/17.

21. Individual Appeals:

(1) The disposal by the UK MDPs of their Capital Interests cannot properly be regarded as giving rise to income that is subject to tax under s.687 ITTOIA (the 'miscellaneous income' provision);

(2) Nor does the disposal by the UK MDPs of their Capital Interests give rise to amounts chargeable to income tax under Chapter 4, Part 13 of the Income Tax Act 2007 (ITA) (tax on sales of occupational income);

(3) The disposal by each of the UK MDPs of their Capital Interest is a disposal of part of a business owned by each relevant UK MDP for the purposes of Chapter 3 Part V (Entrepreneurs' Relief) of the Taxation of Chargeable Gains Act 1992 (TCGA), such that they are each entitled to the entrepreneur's relief claimed in their tax returns.

BURDEN OF PROOF

22. The burden of proof rests with the Respondents to show that the assessments are valid having been issued in accordance with the statutory procedure and within the relevant statutory time limits. The burden of proof rests with the Appellants to show that, if the assessments are valid, the tax liabilities identified by HMRC do not apply and that the correct treatment of payments received for the Capital Interests is as payment for disposal of an asset subject to capital gains tax; and the claimed deferral of MDPs' profit share in 2012/2013 to 2013/2014 was effective. The ordinary civil standard of the balance of probabilities applies.

EVIDENCE

23. The written evidence before us consisted of a hearing bundle running to 7241 pages.

24. We heard evidence from:

(1) Mr Holden, an MDP and Appellant. He is a qualified accountant and member of the CIOT who before working for BCG Ltd was a tax professional at Pricewaterhouse Coopers ("PwC"). He was part of the group in BCG who were responsible for operating the group's compensation and remuneration programme in the UK and came to head that department in 2013. In 2017 he was also given oversight of BCG's tax and accounting departments in the UK. He was the person primarily responsible for the development and implementation of the UK LLP structure. He has been a member of the UK LLP's remuneration/profit allocation committee.

(2) Mr Taylor, an HMRC officer, who was engaged in considering the potential issues affecting the Appellants from early 2018 and who was the officer who issued the appealed assessments/amendments.

25. We found Mr Taylor's evidence to be consistent and we have relied upon it save in respect of evidence where he has strayed into expressing his opinion about the application of the tax rules.

26. We also found Mr Holden's evidence generally to be consistent and reliable but the one area where we have relied more upon evidence other than that from Mr Holden is that concerning the purpose of the Capital Interests. Mr Holden maintained in his oral evidence at the hearing that the Capital Interests formed no part of the MDPs' overall compensation package but we have found this to be inconsistent with the documentary evidence. We set out the reasons for giving greater weight to the documentary evidence in detail later in the decision.

APPLICATION TO DENY HMRC THE ABILITY TO RAISE A NEW ISSUE

27. In a letter dated 23 December 2022 HMRC indicated that they wish to raise a new issue concerning the way in which the profits were allocated in the UK LLP. HMRC asserted that they did not need to make an application to amend their Statements of Case. The Appellants submit that the issue had been raised at too late a stage in the litigation. Issues were agreed as early as June 2021. Mr Grodzinski referred to the case of *Prudential Assurance Co Ltd v Revenue and Customs Commrs* [2017] 1 WLR and submitted that this decision shows there must be a strong justification to admit such a change. In *BPP Holdings Ltd v Revenue and Customs Commrs* [2016] 1 WLR it was made clear that the tribunal should not permit "ambushes" and procedural rigour applies in the FTT as under the general CPR. HMRC say they have only just realised that there is this point but Mr Grodzinski says that the Remuneration Committee minutes have shown the position clearly.

28. At the hearing HMRC submitted that it had not been possible to identify this issue at an earlier stage as disclosure of the relevant fact (that there was no notification of allocation of profit to the corporate member, BCG Ltd despite this being required under the terms of the UK LLP's partnership agreements ("LLPAs") for profits to be validly allocated) was not made until

November 2022. HMRC needed time after disclosure of the relevant evidence to continue their examination of the facts. Prior to that disclosure the evidence available for HMRC was limited to a note in BCG Ltd's accounts which referred to profits allocated from the UK LLP and a letter from PwC saying that BCG Ltd was entitled to residual profits. It was therefore reasonable for HMRC to rely on these statements to conclude that the allocations were correctly made under the terms of the LLPAs. This was a factual matter which could have come out in cross-examination and then be relied upon in HMRC's case. There were no fairness issues raised by admitting consideration of this issue as the Appellants would not need time to prepare to respond, obtain other evidence or instruct experts. HMRC were not ambushing the Appellants who had been aware of the issue since 23 December 2022. Curtailing the power to raise matters coming out in litigation after the assessment cuts across the public interest in getting the tax right.

Our decision

29. We gave our decision during the hearing which we now record here.

30. We agree that it is incumbent on the Tribunal to apply procedural rigour having regard to the overriding objective of the Tribunal rules. However, we concluded that the fact that there were no resolutions or notification of BCG Ltd's profit allocation was not apparent from the evidence until the November 2022 disclosures. The resolutions to which we were referred listed allocations of profit to a series of individuals and did not identify BCG Ltd. However, that evidence was provided in the context of showing what profit allocations had been made to MDPs. It would not have been surprising for there to have been a separate notification of the amount of profit allocated to BCG Ltd. This was a new factual matter which became apparent as evidence was disclosed.

31. Furthermore, the Appellants were not ambushed. They were aware that the point would be taken from 23 December 2022. Although that was just before the Christmas holidays there were then nearly 4 weeks of January before the start of the hearing. There was no need for the Appellants to be granted additional time to address the issue.

32. We therefore concluded that the overriding objective was best served by permitting HMRC to address this issue in the hearing.

33. After the hearing we received submissions from both parties regarding the application of the Upper Tribunal's decision in *Shinelock* .

34. HMRC submitted that one of the issues before the Tribunal was whether the Appellants were required to prove that profit allocations had actually been made. The Appellants can therefore be required to prove matters that are inherently part of that case whether or not HMRC have disputed them in the Statement of Case.

35. Mr Grodzinski submitted that it was not part of either party's pleaded case that profit allocations had not actually been made to BCG Ltd. *Shinelock* simply represents an application of the principle that the exercise by the Tribunal of the power to allow late / new arguments and issues to be raised (by the parties or by the Tribunal itself) has to be balanced against the need to ensure procedural fairness and to prevent one side from "ambushing" the other. How that balance is struck by the Tribunal will depend upon the facts of the particular appeal. In *Shinelock*, the Upper Tribunal found that one of the two 'new' arguments upon which the First-tier Tribunal had based its decision, and upon which HMRC had sought to rely, was "sufficiently in play" (at [134]), it having been an inherent part of the appellant's positive case.

36. Having read the submissions of both parties we concluded that the decision made by us at the hearing should be maintained. As Mr Grodzinski submitted, underpinning the *Shinelock* decision are the principles of procedural fairness which had underpinned our decision.

Arguably, the *Shinelock* decision reinforced our conclusions. Profit allocation is at the heart of this case.

Application to deny HMRC the ability to raise new legal arguments

37. Mr Grodzinski also made an application at the hearing to deny HMRC the ability to raise a new legal argument which had not been identified in their Statement of Case and which had only been briefly alluded to in their skeleton argument. The matter concerned the application of the MMRs contained in s850C; and more particularly whether HMRC relied upon not only on s850C(20)(c) (as previously stated in their Statement of Case) but also on subsections (a) and (d).

38. Mr Grodzinski submitted that the level of detail required in HMRC's Statement of Case should reflect the level of complexity of issues allowing the taxpayer to participate in the hearing fully. He relied upon the case of *Allpay Ltd v HMRC* [2018] UKFTT 0273 (TC) as well as the Court of Appeal decision in *BPP* confirming Judge Mosedale's decision that HMRC's case must be put in its Statement of Case and not the skeleton argument. Mr Chacko's own submissions had shown that this was a highly technical area of law which needed to be addressed line by line. Even at this stage of the hearing HMRC had not set out how the two additional subsections were said to apply. Consequently, the Appellants simply could not properly prepare to respond to the altered case. Indeed, given the nature of the reference to the two additional subsections in HMRC's skeleton it would not be until submissions were made following evidence that HMRC's position could be understood.

39. Mr Chacko submitted that it was clear that in the tribunal proceedings Statements of Case are produced at a high level. The tribunal procedure is not equivalent to the High Court procedure where it is necessary to set out the legal case in full. This was not an example of an ambush as the matters concerned the technical construction of the same section already identified as relevant.

Our decision

40. We gave our decision during the hearing which we now record here.

41. Reliance upon s850CC(20)(a) and (d) was not implicit in HMRC's Statement of Case. Furthermore, there was only the briefest reference to those subsections in HMRC's Skeleton simply stating that:

> (1) each individual has the power to enjoy BCG Ltd's profit share because the enjoyment conditions in (a), (c) and (d) are satisfied;
>
> (2) BCG Ltd has at least the option to pay out the price of a Capital Interest from its profit share thereby satisfying (d);
>
> (3) the MDPs are all members of the US LLP which owns BCG Inc, the ultimate parent of BCG Ltd. Therefore allocations to BCG Ltd increase the value of a company owned by a partnership of which the individuals are members such that condition (a) is satisfied.

42. However, in so doing HMRC have confused subsections. The reference to the ownership structure picks up s850C(18)(a) not s850(20)(a). Quite how s850C(20)(d) in fact applies is not explained. As Mr Grodzinski submitted, HMRC have not said what power is exercised by whom for that subsection to apply.

43. Rule 25 of the FTT Procedure Rules requires HMRC to set out their position in relation to the Appellants' case. We respectfully agree with the decision of Judge Mosedale in *Allpay* where she stated:

> "The Tribunal's rules require HMRC to set out its position in respect of a case; what that means is that [the Revenue] should explain its position in sufficient

detail to enable the appellant to properly prepare its case for hearing. Anything less may lead to injustice."

44. We are clear that HMRC have not come near to setting out their position in relation to subsections (a) and (d) of Section 850C(20) for the Appellants to have properly prepared their case for this hearing. These were not matters which were in any sense "obvious" such that a litigant in the position of the Appellants could reasonably have been expected to anticipate reliance upon them.

45. No application was made by HMRC to amend their Statement of Case. No application was made by HMRC for an adjournment and, given the circumstances involving delay of a long hearing which had been arranged for some time, where there was little reason for HMRC not to have made an application to amend their Statement of Case in advance of the hearing, we were not inclined to adjourn the hearing of our own volition.

46. Our conclusion was that the overriding objective required that the hearing proceeded on the basis of the unamended pleadings.

FINDINGS OF FACT

47. The parties have agreed a statement of facts and issues. We set out the agreed facts in italics in these findings.

Background

48. The UK LLP is part of the privately-owned corporate group, headed by The Boston Consulting Group, Inc. (BCG Inc). BCG Inc holds (directly or indirectly) interests in a variety of different entities, which conduct BCG's business in each of the jurisdictions in which it operates.

49. The group operates in accordance with a global partnership ethos, in which the senior individuals who run the business in every jurisdiction each participate in the ownership and management of the global group. These senior individuals are known as "Managing Directors and Partners" (MDPs).

50. Prior to 2011 the UK business of the group was carried on through BCG Ltd, a wholly owned subsidiary of BCG Inc, and the MDPs were employees of BCG Ltd. In 2011 BCG Ltd transferred its business to the UK LLP and from that point the MDPs became members of the UK LLP.

51. Each MDP is engaged by the local entity in the jurisdiction in which that MDP operates, and is also:

(1) a director and officer of BCG Inc, which allows them to participate in decision-making in respect of the global group; and

(2) a member of The Boston Consulting Group US LLP (US LLP), a US limited liability partnership, which holds all of the voting shares in BCG Inc.

52. The group operates a single, global compensation and equity framework for all MDPs, including its UK MDPs ("the Framework"). The Framework is used to set out the principles which are applied to determine the amount of compensation and equity which each MDP will receive. However, it does not itself provide the MDPs with any legal right to compensation or stake in the group. Instead, MDPs derive such rights through the local "programmes" in place in the jurisdiction in which they operate.

53. There were four 'compensation components' in the Framework:

(1) the "nominal" element, which represented the fixed amount of remuneration which each MDP received each year in respect of their role as MDP, generally paid out monthly.

This is set according to seven levels through which an MDP can progress over time but also depending upon reviews of performance;

(2) the "performance distribution" element ("PD"), which reflects BCG's assessment of that MDP's contribution to the business. This typically reflects the majority of an MDP's annual remuneration;

(3) the "office performance bonus" element ("OPB"), which is calculated by reference to the performance of an MDP's local office system; and

(4) the "profit sharing retirement fund" (PSRF), which is calculated as a specified percentage of the MDP's nominal, PD and OPB and is either invested in qualified retirement savings vehicles or, if such vehicles are not available, paid to the MDP in cash, to enable them to make provision for their retirement.

54. Elements (2) – (4) were generally paid out annually.

55. In addition, there is what the group calls the "equity" component or "LTCV". It was introduced in 1994 to provide MDPs with an interest in the long-term growth in value of the global business, to improve retention of MDPs and to strengthen and increase the stability of BCG's capital base. This latter point was explained by Mr Holden in his Witness Statement where he notes that prior to the introduction of the LTCV, a substantial majority of BCG's annual profits would be distributed to MDPs each year. The LTCV enabled BCG to retain a greater portion of those profits. When it was originally introduced, MDPs in different jurisdictions participated in the LTCV either through holding shares in BCG Inc or derivatives of those shares; or through a phantom stock programme.

56. BCG also operates the LTCV to secure its commercial interests in other ways; for example, in relation to enforcing the 'Officer's Agreement with Respect to Competition' which all MDPs are required to enter into with BCG Inc. (We address the competitor provisions further below.)

57. The LTCV is a mandatory component of the Framework. The Capital Interests have been designed as a way of executing the LTCV in the UK.

58. Under the LTCV, by whatever method is appropriate in their local jurisdictions, MDPs acquire a long-term interest in the group, the value of which increases or decreases, based on BCG's global performance.

59. In many jurisdictions, including in the UK from 2001 until 2011, the LTCV was implemented as an "equity" program, in which MDPs acquired either: (a) shares in BCG Inc; or (b) instruments whose value derived from the value of BCG Inc's shares. In the UK it was the former: the UK MDPs held a specific class of shares in BCG Inc. Prior to 2008, those shares were Sterling-denominated, Class D shares in BCG Inc (the D Shares). In 2008, the existing D shares were re-named "Class D-1 Shares". From that date, UK MDPs received Class D-2 Shares in BCG Inc (the "BCG Inc shares"). From 2011, the BCG Inc share structure for the LTCV was replaced with the Capital Interests following conversion of the UK business to being conducted through the UK LLP.

60. The basic nature of the LTCV and the method for calculating the size of each MDP's LTCV interest was determined in accordance with a global policy forming part of the Framework. That Framework took into account the seniority of the individual and their length of tenure as well as the time since the introduction of the LTCV. Therefore, for example, at the first level of seniority in 1994 an MDP would have been allocated 100 units. A formula was used to identify the number of LTCV units allocated to a newly appointed MDP at the same level after 1994 because the expectation was that the value of the interest would increase

over time. Therefore allocating a later elected MDP the same number of LTCV units as an earlier elected MDP would be expected to result in the later elected MDP having a greater interest in financial terms in the value of the group than the earlier elected MDPs. The formula was used to correct that. In essence, a new MDP would receive fewer units.

61. As an MDP moved through Framework levels due to increased seniority and/or time with the business, the MDP would be allocated additional LTCV units.

62. On retiring an MDP would be required to sell their entire LTCV holding to an entity within the BCG group. On reaching 20 years of service as an MDP, that individual would be required to start selling down their LTCV interest in 10 annual tranches equal to 10% of that MDP's pre sell-down LTCV holding. Prior to 2014 an MDP going through the sell down process was also able to sell up to an additional 10% as part of each annual tranche. Also prior to 2014 an MDP who reached five years of service as an MDP and was at least 45 years of age would be entitled to sell up to 10% of their pre sell-down LTCV holding each year until they had sold a total of 50% of their presell down LTCV holding.

63. BCG retained the general right to require MDPs to sell some or all of their LTCV interest back to the group, including on the occurrence of certain specified events, such as the sale of the global business to a third party. Provisions were made to compensate lateral hires for the fact that if they joined at a higher seniority level they would have missed out on allocations which those who had risen through the organisation would have obtained. Those MDPs who worked at reduced capacity (e.g. nearing retirement) would be required to sell a percentage of their LTCV interests as they started to reduce their work for the organisation.

64. On the introduction of the LTCV MDPs were required to purchase their interests using their own funds but as the value of BCG Inc increased loans were provided for the purchase of the interests. Those loans were limited recourse and only secured against the value of the BCG Inc shares so that the MDP was not left exposed to a liability to repay debt exceeding the payment received on disposal of the shares. No loan funding or capital contribution was required under the UK LLP/Capital Interests structure.

65. The BCG Inc shares held by the UK MDPs were treated by the MDPs as capital assets with no employment income tax arising on their disposal, steps having been taken to ensure that they fell outside the employment-related securities rules. This tax treatment has not been challenged by HMRC.

Change from conducting business through a UK Company to UK LLP in 2010/11

66. *In 2010 and 2011, BCG implemented a restructuring of its UK business (the LLP Conversion).*

67. *The key legal steps in the LLP Conversion were as follows:*

(1) *In February 2010, the UK MDPs sold the non-voting, redeemable "Class D" shares in BCG Inc (D Shares), held by them as their investment in BCG's "Long Term Capital Vehicle" (LTCV).*

(2) *On 28 October 2010, UK LLP was incorporated as a dormant limited liability partnership with two members – BCG Ltd and BCG UK1 Limited.*

(3) *With effect from 1 January 2011, BCG Ltd contributed its entire interest in BCG's UK business to UK LLP by way of a capital contribution.*

(4) *On 1 April 2011, each of the UK MDPs joined UK LLP as a member. A Limited Liability Partnership Agreement in respect of UK LLP was entered into between the members of UK LLP as at that date (the LLPA). Pursuant to the terms of the LLPA, each of the UK MDPs as at this date was also allocated what are described in the LLPA as*

"Capital Interests", representing that UK MDP's participation in the LTCV (the Capital Interests). ("Capital Interests" is the name given to these interests by The Boston Consulting Group but, whilst the term has been used for ease of reference, HMRC do not consider that the interests should be treated as capital assets for UK tax purposes.)

68. *Following implementation of the LLP Conversion:*

(1) *BCG's UK business was carried on (and continued throughout the Relevant Period to be carried on) by UK LLP, rather than by BCG Ltd directly;*

(2) the UK MDPs ceased to perform their role as MDPs in the capacity of employees of BCG Ltd, and instead performed that role in their capacity as self-employed members of UK LLP;

(3) the UK MDPs held their LTCV interest by way of a Capital Interest, rather than as a direct holding of D Shares in BCG Inc; and

(4) the Capital Interests were accounted for as share-based payments within both BCG Ltd and UK LLP's accounts, and continued to be accounted for in this manner throughout the Relevant Periods.

69. In late 2009 to early 2010, there was speculation that there would be US corporate tax reforms which would affect BCG Inc's ability to obtain a deduction in respect of the UK's LTCV in calculating its US tax liability. In addition, BCG had identified a risk that changes to the UK's employment-related securities rules might adversely affect the UK tax treatment of the UK MDPs' LTCV investment held as shares in BCG Inc and cause it to be subject to income tax.

70. To ensure that the US deduction could be secured in respect of existing appreciation in the UK MDPs' shares in BCG Inc and with an eye to the possible UK tax changes UK MDPs were asked to dispose of their BCG Inc shares, which they all did around 15 February 2010. The net proceeds from the disposal of each MDP's BCG Inc shares were subsequently reinvested in the UK LLP by way of capital contribution.

71. The terms of the Contribution Agreement by which BCG Ltd contributed its business to the UK LLP provided for the consideration to be satisfied by the granting to BCG Ltd of:

(1) an interest in the capital of the UK LLP of such number of units as the parties agreed;

(2) a credit to BCG Ltd's capital contribution account of an amount agreed by the parties.

72. The purchase price was stated to be the book value of the assets of the business (excluding goodwill) less the book value of the liabilities.

73. The result was that £5.7m was credited to BCG Ltd's capital contribution account.

74. Mr Holden has provided evidence that the market value of the business at the time of the capital contribution would have been in the range of £140m. However, HMRC has challenged the weight to be given to this evidence given that Mr Holden is not a valuation expert and his estimate of the market value is in essence his opinion. We consider that Mr Holden's evidence in itself is insufficient for us to conclude that the market value was in the range of £140 million, given that he is not a valuation expert and there is no supporting evidence explaining the basis on which this number has been put forward. In our experience we believe that the figure of £140 million is likely to be on the high side. Therefore, while we are clear that the market value would have been in excess of the net book value as no detailed or expert evidence was before us, we express no further view on the market value at the time. Given the submissions

of both parties referred to below suggesting that this matter can be dealt with by negotiation if necessary, we make no further finding of fact on the issue.

75. With effect from 1 April 2011, a Limited Liability Partnership Agreement ("LLPA 2011") was entered into setting out the detailed terms for the operation of UK LLP and the relationships between UK LLP and its members. Each of the UK MDPs ceased to be an employee of BCG Ltd and became members of the UK LLP on 1 April 2011. From then on when a new UK MDP was appointed they became a member of the UK LLP.

76. The four "compensation elements" described earlier were calculated in the same way as before the conversion to the UK LLP structure, but instead of being paid a salary and bonus by BCG Ltd, MDPs were paid those elements by allocation of profits of the UK LLP. The allocation of profits was made under the terms of the LLPAs by the UK LLP's remuneration committee (later named the profit allocation committee) applying the Framework as before the conversion and after an initial retention of what is described as the "18% margin" to fund the future liability under the LTC V. Residual UK LLP profits were also allocated to BCG Ltd. Therefore the result was that both before and after the UK LLP conversion, BCG Ltd received the whole of the profits of the UK business, net of UK MDP remuneration calculated under the Framework. The remuneration elements (but not the Capital Interests as explained below) were calculated for UK MDPs by reference to the results of the UK business.

77. The relevant provisions of the LLPA 2011 regarding allocation of profits stated:

> The extent of each Member's interest in the Profit of the Partnership for any Financial Year shall be determined and notified to each Member by the Remuneration Committee in its discretion from time to time. For the avoidance of doubt, a Member's interest in the Profit of the Partnership may vary and may or may not be in proportion to his interest in the capital of the Partnership.
>
> Each Member shall receive drawings and distributions in respect of his interest in the Profit of the Partnership to the extent and at the times determined for such Member by the Remuneration Committee from time to time.
>
> If there shall be paid to a Member by way of drawing or distribution an amount in excess of his entitlement to an interest in the Profit of the Partnership, the amount of such excess shall be re-payable by that Member to the Partnership at such time as the Remuneration Committee may require.
>
> The Distribution Account of each Member shall be adjusted in accordance with the provisions of this [LLPA] to reflect the Profit allocated to that Member, and the drawings and distributions paid to that Member, pursuant to this Agreement. Profit allocated by the Remuneration Committee to a Member shall be credited to that Member's Distribution Account.
>
> After the annual accounts of the Partnership being approved in accordance with clause 8.1, there shall be added to each Member's Distribution Account any share of the Profit for the relevant Financial Year to which the Remuneration Committee determines he is entitled.

78. The distribution provisions in the LLPAs meant that in line with partnerships generally, the MDPs received payments as "drawings" which were then set against the distributions allocated to them after the profits for each financial year were determined.

79. Amounts in respect of each MDP's profit allocation are determined under the Framework on a calendar year basis. However, as UK LLP has a financial year ending 31 March, there is a mismatch between this calendar year calculation and the UK LLP's financial year.

80. Generally MDPs would be allocated an amount out of UK LLP's profits for the year ending 31 March of that calendar year, representing one quarter of the total amount which (at the time that the UK LLP profit allocations for that year were to be made) BCG estimated would be calculated for that individual under the Framework for that calendar year; and (ii) the remainder (representing approximately three quarters of the full amount) would be allocated to the MDPs out of UK LLP's profits for the year ending 31 March of the following calendar year. A decision of the remuneration committee (later called profit allocation committee) on the allocation of UK LLP profits for a particular year is typically taken in July or August after the end of that year (so, for example, the decision of the remuneration committee regarding the allocation of UK LLP's profits for the year ended 31 March 2016 was taken in late July 2016.)

81. This system was altered in 2013 and we deal with that specific alteration later.

82. The UK MDPs' LTCV interests were now structured as the "Capital Interests" rather than through acquisition of D Shares in BCG Inc. The Capital Interests were allocated to the MDPs. There was no purchase of an asset by the MDPs (in contrast to the previous D2 structure).

83. On being elected an MDP, and thereby becoming a member of the UK LLP, an individual would be granted a number of Capital Interests equivalent to the number of BCG Inc shares which he would have obtained prior to the conversion to the UK LLP, as determined in accordance with the Framework. If an MDP was moved to a higher level within the organisation he would receive an additional number of Capital Interests equivalent to the number of additional BCG Inc shares which he would have received under the old structure.

84. In order to maintain consistency globally UK MDPs who had disposed of their BCG Inc shares in 2010 before the conversion to the UK LLP, were generally required to reinvest the net proceeds of the disposal as capital in the UK LLP. This ensured that they did not realise any value in respect of their LTCV interests in circumstances where, had they continued to hold BCG Inc shares, they would not have been entitled so to do. Each MDP who sold BCG Inc shares agreed with BCG Ltd that the value of the Capital Interests which they acquired on becoming a member of the UK LLP should be determined by reference to the date on which they disposed of the BCG Inc shares, thereby providing continuity of interest as if they had continued to hold their previous BCG Inc shares. As a separate matter those MDPs who disposed of their BCG Inc shares contributed those proceeds as a capital contribution which was reflected in the UK LLP's capital contribution account.

85. Cash distribution of BCG Ltd's allocated profit is through intercompany accounting. There was no cash distribution of profits to BCG Ltd from BCG UK LLP as both entities are within the UK group. Instead, the allocated profit was offset against other intercompany trading balances. Any undrawn profits were recorded in 'amounts owed to members' within creditors. As per the accounts the intercompany balance owed to BCG Ltd is shown as a creditor within BCG UK LLP accounts. These amounts are unsecured, interest free & have no fixed date of repayment and are repayable on demand.

The Capital Interests

86. An issue at the very heart of this dispute is the nature of the Capital Interests. The Appellants say that the Capital Interests give the individuals interests in the goodwill of the UK LLP. This is disputed by HMRC who say, in essence, that the Capital Interests are simply cash rights which crystallise in certain circumstances.

87. Both parties have addressed the law applying to limited liability partnerships where we start to identify the scope of classification of the nature of the Capital Interests.

88. An LLP is a body corporate and has a legal personality separate from that of its members (s.1(2) Limited Liability Partnership Act 2000 ("LLPA 2000"). Section 1(4) LLPA 2000 provides that its members have a liability to contribute to its assets in the event of its being wound up. Section 1(5) LLPA 2000 provides that unless otherwise provided the law relating to traditional partnerships does not apply to a limited liability partnership.

89. Under s.5 LLPA 2000 the mutual rights and duties of the members of the limited liability partnership are governed by the agreement between the members, or between the partnership and the members, or in the absence of agreement, by any provision made by regulations. Regulation 7 of the Limited Liability Partnership Regulations 2001 provides the default that all members of a limited liability partnership are entitled to share equally in the capital and profits thereof. In this case the limited liability partnership agreements do make provision to which we turn after addressing particular submissions on the nature of an interest in capital to which members of a limited liability partnership may be entitled.

90. Mr Grodzinski referred us to the case of *Reinhard v Ondra LLP and others* [2016] 2 BCLC 571:

> [53] In contrast, an LLP is a separate legal entity and it owns all the firm's assets, both legally and beneficially. The members have no direct legal or beneficial interest in those assets. Instead, the members have only those rights which their membership confers, rights which are ascertained in accordance with the relevant LLP agreement coupled with the statutory default provisions….
>
> [55] …so far as a `share' in an LLP is concerned, the position is different. It makes perfectly good sense for members of an LLP to describe themselves as having `shares' in the LLP. And the same goes for an `interest' in the LLP itself in contrast with a direct interest in the assets of the LLP. Indeed, s 7(1)(d) of the LLP Act speaks of a member having assigned the whole or any part of his share and there are other statutory provisions taking the same approach…
>
> [56] However, what rights such a `share' carries with it can only be ascertained by reference to the agreements referred to in s 5(1) of the LLP Act and to the default provisions of the Regulations…
>
> …I agree with the way the nature of the share is succinctly put in Whittaker and Machell The Law of Limited Liability Partnership (3rd edn) at 8-18:
>
> `... the "share" of a member is the totality of the contractual or statutory rights and obligations of that member which attach to his membership; and that an "interest" of a member is one or more components of his share.'

91. We are therefore satisfied that there is considerable flexibility for members of a limited liability partnership to agree the basis upon which they share in the profits and capital of the partnership. Indeed, this is reflected in paragraphs 8.18 and 8.19 of Whittaker and Machell to which Warren J referred in *Reinhard* where it is stated:

> "…there are no statutory restrictions on dividing an LLP's undertaking into shares or interests, and that there are no statutory restrictions on reduction of an LLP's capita1, and also that shares or interests can be made transferable, an LLP may, for instance, have a class of members who subscribe for participating units in the LLP (`shares') upon terms that these units are redeemable (whether by the member or by the LLP), and/or are transferable, in specified circumstances… Given also that there are no statutory requirements as to subscription of capital, an LLP may, for instance, have a class of members whose shares and interests do not include capital invested in the business."

92. We therefore now turn to the terms of the LLPAs. As time progressed the UK LLP's governing partnership agreement was amended. The parties have agreed that the amendments made no difference in substance to the arrangements. We have therefore proceeded on that basis. However, submissions were made about the implication of certain drafting made in later drafts for the interpretation of the initial agreement which we address in these findings.

93. The original LLPA 2011 applied from 1 April 2011 until 30 November 2014. It stated:

(1) Each Member (BCG Ltd, BCG UK1 Ltd and the MDPs) had a Capital Contribution Account. (BCG UK 1 Ltd held a nominal interest of 0.01%. Its interest has not been relied upon by either party and we say no more about it);

(2) the extent of each Member's interest in the capital of the UK LLP was to be determined and notified to each Member by the Remuneration Committee. On each occasion on which a Member was notified of the granting of a new interest in the capital of the UK LLP, such Member would also be notified of the number of units in the capital of the UK LLP that were being granted. No financial contribution was required from the Member in order to acquire an interest in the capital of the UK LLP. This interest in the capital is what was defined in the later LLPAs to be the Capital Interests. It is separate from and unrelated to the interest (if any) an MDP may have in the UK LLP as a capital contribution as reflected in the Capital Contribution account;

(3) the extent of each Member's interest in the profit of the UK LLP for any financial year was to be determined and notified to each Member by the Remuneration Committee. The member's interest in the profit of the UK LLP could vary and was not related to the extent of the Member's interest in the capital of the UK LLP;

(4) each member would have a Distribution Account, a Loan Account and a Capital Contribution Account;

(5) the Remuneration Committee was to have regard to the global compensation policies and procedures of BCG Inc in making any decisions;

(6) on the occasion of any Member dying, retiring or otherwise ceasing to be a Member specific provisions ("the disposal provisions") were stated to apply in respect of the outgoing Member's "interest in the capital of the LLP". (That was understood to mean what became referred to as the Capital Interests, not any capital contributions.) Those provisions were drafted in terms of payment being made as purchase price payable by BCG Ltd (or any other person designated by it) to a Member for a "Sale Interest", itself defined as the Member's interest in the capital of the LLP being sold under the provisions. The amount payable was the increase in value of the relevant notional number of BCG Inc shares since the "Grant Date" (undefined). The notional number of BCG Inc shares was itself defined as being the number equal to the units in the capital of the UK LLP comprised in the sale;

(7) as under the previous LTCV structure, a "sale", as provided for in the disposal provisions, was mandatory upon a Member ceasing to be a member of the UK LLP. Provisions were included for gradual disposal by Members who had been such for 20 years and further provisions enabled those with sufficient long service to receive payment for their interests;

(8) the UK LLP was entitled to redeem and BCG Ltd was entitled to purchase any or all interests in the capital of the UK LLP from any or all of the Members on at least 10 days' prior written notice (again understood to be the capital later defined as Capital Interests);

(9) in the event of the winding up of the UK LLP provisions provided for the payment of monies under waterfall provisions setting out a specified order subject to the availability of assets so to do:- amounts owing on the Distribution Account; the amount standing to the credit of the Capital Contribution Account of BCG Ltd reflecting the contribution of the business to the UK LLP in 2010; paying to each Member the amount to which that Member would be entitled under the disposal provisions or paying a pro rata amount of the funds where insufficient to pay in full; paying Members the amount shown in their respective Capital Contribution Accounts; and finally paying all remaining assets to BCG Ltd;

(10) MDPs had no voting rights in the UK LLP.

94. There was no reference to "Capital Interests" in the original LLPA 2011. Instead, there was simply reference to Members' interests in the capital of the UK LLP being determined and notified by the Remuneration Committee; but as noted that interest in the capital of the UK LLP was not an interest reflected in the Capital Contribution account which was an entirely separate interest in the LLP.

95. If the UK LLP became insolvent the fact that the BCG Inc shares had increased in value would not avail the MDPs, who would have no right to payment. The LLPA specifically provided that there was no obligation on BCG Ltd or the UK LLP to acquire the "sale interest" if the UK LLP or BCG Ltd was insolvent or if either of them would be rendered insolvent by doing so. Furthermore, BCG Ltd was entitled to defer payment otherwise due to an MDP if the board of BCG Ltd determined that such payment must be deferred in order to avoid jeopardising the financial position of BCG Ltd.

96. In relation to the provision under which BCG Ltd could designate another person to buy the Sale Interests it was confirmed by Mr Holden that this had never in fact taken place. Moreover we are clear that it was very unlikely to take place as the purchaser would then become a member of the UK LLP. This conclusion is consistent with the accounting which has worked on the basis under FRS20 that the purchaser will be BCG Ltd.

97. In practice UK LLP satisfied BCG Ltd's obligation to pay MDPs for the Capital Interests on behalf of BCG Ltd and the resulting intra-group balance is settled on an annual basis.

98. The way in which the UK LLP operated in relation to allocating profit and Capital Interests was as follows:

(1) An amount described as the "18% margin" would be retained on the UK LLP's balance sheet to fund the future liabilities under the Capital Interests. This was in line with the worldwide policy of putting aside the 18% margin for such funding. The amount was available to be used in worldwide BCG Treasury operations to fund the worldwide business;

(2) MDPs would receive allocations of profit representing the four compensation elements of the Framework out of the remaining amount;

(3) MDPs would receive allocations of Capital Interests. The allocation of those was not dependent on the profit of the UK LLP or its balance sheet.

99. The second LLPA ("LLPA 2014") applied from 1 December 2014 until 31 December 2015. Notably at this point a defined term of "Capital Interests" was introduced as follows (so far as relevant):

> "Capital Interests means, in respect of a Member, his interest (or, if part only of a Member's interest is being sold, that part) in the capital of the Partnership for the time being represented by the Notional Number, such interest being:

(a) a right to share, subject to the terms of this Agreement, in the assets of the LLP including the right to participate in the proceeds of disposal of the LLP or any of the LLP's capital assets…

(b) determined, at any date, by applying the A-B calculation specified in [the disposal provisions].

100. The introduction of the term "Capital Interests" meant that the provisions dealing with disposal no longer referred to "sale interests" and more simply provided for the purchase of the Capital Interests although on the same basis as before; i.e. with the amount payable calculated by reference to the increase in value of the BCG Inc shares.

101. In addition, the new LLPA provided that the extent of each Member's Capital Interests would be determined and notified to the MDPs rather than "the extent of each Member's interest in the capital of the UK LLP". The previous wording clearly had the potential to confuse given that some of the MDPs had contributed capital reflected in the Capital Contribution account. The 2014 amendments made clear that the Capital Interests were some other interest, separate from the standard concept of an interest in a partnership's capital.

102. It was also stated that "all capital profits shall belong to and be allocated to BCG Ltd". In June 2013 BCG Ltd contributed a leasehold property to the UK LLP with a book value in excess of £3.5 million. That amount was credited to BCG Ltd's capital contribution account with the UK LLP. It was accepted at the hearing by Mr Grodzinski that on the occasion of the sale of a capital asset such as a property the MDPs would have no entitlement to be paid any amount in respect of that sale.

103. Mr Grodzinski says that it is a matter of obvious implication that the provision dealing with the capital profits should be read as being subject to the definition of Capital Interests and the provision stating that the extent of each member's Capital Interests should be determined by BCG Inc. However, we do not consider that this is a matter of "obvious implication". On its face the provision states that BCG Ltd is entitled to all "capital profits". That term is not defined and we therefore interpret it as referring to the profits arising on the disposal of any capital items. It is therefore clear that the MDPs do not have an interest in any profits arising from the disposal of capital items. This conclusion is in line with the evidence from PwC writing to HMRC to clarify the accounting for the Capital Interests and saying that "it is clear that all of the capital profits of the LLP (after partners have received back any balances on their Distribution and Capital Contribution accounts) shall belong to, and be allocated to BCG Ltd."

104. We have explained how the disposal provisions operate such that the Capital Interest holders' receipts thereunder were not tied to the value of the UK LLP. In relation to the new definition of Capital Interests there is clearly a tension between the provisions in that definition saying that the holders have a right to participate in the proceeds of the sale of a capital asset and the provision stating that all capital profits are allocated to BCG Ltd. We recognise that one provision refers to "proceeds" and the other to "profit". However, there is no explanation in the LLPA of how the Capital Interest holders participate in the proceeds of the disposal of a capital asset.

105. Furthermore, it is unclear on its face how the right to participate in the proceeds of a disposal of the UK LLP should be interpreted: is this simply referring to a disposal of BCG Ltd's interest or is it referring to a disposal of the business of the UK LLP? However, what is clear is that whatever scenario was envisaged, the Capital Interest holders would receive an amount calculated on a basis which had no direct relationship with the value of the UK LLP as again the amount is to be determined by applying the formula in the disposal provisions addressing the change in value of BCG Inc.

106. One matter raised at the hearing was that the accounts for the year ended 31 March 2019 states that a figure for the disposal of assets related to the transfer of office equipment in relation to the sale of a business from the UK LLP to BCG Ltd. However, the disposal of the office equipment was recorded at net book value with therefore no gain or loss recorded. Therefore while it would have been a capital transaction there was no profit to allocate.

107. The provisions dealing with a winding up of the UK LLP were, on the face of it at least, significantly altered in the LLPA 2014. Those provisions now stated that payment would be made to the Members in relation to credits on the Distribution Accounts, then the Capital Contribution Account of BCG Ltd (to the extent of the purchase price for the transfer of the business in 2010), then the Members respective capital contribution accounts and then finally all remaining assets to BCG Ltd. The provisions under which payment would be made to the MDPs in accordance with the disposal provisions were gone.

108. The evidence of Mr Holden was that in practice this was not a significant change because the assets of the UK LLP primarily comprise goodwill so it was unlikely that Capital Interest holders would receive any value on an insolvent winding up. However, as we have explained earlier, separate provisions mean that the Capital Interest holders had no rights to sell those interests if the UK LLP or BCG Ltd was insolvent.

109. Mr Holden says that the most likely scenario in which the Capital Interest Holders would share in the value of the UK business would be on a sale of that business or on the winding up of the UK LLP following a sale. He says that the intended result of the changes to the LLPA was to provide that on the sale of the UK LLP's business, BCG Ltd would receive the profits resulting from the sale but the MDPs would have a right in their capacity as Capital Interest holders, to receive from BCG Ltd (or a nominated entity) the then current value of their Capital Interests under the disposal provisions. In this way he says that, as a result, the Capital Interests gave the MDPs a direct right in the capital of the business both on the application of the disposal provisions and in the event of a sale of that business.

110. His evidence reinforces the conclusion that the LLPA 2014 provision stating that the Capital Interests gave a right to share in proceeds on the disposal of capital assets was overridden by the provision stating that all capital profits belonged to BCG Ltd.

111. A further provision stated that the extent of each Member's Capital Interests shall be determined solely by the board of BCG Inc in accordance with its global policies and notified to each Member by committee referred to as the Profit Allocation Committee". No financial contribution was required to be made by a Member in order to receive a Capital Interest; and the value of such interests did not affect a Member's allocation of profit under the LLPA.

112. Other less significant changes were made in the 2014 LLPA as follows:

(1) the number of Capital Interests held by each MDP was to be determined by the board of BCG Inc rather than by the previous remuneration committee/profit allocation committee. This was designed to emphasise that the allocation of the Capital Interests was not linked to allocation of the UK LLP's profits. However neither party argues that this change was one of substance. We agree: the previous remuneration committee/profit allocation committee had applied the Framework as set by BCG Inc in allocating the Capital Interests;

(2) it was stated expressly that the value and number of Capital Interests held by a MDP would not affect the allocation of profit, but again this simply reflected the pre-existing Framework;

(3) the rights to dispose of the Capital Interests at a certain age and/or after a particular length of tenure were removed, reflecting a global change in BCG's policy.

113. In 2016 further changes were made to the LLPA with the intention that MDP should be able to claim Entrepreneurs' Relief in respect of disposals of the Capital Interests. (In essence, where previously a MDP would have been required to sell a portion of their Capital Interests on a particular date prior to retirement, the changes meant that the value of those Capital Interests would be frozen until the disposal provisions applied on retirement. In the meantime the MDP received an additional amount by way of additional allocation of UK LLP profit calculated by applying a rate of interest to the value of the frozen Capital Interests.)

114. Notably Mr Holden describes the change in the following way: "Specifically, BCG's concern, following discussions with PwC, was that the Capital Interests might be viewed as an interest in the goodwill of the UK LLP and BCG Ltd might be treated as a close company such that a sale of Capital Interests might not qualify for Entrepeneurs' Relief as a result of changes made in the Finance Act 2015." This is not consistent with the current position of the Appellants that the Capital Interests were very clearly interests in the goodwill of the UK LLP.

115. Mr Grodzinski submitted that the correct interpretation of LLPAs is that on a Member retiring or otherwise becoming subject to the disposal provisions in the UK LLP it is the goodwill of the UK LLP which is being disposed of as a result of the provisions stating that the Capital Interests give Members a right to share in the assets of the UK LLP and that the formula for calculating the payment is simply that – a way of calculating the disposal price.

116. However, in our view the way in which payments were calculated when paid to MDPs for their Capital Interests raises real questions as to the nature of those interests. It is clearly unusual to say the least for a departing partner to be paid for their share of the partnership on a basis which bears no direct relationship to the value of their stated rights in the partnership. It was possible for the value of the UK LLP to fall and the value of the BCG Inc shares to rise such that an MDP would be able to realise value relating to the worldwide group even when the UK business was struggling. The opposite was also possible – the value calculated by reference to the value of the global business could be less than the value of the UK business alone. The UK business only reflected about 5% of the value of the global business and therefore there was ample opportunity for a disparity to arise. Yet the Appellants argue that the rights were shares in the goodwill of the UK LLP.

117. In contrast, the advice provided from PWC when considering the restructuring of the LTCV in the UK was to give the members shares in the capital of the UK LLP itself, but that was not wanted by the business who maintained that the interest should continue to be an interest in the results of the group globally and therefore based upon the value of the BCG Inc shares as before.

118. Turning to the accounts, those of the UK LLP state for the 2012 accounting period that:

> "During 2011, partners in the LLP were granted interest rights in Boston Consulting Group UK LLP the value of which are tracked with reference to the value of BCG Inc shares. This is akin to a share-based payment scheme. The Black-Scholes option pricing model has been used to calculate the FRS20 fair value of the interest on appreciation on these rights."

119. This was reflected in the accounts of the UK LLP by showing the "FRS 20 share-based payment" as "other reserves (classified as equity)" as follows (here taking the 2012 accounts as an example):

Members' capital (liability)

Capital contributions	£4,500,877

Members' capital (equity)

Investment by BCG Ltd	£5,733,110
Other reserves – FRS20 based payment	£3,392,481

120. Furthermore, the evidence of Mr Holden explains that for accounting purposes the UK LLP is treated as having the benefit of the services provided by the UK MDPs. The fair value of the Capital Interests is fixed at the date they are acquired by the MDPs and a debit is recognised equal to that value as calculated by applying Black-Scholes. Such amounts are categorised as "members' remuneration" even though in practice no amount will be paid by the UK LLP to the MDPs in respect of their Capital Interests. That amount is therefore recognised as an expense in the UK LLP's profit and loss account. However, it is the profit for the financial year before members' remuneration and profit shares which is used as the starting point for determining the profits of the UK LLP to be allocated amongst its members for income tax and corporation tax purposes.

121. On disposal of the Capital Interests the price paid by BCG Ltd under the disposal provisions is recognised for accounting purposes by the UK LLP as a capital contribution made to it by BCG Ltd on the basis that the UK LLP is treated as having the benefit of the services provided by the MDPs and the Capital Interests are treated as connected to the provision of those services by them.

122. In the accounts of BCG Ltd it was stated:

> "The ultimate parent company allows participants in BCG LLP to be granted interest rights over its shares. The accounts for the plan as a cash settled share-based payment under FRS 20 because the obligation to settle the award resides with BCG Ltd.
>
> There are no share-based payment expenses recorded as the employees are not providing services to the company, instead the fair value of the services provided are recorded against investment in BCG LLP with the corresponding liability recorded within [the] company at each reporting period end. The fair value is measure[d] by the use of the Black-Scholes pricing model….
>
> [the Capital Interest scheme] … is akin to a share-based payment scheme. "

123. The evidence of Mr Holden explained that while BCG Ltd is required to recognise a debit on the allocation of Capital Interests to MDPs it is also required to determine the fair value of those interests at each balance sheet date. Again, as the UK LLP is treated as having the benefit of the services provided by the MDP and the Capital Interests are connected to the provision of those services, the amounts which BCG Ltd recognises are treated as adjusting its investment in the UK LLP. If the value of a Capital Interest increases following acquisition by a MDP, BCG Ltd will be required to recognise that increase in liability at each subsequent balance sheet date in the investment in the UK LLP.

124. PwC explained in correspondence with HMRC that the following factors led to the MDPs' Capital Interests being included in the accounts as liabilities of BCG Ltd:

(1) BCG Ltd was required to recognise a cash settled share-based liability. The net effect was to recognise the whole of the ownership of the UK LLP less the value held by the individual partners as liabilities;

(2) under the LLPAs all capital profits of the UK LLP would be allocated to BCG Ltd.

125. BCG Ltd does not obtain a deduction in calculating its profits for UK corporation tax purposes in respect of the accounting debits which it is required to recognise in connection with the Capital Interests.

126. UK MDPs were not required to pay to acquire their Capital Interests, and therefore they would not make an overall loss in respect of their Capital Interests, if the value of the BCG Inc shares fell during the period in which the UK MDPs held their Capital Interests to below the share value as at the date of acquisition. Economically, this put the UK MDPs in largely the same position they had been in before the LLP Conversion, in which the funds required to purchase BCG Inc shares were advanced to them by way of a loan, with the creditor's recourse under that loan being limited to the UK MDP's LTCV investment.

127. However, once the value of their Capital Interests increased (by virtue of the increase in value of the BCG Inc Shares), the MDPs were at risk of losing some or all of that increase in value if the UK LLP or BCG Ltd became insolvent, or if the value of the BCG Inc shares fell. That again is economically the same as with the BCG Inc shareholding structure.

128. If the MDPs were receiving interests in the goodwill of the UK LLP as the Appellants maintain we would expect those interests to have some value on their grant. Instead, the Capital Interests were said to have no value on grant because they were solely linked to the increase in value from that point of the BCG Inc shares (although we would note that we would expect the Capital Interests to have some "hope" value in the context of the successful BCG Group).

129. Similarly, in a normal arrangement in which partners share the value of the capital of the partnership, the introduction of a new partner would be expected to have some impact on the value of the interests held by the existing partners. Those interests may not decrease in value if the business is growing, but the basic premise exists that the division of the capital between x partners is now a division between x+1 partners. That is not the case here. The MDPs' interests are solely dependent upon the changing value of the BCG Inc shares between the grant of the interest and its disposal.

130. So far as BCG Ltd is concerned it held an interest in the capital of the UK LLP which remained constantly shown as owning 100% of the UK LLP (99.9% directly and the remainder through another group member, BCG UK1 Ltd) despite the fact the MDPs are said to have been holding Capital Interests in the partnership. However, PwC have explained that this was required under the applicable Financial Reporting Standard because BCG Ltd held the majority (in fact all) of the votes.

131. The total value of the Capital Interests could potentially exceed the fair market value of the UK LLP. There is no cap on the value and indeed no direct link. Although the evidence from Mr Holden was that the values were regularly reviewed by the business to ensure that the value of the Capital Interests did not exceed the value of the UK LLP, there is no evidence as to what would happen in such a situation. Such a review and action would not be necessary if those interests were in fact interests in the capital of the UK LLP. The limitation would be self-fulfilling.

132. If the profits of BCG Ltd were insufficient to fund purchases of the Capital Interests the evidence of Mr Holden is that BCG Ltd would be put in funds by way of capital injection from BCG Inc or from intragroup borrowing.

133. Clearly arrangements under which a formula price is paid on disposal of members interests where that formula is not linked to the value of the business itself is unusual. The fact that the interest has no value on grant would tend to lead us away from the conclusion that the Capital Interests were in fact interests in the partnership itself.

134. Mr Holden said that the intended effect of the Capital Interest rights was that a portion of the entitlement to share in the assets of the UK LLP was, in effect, transferred out of BCG Ltd's residual share of the capital and into the hands of the relevant MDP. While this may be so in funding terms as a result of the 18% margin being used to fund the purchases of Capital

Interests, we find little basis to conclude that BCG Ltd had transferred any rights in the capital of the UK LLP itself.

135. Although PwC stated in their advice in 2010 that the membership of the UK LLP would provide a substantial incentive for the partners in comparison to their previous position where they did not have a material equity stake in either BCG Inc or the UK business, in fact the UK LLP arrangements resulted in the real equity stake remaining that in BCG Inc. as before as a result of the form of the formula price payable for the Capital Interests. PwC had been envisaging a somewhat different structure in which the partners very clearly had the sort of rights as partners in a limited partnership which would normally be seen in professional partnerships.

136. Given all the elements of the LLPAs and the Capital Interests we have described we have concluded that:

(1) the MDPs were members of the UK LLP;

(2) the MDPs had a right to the return of their capital contributions (if any) in various circumstances;

(3) the MDPs had no right to share in the profits of the LLP. Any profit allocation was entirely in the discretion of the remuneration committee/profit allocation committee/BCG Inc.

(4) the winding up provisions in the 2014 LLPA aim to make clear that they had no rights on the winding up of the UK LLP and given that we were consistently told that the agreements were to be construed as not giving rise to changes of substance we must therefore conclude that the original LLPA did not provide any real rights on a winding up;

(5) If the UK LLP was sold the MDPs had the right to have their Capital Interests bought with the price paid by BCG Ltd calculated by reference to the increase in value of BCG Inc but the MDPs had no other right to participate in any profit on sale of the UK LLP.

137. We consider that the fact that BCG Ltd would not be required to pay for the Capital Interests where the UK LLP was insolvent does not in itself alter our conclusion as to whether the Capital Interests were in fact interests in the capital (goodwill) of the UK LLP. The insolvency provisions simply meant that the MDPs could not profit from good results in the worldwide group in circumstances where the UK business had gone bust but that is no more than a contractual term of the rights to payment on "sale" of the Capital Interests.

138. Given our findings we conclude that the Capital Interests were not interests in the capital of the UK LLP or a share in its assets. Indeed, the Capital Interest holders had no right as Capital Interest holders as against the UK LLP itself (in contrast to a capital contribution right). Their rights were against BCG Ltd to be paid an amount at a future date calculated by reference to the increase (if any) in the value of BCG Inc. As HMRC submitted, the incorporation of this right under the LLPAs means that the right is part of each MDP's "interest in the UK LLP" in the broadest *Reinhard v Ondra* sense, but that does not make them a right in the goodwill, the capital or any other asset in the UK LLP itself. That conclusion reflects the very flexibility of LLP agreements. We recognise that this does not reflect the evidence of Mr Holden as to the intended effect of the rights, but given the conclusions we have reached we are unable to accept his interpretation of those rights.

139. We also recognise that on an MDP leaving a document was prepared which recorded that the MDP assigned all rights under the Capital Interests to BCG Ltd. The "purchase price" was

the amount calculated under the LLPA provisions (but was not paid to the departing MDP for a year in order that there could be set off under anti-competitor penalty provisions – see paragraph 143 below). Although the document appears on its face to suggest a sale of an interest in the UK LLP we have concluded that the substance of the Capital Interests is that they are rights against BCG Ltd to payment. While the drafting of the assignment or sale documents would be consistent with a sale of an asset in the UK LLP itself, those documents do not alter the underlying nature of the Capital Interests. The word "sale" must therefore be interpreted in that context. We therefore use the word "sale" in this decision in quotation marks.

140. Mr Grodzinski submits that the effect of s863(1)(c) ITTOIA and s59A(1)(a) TCGA is that the members are treated as holding the assets of the partnership for income and capital gains tax purposes and therefore even if the interests of its MDPs were not properly to be regarded for general purposes as direct interests in the capital of the UK LLP they are treated as direct interests in the assets of the UK LLP for tax purposes.

141. We return to this argument later, but would note that at most it is an overriding "fiction" for tax purposes which treats membership of the partnership as meaning that the partner holds a share in the assets of it, reflecting the transparent treatment of partnerships for tax purposes. It does not override the proper analysis of the nature of the Capital Interests. It is accepted (and indeed relied upon) by the Appellants that in the context of an LLP as a matter of general law there is total flexibility regarding the terms of the LLP agreement as to ownership of the assets.

142. We now turn to consider whether the Capital Interests should be regarded as part of the MDPs' remuneration or compensation for services.

143. The following factors weigh in favour of concluding that the Capital Interests operated to give the MDPs part of their reward for services:

(1) in January 2010 a new partner presentation produced by BCG described the LTCV as part of partners' compensation. It said that the LTCV "rewards firm value creation and individual's sustained contributions" and noted that annual letters would explain the value of various elements of their compensation including the LTCV values and provide a summary of their total compensation. In the same presentation a table setting out total partner compensation in the years 2004-2008 included a line for the LTCV. The same consideration of the LTCV as part of the partner compensation is seen in other BCG presentations;

(2) partners were given annual statements of how much their Capital Interest had increased in value that year and their awards were increased with promotion and/or continued work for the business which was coupled with a review system effectively meaning that the Capital Interests had some element of reward for good work;

(3) the Capital Interests were referred to as deferred compensation;

(4) although the underlying structure through which the LTCV was provided changed, the consistent evidence was that its role remained the same, aligning MDPs' interests with that of the business and incentivising them;

(5) the use of an LLP was described by PwC when advising the business in 2010 as an opportunity to review the existing <u>reward</u> strategy to ensure that it was both tax efficient and aligned members' interests with those of the business;

(6) Ernst & Young's advice in 2014 describing the Capital Interests as a long-term capital incentive plan for the partners;

(7) BCG has described them as “more competitive incentives” to enhance recruitment and retention of partners in the UK;

(8) The chief financial officer said in an email considering the proposed structure that she viewed it as taking “old comp” and making it new capital gain;

(9) Mr Holden explained in his evidence that MDPs are required to enter into competition agreements under which if an MDP leaves and joins a competitor within one year of departure the MDP has to pay to BCG a penal amount. To secure compliance the MDP is required to sell their Capital Interests with the proceeds only being paid one year after departure and with the ability for BCG to offset amounts payable by the MDP against those disposal proceeds. Consequently he says that the Capital Interests are a way of enabling BCG to protect its goodwill. However, these penalty provisions also acted economically in much the same way as provisions in other share incentives where a “bad leaver” is required to forfeit some or all of their award;

(10) Mr Holden has also provided evidence that in the absence of the LTCV the MDPs previously received more in the form of the other compensation elements each year. This, in effect, reflects the fact that senior personnel would expect some other form of remuneration in the absence of the LTCV (whatever structure may be used) and that the LTCV is seen as part of their package; and

(11) the evidence of Mr Holden explaining that in its accounts the UK LLP is treated as having the benefit of the services provided by the UK MDPs so the fair value of the Capital Interests (calculated as described earlier) is categorised as “members' remuneration” and consequently recognised as an expense in the UK LLP's profit and loss account.

144. We recognise that by 2012 new partner presentations were excluding the LTCV from illustrations of total compensation. However, we read this in the context of the presentation overall which explains BCG's compensation and equity framework as being made up of two components: a global performance evaluation system and a profit sharing and distribution model. Within that it is stated that there are five structural components of the model including the LTCV and a bonus scheme. The LTCV is specifically addressed and described as having three basic objectives: to provide a long-term mechanism linked to BCG's performance; to incentivise high performing partners to remain with BCG; and to strengthen and increase the stability of BCG's capital base. The presentation however, is high level covering the LTCV in varying forms globally. It describes the partners as purchasing an initial interest, whereas in the UK the Capital Interests were not purchased by the partners. We therefore consider that its value in accurately identifying the role of the Capital Interests is limited.

145. Mr Holden's oral evidence at the hearing in re-examination was that the Capital Interests were nothing to do with compensation and were a separate investment as part of the business' working capital. However, Mr Holden has been intimately involved with the litigation of this dispute and is fully aware of the case which the Appellants seek to present. We have therefore considered his evidence in the context of the various items we have identified in the evidence leading to the conclusion that the Capital Interests were part of the MDPs compensation package. Moreover, the fact that the Capital Interests (just as the predecessor structure of the LTCV in the UK) gave the MDPs a form of equity style investment in the business was particularly focused on by Mr Grodzinski at the hearing. We accept that the Capital Interests operated in that way by reference to the increase in value of the BCG Inc shares, but that in itself is not determinative of the question of whether the interests were part of the MDPs' overall compensation.

146. We have therefore concluded that considering the evidence overall and, in particular, the factors identified above, the Capital Interests should be found to have been part of the overall package of remuneration provided to senior personnel for the services they provided to the organisation.

Disposal and re-acquisition of Capital Interests in 2014

147. On 20 May 2013, HMRC published a consultation document entitled "Partnerships: A review of two aspects of the tax rules" setting out proposals for what became the "mixed member rules" or "MMRs".

148. Given the perceived risk of tax costs arising from the proposals it was decided that BCG Ltd would purchase all the UK MDPs' Capital Interests with effect from 31 March 2014.

149. *With effect from 31 March 2014, each of the UK MDPs sold their entire Capital Interest in UK LLP to BCG Ltd, in accordance with the terms of the LLPA (the March 2014 Disposal). Each of Mark Benedict Holden (BH), Afonso Nascimento (AN) and Thomas Garside (TG), being the individual Appellants who were UK MDPs as at that date, was required to reinvest the proceeds which they received as part of the March 2014 Disposal (less an amount retained to satisfy the estimated tax liability arising to each individual on that disposal) as a capital contribution to UK LLP.*

150. BCG Ltd funded the purchase by way of intra-group borrowing.

151. The contribution of the proceeds from the disposal as capital was to ensure that the MDPs concerned did not realise cash as a result of the disposal and therefore were not in a better position than non-UK MDPs participating in the LTCV.

Further acquisitions / disposals of Capital Interests during the Relevant Period

152. *Aside from the acquisitions of Capital Interests on 1 April 2011 and between 1 December 2014 and 1 January 2015, and the disposals of Capital Interests on 31 March 2014, as described above, during the Relevant Period, the Individual Lead Appellants participated in further acquisitions and / or disposals of Capital Interests, as follows:*

(1) With effect from 31 October 2012 (being the date on which he ceased to be a UK MDP and a member of UK LLP), Philip Krinks (PK) sold his Capital Interest to BCG Ltd, in accordance with the terms of the 2011 LLPA.

(2) With effect from 1 July 2013 (being the date on which he became a UK MDP and a member of UK LLP), AN acquired a Capital Interest with 1,534 units.

(3) With effect from 1 July 2013 (being the date on which he became a UK MDP and a member of UK LLP), TG acquired a Capital Interest with 1,917 units.

(4) With effect from 1 July 2015 (being the date on which he became a UK MDP and a member of UK LLP), Michael Niddam (MN) acquired a Capital Interest with 2,462 units.

(5) With effect from 30 April 2016 (being the date on which he ceased to be a UK MDP and a member of UK LLP), MN sold his Capital Interest to BCG Ltd, in accordance with the terms of the 2016 LLPA.

(6) With effect from 28 February 2017 (being the date on which he ceased to be a UK MDP and a member of UK LLP), TG sold his Capital Interest to BCG Ltd, in accordance with the terms of the 2016 LLPA.

Reintroduction of the Capital Interests

153. *Between 1 December 2014 and 1 January 2015, each of the UK MDPs was granted a new Capital Interest in UK LLP. The members of UK LLP also entered into an amended and restated LLPA (the 2014 LLPA) with effect from 1 December 2014.*

154. Once the view was formed that the MMRs should not apply to the UK LTCV, in December 2014 and January 2015, UK MDPs were granted new Capital Interests under the LLPAs. The size of the Capital Interest which each UK MDP acquired at that date was intended to be equivalent to the size of the Capital Interest which that UK MDP had held prior to the March 2014 Disposals, but taking into account the amount which had been realised by that UK MDP via the March 2014 Disposal (with some further adjustments, to ensure the size of those Capital Interests remained consistent with the LTCV Policy; for example, where a UK MDP had increased in seniority prior to the reintroduction of the Capital Interests).

155. By way of illustration, using one Appellant, AN, as an example:

(1) AN became an MDP on 1 July 2013 and by 31 March 2014, the value of AN's Capital Interest was £28,854.54, reflecting the change in the value of 1,534 D-2 Shares in the period between these dates;

(2) on the March 2014 Disposal, AN retained £9,000 out of the proceeds of £28,854.54, to cover his estimated liability to UK capital gains tax on that disposal. The remaining £19,854.54 was reinvested by AN, as a capital contribution in UK LLP; and

(3) when the Capital Interests were re-introduced in December 2014, the extent of AN's share in the assets of UK LLP reflected the value of his "new" Capital Interest, which was to be determined by reference to the change in value of 1,534 D-2 Shares, from 1 April 2014 (i.e., the date immediately after the March 2014 Disposal).

156. The result was that for the MDPs participating in the 2014 disposal the change in value of the BCG Inc shares had been locked in at the point of that disposal as it had been converted to a capital contribution in the UK LLP.

The objects of the UK LLP structure

157. The trigger for restructuring the LTCV in the UK was a concern regarding US tax changes potentially causing US tax deductions no longer to be available as well as sensitivity to UK tax law changes indicating an increased scrutiny of executive share based programmes.

158. The perceived tax risks particularly focused in 2010 on the possible introduction of changes to employment-related securities rules where shares are provided to employees through share options where the shares have no rights or limited rights over the value of the company at the time at which the options are granted but have rights over all subsequent growth from that time onwards. The consultation which was being considered at the time explained that the aim of the provisions was to ensure that employment income from employment-related securities would be subject to income tax and National Insurance Contributions. The evidence of Mr Holden is that simply re-implementing the previous LTCV programme in the UK as before was considered to carry that income tax and National Insurance risk.

159. Therefore the restructuring from the BCG Inc share structure was driven by the desire to avoid the effect of expected changes in both the US and the UK. On a worldwide basis BCG sought to obtain capital gains tax treatment for the LTCV programme where possible.

160. In considering what alternative structure could be used BCG was receiving advice that it was still normal and acceptable for individuals who are part owners of private businesses to hold interests in them which would be subject to capital gains tax rather than income tax on disposals, consistent with the treatment that individuals disposing of their BCG Inc shares had

obtained. Therefore BCG looked to find a new structure replicating that capital gains tax result, although it was recognised that the corporation tax deduction which BCG Ltd had claimed in respect of the pre-February 2010 LTCV programme was unlikely to be obtained.

161. Internal BCG documents show that the LTCV had four basic objectives: to provide a long-term reward mechanism linked to BCG's performance; to incentivise high performing partners to remain with BCG; to strengthen and increase the stability of BCG's capital base; and to provide tax advantages where possible.

162. Indeed, the tax advantages of the UK LLP structure were a key feature of its adoption as shown by the following evidence in particular:

(1) when considering the potential UK LLP structure it was identified that there were three key features making it appropriate and beneficial: it reinforced BCG's partnership relationship as opposed to an employer/employee relationship; partners would be considered self-employed and that would generate significant National Insurance Contribution savings which in turn would help address the competitive issue the business faced; and the flexibility of an LLP made it very attractive to " tailor an LTCV option using a capital interest". In particular, it was identified that the sale of such an interest had the potential to qualify for entrepreneurs' relief with capital gains tax applying at the rate of 10% on the first £5 million as opposed to the standard 28%;

(2) Mr Holden has described the administrative steps needed to ensure that the previous BCG Inc shares were not subject to an income tax charge under the employment related securities tax rules, including obtaining valuations from PwC and getting MDPs to enter into elections. Those steps would not be necessary under the LLP structure. In addition, the LLP structure did not require the financing structure enabling MDPs to purchase their shares and BCG did not need to obtain clearance under the double tax treaty between the USA and the UK for payments of interest to be made without withholding. The removal of the need for financing also removed any residual concern that it could be treated as a beneficial loan arrangement with associated employment income tax consequences;

(3) internal emails show that PwC introduced the idea of how to structure the LTCV going forward in order to try to obtain the new 10% tax rate. A set of slides identifying the benefits of the LLP idea solely listed tax benefits: the NIC savings for BCG Ltd together with numerous benefits for the individuals: being taxed on a capital gains tax basis and potentially with entrepreneurs' relief, being treated as self-employed, and being eligible for business property relief for inheritance tax; and

(4) a slide summarising the LTCV alternatives compared structuring the LTCV through a holding in BCG Inc and an LLP, noting the potential to obtain entrepreneurs' relief for the LLP and concluding that the risk of qualification to ordinary income was lower as the investment in BCG Inc was caught by employment related security rules whereas it was most likely that the investment in the LLP would not be.

163. We recognise that there were tax disadvantages to the structure for non-UK domiciled MDPs. We recognise also that there were other non-tax benefits identified with the UK LLP structure. A presentation to the BCG audit committee identified the benefits of the UK LLP as being: greater competitive remuneration incentives, through capital interests, to enhance recruitment and retention of MDPs; the fact that partners in UK LLP are not protected by employment law; a tax effective reward system that aligns the MDP and BCG interests; social tax savings; a deferral of tax which enhanced working capital; and the potential to realise the entrepreneurs' relief benefit. Using the UK LLP was also identified as offering the opportunity

to ensure that the MDPs did not obtain minority shareholders rights. The UK LLP could be structured with no voting rights given to the MDPs.

164. Recognising that there were other elements of the UK LLP/Capital Interest structure which made it attractive to BCG and that for the non UK domiciled MDPs there were disadvantages compared to the previous BCG Inc share structure, we are however, clear that avoiding income tax on the LTCV was one of the main objects of the restructuring. The UK LLP structure using the Capital Interests was seen as a way to achieve that. We are also clear that the capital gains tax treatment and the potential tax and social security savings to both BCG and the individuals was a main object of the use of the UK LLP and the Capital Interests.

Advice obtained in respect of the Capital Interest arrangements

165. *BCG obtained the following written advice from third party advisors in relation to the transactions described above:*

(1) LLP Conversion:

(a) In August 2010, PricewaterhouseCoopers (PwC), BCG's tax advisors, prepared a "Feasibility Report", comprising an overview of the key legal, tax and accounting considerations associated with the LLP Conversion.

(b) On 22 March 2011, PwC issued a formal letter of advice to BCG Inc, summarising the U.S. federal income tax and U.K. income and employment tax consequences of the LLP Conversion, for both BCG and the UK MDPs.

(2) Re-introduction of Capital Interests:

(a) In June 2014, PwC provided BCG with a memorandum of advice (in draft form), considering the potential application of the mixed membership partnership legislation, subsequently enacted as sections 850C to 850E of the Income Tax (Trading and Other Income) Act 2005 (the MMRs), to UK LLP as a result of the Capital Interest arrangements (should they be re-introduced).

(b) Ernst & Young LLP (EY) provided BCG with an undated note of advice (in draft form), which summarised EY's views on the UK tax risks associated with the re-introduction of the Capital Interests. That advice concluded that, on balance, the MMRs ought not to apply to UK LLP if the Capital Interests were re-introduced. This advice also supported the view that disposals of Capital Interests would be treated as disposals of an interest in the business of UK LLP, which would be subject to UK capital gains tax, and in respect of which entrepreneurs' relief would, in principle, be available.

166. *In addition to the advice described above, in respect of each tax year within the Relevant Period, each UK (including the individual Appellants) was provided with a letter of advice from PwC, setting out how PwC considered that that UK MDP should report the various amounts arising to that UK MDP out of his or her relationships with BCG in his or her UK self-assessment return for that year (the PwC Advice Letters). Where a UK MDP disposed of his or her Capital Interest in the year in question, the PwC Advice Letter sent to that UK MDP for the relevant year advised that UK MDP to report that disposal on the UK MDP's self-assessment return as a disposal of a capital asset (and, for certain of those UK MDPs, to claim entrepreneurs' relief in respect of that disposal, and to include a "white space" disclosure in their self-assessment return in respect of such claim). PwC was engaged to provide these letters by BCG and not by the individual UK MDPs themselves.*

167. The Feasibility Report prepared by PwC in 2010 was based on a structure of the Capital Interests as providing MDPs with interests in the value of the UK LLP itself and not the value

of BCG Inc's shares. The report also contemplated a structure where the MDPs purchased the Capital Interests – contributing capital for an interest in the capital of the UK LLP. That purchased interest in the capital could then be structured such that it gave a right to be paid an amount equal to the change in value of the BCG Inc shares (as before). However, it was noted that there was a potential problem if the value of UK LLP did not increase as fast as the increase in the value of BCG Inc shares. In that case, it was suggested that income interests could be allocated that gave the MDP the same rights as BCG Inc equity would have delivered, albeit as income not capital.

168. The advice was therefore predicated on the value of the Capital Interests reflecting the value of the UK LLP which is significantly different to the structure put in place. Indeed, Mr Holden wrote to colleagues in relation to the PwC report saying "This last point is the crux, if the LLP does not grow revenue then the capital interests don't grow in value."

169. The March 2011 letter of advice from PwC was written by PWC in the USA addressed to BCG Inc. By that stage the structure did not involve the MDPs paying for the Capital Interests and those Interests would be realised by an MDP generally after 20 years or on retirement for a value determined by reference to the difference in the value of BCG Inc shares between allocation of the Capital Interests and their assignment to BCG Ltd. However, the structure PwC advised upon also:

(1) involved BCG Ltd and the MDPs lending amounts interest free to the UK LLP to provide working capital to it in a way which meant that the loans could not be said to relate to the profit interest of the Capital Interest held by the MDPs. That step did not take place. Instead, BCG Ltd profits were retained by BCG Ltd to fund working capital; and

(2) advised that the value of all outstanding Capital Interests should not exceed the value of the UK LLP and there would be a process in place to monitor this.

170. The evidence from Mr Holden was that there would have been conversations about the structure and differences between what had been assumed by PwC and what was to be implemented. He also thought that PwC had decided that it was not in fact necessary to check that the value of the Capital Interests did not exceed the value of the UK LLP. Mr Grodzinski referred to emails in 2010 referring to the need for a significant amount of detailed work to be done before an informed decision can be made about the appropriateness of the structure and raising the possibility of seeking a second opinion from the law firm, Norton Rose. The timetable shows a series of meetings over the course of four days in November 2010 to discuss the structure with PwC and internally. However, these meetings and comments pre-dated the PwC advice. No further written evidence has been provided and Mr Holden recognised that given the passage of time it was difficult to remember just what was said at the time.

171. The chief financial officer at the time identified that the structure had the sense of being too good to be true saying: "Anytime we can take old comp and make it new capital gain….my radar goes on high alert. And then my follow up question is that if it really works, why didn't we do it with all of their comp?" She wanted to follow up the PwC letter with a phone call to understand the level of risk.

172. Notably, the March 2011 letter of advice was stated not to be an opinion about the tax consequences of the transactions. In our experience it would be standard practice for an opinion to be obtained in such situations setting out identified risks. That opinion may use "should" wording rather than the more definite "would" but would give the client the clear identification of the extent of risk of challenge to the tax treatment of such a structure. The need for such an opinion is particularly strong where the chief financial officer has identified a concern with the structure and advice.

173. We do not find Mr Holden's general assertions that there would have been some conversations to be sufficient to show that an opinion addressing the differences in structure between the PWC March 2011 letter and that implemented was in fact obtained.

174. In relation to 2014/2015 onwards the application of s850C ITTOIA needed to be addressed. Concern about the impact of the new mixed member partnership rules had prompted the disposal of Capital Interests by the UK MDPs in March 2014. There is reference in the evidence to the business working with multiple external advisers to analyse the draft rules. However, there is little evidence beyond that showing what those multiple external advisers said save for the evidence of advice from PWC and a very generalised level of evidence from Mr Holden.

175. Before moving forward to implement that structure again PwC wrote a report in June 2014 in which it was stated that:

> "PwC believe that the proposed changes to the LTCV will segregate the profits that are subject to tax on the partners and any gain realised on the growth in value of the LTCV. However to gain further comfort on [how] the likely interpretation of the tax tribunal's and courts would apply the "reasonable suppose" test we would recommend that BCG seek specialist counsel's opinion before implementing the new LTCV in the UK."

176. One element seen as key to the operation of the UK LLP outside s850C ITTOIA was that BCG Ltd would not use "warehoused profits" to pay MDPs for their Capital Interests.

177. PwC identified a potential issue for the structure in connection with the uncertainty surrounding the application of Condition Y in s850C ITTOIA. They advised that the "power to enjoy" condition in Condition Y (see later in this decision) would be met. PwC then set out several pages of detailed analysis about the interpretation of the provision in Condition Y which addresses whether it is reasonable to suppose that the individual partner's profit share is lower than it would have been absent the Capital Interests. The analysis makes clear that this is not a straightforward question to answer. Reference is made to several HMRC guidance examples and concludes that there remains a risk that Condition Y would be satisfied. PWC then recommended that tax counsel's opinion should be sought. No such opinion was in fact obtained.

178. In mid to late 2014 EY were engaged by BCG to consider options for re-introducing the LTCV for MDPs including the Capital Interests. EY provided a note of advice in draft form. A finalised version of that note has not been provided and given the fact that Mr Holden told us that BCG relied on the EY note as well as the PwC advice it is somewhat surprising that a final version was not obtained. Furthermore, the advice obtained was limited to a few briefly stated conclusions with little underling analysis. Without any explanation of the factors considered in relation to the Capital Interests EY simply state that as the UK LLP is transparent, they would argue that the LTCV is treated as a disposal of goodwill on sale. The tax risks associated with the MMRs are dealt with in one short paragraph concluding that EY would "argue" that the rules would not apply primarily because of the "defence" that the LTCV is mandatory and has no effect on the level of the UK LLP partnership profits which accrue to the partners.

179. In using the words "argue" and "defence" the reader is put on notice that this is a potentially contentious area. Yet EY were not asked to provide a fuller analysis of the risks or even to finalise the draft.

180. In relation to the individual Appellants, a letter from PwC advised them as to what entries and figures to include in their tax returns. Each letter would include an appendix which was said to detail instructions on how to enter the individual's BCG income onto their tax return.

The individuals were told that if they had a tax adviser they should pass those instructions onto them. Where Capital Interests were sold there was a section under the heading of "details of chargeable assets disposed of and gains and losses" which described the sale of a Capital Interest and the "disposal proceeds" resulting therefrom.

181. We find that the MDPs relied on the advice contained in the PwC letters in order to work out how to report their partnership income and the proceeds from "sale" of the Capital Interests.

182. Some of the individual Appellants also engaged agents who filed their returns on their behalf. There is no evidence that any of the agents acting on those individuals' behalf took a different view to that stated in the PWC advice letters.

Change in timing of allocation of the profit allocation for 2012 calendar year

183. In March 2012 the Budget set out the reduction in the top rate of income tax from 50% to 45% with effect from the tax year beginning 6 April 2013.

184. An internal memorandum was produced by BCG's UK tax department which noted that due to the early announcement of the tax rate changes it was widely anticipated that businesses would react and large payments such as bonuses or equity awards would be postponed until the 2013/2014 tax year or later. It was further noted that there were no measures introduced in the budget or subsequently to restrict any such deferrals and UK Treasury forecasts had modelled the tax impact of expected forestalling. It was therefore proposed that the UK LLP profit allocations should not include lump sum distributions payable in May and December 2013, but instead they should be allocated at the same time as the 2014 distributions in the 2013/2014 tax year. It was noted that this proposal had been discussed with PwC who were comfortable with the position and the income tax savings for MDPs would be around £600,000. PwC later prepared the 2012/2013 tax return on behalf of the UK LLP on the basis of a valid deferral.

185. As explained earlier the profit allocation made in the summer of each year would generally run on the basis of one quarter from the year just ended and three quarters from the expected results of the current year.

186. In May and June 2013, prior to the decision of the Remuneration Committee regarding the allocation of UK LLP's profits for the year ended 31 March 2013, it was decided that the MDPs would not receive any allocation of UK LLP profits for the year ended 31 March 2013 in respect of their PD and OPB (and associated PSRF) (see paragraph 52 above) for the 2012 calendar year. That amount (less the portion of that amount which had already been allocated to the UK MDPs out of UK LLP's profits for the year ended 31 March 2012) was instead allocated to those MDPs out of UK LLP's profits for the year ended 31 March 2014 by a decision of the Remuneration Committee for that year, made in July 2014. All of the profits for the year ended 31 March 2013 were taken into account by BCG Ltd as profits to which it was entitled.

187. While it was expected in mid-2013 that the allocation of UK LLP's profits for the year ended 31 March 2014 would be made in such a way as to deliver to the UK MDPs an amount in respect of their 2012 PD and OPB (and associated PSRF), to the extent not already received out of UK LLP's profits for the year ended 31 March 2012, it was not intended that the MDPs would have any right to that amount, unless (and until) that amount was allocated to them by the remuneration committee in July 2014. Indeed, the terms of the LLPA made clear that MDPs had no right to share in profits until an allocation was made.

188. Provisions in the LLPAs (set out above) made clear that if the drawings exceeded the profit allocation the MDP would be required to repay the difference.

189. When the proposal was discussed within BCG it was stated that it was anticipated that the UK LLP's profits would be more than sufficient to cover the increased MDP profit allocations in 2013/14, with approximately £10-15m being the remaining profit for BCG Ltd.

190. The allocation deferral had no impact on the amount of PD and OPB which each MDP received in cash in 2012; or the time at which that amount was paid to the UK MDP. Amounts were paid to the MDPs by way of partners' drawings, instead of by way of profit allocation and those drawings were then set against the amounts of profit allocated for the financial year ended 31 March 2014.

Allocation and use of profit

191. For the reasons we have set out earlier we have decided that it is relevant for the issue raised by HMRC regarding the process for allocation of the UK LLP's profits to be addressed.

192. The LLPA 2011 stated that the extent of each Member's interest in the profit of the UK LLP for any financial year shall be determined and notified to each Member by the Remuneration Committee. (In 2014 the committee changed to the profit allocation committee but the provisions remained essentially the same.)

193. In addition, the agreements provided that the Distribution Account of each Member would be adjusted to reflect the profit allocated to that member and the drawings and distributions paid to that Member. Profit allocated by the Remuneration Committee to a member was to be credited to that Member's Distribution Account.

194. However, there was no notification of allocation of profits to BCG Ltd by the Remuneration Committee. Yet despite this apparent omission, apart from the amounts allocated to MDPs as their profit shares, all profits have been treated by the Appellants as allocated to BCG Ltd. The evidence of Mr Holden confirms that BCG has operated on the basis that the amount left after allocation to the MDPs is treated as allocated to BCG Ltd without a separate resolution allocating that residual profit to the company. Notification of allocations was made by the Remuneration Committee/Profit Allocation Committee to individual MDPs and the same "back office" system ensured that the accounts of BCG Ltd took into account its receipt of the residual profit. The accounts have reflected this and BCG Ltd has paid Corporation tax on its allocation. The monies have been used for a variety of purposes by BCG Ltd and no MDP has ever challenged the operation of the UK LLP in this way.

195. From the perspective of BCG it is clear from the documents considering the possibility of conversion operating through an LLP that it was intended that residual profit (after allocation to MDPs) would be received by BCG Ltd.

196. It was also made clear in communications with the UK MDP's prior to the transfer to the LLP structure that those MDP's would receive an allocation of the UK LLP's profits the extent of which would be determined in accordance with the Framework. There is no evidence to suggest that the MDPs or BCG Ltd contemplated that the MDPs would be entitled to the entirety of the profits.

197. However, there is an entire agreement clause which stated:

> This Agreement constitutes the entire agreement between the Members and the Partnership and, upon it becoming effective, shall supersede and replace any other agreement between the Partnership and the Members and, as between the Members and the Partnership, there are no other written or verbal agreements or representations with respect to the subject matter of this Agreement.

198. The practical implementation did not reflect the requirement of the LLPAs for the Remuneration Committee to notify each Member of their entitlement. Under the terms of the LLPAs alone, without that notification a Member had no entitlement. However, the members of the UK LLP all acted on the basis that BCG Ltd was entitled to the residual profit.

Information provided to or available to HMRC

199. The tax computations of the UK LLP for 2011/2012 to 2013/2014 did not mention the Capital Interests. They were mentioned in the notes to the accounts for those years.

200. On 17 and 19 January 2018 an HMRC officer opened enquiries into two individual MDPs in relation to their tax returns for the year 2015/2016. Those queries were raised regarding the disposals of Capital Interests. At the same time disposals of Capital Interests by those MDPs had also been identified by the officer as having taken place in 2013/2014. The matter was then handed to Mr Taylor.

201. Mr Taylor identified that around 40 MDPs had disposed of Capital Interests in 2013/2014 and had claimed entrepreneurs' relief. He noted that most of them had not included any acquisition costs for the Capital Interests and had stated in their returns:

> "I hereby claim Entrepreneurs Relief… on the sale of an interest in UK LLP on 31 March 2014. I sold x Class D shares in BCG Inc."

202. Mr Taylor then reviewed UK LLP's partnership tax computations for 2011/2012 - 2013/2014 and found no reference to the Capital Interests. However, the UK LLP's accounts for the accounting periods ended 31 March 2012, 31 March 2013 and 31 March 2014 made reference to what was described as a "Capital Interests Scheme" in the notes describing them as follows:

> "partners in the LLP are granted interest rights in UK LLP. The value of the rights is tracked with reference to the value of BCG Inc shares. This is akin to a share-based payment scheme. The LLP accounts for the plan as an equity settled share-based payment under FRS 20 because the obligation to settle the award resides with another group company, BCG Ltd.
>
> The fair value of the services received from participants in exchange for the share interest awards is recognised as an expense over the vesting period (if any). The fair value is measured by the use of the Black-Scholes option pricing model.

203. The BCG Ltd accounts for the same periods included consistent notes about the Capital Interests. The investments note within the accounts stated that BCG Ltd owned 99.9% of UK LLP and the remaining 0.01% was owned by BCG UK 1 Limited.

204. Given the descriptions in the accounts, the fact that the individuals had been granted the rights for no consideration, the fact that BCG Ltd was receiving a significant portion of the UK LLP profits and the fact that a new tranche of Capital Interests was granted within nine months of the declared disposals on 31 March 2014, Mr Taylor thought it likely that the Capital Interests were in effect a share-based incentivisation/remuneration scheme for individuals.

205. Mr Taylor consequently concluded that the proceeds of the Capital Interests may be taxable under the profit sharing rules of s850 ITTOIA, the miscellaneous income rule in s687 ITTOIA or the provisions of ss773-778 ITA 2007. He considered that he had made a valid discovery on 16 February 2018 because it appeared that the profits allocated to the MDPs were too low or the amounts assessed in their individual self-assessment returns were insufficient.

206. He then issued the s30B TMA discovery amendments to UK LLP on 23 February 2018 in relation to the 2013/2014 return. On the same day he issued s29 TMA discovery assessments to 38 MDPs for 2013/2014.

207. On 19 April 2018 Mr Taylor met with representatives of PwC who were representing UK LLP. Meeting notes show that HMRC was told that following conversion to an LLP Capital Interests were allocated in the UK LLP. PwC explained that the value of the Capital Interests in the UK LLP was based on the value of shares in BCG Inc. HMRC noted that on the face of it the value of the Capital Interests in the UK LLP would be different to the value of shares in BCG Inc and commented that the economics of the Capital Interests were considered to be same as the economics of the BCG Inc shares. HMRC noted that there were concerns that the Capital Interests were possibly replicating an incentive scheme resulting in income being converted into capital. PwC explained the intention that MDPs held the Capital Interests until retirement or leaving BCG and noted the announcement of the MMRs had triggered disposals in 2014. MDPs then reacquired interests when the legislation was passed. A list of outstanding points/enquiries was identified which included:

(1) asking about the commercial rationale behind the LLP conversion and implementation of the Capital Interests;

(2) seeking clarification of the accounting including the accounting showing the BCG group owning 100% of the UK LLP;

(3) identification of the rights attached to the Capital Interests including their ability to obtain any benefit from those capital interests;

(4) the relationship between the value of the Capital Interests and shares in BCG Inc;

(5) details of Capital Interests owned and disposed of by each MDP;

(6) details of what BCG Ltd provides to the UK LLP as corporate member.

208. PwC responded on 18 June 2018 and 31 July 2018. The responses included a copy of the 2014 LLPA and an explanation of its key terms and a schedule showing for each MDP the Capital Interests held from the inception of the UK LLP to 5 April 2014 inclusive. It did not include a schedule for the Capital Interests held after that date.

209. On 6 September 2018 Mr Taylor spoke with PwC representatives explaining that HMRC continued to believe that there had been an underpayment of tax relating to the Capital Interests and intended to raise additional discovery assessments for nine individual members listed in a schedule of pre-April 2014 Capital Interests who had not previously been assessed.

210. In an email dated 7 September 2018 HMRC requested further information, commenting that it would appear to be the case that profit entitlements of the individual members are deferred in favour of the corporate member until the agreed encashment date. Comments regarding this suggestion were requested.

211. On 17 September 2018 and 27 September 2018 Mr Taylor indicated in telephone calls that additional discovery amendments were to be issued imminently.

212. On 15 October 2018 Mr Taylor emailed PwC explaining that it was understood that at least some of the MDPs continued to hold equity interests in BCG Inc. It was commented that the concerns in respect of the draft MMRs would not be expected to be negated if the partners of the UK LLP continued to hold equity stakes in the corporate group where they continued to have an indirect power to enjoy profits allocated to the corporate member of the UK LLP. Therefore the reason for re-acquiring the Capital Interests in March 2014 was still not understood. Further explanation was sought.

213. On 9 November 2018 PwC provided further information and documents including a schedule of the grants of Capital Interests granted post-April 2014. The information and documents also included a slide deck explaining profit allocation methodology, written

resolutions of the Remuneration Committee, profit allocation statements and PwC's letter of advice dated March 2011. Mr Taylor says that it was upon reviewing this document that he discovered the value of the Capital Interests allocated to each individual which he believes should have been treated as share-based payments, or that amounts of individual members' profit entitlements had been deferred to the corporate member or that the individual members could potentially have the power to enjoy amounts allocated to the corporate member.

214. During a telephone call between Mr Taylor and PwC on 12 December 2018 it was agreed that Mr Taylor would issue a further request for information to seek to address HMRC's concerns that there had been an underpayment of tax.

215. On 10 January 2019 Mr Taylor wrote to PwC stating that he continued to believe that HMRC had made a discovery in respect of there being a shortfall in tax paid resulting from the transactions surrounding the Capital Interests. It was noted that detailed information had been provided but further clarifications were sought. In the letter Mr Taylor set out a summary of the concerns regarding the Capital Interests:

(1) whether the Capital Interests were in fact owned by the MDPs and concerns about the interaction in value between the value of the UK LLP and BCG Inc;

(2) whether BCG Ltd had made payment to the MDPs in relation to the Capital Interests which was surplus to their actual value and which should be considered to be a deemed distribution from the corporate member;

(3) whether the individuals were participators in the corporate member;

(4) about potential deferral of profits allocated to the MDPs and the conversion of income to capital;

(5) as to how the Capital Interests could be created and disappear with other interests in the UK LLP apparently being unaffected particularly where there is no additional capital contributed to the business for the new Capital Interests.

216. In addition, the 10 January 2019 letter included an unusually long schedule of information and documents sought by HMRC.

217. On 25 February 2019 PwC responded in detail in a 23 page letter.

218. On 8 March 2019 HMRC issued further discovery assessments to 9 individual MDPs.

219. On 29 March 2019 a s30B amendment was issued to UK LLP in respect of 2012/2013 and 2014/2015 on the basis of allocation of profits under s850 and/or s850C.

220. The s30B amendment issued to UK LLP did not encompass any amendment required to reflect HMRC's current position that the deferral of profit allocation to MDPs in 2012/2013 to 2013/2014 was not valid.

221. Mr Taylor has confirmed in his Witness Statement that there were a number of items of correspondence exchanged between August 2020 and February 2021 but no further information was provided that changed his opinion as the tax consequences of the arrangements which he had formed from his initial review of the UK LLP accounts.

222. We conclude that:

(1) the Capital Interests and the Framework were not sufficiently explained prior to January 2018 for an HMRC officer to have understood how the funding operated through an 18% retention;

(2) Prior to 31 January 2019 information had been provided which showed the grant value of the Capital Interests held by MDPs and granted after 2014. By that time HMRC

also had the information regarding the disposal proceeds for Capital Interests disposed of during the tax year 2016/2017 (and prior years) which was shown on the MDPs' individual tax returns.

AGREED ISSUES

223. The parties have agreed that the appeals raise the following issues.

Substantive legal issues

224. Whether (and, if so, the extent to which) the arrangements concerning the Capital Interests form part of the "profit sharing arrangements" of UK LLP for the purposes of section 850 ITTOIA; and, if so, how the UK MDPs' and BCG Ltd's allocation of UK LLP profits for income or corporation tax purposes in each of the years within the Relevant Period should be adjusted to take into account those arrangements.

225. Whether the disposal by the UK MDPs of their Capital Interests should be treated as giving rise to income, subject to UK income tax under section 687 ITTOIA, rather than as the disposal of a capital asset, potentially subject to UK capital gains tax.

226. Whether disposals by the UK MDPs of their Capital Interests should be treated as giving rise to amounts chargeable to income tax under Chapter 4, Part 13 of the Income Tax Act 2007.

227. Whether the UK MDPs' allocations of UK LLP profit for the 2012/2013 year should be increased to include a portion of the profits included in those UK MDPs' UK LLP profit allocations, as returned, for the 2013/14 year.

228. Whether section 850C ITTOIA applies in respect of the allocation of UK LLP's profits between the UK MDPs and BCG Ltd for each of the financial years ended 5 April 2015, 5 April 2016 and 5 April 2017.

229. If the disposal by the UK MDPs of their Capital Interests is treated as a disposal of a capital asset, potentially subject to UK capital gains tax, whether those disposals are disposals of the whole or part of a business owned by the relevant UK Partner, for the purposes of Chapter 3 Part V of the Taxation of Chargeable Gains Act 1992. However, HMRC have conceded that if sales of the Capital Interests are correctly taxed as disposals of capital assets, Entrepreneurs' Relief is available.

Procedural legal issues

230. In relation to the assessments raised by HMRC against each of the individual Appellants pursuant to section 29 TMA (the Discovery Assessments), whether the conditions in section 29 TMA are met in respect of those Discovery Assessments.

231. In relation to the amendments made by HMRC to the partnership statements of UK LLP pursuant to section 30B TMA (the Partnership Amendments):

(1) whether the conditions in section 30B TMA are met in respect of those Partnership Amendments; and

(2) whether HMRC is out of time to issue consequential amendments to the returns of the UK MDPs and BCG Ltd pursuant to sub-section 30B(2) TMA, reflecting the amendments made to UK LLP's partnership statements through the Partnership Amendments.

232. Whether the Discovery Assessments represent the appropriate means of effecting changes to the allocation of UK LLP's profits for the financial years to which they relate (and, if so, what is the correct interaction between the Discovery Assessments raised for a particular year and the Partnership Amendment made to UK LLP's partnership statement for its accounting period ending during that year).

233. Whether the scope of any "discovery" giving rise to the Partnership Amendments for 2012/13 and 2013/14 (and, as a result, the scope of those Partnership Amendments and of the Appeals against those Partnership Amendments) is sufficiently broad as to encompass the issue described in paragraph 227 above.

234. In relation to each of the Discovery Assessments issued:

(1) to PK in respect of the year ended 5 April 2013;

(2) to AN in respect of the year ended 5 April 2014;

(3) to BH in respect of each of the years ended 5 April 2015 and 5 April 2016;

(4) to TG in respect of each of the years ended 5 April 2015 and 5 April 2016; and

(5) to MN in respect of the year ended 5 April 2016,

if HMRC has identified correctly a "loss of tax" within sections 29(1)(a) to 29(1)(c) TMA giving rise to that Discovery Assessment, whether that loss of tax was brought about carelessly or deliberately by the relevant Appellant, or any person acting on the relevant Appellant's behalf, for the purposes of section 36 TMA.

235. In relation to each of the Partnership Amendments to UK LLP's partnership statements for 2012/2013 and 2015/16, respectively, if HMRC has identified correctly a "loss of tax" within sections 30B(1)(a) to 30B(1)(c) TMA in respect of the relevant partnership statement, whether that loss of tax was brought about carelessly or deliberately by UK LLP's representative partner, or any person acting on his behalf, for the purposes of section 36 TMA.

STRUCTURE OF THIS DECISION

236. Although the burden of proof is on HMRC to show that the assessments and amendments were validly issued, that involves at least in part a consideration of whether HMRC has shown that the taxpayers were careless when completing their returns. Clearly if the proper tax treatment of the payments is as declared by the taxpayers they cannot have been careless. We therefore consider the substantive issues first.

THE PARTIES' CASES

237. We heard extensive submissions from both parties and only summarise key points in this decision in the context of each issue.

THE UK LLP APPEALS – SUBSTANTIVE ISSUES

238. Before analysing the issues one by one we comment on three cases to which much reference was made in the hearing: *HMRC v BlueCrest Capital Management LLP and ors [2022] STC 1696, Odey Asset Management LLP and ors v HMRC [2021] UKFTT 31 and HFFX LLP and ors v HMRC [2023] UKUT 00073 (TC).*

239. The cases concern the tax treatment of another LLP structure and as the parties have acknowledged there are notable differences between the structure in those cases and the structure in this. In particular, in this case once Capital Interests are awarded to an MDP there are no bad leaver/forfeiture provisions although the penalty provisions have substantially the same effect. The MDP can count on being able to realise value from the Capital Interests so long as the value of the shares in BCG Inc increases over the time and the UK LLP does not become insolvent. The LLP structure here is also much longer term: in the other cases the participants could access the value after a period of varying between six months and three years. In addition, and importantly, the other cases:

(1) involved a profit allocation to the individuals which was then invested into what was called Special Capital;

(2) involved a corporate partner newly created for the structure.

240. However, the cases have been relied upon by the parties in various contexts and we address the principles derived from the Upper Tribunal decisions in *HFFX* and *BlueCrest* in particular in the context of this decision, while recognising that the decisions were based upon notably different facts.

Whether the Capital Interests are part of the UK LLP's profit sharing arrangements for s.850 ITTOIA

The Law

241. Section 848 ITTOIA provides that:

> "unless otherwise indicated (whether expressly or by implication), a firm is not to be regarded for income tax purposes as an entity separate and distinct from the partners".

242. Section 850 ITTOIA currently provides as follows:

> 850 Allocation of firm's profits or losses between partners
>
> (1) For any period of account a partner's share of a profit or loss of a trade carried on by a firm is determined for income tax purposes in accordance with the firm's profit-sharing arrangements during that period.
>
> This is subject to sections 850A to 850D…
>
> (2) In this section and sections 850A and 850B "profit-sharing arrangements" means the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade.

243. These sections together mean that the partners are taxed on the amounts of profits or losses allocated to them by the profit sharing arrangements of the firm.

244. In the Relevant Periods s850(1) was subject only to s850A and s850B in 2012/2013 and 2013/2014. Neither s850A nor s850B is relevant in this case.

245. From 2014/2015 s850 was also subject to s850C. These rules are therefore relevant for the tax years 2014/2015, 2015/2016 and 2016/2017.

246. Section 850C is the section which was introduced to counter manipulation of profit sharing arrangements by taxpayers in the context of mixed member partnerships – where there are one or more individual partners and one or more non individual partners. Section 850C requires three cumulative conditions set out in s850C(1) to be met. It is accepted that the first two are met by virtue of "A" (being an MDP) being treated under s849 as having been allocated a profit from the UK LLP; and "B" (being BCG Ltd) also being treated under s849 and s850 as having been allocated a profit from the UK LLP.

247. The dispute in this case focusses on Section 850C requiring that one of two conditions – Condition X and Condition Y – is met.

248. Section 850C(2) states:

> Condition X is that it is reasonable to suppose that—
>
> (a) amounts representing A's deferred profit (see subsection (8)) are included in B's profit share, and
>
> (b) in consequence, both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would otherwise have been.

249. Section 850C(3) states so far as relevant that:

Condition Y is that—

(a) B's profit share exceeds the appropriate notional profit (see subsections (10) to (17)),

(b) A has the power to enjoy B's profit share ("A's power to enjoy") (see subsections (18) to (21)), and

(c) it is reasonable to suppose that (i) the whole or any part of B's profit share is attributable to A's power to enjoy, and

(ii) both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would have been in the absence of A's power to enjoy.

250. Where either Condition X or Y is met then:

(4) A's profit share is increased by so much of the amount of B's profit share as, it is reasonable to suppose, is attributable to

(a) A's deferred profit, or

(b) A's power to enjoy,

as determined on a just and reasonable basis. But any increase by virtue of paragraph (b) is not to exceed the amount of the excess mentioned in subsection (3)(a) after deducting from that amount any increase by virtue of paragraph (a).

251. Section 850C(8) defines “A’s deferred profit”:

(a) is any remuneration or other benefits or returns the provision of which to A has been deferred (whether pending the meeting of any conditions (including conditions which may never be met) or otherwise), and

(b) includes A's share (as determined on a just and reasonable basis) of any remuneration or other benefits or returns the provision of which to A and one or more other persons, taken together, has been deferred (whether pending the meeting of any conditions (including conditions which may never be met) or otherwise).

252. "The appropriate notional profit" is defined by s850C(10) as the sum of the appropriate notional return on capital and the appropriate notional consideration for services.

253. "The appropriate notional return on capital" is defined in s850C(11):

(a) the return which B would receive for the relevant period of account in respect of B's contribution to the firm were the return to be calculated on the basis mentioned in subsection (12), less

(b) any return actually received for the relevant period of account in respect of B's contribution to the firm which is not included in B's profit share.

(12) The return mentioned in subsection (11)(a) is to be calculated on the basis that it is a return which is—

(a) by reference to the time value of an amount of money equal to B's contribution to the firm, and

(b) at a rate which (in all the circumstances) is a commercial rate of interest.

(13) For the purposes of subsections (11) and (12) B's contribution to the firm is amount A determined under section 108 of ITA 2007 (meaning of "contribution to the LLP").

(14) That section is to be applied—

(a) reading references to the individual as references to B and references to the LLP as references to the firm, and

(b) with the omission of—

(i) subsections (5)(b) and (9), and

(ii) in subsection (6) the words from "but" to the end.

254. Section 108 ITA provides:

(1) For the purposes of section 107 the individual's contribution to the LLP at any time ("the relevant time") is the sum of amounts A and B.

(2) Amount A is the amount which the individual has contributed to the LLP as capital less so much of that amount (if any) as is within subsection (5).

(3) In particular, the individual's share of any profits of the LLP is to be included in the amount which the individual has contributed to the LLP as capital so far as that share has been added to the LLP's capital.

(4) In subsection (3) the reference to profits is to profits calculated in accordance with generally accepted accounting practice (before any adjustment required or authorised by law in calculating profits for income tax purposes).

(5) An amount of capital is within this subsection if it is an amount which—

(a) the individual has previously drawn out or received back,

(b) the individual draws out or receives back during the period of 5 years beginning with the relevant time,

(c) the individual is or may be entitled to draw out or receive back at any time when the individual is a member of the LLP, or

(d) the individual is or may be entitled to require another person to reimburse to the individual.

(6) In subsection (5) any reference to drawing out or receiving back an amount is to doing so directly or indirectly but does not include drawing out or receiving back an amount which, because of its being drawn out or received back, is chargeable to income tax as profits of a trade.

(7) Amount B is the amount of the individual's liability on a winding up of the LLP so far as that amount is not included in amount A.

(8) For the purposes of subsection (7) the amount of the individual's liability on a winding up of the LLP is the amount which—

(a) the individual is liable to contribute to the assets of the LLP in the event of its being wound up, and

(b) the individual remains liable to contribute for the period of at least 5 years beginning with the relevant time (or until the LLP is wound up, if that happens before the end of that period).

(9) This section needs to be read with [section 113A and any regulations made under section 114 (exclusion of amounts]1 in calculating the individual's contribution to the LLP for the purposes of section 107).

255. Section 850C(18) provides that A has the power to enjoy B's profit share if:

…(c) (any of the enjoyment conditions (see subsection (20)) is met in relation to B's profit share or any part of B's profit share.

256. Those conditions are provided so far as relevant by subsection (20) as follows:

(c) A receives or is entitled to receive at any time any benefit provided or to be provided (directly or indirectly) out of B's profit share or the part;

The UK LLP's case

257. The UK LLP relies upon the flexibility provided by the LLP Act. The rights of a member are determined by the LLPA. Reliance is placed on the description of the nature of the members' interests provided by Warren J in *Reinhard v Ondra LLP and others* [2016] 2 BCLC 571. In this case the Capital Interests are the MDPs' share of the goodwill of the UK LLP.

258. Although members do not have any direct legal or beneficial entitlement to the assets of an LLP the position is modified for tax purposes in relation to LLPs that are carrying on a trade or business with a view to profit. Section 836(1)(c) ITTOIA and s.1273(1)(c) of the Corporation Tax Act 2009 state that the property of an LLP is treated as "held by the members as partnership property". For capital gains tax purposes s.59A(1)(a) TCGA provides that the property of an LLP is treated as "held by its members and partners". Therefore even if the interests of the MDPs were not properly to be regarded as direct interests in the capital of an LLP they are treated as direct interests in the assets for tax purposes.

259. Reliance is placed on the cases of *HMRC v BlueCrest Capital Management LLP and ors* [2022] STC 1696, *Odey Asset Management LLP and ors v HMRC* [2021] UKFTT 31 and *HFFX LLP and ors v HMRC* [2023] UKUT 00073 (TC).

260. The key determining facts are those relating to the rights of the members to share in profits in the relevant period of account as determined under the relevant LLPA. Importantly in this case the payments are made by one member of the UK LLP - BCG Ltd - to another member - the UK MDP - in consideration for the acquisition of an asset, i.e. the Capital Interest.

261. HMRC rely on the case of *Morgan and Self v HMRC* [2009] SFTD 160, but the fact that it was concluded that payments made to partners leaving the firm were payments out of profits does not mean that payments to departing partners are always to be regarded as such. Furthermore, an acquisition of an asset is no less an acquisition because it occurs where an individual ceases to be a member of the UK LLP and in this case, as regards the March 2014 disposals, the UK MDPs who sold their Capital Interests were not departing members.

262. The UK LLP does not provide a mechanism for enabling the gratuitous or disguised transmission of profits from BCG Ltd to the UK MDPs. The fact that BCG Ltd may use money generated from profits that have accrued to it under the terms of the LLPA to acquire Capital Interests does not transform the receipt by the member of the consideration he receives for their "sale" into a share of the profits of the LLP. BCG Ltd is only one of the entities able under the terms of the LLPA to acquire the Capital Interests as BCG Ltd can designate that another person shall purchase the Capital Interests. Accordingly, sums that are not derived from BCG Ltd's share of the profits may also be used to acquire the Capital Interests. The value of the Capital Interests is not directly related either to the profitability of the UK business or to BCG Ltd's profit share. The value of the Capital Interests may rise or fall in value unlike an allocation of profits. BCG Ltd is not a mere conduit. It was not inserted into an existing partnership or LLP to perform a conduit function. It owned the whole of BCG's UK business before it transferred that business to the UK LLP. Following the LLP conversion no change was made to the way that the Framework was applied to the UK MDPs and BCG Ltd continued to receive (in substance) the entirety of the profits from the UK business net of UK MDP remuneration (albeit as a share of the profits of the UK LLP rather than employment income). The profits are not legally or in practice held for the UK MDPs' benefit by BCG Ltd. They were available for distribution to, or use by, BCG group entities as and when required and have in fact been distributed to and/or used by BCG Ltd and other group entities before, during and after the Relevant Period.

263. In relation to the provisions of s850C:

(1) the Capital Interests are not remuneration or other benefits or returns the provision of which to the MDPs has been deferred. Instead, the Capital Interests are the means by which the MDP is given a stake in the UK LLP. There is no link between the value of the Capital Interests and either BCG Ltd's share of the profits of the UK LLP or the MDPs' share of the profits of the UK LLP. Following their acquisition, the value of each of the Capital Interests may increase, decrease, fluctuate, or disappear prior to their "sale";

(2) it is not reasonable to suppose that amounts representing an MDP's deferred profit were included in BCG Ltd's profit share. A UK MDP's profit share was determined by the remuneration or profit allocation committee guided by the Framework. BCG Ltd was entitled to its profit share because it contributed its business to the UK LLP in the first place. BCG Ltd does not accumulate its profits in order to have available funds to acquire Capital Interests. Instead, the profits are used in a manner determined at a group level by the Treasury function of the group. Therefore Condition X does not apply;

(3) in relation to Condition Y, BCG Ltd's profit share does not exceed the appropriate notional profit. In particular, its contribution is the current value of the UK LLP's assets which can properly be attributed to its share of the UK LLP's business in each period of account. The purpose of section 108 ITA is to identify the amount and substance contributed by the corporate partner and should therefore be calculated on the basis of the market value at the time of the transfer. Unrealised capital profits should be seen as an additional capital contribution. HMRC have challenged the evidence provided by Mr Holden regarding the potential values of the capital contribution as opinion evidence and therefore the Appellant invites the tribunal to decide whether in principle the submissions on how to determine the capital contributed to the UK LLP are correct. If they are and this condition should prove to be determinative of the issue, the Appellants will seek to agree with HMRC the relevant questions of valuation;

(4) However, Condition Y was not satisfied because no UK MDP had the "power to enjoy" BCG Ltd's profit share. Even to the extent that BCG Ltd uses its share of the profits to acquire the Capital Interests, it is not providing a benefit because it is simply acquiring the capital asset from the MDP at its market value. To the extent that the decision to allocate units of Capital Interests could be characterised as conferring an entitlement to receive a benefit from BCG Ltd, that benefit consists of the entitlement to share in the capital of the UK LLP. When the Capital Interests accrue value and confer an entitlement to an interest in the goodwill of the UK LLP, this benefit is provided out of BCG Ltd's share of the capital of the UK LLP and not out of its share of the profits. In interpreting s850C(20)(c) a contrast with the wider drafting of the Transfer of Assets Abroad provisions contained in s722(3) ITA shows that Parliament had narrowly focused the s850C "power to enjoy" provisions.

(5) In addition s850C(3)(c) is not met: BCG Ltd is entitled to its profit share because it contributed the business to the UK LLP. It is not entitled to its profit share because of any UK MDP's power to enjoy. The Framework did not allow for the possibility of an MDP demanding a higher proportion of BCG Ltd's profit share in return for forfeiting his Capital Interest.

HMRC' s case

264. Each individual's LTCV entitlement can be calculated year by year and reflects a right against BCG Ltd. Unlike the corporate member in *BlueCrest* the obligations on BCG Ltd on purchasing the Capital Interests and the rights of the individuals are absolute in this case. BCG

Ltd was required to make the payments (or direct someone else to) when the conditions were met with no exercise of discretion. BCG Ltd was a mere conduit for the LTCV, being allocated sums purely to satisfy its obligations under the LLPA and accordingly the Capital Interests should be considered part of the profit sharing arrangements of the UK LLP in line with the description of such a "conduit" in *BlueCrest.* Rights under the LTCV were fixed once and granted. There were no provisions for "bad leavers" to lose their Capital Interests. A significant sum (18% of margin according to the Framework) was to be retained separately to any profits paid out via the Framework to fund the LTCV and therefore a significant part of BCG Ltd's entitlement was given to it for this funding.

265. If it is accepted that the disposal of the Capital Interest represents the sale of a valuable asset to BCG Ltd then it follows that year-on-year that asset has had its value increased. As the asset is, in substance, a right to a sum of money from BCG Ltd and BCG Ltd is put in funds to meet that liability, it makes sense to treat that as an allocation in favour of the individual MDP.

266. From 2014/2015 all of BCG Ltd's allocation would be treated as allocated to the individuals by s850C ITTOIA which was introduced to enable HMRC to reallocate profits from corporate partners to individuals where a corporate partner was either obtaining an excessive proportion or the structure was being used to confer benefits on the individuals out of the company's profit share.

267. Condition X applies because sums intended to fund the LTCV are an individual's "deferred profit" within s850C(8) as the payment made under the LLPAs is a benefit which is deferred according to conditions as to exit or long service. It is clear from the Framework that the LTCV is one of the benefits enjoyed by the partners, albeit a long term equity benefit.

268. Given that part of the reason for making allocations to BCG Ltd is to fund the LTCV, if there were no LTCV then the individuals would, in general, receive higher profit shares each year. Furthermore, as the Framework shows that 18% is used to fund the LTCV rather than form part of the profit pool to which the compensation pillars applied, the pool would have been larger and profit shares would be larger without the LTCV.

269. In relation to Condition Y the amount contributed as capital by BCG Ltd is the amount recorded as its capital contribution, i.e. £5.7 million in 2011 and the value of approximately £3.5 million of the lease it transferred in 2013 making a total of a little under £9.3 million. Evidence from Mr Holden regarding the value of the business is not admissible as he was not put forward as a valuation expert. Furthermore, the Appellants have not until now challenged their own valuation in the accounts. The capital contribution of BCG Ltd is therefore very limited. The individuals had power to enjoy BCG Ltd's profit share as defined in s850C.

Discussion

Section 850 ITTOIA

270. The LLPAs expressly provide for what both parties accept are profit sharing arrangements. Those non-contentious arrangements are found in the terms of the LLPAs setting out that the extent of each Member's interest in the profit of the UK LLP in any financial year would be determined and notified to each Member by the Remuneration Committee (and later the profit allocation committee). The allocation of profits to the MDPs reflected the four compensation components of the Framework.

271. The contentious matter concerns the Capital Interests which HMRC maintain should be taken into account as taxable income of the MDPs by virtue of forming part of the profit sharing arrangements of the UK LLP, either on the basis of the application of the general profit sharing

rules for partnerships contained in s850 ITTOIA, or the special rules for mixed partnerships contained in s850C ITTOIA.

272. We consider that as a matter of general principle the Capital Interests should not be treated as part of the allocation of profit of the UK LLP under s850 for the following reasons:

(1) our findings have made clear the disconnect between the profit of the UK LLP and the value of the Capital Interest. The UK LLP may make significant profits, but if the results of the worldwide group are poor the value of the Capital Interest reduces. Contractually the MDPs had no right to share in the profits of the UK LLP beyond the allocations determined annually by the remuneration/profit allocation committee. As a matter of basic statutory interpretation we find that such arrangements do not fall within the definition of "the profit sharing arrangements" provided by s850(2). The arrangements did not give the MDPs rights to share in the profits of the trade beyond the right to receive an allocation of profit as determined by the Remuneration/profit allocation committee. The Capital Interests therefore do not have the intrinsic character of profit sharing arrangements;

(2) BCG Ltd is not a "mere conduit" as contemplated by *BlueCrest*. The company previously carried on the UK business which it contributed to the UK LLP in return for an interest in that partnership. The profits to which it became entitled each year were used by it to support the treasury function of the worldwide group. This is some way from the conduit example described in *BlueCrest* where the right to share in the profits of the partnership in essence remained in the hands of individual partners.

273. Our conclusion is reinforced by the approach taken in *BlueCrest* and *HFFX*. Those cases involved partnerships where the corporate partner was awarded a portion of the partnership's profits on a discretionary basis and used those profits to make discretionary awards of "special capital" to the individual partners. There was therefore a closer connection between the partnership profits and the "capital" provided to the individual partners than in this case. Yet the Upper Tribunal were satisfied in each case that the special capital allocation did not form part of the partnerships' profit allocation. Here there is no allocation of some or all of BCG Ltd's allocation of profit of the UK LLP to some category of interest/capital in the UK LLP. It is even further removed from a profit-sharing arrangement than the situation in *BlueCrest* and *HFFX*. To conclude that the Capital Interests form part of the profit sharing arrangements of the UK LLP would involve rewriting the contractual arrangements between the parties in such a way as the Upper Tribunal in *BlueCrest* decided was outwith even the most purposive construction of s850.

274. We recognise that the 18% margin was retained on the UK LLP's balance sheet and that amount was treated as allocated to BCG Ltd for tax purposes, but there was no requirement to set money aside from BCG Ltd's profit allocation or indeed even to use these retained funds. The MDPs could not make any claim against that retention. We therefore conclude that this funding system does not alter our conclusion about the application of s850.

Section 850C ITTOIA

275. We now turn to consider whether the provisions in s850C altered this conclusion. Those provisions only apply for the tax years 2014/2015, 2015/2016 and 2016/2017 from the Relevant Periods.

276. The matter in dispute is whether Condition X or Y is met.

277. Before setting out our specific conclusions regarding the Conditions we note the guidance provided by the Upper Tribunal in the case of *Walewski v HMRC* [2021] STC 1749 where the role of s850C was set out as follows:

> "…the purpose of the rule is to prevent individual partners making arrangements which seek to accumulate profits in a corporate partner at a lower tax rate - for example, benefiting from the rate of corporation tax which is lower than the higher or additional rate of income tax."

278. We agree with Mr Grodzinski that the context of the UK LLP is relevant. The Framework was in place for many years before the conversion to the LLP structure. It is part of a global remuneration and incentivisation programme operated by BCG, which, as we have found, also operates to contribute to the working capital base of BCG's global business.

279. The evidence also shows that the conversion to the LLP structure was not driven by the existence of a lower corporation tax rate in the UK for BCG Ltd. Instead, it was initially prompted by US tax concerns. The structure involving the UK LLP was then seen to offer potential incentivisation advantages by providing a corporate structure akin to other professional firms, but was also importantly seen as a way of achieving tax advantages in social tax savings as well as the potential significant benefit of capital gains tax treatment combined with entrepreneurs' relief for the individuals and potential business property relief for inheritance tax.

280. Benefiting from a lower corporation tax rate is only one example of the type of arrangements which *Walewski* describes as being the target of s850C. However the core element of the purpose of the rule is to prevent individual partners making arrangements which seek to accumulate profits in a corporate partner. It is with this purpose in mind that we address the Conditions.

<u>Condition X</u>

> "Condition X is that it is reasonable to suppose that—
>
> (a) amounts representing A's deferred profit (see subsection (8)) are included in B's profit share, and
>
> (b) in consequence, both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would otherwise have been."

281. At the heart of this Condition is the concept of deferral of profit by "A" i.e. the MDPs. "A's deferred profit" is defined by s850C(8), in essence, as "remuneration, benefits, or returns, the provision of which to A has been deferred".

282. We consider that the use of the terminology "remuneration, benefits, or returns" shows a clear purpose of casting the net widely and in consequence we are satisfied that the Capital Interests fall within that description. The UK MDPs are entitled to receive the amount provided for under the LLPAs on their "sale" of the Capital Interests. We consider that is a "benefit or return" in its broadest sense. Mr Grodzinski submits that the MDPs receive the market value of the Capital Interests but they have paid nothing for them and we have found as a fact that the Capital Interests are similar to an employee share scheme in providing the recipient with a stake in the business and at the same time providing the recipient with a potential benefit/return if the business prospers.

283. We must then consider whether the provision of that "remuneration benefit or return" reflected by the Capital Interests is deferred.

284. Mr Grodzinski submits that something which is deferred is something to which the person would otherwise be entitled, but which is postponed. However, we consider that "deferral" should be given its ordinary meaning. The Oxford English Dictionary defines "defer" as:

> "put off to a later time; postpone."

285. We are satisfied that the provision of the remuneration benefit or return encapsulated within the Capital Interests is deferred applying this ordinary simple definition of the term. There is no requirement that there is an entitlement which is crystallised prior to the deferral. Mr Chacko conceded that this was not a case such as seen in *Odey* and *HFFX* where profits otherwise payable to a member are deferred. However, he maintained that s850C(8)(a) is still met. We agree. The wording of that subsection applies not only to a deferral of a profit share but also more widely given the extended meaning of "deferred profit". The benefit deferred in this case is the value received by MDPs from the realisation of the Capital Interests.

286. Furthermore, s850C(8)(a) provides that the deferral may be "pending the meeting of any conditions (including conditions which and may never be met) or otherwise". Therefore the fact that the value of the Capital Interests may increase, decrease, fluctuate, or disappear prior to their "sale" does not undermine the conclusion that there is a deferral.

287. The next question is whether the amounts representing the deferred profit are included in B's (i.e. BCG Ltd's) profit share. We are clear that it is important to recognise that the question here is focusing on whether an amount representing the deferred remuneration, benefit or return is included in BCG Ltd's profit share.

288. 18% of the group's "adjusted margin" on a global basis is retained within the BCG group in order to fund the LTCVs. Quite how the adjusted margin precisely relates to the accounting profit is not addressed in the evidence but that does not matter. The important fact is that that a portion of the UK LLP's profits are set aside and are not available to be allocated by the Remuneration Committee. For tax purposes all of the profits are allocated each year under s850 and this amount is therefore allocated for those purposes to BCG Ltd. Therefore the 18% which is considered to provide for the liabilities arising on the "sale" of the Capital Interests is included in BCG Ltd's profit share for tax purposes. The fact that BCG Ltd does not then warehouse the 18% does not affect the underlying point that an amount which is seen to represent the potential liability under the terms of the Capital Interests is allocated to BCG Ltd.

289. We therefore conclude that "amounts representing the deferred profit are included in BCG Ltd's profit share." We consider that the provision was drafted widely as shown by the definition of deferred profit addressed above and consistent with that approach is the use of the word "representing". The 18% margin represented the expected liability to pay MDPs for their Capital Interests; i.e. the deferred profit; and the margin amount was included in BCG Ltd's profit share.

290. We now turn to the final part of Condition X which requires that "in consequence" of the amount representing the MDP's deferred profit being included in BCG Ltd's profit share, both the MDP's profit share and the relevant tax amount are lower than they would otherwise have been. In this regard we take into account the following factors in particular:

(1) The profit share allocated to the MDPs represents the annual four compensation elements. It is entirely separate from the award of the Capital Interests or payment made in relation to them. This is not a situation where the MDPs have an option to receive Capital Interests or receive some other form of "benefit".

(2) The MDPs' receipt of the annual four compensation elements under the Framework is not lower than it would have been without the Capital Interests. The MDPs' receipts through the profit share are the equivalent for them to their previous employment income before the conversion to the LLP structure. Under that previous structure the MDPs did not give up remuneration in order to receive the BCG Inc shares. Similarly, there is no profit sacrifice operating under the LLP structure. The Capital Interests stand outside the four compensation elements of the Framework;

(3) The 18% margin retention takes place on a global basis and there is no direct correlation between the profits made by the UK LLP and the appreciation in the value of the UK MDPs' Capital Interests. We do not accept HMRC's argument that if this amount was not retained the pool to which the compensation pillars were applied would have been larger and profit shares would be larger. That assumes that the Remuneration Committee would have allocated some or all of that 18% to the MDPs if the Capital Interests did not exist, but the evidence does not show that it would be reasonable to suppose that this would happen for the following reasons:

(a) We see little basis to conclude that if the 18% was not retained by UK LLP (and allocated to BCG Ltd) to fund the LTCV the profits would otherwise be allocated to the MDPs. They would then be receiving annual remuneration completely out of line with their counterparts in other jurisdictions.

(b) The group has taken the decision to put aside the 18% on a worldwide basis to fund LTCVs. Each BCG entity around the world does that. Therefore without the Capital Interests there would still be an allocation of the 18% margin towards the worldwide LTCV structure.

(c) The evidence of Mr Holden shows that if there was no LTCV at all the annual amounts paid out to MDPs would be larger. That was the case before the introduction of the LTCV. However, we do not consider that a situation involving no LTCV is the correct alternative to consider when identifying what is "reasonable to suppose" now. Instead the alternative should take into account the established worldwide remuneration structure including the LTCV in some form. Having considered the evidence overall we find that if the Capital Interests did not exist there would be another structure or instrument tracking the value of BCG Inc used to provide the LTCV even if this was taxed on an income basis (as is the case in some jurisdictions) rather than a capital gains tax basis and the 18% would still be retained by the group.

291. Therefore we conclude that even though an amount representing the deferred profit was included in BCG Ltd's profit share this did not mean that the MDPs' profit share was reduced.

292. The result is that Condition X does not apply.

<u>Condition Y</u>

> Condition Y is that—
>
> (a) B's profit share exceeds the appropriate notional profit (see subsections (10) to (17)),
>
> (b) A has the power to enjoy B's profit share ("A's power to enjoy") (see subsections (18) to (21)), and
>
> (c) it is reasonable to suppose that:
>
> (i) the whole or any part of B's profit share is attributable to A's power to enjoy, and
>
> (ii) both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would have been in the absence of A's power to enjoy.

293. The "appropriate notional profit" is defined in s850C(11) – (13). In short, it is a return calculated on the basis of an amount of money equal to B's (BCG Ltd's) contribution to the UK LLP at a commercial rate of interest.

294. The contribution to the UK LLP is determined by applying the rules set out in s108 ITA as amended by s850C(14). The parties agree that the amount contributed as capital by BCG Ltd is the amount reflecting its contribution of the business to the UK LLP in 2011 together with the value of the lease it transferred in 2013. The parties do not agree on how the value of the business contribution is calculated. In short, HMRC says that the amount recorded as BCG Ltd's capital contribution in the accounts i.e. its net book value of £5.7 million is the value of its contribution of the business to the UK LLP; whereas the Appellants maintain that the initial contribution of the business should be valued according to market value and the increase in the value of the business should be taken into account on an annual basis.

295. We agree with the Appellants that the determination of whether Condition Y is satisfied must take place for each period of account. This reflects the fact that the starting point for the partnership taxation in s849 refers to the profits or losses of the trade being calculated for any period of account and s850C(1) itself starts by considering whether the three requirements in s850C(1) (including the requirement that either Condition X or condition Y is met) are met "for a period of account". The appropriate notional return calculation must then also take place for each relevant period of account (s850C(11)). This is a natural consequence of considering the return provided by a commercial rate of interest given that interest rates will generally be expected to change.

296. However, that in itself does not mean that "B's contribution to the firm" i.e. BCG Ltd's contribution to the UK LLP should be revalued each year. The rules for determining the value of that contribution are set out in an amended version of s108 ITA. The annual calculation will reflect additional contributions such as the transfer of the lease.

297. The parties dispute what amount should be taken into account under s108(2) as "the amount which BCG Ltd has contributed to the UK LLP as capital".

298. HMRC rely upon the cases of *Hamilton and Kinneil* and *Papat* to say that the amount contributed as capital by BCG Ltd is the amount recorded as its capital contribution. We note that this contradicts HMRC's stated position in the Partnership Tax Manual where it is stated that if a member has contributed an asset the capital contribution is the market value at the time of transfer even where the capital account of the partner is credited with the amount reflecting historic cost rather than market value. However, HMRC's manuals are not law. They set out HMRC's opinion and therefore must be viewed as no more than that.

299. The case of *Papat* concerned the situation where two individuals entered into a partnership in each case contributing unequal amounts of cash. The question was whether the profit realised on a sale, after dissolution, of the assets of the partnership was divisible equally between the partners (pursuant to the provisions of the Partnership Act 1890) or in shares corresponding to their respective shares of the capital of the partnership as at the date of dissolution. The court held that there was a distinction to be made between capital of the partnership and its assets and Nourse LJ refers to a previous decision of his in *Reed v Young* (1983) 59 TC 196 stating that:

> "Each contribution must be of a fixed amount. If it is in cash, it speaks for itself. If it is in-kind it must be valued at a stated amount."

300. *Hamilton and Kinneil* was a decision of the Upper Tribunal considering other tax rules affecting limited liability partnerships dealing with loss relief which could be claimed by a corporate limited partner. The provisions (in s118ZC ICTA 1988) state that a member's contribution to a trade is the greater of: (a) the amount subscribed by it, and (b) the amount of its liability on a winding up. The amount subscribed is stated to be the amount which it has contributed to the limited liability partnership as capital, less so much of that amount as it is or may be entitled to draw out or received back or which may be entitled to require another person

to reimburse to it. Therefore the case specifically addresses the concept of an amount contributed to a limited partnership. However, the case concerned a situation where the partner contributed cash and therefore the issue before this tribunal was not at large, although statements made by the Upper Tribunal serve to inform the approach we should take.

301. The Upper Tribunal considered the requirement under the Limited Partnerships Act 1907 for limited partners to contribute a sum or sums as capital or property valued at a stated amount which would be reflected in the capital account of the limited partner. While there was no such requirement under the LLP Act the Upper Tribunal stated that:

> "where contributions are in fact made and are credited to the capital accounts of members, there is capital of the LLP just as much as there is capital in the case of a limited partnership. The asserted differences between an LLP and limited partnership in relation to capital do not require, in my view, fundamentally different approaches to be taken to the concept of "contribution"."

302. The Upper Tribunal went on to consider the amount subscribed and in particular the legislative requirement to consider the amount contributed as capital. In doing so the Upper Tribunal considered that subscription was "the transfer of assets, usually money but sometimes assets valued at a stated amount" in return for an interest in the LLP at [34].

303. We consider that this reference to the valuation at a stated amount reflects the fact that what is being considered is the "<u>capital</u> contribution" to the LLP. The term is specifically addressing the value in the LLP's capital. In that sense we agree with HMRC that as identified in *Papat* there is a difference between the capital of an LLP and its assets. Therefore it is necessary to look to the accounts and the amounts shown in the capital of the UK LLP as the amount contributed by BCG Ltd.

304. In each period of account the capital contribution of BCG Ltd should be identified. In 2013 its capital contribution increased when it contributed the leasehold property and this is reflected in the UK LLP's accounts.

305. Consequently we conclude that the amount which BCG Ltd has contributed to the UK LLP as capital is £9.3m.

306. Mr Grodzinski submits that we should consider the overall substance and purpose of the provisions contained in s850C and so, for example, regard unrealised capital profit as additional capital contribution. While we recognise that a purposive approach should be taken to legislative interpretation where the wording is unclear we consider it to be beyond the scope of such an approach to read into the words "capital contribution" items which go beyond amounts recognised in the accounts as capital contributed by a member.

307. It is not disputed that BCG Ltd's share of the profit exceeded the appropriate notional profit when an amount of only £9.3 million is treated as its capital contribution.

308. We therefore must then consider whether the UK MDPs have the "power to enjoy" BCG Ltd's profit share.

309. Section 850C(18) provides that A has the power to enjoy B's profit share if:

> "(c) any of the enjoyment conditions (see subsection (20)) is met in relation to B's profit share or any part of B's profit share."

310. In this regard HMRC has relied upon s850C(20)(c) which applies where:

> "(c) A receives or is entitled to receive at any time any benefit provided or to be provided (directly or indirectly) out of B's profit share or the part."

311. HMRC says that the Capital Interests accrue as liabilities of BCG Ltd and therefore whether or not it actually uses its current profits to pay them out, profit allocations to BCG Ltd support its ability to meet its obligations at least indirectly and enure for the benefit of the individuals.

312. The UK MDPs are entitled to receive the amount provided for under the LLPAs on their "sale" of the Capital Interests. We consider that is a "benefit" in its broadest sense for the same reasons that we concluded it is a "benefit or return" for Condition X, Mr Grodzinski submits that the MDPs receive the market value of the Capital Interests on grant, but we have found as a fact that the Capital Interests are similar to an employee share scheme in providing the recipient with a stake in the business and at the same time providing the recipient with a potential benefit if the business prospers.

313. That benefit is provided by the "sale" of the Capital Interests to BCG Ltd or another person nominated by BCG Ltd. Whether or not the purchase is by BCG Ltd itself (and in fact the evidence is that it would be expected that BCG Ltd would be the purchaser) the 18% margin is allocated to BCG Ltd as part of the worldwide retention to fund the purchase of LTCV interests. The wording of s850C(20)(c) is widely drawn referring to benefits provided directly or indirectly out of B's share or any part of B's profit share. We consider that "profit share" for these purposes is interpreted by reference to the profits allocated to each partner under s850. The amount retained is treated as profit allocated to BCG Ltd. The expectation is that the 18% amount will provide the funds needed by BCG Ltd when the benefit is paid to MDPs on the "sale" of their Capital Interests. We therefore consider that in the ordinary course the expectation of the parties is that the "benefit" will be provided out of that retention of profits allocated to BCG Ltd.

314. It is then finally necessary to consider s850C(3)(c). We consider that it is "reasonable to suppose" that part of BCG Ltd's profit share is attributable to the MDPs' "power to enjoy" (as that term is defined in the legislation) given the retention and allocation of the 18% amount to BCG Ltd to fund the future purchase of the Capital Interests. In other words the MDPs receive a benefit at a time after generation of the profits which benefit is paid out of BCG Ltd's profit share.

315. In addition, there is also the requirement that the MDP's profit share and the relevant tax amount are lower than they would have been in the absence of the MDPs' power to enjoy. Notably the wording in Condition Y is wider than Condition X. Condition X requires that it is reasonable to suppose that <u>in consequence</u> of amounts representing the MDPs' deferred profit being included in BCG Ltd's profit share, the MDPs' profit share and relevant tax amount are lower than they would otherwise have been. The "in consequence" linkage is not included in Condition Y, which is therefore a provision of wider scope.

316. However, the requirement that the MDP's profit share and relevant tax amount are lower than they would otherwise have been clearly begs the question as to what the comparison should be made just as in the case of considering s850C(2)(b) for Condition X? If the MDPs did not have the power to enjoy a benefit out of BCG Ltd's profit share on the "sale" of the Capital Interests, would their profit share otherwise have been higher?

317. For the same reasons as we have found in considering the application of s850C(2)(b) above we conclude that in the context of Condition Y the MDP's profit share and the relevant tax amount are not lower than they would have been in the absence of the MDP's power to enjoy.

318. Accordingly even if we conclude that the "power to enjoy" condition is satisfied under s850C(20)(c), the arrangements do not meet the requirement of s850C(3)(c)(ii). Therefore Condition Y is not met.

319. Consequently the arrangements do not fall within s850C.

INDIVIDUAL APPEALS

Attribution of all of the profits to the MDPs

320. We address this issue first. It is a discrete issue concerning the allocation of the profits rather than the taxation of the Capital Interests.

321. We have found that the implementation of the LLPAs did not reflect their terms; in particular under those terms no Member was entitled to share in profits until the Remuneration Committee allocated the profits to them. Yet BCG Ltd was treated in its accounts and by all involved as being entitled to the residue of the profits after the allocation to the MDPs without any decision being made by the Remuneration Committee to that effect.

322. HMRC accept that it was (prior to the LLPAs) intended and expected that residual profits would be allocated to BCG Ltd but that was not achieved in practise. It is submitted that pre-contractual negotiations are not part of the matrix of fact for construing the LLP Agreements. Although the residual profits were treated as having been made available to BCG Ltd the amount was not drawn down but left with the UK LLP as a balance on its balance sheet. The fact that the accounts of the UK LLP and BCG Ltd reflect the allocation of profit to BCG Ltd cannot be determinative as they are not part of the profit sharing arrangements.

323. Mr Grodzinski submitted that even if HMRC were right about the need for the Remuneration Committee to allocate profit to a Member, that was done in relation to the MDPs. There is no mechanism to deem that to be increased. The LLPAs did not require a formal resolution – simply notification. The "notification" effectively happened within BCG not least by virtue of Mr Holden being a member of the Remuneration Committee and a director of BCG Ltd. There was a consistent pattern of behaviour and therefore even if the LLPAs were construed such that under their terms the required notification had not taken place for BCG Ltd to have been entitled to the residue of the profits, there was variation by conduct of the LLPAs.

Discussion

324. The relevant provision at the heart of this issue is that contained in s850 ITTOIA. What were the "profit sharing arrangements"? The statutory definition tells us that they are: "the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade".

325. If we follow HMRC's analysis the only profits to which the MDPs had a right to receive were those allocated to them by the Remuneration Committee. That leaves the residue unallocated – yet s850 works on the basis of allocation of all of the profits.

326. The section refers to "profit sharing arrangements". Arrangements is a broad term which can encompass more than simply a partnership agreement. We are satisfied that the arrangements overall – including the parties' understanding and expectations must be taken into account in that context. We recognise that the LLPAs stated that they set out the entire agreement between the parties but the conduct of the parties effectively meant that no actual notification by the Remuneration Committee was required in order for BCG Ltd to be treated by all involved as entitled to the residue of the profits.

327. As a result, we conclude that the rights to profits under the profit sharing arrangements for the MDPs were solely to the amounts allocated to them by the Remuneration Committee and BCG Ltd had a right to the residue. The fact that the profit to which it was entitled was not paid out to it but set against other balances or left as an outstanding debt owed to BCG Ltd does not alter the existence of that right.

The miscellaneous income charge – Section 687 ITTOIA

The law

328. Section 687 ITTOIA states that:

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

329. The parties agree that this charge was historically found under the previous Schedular system in Schedule D Case VI and that the jurisprudence relating to that charge remains relevant. In particular, they agree that we should have regard to the principles set out in *Kerrison v HMRC* [2019] 4WLR at [68] and therefore agree that for a receipt to be chargeable on this basis:

(1) it must have the nature of "annual profits" such that it must be capable of being calculated in any one year although this does not mean it must recur every year;

(2) it must be of an income nature;

(3) it must be analogous to some other head of charge under what was previously Schedule D;

(4) it must be the recipient's income; and

(5) it must involve a sufficient link between the source and the recipient.

Discussion

330. Mr Grodzinski argued that the Capital Interests should be treated in the same way as an individual buying a share in a general partnership. However, our findings of fact earlier in this decision detract from that conclusion. We agree with HMRC that the fact that the rights are described as "capital" in the LLPAs is not itself determinative. Instead, we have considered the true nature of the rights and we have not accepted that they are in any real sense interests in the goodwill or other assets of the UK LLP.

331. Furthermore, we do not accept Mr Grodzinski's argument that the effect of the partnership being transparent for tax purposes is that the MDPs are treated as owning the capital of the UK LLP such that any payment made in relation to the "sale" of the Capital Interests cannot be income in nature. That transparency rule does not override the need when applying s687 to determine the nature of the payment received by the MDPs. Furthermore, we are also satisfied that the realisation of value in relation to the Capital Interests does not involve the disposal of any interest in the UK LLP or its assets as the money is paid by BCG Ltd.

332. Turning to the *Kerrison* principles in turn, we start with considering whether the payments made on "sale" of the Capital Interests have the nature of "annual profits". Mr Grodzinski relied on the case of *Moss Empires Limited v IRC* [1937] AC 785 to submit that this requirement was not met, referring, in particular, to the judgement of Lord Maugham who stated that in determining whether the payments in that case were "annual payments" the word "annual" must be taken to have the quality of being recurrent or being capable of recurrence. That decision was considering whether or not sums paid fell within the term "annual payment" where it was used in the context of a legislative provision (in r.21 of the Income Tax Act 1918) referring to "payment of any interest of money, annuity or other annual payment, etc. ". Lord Maugham's stated that:

> " in r.21"annual" must be taken to have, like interest on money or an annuity, the quality of being recurrent or being capable of recurrence." (Underlining added.)

333. It is clear therefore that this decision was focused upon the context of the use of the word "annual". We do not consider it undermines the principle set out in *Kerrison,* relying upon the decision in *Ryall v Hoare* 8 TC 521, that the receipt must be capable of being "calculated in any one year". It is not necessary for the income to recur every year (*Leeming v Jones (Inspector of Taxes)* 15TC 333).

334. In *BlueCrest* in the Upper Tribunal it was accepted by the taxpayer that the receipts in question were annual profits, but in that case the deferral period of the awards was six months, one year, two years or three years to ensure that should a partner leave they would automatically breach the eligibility criteria or forfeit the possibility of an award being made final. We are therefore clear that the facts in *BlueCrest* are fundamentally different.

335. Turning instead to *Ryall v Hoare* Rowlatt J considered various options for the meaning of the word and concluded that the word meant "calculated in any one year". In that sense payment received on "sale" of the Capital Interests would be "annual". Consequently, the first of the criteria is satisfied.

336. This leads us to the second of the *Kerrison* principles at the heart of this case which is whether the payment on "sale" of the Capital Interests was income in nature. We refer to our findings made earlier as to the nature of the Capital Interests and, in particular, the following:

(1) they are awarded in recognition of a person's seniority as well as length of service;

(2) they are designed to align the interests of the individuals with that of the business and consequently incentivise them;

(3) they are in substance analogous to a pre-determined retirement/departure payment; and

(4) in the accounts the UK LLP is treated as having the benefit of the services provided by the MDP with the Capital Interests being treated as connected to the provision of those services.

337. We therefore consider that these factors lead to the conclusion that the payments received on "sale" of the Capital Interests were income in nature. The fact that there is what is described in documents as a "sale" of the Capital Interests to produce the payment does not outweigh these considerations.

338. In considering whether the payments are analogous to the other cases in Schedule D the decision in *BlueCrest* sets out relevant principles. The Upper Tribunal referred in particular to the decision in *Manduca v Revenue and Customs Comrs* [2015] UKUT 262. Mr Grodzinski submitted that *Manduca* is not an appropriate authority given that it was considering the situation of employees, but this was specifically acknowledged in *BlueCrest* where it was noted that the payments in that case were not paid pursuant to a contract of employment but were considered to be a reward for services. The Upper Tribunal identified specifically that the FTT had found that the scheme in that case was intended to reward individual partners for their contribution to the success of the partnership because of the services they provided and to incentivise them for the future. As a result the Upper Tribunal concluded that the FTT was entitled to find that those services were eiusdem generis with the services listed within the other cases in Schedule D (see [117]).

339. Given our findings referred to above we similarly conclude that the payments are in substance analogous to other amounts taxable under Schedule D.

340. It is clear that the payment is made to each MDP and is theirs.

341. That leaves the matter of the source of the income.

342. HMRC submit the rights under the LLPAs are the rights in respect of which the payment under the Capital Interest arises. We agree. The source of the income is the terms of the LLPA which sets out the terms of the Capital Interests and the ability to access those terms is rooted in the individual's service with BCG in the context of the remuneration/ reward/ incentivisation programme operated by the group as a whole.

343. We respectfully agree with the FTT in the case of *Versteegh Ltd v HMRC* [2014] SFTD 547 at [126] that for there to be a source the recipient does not need to have a right, still less an enforceable right, to the payment before it is made. Indeed, that is reinforced by the Upper Tribunal decision in *Spritebeam Ltd v Revenue and Customs Comrs* [2015] UKUT 75 as noted by the Upper Tribunal in *BlueCrest* at [124].

344. The source of the payments is the terms on which the Capital Interests are allocated under the LLPAs. That is where the obligation to purchase the Capital Interests and make the payment is found. And there is a sufficient link between that source and the MDPs.

345. Mr Grodzinski submits that there is only one source of income here which is the trade of the LLP and that is "exhausted" by the profit sharing arrangements under the LLPAs. Mr Baldry submits that such an approach was rejected by the Upper Tribunal in *BlueCrest.* Indeed, we are clear that the source is not the underlying business of the UK LLP or profits of the UK LLP. We have already found that the Capital Interests are not part of some profit sharing arrangements. They stand outside the business and profits of the UK LLP. Just as the Upper Tribunal noted in *BlueCrest* that the taxpayer could not have it both ways in arguing that the payments made there were not part of the profit sharing and at the same time arguing that the LLP's trade was the source of the payments; so the Appellants here cannot have it both ways.

346. Our conclusion therefore is that s687 applies to the payments made on the "sale" of the Capital Interests. That conclusion means that we would dismiss the individuals' appeals (subject to our conclusions about the validity of the assessments to which we turn later). However, as the issue was fully argued we also address the application of the "sale" of occupational income provisions.

Sales of occupational income

347. If we are incorrect in concluding that s687 applies to the payments we must consider the application of the legislation contained in Chapter 3 of Part 13 ITA.

The law

348. Section 773 ITA provides as follows:

> 773 Overview of Chapter
>
> (1) This Chapter imposes a charge to income tax—
>
> (a) on individuals to whom income is treated as arising under section 778 (income arising where capital amount other than derivative property or right obtained),…
>
> (b) …
>
> (2) Income is treated as arising under those sections only if—
>
> (a) transactions are effected or arrangements made to exploit the earning capacity of an individual in an occupation, and
>
> (b) the main object or one of the main objects of the transactions or arrangements is the avoidance or reduction of liability to income tax.

349. Section 775(b) ITA provides that Chapter 4, Part 13 ITA has effect subject to any other provision of the Tax Acts treating income as belonging to a particular person. Section 776 ITA

imposes a charge on the full amount of income treated as arising in the tax year. The person liable for any tax charged is the individual to whom the income is treated as arising.

350. Section 777 ITA provides that three conditions must apply, for the charge to arise, as follows:

> (2) Condition A is that the individual carries on an occupation wholly or partly in the United Kingdom.
>
> (3) Condition B is that transactions are effected or arrangements made to exploit the individual's earning capacity in the occupation by putting another person (see section 782) in a position to enjoy:
>
> (a) all or part of the income or receipts derived from the individual's activities in the occupation, or
>
> (b) anything derived directly or indirectly from such income or receipts;
>
> …(5)Condition C (so far as relevant) is that as part of, or in connection with, or in consequence of, the transactions or arrangements a capital amount is obtained by the individual.

351. Section 774 ITA defines what is meant by "occupation".

352. Section 777(6) explains that:

> For the purposes of subsection (5), the cases where an individual ("A") obtains a capital amount for another person ("B") include cases where A has put B in a position to receive the capital amount by providing B with something of value derived, directly or indirectly, from A's activities in the occupation.

353. Section 777(7) defines "capital amount" as:

> "an amount in money or money's worth which does not fall to be included in a calculation of income for purposes of the Tax Acts otherwise than as a result of) this Chapter"

354. Section 773(2)(b) makes clear that tax avoidance is the focus of these provisions which only apply if the avoidance or reduction of liability to income tax was the main object, or one of the main objects of the transactions or arrangements.

355. Where the requirements are satisfied, s.778 applies. It provides as follows:

> 778 Income arising where capital amount other than derivative property or right obtained
>
> (1) This section applies if the capital amount obtained as mentioned in section 777(5) does not consist of—
>
> (a) property which derives substantially the whole of its value from the individual's activities, or
>
> (b) a right which does so.
>
> (2) The capital amount is treated for income tax purposes as income arising to the individual.
>
> (3) The income is treated as arising in the tax year in which the capital amount is receivable.
>
> (4) A capital amount is not regarded as having become receivable by a person for the purposes of this section until the person can effectively enjoy or dispose of it.

356. An exemption to the application of the provisions is provided in Section 784 ITA which provides (so far as relevant) as follows:

> 784 Exemption for sales of going concerns
>
> (1) This section applies if a capital amount is obtained from the disposal-
>
> (a) of assets (including any goodwill) of a profession or vocation,
>
> (b) of a share in a partnership which is carrying on a profession or vocation, or
>
> (c) …
>
> (2) An individual is not liable to income tax under this Chapter in respect of the capital amount so far as the going concern condition is met (see subsections (4) …)
>
> (3) Subsection (2) is subject to section 785 (restriction on exemption: sales of future earnings)
>
> (4) In the case of a disposal within subsection 1(a) or (b), the going concern condition is that the value of what is disposed of at the time of the disposal is attributable to the value of the profession or vocation as a going concern.

Discussion

357. The Appellants submit that s784 applies to exempt their situation as the sale of the Capital Interests is the sale of an asset representing the MDP's share in the UK LLP and/or goodwill and the UK LLP was carrying on a profession. Mr Baldry submits that the MDPs are receiving money because of their position as members of the UK LLP holding the Capital Interests, but they are not selling assets of the UK LLP or a share of it. Furthermore, he submits that s784(4) restricts the application of this exemption to the UK LLP as the value received for the Capital Interests is attributable to the growth in value of BCG Inc's shares and not the LLP. The fact that the MDP received no payment if the UK LLP is insolvent does not alter that conclusion. Mr Grodzinski relies on the core analysis that the Capital Interests give the MDPs a share in the capital of the UK LLP. In relation to s784(4) he submits that there is nothing impermissible in using a metric such as the formula for the sale price of the Capital Interests to work out the value of the members' shares in the goodwill. Furthermore, the clear purpose of the going concern condition is to recognise the difference between selling interests in going concerns and selling an individual's future earnings.

358. It is not disputed that the UK LLP carries on a profession. We have addressed the arguments regarding the Capital Interests being interests in the goodwill of the UK LLP and have explained earlier why we do not accept that analysis. However, in any event we consider that the going concern condition referred to in s784(4) is not satisfied as the value of the Capital Interests is not attributable to the value of the profession as a going concern. Those words clearly refer to the profession carried on by the LLP as opposed to a wider valuation of the group overall. As we have explained earlier, the value of the UK LLP can fall while at the same time the value of the Capital Interests increases.

359. We therefore turn to consider the general anti avoidance rules set out above.

360. The first point of dispute in the provisions concerns the application of Condition B.

361. In *BlueCrest* the Upper Tribunal held that Condition B was satisfied. However, in that case the scheme which was operated had been found to have replaced the profit allocations which had been made to individual partners to reward their performance. That is notably different to the facts in this case where the Capital Interests replace the BCG Inc shares rather than previous profit allocations.

362. Mr Grodzinski submits that the facts are similar to those which led the FTT in the case of *Odey* to accept that Condition B was not satisfied. However, given that the discussion in that case regarding Condition B was obiter dicta and the conclusions are inconsistent with those in the Upper Tribunal in both *BlueCrest* and *HFFX* concerning essentially the same structure as in *Odey*, we do not adopt the reasoning there.

363. HMRC submit that the UK LLP's income came solely from the personal exertions of the MDPs and fellow employees. Some at least of those profits arising from the activities of the MDPs were allocated to BCG Ltd. Mr Grodzinski submits that the Condition is not satisfied because prior to the conversion to the UK LLP it was BCG Ltd which generated and received the income from the business in the UK. Following the conversion to the UK LLP structure BCG Ltd put the MDPs in the position to directly receive income derived from their activities as members of the UK LLP. The MDPs did not become entitled to less income by becoming members of the UK LLP or because of the implementation of the Capital Interests. Moreover, the anti-avoidance provisions are designed to apply to schemes in which individuals sell their earning potential in exchange for capital payments and there was no such sale by the MDPs of their earnings potential to BCG Ltd.

364. We recognise the target of the anti-avoidance rules when introduced. While that is, of course, of particular relevance in applying a purposive interpretation of the legislation it is also well recognised that widely drawn anti-avoidance provisions often capture more than the original schemes for which they were drafted. We must apply the legislation as drafted and it is drafted very widely with a limitation being provided by the tax avoidance purpose rule.

365. Arrangements were made (the UK LLP and the terms of the LLPAs) which meant that BCG Ltd was put in a position to enjoy part of the income or receipts derived from the MDPs' activities in the occupation. That is sufficient for Condition B to be satisfied. The Condition does not envisage the sort of comparison to the circumstances before the LLP Conversion which Mr Grodzinski refers to.

366. Condition C is satisfied given that consideration of the application of this section only arises where s687 is found not to have applied.

367. However, the provisions only apply if the avoidance or reduction of liability to income tax was the main object, or one of the main objects of the transactions or arrangements. Mr Grodzinski referred us to the case of *Euromoney v HMRC* [2022] STC 1457 and the need to consider the purpose of the totality of the scheme or arrangements.

368. In considering the totality of the arrangements in this case we take into account the following findings in particular:

(1) the perceived tax risks particularly focused in 2010 on the possible introduction of changes to employment-related securities rules where shares are provided to employees through share options and the shares have no rights or limited rights over the value of the company at the time at which the options are granted but have rights over all subsequent growth from that time onwards. The consultation which was being considered at the time explained that the aim of the provisions was to ensure that employment income from employment related securities would be subject to income tax and National Insurance Contributions. The evidence of Mr Holden is that simply re-implementing the previous LTCV programme in the UK as before was considered to carry the risk of that income tax and National Insurance risk;

(2) the LTCV had four basic objectives: to provide a long-term reward mechanism linked to BCG's performance; to incentivise high performing partners to remain with

BCG; to strengthen and increase the stability of BCG's capital base; and to provide tax advantages where possible;

(3) The UK LLP structure was identified as having the following particular benefits: it reinforced BCG's partnership relationship as opposed to an employer/employee relationship; partners would be considered self-employed and that would generate significant National Insurance Contribution savings which in turn would help address the competitive issue the business faced; and the flexibility of an LLP made it very attractive to "tailor an LTCV option using a capital interest". In particular, it was identified that the sale of such an interest had the potential to qualify for entrepreneurs' relief with capital gains tax applying at the rate of 10% on the first £5 million as opposed to the standard 28%;

(4) It was also seen as being more administratively straight forward than the D2 Share scheme given the fact that steps such as valuations and elections were not needed to ensure the shares remained outside the income tax treatment of employment related securities and financing was not needed under the structure.

369. Obtaining capital gains tax treatment was a desired object of the implementation of the LTCV programme wherever possible and simply using the BCG Inc shares again was seen as being prone to the risk of income tax treatment. The UK LLP structure enabled the other commercial objectives regarding incentivisation and strengthening of the capital base to be achieved as well but those were also obtained by the previous share structure. The UK LLP offered non income tax advantages connected to self-employment status and the added potential benefit of entrepreneurs' relief, but that was in the context of the underpinning object of achieving capital gains tax rather than income tax treatment if possible. BCG had gone to some lengths to ensure that the previous structure remained outside the income tax treatment resulting from the employment related securities rules. Indeed, we would go so far as to say that if the UK LLP structure was one which led to income tax treatment of the LTCV and there was another commercially acceptable structure which provided capital gains tax treatment the UK LLP structure would have been rejected given the worldwide aim of capital gains tax treatment where possible.

370. We therefore conclude that the avoidance or reduction of liability to income tax was the main object, or one of the main objects of the transactions or arrangements when considered overall. (The avoidance of National Insurance contributions was also a main object but that is in addition to the conclusion that the avoidance of income tax was a main object.)

371. We have not received submissions from the Appellants regarding s778. For the avoidance of doubt we are satisfied that the capital amount obtained on "sale" of the Capital Interests does not consist of property which derives substantially the whole of its value from the individual's activities.

372. We therefore conclude that disposals by the UK MDPs of their Capital Interests should be treated as giving rise to amounts chargeable to income tax under Chapter 4, Part 13 ITA if the charge in s687 ITTOIA does not apply.

The deferral of profit allocation from 2012/2013

373. HMRC say that the MDPs received the amounts via partners' drawings and simply calling it an allocation for a later period without any change whatsoever in the receipts by the MDPs cannot change the tax position. HMRC recognises that there was some risk that the deferred allocation of profit would not be made (if for example, profits were then insufficient) but say that everyone worked on the basis that in the ordinary course the MDPs would be

allocated their shares of the profit for the year ended 31 March 2013 and which they had already received via drawings.

374. The Appellants say the question is when the right to the profit share arose, by reference to the terms of the LLPA 2011 and the decisions made by the UK LLP's Remuneration Committee, in accordance with the terms of the LLPA 2011 for the tax years 2012/13 and 2013/14.

The Law

375. Section 5 of ITTOIA 2005 provides that income tax is charged on the profits of a trade, profession or vocation. Limited liability partnerships are transparent for tax purposes such that the LLP is not a separate taxable entity (s848 ITTOIA).

376. Section 849 of ITTOIA 2005 makes provision for the way in which a partnership's trading profits are to be calculated:

> '(1) If—
>
> (a) a firm carries on a trade, and
>
> (b) any partner in the firm is chargeable to income tax, the profits or losses of the trade are calculated on the basis set out in subsection (2) or (3), as the case may require.
>
> (2) For any period of account in which the partner is a UK resident individual, the profits or losses of the trade are calculated as if the firm were a UK resident individual…

377. As a consequence of the tax transparency of a LLP, the profits of the trade carried on by a limited liability partnership are divided among their members who pay tax. Once those profits have been calculated, they must be allocated to the partners or members for tax purposes.

378. For the tax year ended 5 April 2013 s850 of ITTOIA 2005 provided (so far as relevant) as follows:

> '(1) For any period of account a partner's share of a profit or loss of a trade carried on by a firm is determined for income tax purposes in accordance with the firm's profit-sharing arrangements during that period.
>
> (6) In this section—
>
> "profit-sharing arrangements" means the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade.'

Discussion

379. The deferral issue resulting from the steps taken to defer allocation of profits to MDPs until the summer of 2014 therefore turns upon the application of s850 in particular. We must decide what the profit sharing arrangements were for the tax years 2012/2013 and 2013/2014. In particular, we must decide whether the purported deferral of the allocation of profits to the MDPs from the financial year ended 31 March 2013 to the financial year ended 31 March 2014 was effective.

380. In this regard we agree with Mr Grodzinski that HMRC's case has been somewhat inconsistent. HMRC say that the lack of a Remuneration Committee resolution allocating profits to BCG Ltd means that BCG Ltd was not in fact allocated profits. However, in the context of the deferral HMRC say that despite the fact that there was no Remuneration Committee allocation of profits to the MDPs for the year ended 31 March 2013 the MDPs should be treated as entitled to those profits which were later allocated to them.

381. We do not agree with HMRC's submissions on this point. There was no allocation to the MDPs and without such allocation there was no entitlement. In contrast to the situation concerning the lack of notification of allocation to BCG Ltd addressed earlier the understanding of the parties was not that there had been an allocation to the MDPs which was just not notified. Indeed, HMRC recognise there was no right to the amounts before allocation – just an expectation and understanding that in the ordinary course the allocation would be made. There were payments made as drawings but that does not alter the conclusion – it is a fundamental of partnership taxation that partners are not taxed on the basis of payments made to them but on the basis of the sharing of the profits agreed between them. The terms of the LLPAs made it clear that if the profits in fact were lower than the profits allocated to an MDP the difference was repayable by the MDP.

PROCEDURAL ISSUES

382. In relation to the individual Appellants it is necessary to move to consider the procedural issues now that we have concluded that there were substantive errors in their returns.

383. Given our conclusions about the UK LLP's appeals the issues regarding the validity of the discovery amendments fall away. However, given the nature of this case we have decided that we should address the validity of the discovery amendments assuming that the UK LLP is not successful in relation to the substantive issues considered above.

Amendments to returns made under Section 30B TMA

Ability of HMRC to amend allocations of profit

384. Section 12AA TMA provides for HMRC to require a partnership return to be submitted:

> (1) Where a trade, profession or business is carried on by two or more persons in partnership, for the purpose of facilitating
>
> the establishment of the following amounts, namely—
>
> (a) the amount in which each partner chargeable to income tax for any year of assessment is so chargeable and the amount payable by way of income tax by each such partner, and
>
> (b) the amount in which each partner chargeable to corporation tax for any period is so chargeable,
>
> an officer of the Board may act under subsection (2) or (3) below (or both).
>
> (2) An officer of the Board may by a notice given to the partners require such person as is identified in accordance with rules given with the notice or a successor of his—
>
> (a) to make and deliver to the officer in respect of such period as may be specified in the notice, on or before such day as may be so specified, a return containing such information as may reasonably be required in pursuance of the notice, and
>
> (b) to deliver with the return such accounts, statements and documents, relating to information contained in the return, as may reasonably be so required.

385. Section 12AB sets out what must be included in the partnership return:

> 12AB.— Partnership return to include partnership statement.
>
> (1) Every partnership return shall include a statement (a partnership statement) of the following amounts, namely
>
> (a) in the case of the period in respect of which the return is made and each period of account ending within that period

> (i) the amount of income or loss from each source which, on the basis of the information contained in the return and taking into account any relief or allowance a section 42(7) claim for which is included in the return, has accrued to or has been sustained by the partnership for the period in question,
>
> (ia) the amount of the consideration which, on that basis, has accrued to the partnership in respect of each disposal of partnership property during that period,
>
> (ii) each amount of income tax which, on that basis, has been deducted or treated as deducted from any income of the partnership, or treated as paid on any such income, for that period, and
>
> (iii) the amount of each tax credit which, on that basis, has accrued to the partnership for that period,
>
> (b) in the case of each such period as is mentioned in paragraph (a) above and each of the partners, the amount which, on that basis and (where applicable) taking into account any such relief or allowance, is equal to his share of that income, loss, consideration, tax or credit.

386. Section 8(1B) TMA then provides for each partner to include their relevant share of the income or losses etc in their own tax return:

> "(1B) In the case of a person who carries on a trade, profession, or business in partnership with one or more other persons, a return under this section shall include each amount which, in any relevant statement, is stated to be equal to his share of any income, loss, tax, credit or charge for the period in respect of which the statement is made."

387. Section 30B TMA provided as follows in the relevant years:

> 30B.— Amendment of partnership statement where loss of tax discovered.
>
> (1) Where an officer of the Board or the Board discover, as regards a partnership statement made by any person (the representative partner) in respect of any period—
>
> (a) that any profits which ought to have been included in the statement have not been so included, or
>
> (b) that an amount of profits so included is or has become insufficient, or
>
> (c) that any relief or allowance claimed by the representative partner is or has become excessive, the officer or, as the case may be, the Board may, subject to subsections (3) and (4) below, by notice to that partner so amend the partnership return as to make good the omission or deficiency or eliminate the excess.
>
> (2) Where a partnership return is amended under subsection (1) above, the officer shall by notice to each of the relevant partners amend—
>
> (a) the partner's return under section 8 or 8A of this Act, or
>
> (b) the partner's company tax return,
>
> so as to give effect to the amendments of the partnership return…
>
> … (4) No amendment shall be made under subsection (1) above unless one of the two conditions mentioned below is fulfilled.
>
> (5) The first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by —
>
> (a) the representative partner or a person acting on his behalf, or

(b) a relevant partner or a person acting on behalf of such a partner.

(6) The second condition is that at the time when an officer of the Board—

(a) ceased to be entitled to give notice of his intention to enquire into the representative partner's partnership return ; or

(b) in a case where a notice of enquiry into that return was given—

(i) issued a partial closure notice as regards a matter to which the situation mentioned in subsection (1) above relates, or

(ii) if no such partial closure notice was issued, issued a final closure notice,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above…

… (9) In this section—

'profits' —

(a) in relation to income tax, means income,

(b) in relation to capital gains tax, means chargeable gains, and

(c) in relation to corporation tax, means profits as computed for the purposes of that tax;

388. In this case HMRC do not allege that the inaccuracies were deliberate.

389. The two conditions in subsection (5) and (6) are referred to by us as the "carelessness condition" and the "hypothetical officer condition". *HMRC v Hicks* [2020] STC 254 makes clear that carelessness can take the form of omissions as well as positive acts.

390. Section 118(5) TMA provides that for the purposes of the TMA, a loss of tax is brought about 'carelessly' by a person: "if the person fails to take reasonable care to avoid bringing about that loss or situation".

391. In *Atherton v Revenue and Customs Commissioners* [2019] UKUT 41 (TCC) the Upper Tribunal said at [37]:

> "The reasonable care which should be taken by a taxpayer is assessed by reference to a prudent and reasonable taxpayer in the position of the taxpayer in question."

392. Furthermore, the Upper Tribunal went on to say at [61-62]:

> "Accordingly, the relevant question is not that which would arise under the general law, nor whether the tax return was carelessly submitted, but whether the taxpayer and those acting on his behalf took reasonable care to avoid creating the insufficiency in the assessment.
>
> [62] When the question is asked in that way, the answer becomes clear. The duty of the taxpayer is to take reasonable care to avoid bringing about an insufficiency and if he does not do so then the insufficiency is brought about carelessly. "

393. The case of *Hicks* and *Anderson v HMRC* [2017] SFTD 100 makes clear that what the reasonable and prudent taxpayer would do is not assessed in a vacuum but by reference to the actual circumstances of the taxpayer in question.

394. In relation to the hypothetical officer test s30B(7) TMA imports a modified version of s29(6) and (7) TMA as follows:

> "(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if—
>
> (a) it is contained in the representative partner's partnership return in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;
>
> …
>
> (c) it is contained in any documents, accounts or particulars which, for the purposes of any enquires into the return or any such claim by an officer of the Board, are produced or furnished by the representative partner to the officer; or
>
> (d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above—
>
> (i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or
>
> (ii) are notified in writing by the representative partner to an officer of the Board.
>
> (7) In subsection (6) above—
>
> (a) any reference to the representative partner's partnership return in respect of the relevant year of assessment includes—
>
> (i) a reference to any return of his under that section for either of the two immediately preceding year of assessments;
>
> (ii) [omitted pursuant to s. 30B(7)(c)]; and (b) any reference in paragraphs (b) to (d) to the representative partner includes a reference to a person acting on his behalf."

Submissions

395. Mr Grodzinski submits that s30B TMA is not capable of allowing HMRC to vary the allocation of profits as between the partners. HMRC do not claim that the profits included in the UK LLP's partnership statement for any of the tax years are in any way insufficient. Even if that is correct (which is disputed), there are simply no profits which ought to have been included in the partnership statement which have been omitted from it. The reference in s.30B(1) to profits not being included in the partnership statement is to the income which under s.12AB(1)(a) must be included in the partnership statement, namely, the income from each source which has accrued to the partnership for the period in question. All of that income has been included in the relevant partnership statements.

396. Furthermore, s30B makes no provision for an adjustment mechanism to allow for the fact that if one partner's allocation of profit is increased the profit of the other partner or partners needs to be decreased. Section 30B TMA does not refer to "share" in contrast to s12AB(1)(a) and (1)(b). Further support for the Appellant's position is provided by the heading of s30B TMA itself. Therefore the s30B TMA amendments are invalid.

397. The fact that the result may be a lacuna in the tax rules does not in itself mean that the legislation should be interpreted to say what is not written. In *Hamilton and Kinneil* Warrne J at [61] noted that "sometimes, it has to be accepted, statutory provisions do not always precisely hit the target at which they are aimed, or, if they do hit the target, there is unforeseen collateral damage".

398. Mr Chacko submits that the partnership statement includes amounts for income allocated to each partner. The purpose of the partnership return is "for the purpose of facilitating the

establishment of…" (a) "the amount in which each partner chargeable to income tax… is so chargeable" and (b) "the amount each partner chargeable to corporation tax… is so chargeable". Section 12AB states that the partnership return must include a statement which includes identification of the share each partner's income or loss. Each partner will then include their respective share in their own tax return pursuant to s8(1) TMA

399. It would be extraordinary if pursuant to s30B, (the power to make amendments to that return after the one-year enquiry window has closed), HMRC could not change the amounts to which any given partner is chargeable to income tax unless they changed the amount of income received by the partnership as a whole. The Appellants' construction leaves the rules in disarray: HMRC would need to raise discovery assessments against each individual who had been allocated too little, with no apparent means of correcting the position for the individuals who had been allocated too much (and had paid too much tax).

Discussion

400. There are three FTT decisions to which we have been referred on this issue: *Albermarle*, *Odey* and *HFFX*. However, *Albemarle* considered a different point as to whether a 30B amendment could be used to apply a loss to partnership profits. The remaining two decisions reach opposite conclusions, but *Odey* does so relying upon *Albermarle* which, as said, is on a different point. We respectfully agree with the approach of Judge Fairpo in *HFFX* namely that:

> "262. The legislation clearly defines "profits" in s30B(9) TMA 1970 as being both "income" for the purposes of income tax and "profits as computed for the purposes of [corporation] tax".
>
> 263. Section 30B(1)(b) applies where "an amount" of profit included in the statement is insufficient, not "the amount". I consider the definition of "profits" in s30B(9) means that no additional words are required to read into s30B(1)(b) the ability for HMRC to make an amendment where the partnership statements includes an amount of income as calculated for the purposes of income tax which has been found to be insufficient. It does not require that the total profit of the partnership has been found to be insufficient."

401. We go further in reaching this conclusion addressing points raised before us. Section 12AB requires each partner's share of the income to be stated in the partnership statement which forms part of the required return. Section 30B(1) then addresses the position of a discovery of insufficient profits (defined as set out by Judge Fairpo) as regards a partnership statement. The officer may then "make good the deficiency". A purposive reading of these words enables us to conclude that "making good" the deficiency is wide enough to encapsulate both increasing the amount of "profit" share of partner A and decreasing the "profit" share of partner B. This reading does not require us to go beyond the words of the legislation in order to conclude that an adjustment mechanism is contained within s30B TMA.

402. The structure of the TMA partnership tax provisions is not left with the lacuna HMRC have identified as existing under the Appellant's approach; i.e. the need for HMRC to raise discovery assessments against each individual who had been allocated too little, with no apparent means of correcting the position for the individuals who had been allocated too much (and had paid too much tax).

403. We therefore conclude that s30B can be used to make amendments to the allocation of profit between partners as well as amendments of the overall profit.

Scope of the discovery and its implication for the discovery amendments

404. We have decided that the deferral of profits from 2012/2013 to 2013/2014 was validly made. That disposes of the issue as to whether the discovery amendments can permit assessment on the basis of the deferral issue in 2012/2013 rather other than that of the discovery itself which was concerning the treatment of the Capital Interests and the allocation of profits between the MDPs and the UK LLP for tax purposes. To the extent that this issue needs to be addressed on any onward appeal, the relevant facts have been set out by us.

Validity - The Carelessness Condition

405. The Discovery Amendments for 2012/13 (issued on 29 March 2019) and 2015/16 (issued on 26 March 2021), can only be valid if HMRC can show that the UK LLP (by its representative partner), or a person acting on its behalf, was careless. That is because for those two tax years, HMRC need to rely on the extended time limits in s.36(1) TMA.

406. In addition, for the tax years 2013/14, 2014/15 and 2016/17, HMRC would also have to show carelessness, unless the "hypothetical officer" test was met for those years.

407. The first question is what is the situation said to have been brought about carelessly by the representative partner or a person acting on his behalf (s30B(5))? There are various potential answers:

(1) A failure to correctly allocate profits under the profit sharing rules contained in ss850 and 850C;

(2) A failure to correctly allocate profits given that the terms of the LLPAs had not been complied with and BCG Ltd was therefore not in fact allocated any profit;

(3) A failure to correctly allocate profits as the claimed deferral in 2012/2013 of the MDPs' profits shares was ineffective.

408. In relation to the profit sharing rules, HMRC's case that there was carelessness turns upon the steps taken to implement the Capital Interests and the advice received in relation thereto. HMRC submit that the level of care taken fell below the reasonable standard for a large business with access to tax expertise given that the arrangements involve very large sums of money, the UK LLP was aware that the structure was a means of saving very substantial income tax, the structure was perceived internally as a means of converting income to capital with serious tax risk and the arrangements involve the insertion of complicated and contrived provisions into the LLPA. The analysis in the PwC reports is high level without detailed consideration of whether, in light of the terms of the Capital Interests, they are actually capital assets. Neither report considers whether the Capital Interests should be viewed as a vehicle for income benefits.

409. For 2014/2015 onwards HMRC submit that the advice from PwC was that there was doubt about the application of s850C and counsel's advice should be obtained which BCG failed to obtain. HMRC submits that was therefore careless. The analysis in the EY draft advice is minimal and was never finalised. It did not provide an adequate second opinion.

410. The Appellants submit that the UK LLP always took advice, carefully considered that advice and then followed it, having reasonably considered it appropriate to do so.

411. We consider that the following facts lead to a conclusion of carelessness by the UK LLP/the representative partner of the UK LLP:

(1) the structure PwC advised upon in March 2011 was notably different to that implemented. It involved BCG Ltd and the MDPs lending amounts interest free to the UK LLP to provide working capital to it in a way which meant that the loans could not

be said to relate to the profit interest of the Capital Interest held by the MDPs. That step did not take place. Instead, BCG Ltd profits were retained by the UK LLP/BCG Ltd to fund working capital. In addition, it was assumed that the value of all outstanding Capital Interests would not exceed the value of the UK LLP and there would be a process in place to monitor this. That process was not put in place;

(2) The chief financial officer at the time identified that the structure had the sense of being "too good to be true". In that context our expectation is that those involved within BCG's UK tax department would have wanted to make sure there was clear advice on file to support implementing what was seen as a surprising result. We would expect to see an opinion on file from a professional firm assessing the risk of challenge to the structure, or at the very least an internal paper produced by the BCG tax department assessing the same;

(3) In 2014 the potential for challenge increased as the MMRs were drafted and then implemented. There had been sufficient concern for BCG to decide that the MDPs should all sell their Capital Interests. Before reintroducing the structure advice was obtained from PwC which clearly indicated a risk of challenge under the new s850C and which recommended that BCG obtained tax counsel's opinion, but that step was not taken. In that context we consider it would be entirely reasonable to expect a large corporate with a large amount at stake and clear advice to obtain a specialist opinion, to do just that;

(4) The advice received from EY in 2014 was very high level with minimal analysis of the tax position or risks and was never finalised. Its wording, using terms such as "argue" and "defence" made clear, however, that the treatment of the Capital Interests was potentially contentious.

412. We do not consider that the evidence of obtaining advice by the business is sufficient to counter the evidence that the UK LLP was careless. The advice from PwC was predicated upon different structural elements to those involved with the actual operation of the Capital Interests. The advice obtained from both PwC and EY was lacking in depth and quality given the concerns raised by senior management in BCG and by the adviser, PwC, themselves. We conclude that the level of care taken in this respect was not in line with what would be expected of a prudent and reasonable taxpayer in the position of the UK LLP.

413. Mr Grodzinski submitted that there must be a causal connection between the carelessness and the insufficiency in the tax assessments or returns. He submits that HMRC must provide evidence to prove that if the UK LLP had not been careless it would have allocated the profits correctly under the profit sharing rules relying upon cases such as *Anderson v HMRC* [2016] UKFTT 335 and *HMRC v Bella Figura* [2020] STC 922.

414. HMRC submit that the answer is provided by s118(5) TMA which states:

> "For the purposes of this Act a loss of tax or a situation is brought about carelessly by a person if the person fails to take reasonable care to avoid bringing about that loss or situation".

415. We agree that we should apply the approach as set out in the Upper Tribunal case of *Atherton v HMRC* [2019] STC 575. There the Upper Tribunal specifically referred to s118(5) TMA and said at [61]:

> "… The relevant question is… Whether the taxpayer and those acting on his behalf took reasonable care to avoid creating the insufficiency in the assessment.

> 62 … The duty of the taxpayer is to take reasonable care to avoid bringing about an insufficiency and if he does not do so then the insufficiency is brought about carelessly."

416. On the assumption that there was an insufficiency as a result of the application of the profit sharing rules we are satisfied that the UK LLP did not take reasonable care to avoid bringing that about given the findings we have made and conclusions we have reached above.

417. None of the Upper Tribunal authorities to which we were referred suggest that there is some requirement that HMRC procure expert evidence to show that if, in this case, the UK LLP had obtained counsel's opinion, that opinion would have concluded that the profit sharing legislation requires a different allocation of profits in the tax returns.

418. In relation to the omission of notification by the Remuneration Committee to BCG Ltd, HMRC say that if they are correct that no allocations were properly made to BCG Ltd then the filing of partnership returns which recorded such allocations, despite the Profit Allocation (or Remuneration) Committee not having made the appropriate resolutions, was careless.

419. We have found that the allocations were properly made and therefore this issue falls away. However, even if that conclusion were to be incorrect we do not consider that filing on the basis of the assumption that the residual profits should be treated as allocated to BCG Ltd was careless. The substantive law in issue on this point depends upon the meaning of "profit sharing arrangements". It was the understanding of all involved that BCG Ltd was entitled to the residue and filing on that basis was a reasonable result. As we have identified, there is a good argument that the term "profit sharing arrangements" should be considered beyond merely the terms of the LLPAs. We therefore conclude that a prudent and reasonable taxpayer in the position of the UK LLP would not be expected to do more to clarify or check the position before filing the partnership return on the basis of the profit sharing as understood by all involved.

420. In relation to the deferral of profit allocation to the MDPs in 2012/2013 to 2013/2014, (assuming for these purposes that this was not effective), we are satisfied that the UK LLP was not careless. HMRC say that it was not reasonable to take this course of action without external advice. We do not agree. This is the sort of matter about which we would expect the internal department of a large corporate such as BCG, to be well qualified to take a view. In fact, the evidence shows that the internal tax department produced a memorandum considering matters such as UK Treasury forecasts which had modelled the tax impact of expected forestalling, and this memorandum was produced after obtaining advice from PwC that the deferral should work. We consider that was in line with what would be expected of a prudent and reasonable taxpayer in the position of the UK LLP.

Hypothetical officer

421. This test is only relevant where HMRC raised the discovery amendment within four years as otherwise HMRC need to establish carelessness and if carelessness is established there is no need also to satisfy this test. The relevant tax returns are therefore the UK LLP returns for the tax years 2013/2014, 2014/2015 and 2016/2017.

422. The parties agree that the focus of this test is on the quality of the taxpayer's disclosure and whether it clearly alerts the hypothetical officer to the insufficiency in the assessment or return (*Sanderson v HMRC* [2016] 4 WLR 67).

423. The Appellants submit that it is for HMRC to discharge the burden which rests on them by showing in respect of each of the relevant tax returns what information was available to the hypothetical officer and then to explain why that was insufficient. In making this assessment Mr Taylor is a useful comparator taking account of what he in fact knew in the earlier years.

It is recognised that where the law is complex even adequate disclosure by the taxpayer may not make it reasonable for the officer to have discovered the insufficiency on the basis of the information disclosed at the time. *Sanderson* makes clear that the purpose of the hypothetical officer conditions is to test the adequacy of the taxpayer's disclosure.

424. HMRC say that the Capital Interest structure was complex and was not one that HMRC could have inferred the detail of from the material supplied.

425. The first issue is the time at which the hypothetical officer test is applied. The enquiry time limits for the relevant tax returns expired on 20 December 2015 (for 2013/2014), 23 December 2016 (for 2014/2015) and 15 January 2019 (for 2016/2017).

426. We are satisfied that the evidence shows that the hypothetical officer test was met in relation to the two earlier tax years and indeed in the hearing Ms Lemos conceded that the Appellants were content not to press their case in relation to those earlier years.

427. The situation is not so clear in relation to the tax return for 2016/2017. We have set out earlier the progress of the enquiries and the information provided to Mr Taylor at various times. HMRC submitted at the hearing that it was not until Mr Holden's witness statement was provided together with the exhibit of the Framework that they had sufficient information for the assessments to be made. In particular, it had been difficult to understand how the LTCV related to other elements of the MDPs' compensation.

428. In this regard Mr Baldry submitted that the question is not whether the hypothetical officer was in the position to make the assessment made by the actual officer but whether the hypothetical officer could assess the actual insufficiency of tax. In particular, he submitted that it was only when the Witness Statement and Framework documentation were provided that HMRC knew how the Capital Interests were funded such that a hypothetical officer could identify an actual insufficiency by reference to s850C.

429. We agree that *Sanderson* drew a clear distinction between the actual officer and the hypothetical officer stating at [17[:

> "… What the hypothetical officer must have been reasonably expected to be aware of is an actual insufficiency."

430. Our decision about the hypothetical officer test turns on what the hypothetical officer needed to know in order to make the assessment. We have found that the UK LLP's appeal is successful. Were this to be wrong the profit sharing rules would have applied. In that regard we agree with Mr Baldry that the hypothetical officer could not have reasonably been expected on the basis of the information made available to him before January 2019 to have been aware of the way in which sums were put aside to fund future purchases of the Capital Interests. That would be a key element of any charge under the profit sharing rules and the MMRs. Consequently, the hypothetical officer test would have been met if HMRC had succeeded in relation to the substantive issues underpinning the discovery amendment made in relation to the 2016/2017 return.

431. We therefore conclude that the discovery amendment made in relation to 2016/2017 would have been validly made.

Validity of the discovery assessments issued to the individual Appellants

432. Mr Grodzinski submits that if we decide that adjustments to the amounts of profits allocated to the MDP's are appropriate under s850 and/or s850C ITTOIA and the correct procedural approach is by making discovery amendments under s30B TMA, it is not then open to HMRC to seek to assess profits that ought to have been allocated those individuals via discovery assessments made under s29 TMA.

433. Given our conclusions that adjustments to the amounts of profits were not required that issue falls away. However, we would comment that we see no restriction in the legislation which would prevent HMRC from issuing both the discovery amendments under s30B and the discovery assessments under s29 TMA. Clearly, as a matter of first principle, HMRC cannot tax the same income in the hands of the individuals twice. Therefore as a practical matter if the profits were to be reallocated to the MDPs we would expect that the discovery assessments raised to tax the allocation of profits would fall away. Indeed, HMRC has said that if the Appellants are correct that s30B cannot be used to adjust the profit shares between partners, HMRC would then rely on the s29 discovery assessments against those partners that deal with tax on the s850 / s850C basis (rather than on receipt of the price of a Capital Interest). Those s29 assessments were raised in case s30B could not be used, unlike the other s29 assessments which were raised in respect of receipt of the proceeds on the "sale" of the Capital Interests. If s30B can be used to adjust profit shares, then those (non-receipt) s29 assessments fall away.

434. We now move on to consider the validity of the discovery assessments otherwise. This is of particular relevance for the assessments raised to deal with the treatment of disposals of the Capital Interests, but we have addressed the validity of all of the s29 TMA assessments below.

435. The discovery assessment legislation in s29 TMA which is in substantially the same terms as s30B TMA states, so far as relevant:

> "Assessment where loss of tax discovered.
>
> (I) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment —
>
> (a) that any income, unauthorised payments under section 208 of the Finance Act 2004 or surchargeable unauthorised payments under section 209 of that Act or relevant lump sum death benefit under section 217(2) of that Act which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax have not been assessed, or
>
> (b) that an assessment to tax is or has become insufficient, or
>
> …the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.
>
> (3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—
>
> (a) in respect of the year of assessment mentioned in that subsection; and
>
> (b) ... in the same capacity as that in which he made and delivered the return,
>
> unless one of the two conditions mentioned below is fulfilled.
>
> (4) The first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf.
>
> (5) The second condition is that at the time when an officer of the Board—
>
> (a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of his Act in respect of the relevant year of assessment

> …the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.
>
> (6) For the purposes of subsection (5) above, information is made available to an officer of the Board if—
>
> (a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;
>
> (b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;
>
> (c) it is contained in any documents, accounts or particulars which, for the purposes of any enquires into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer ; or
>
> (d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above—
>
> (i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or
>
> (ii)are notified in writing by the taxpayer to an officer of the Board."

Carelessness

436. HMRC submits that the UK LLP instructed PwC on the individual's behalf to advise them how to fill out their returns. Therefore carelessness by the UK LLP can be attributed to those individuals, applying *Hicks*.

437. We therefore start by considering whether the UK LLP was "a person acting on behalf" of the individual Appellants.

438. Section 29(4) TMA applies where, in this case, an assessment to tax is or has become insufficient and that was "brought about carelessly by the taxpayer or a person acting on his behalf". In *Hicks* at [122] the Upper Tribunal said:

> …" The expression "person acting on… behalf"… connotes a person who takes steps that the taxpayer himself could take, or would otherwise be responsible for taking… Examples would in our view include completing a return, filing a return, entering into correspondence with HMRC, providing documents and information to HMRC and seeking external advice as to the legal and tax position of the taxpayer. The person must represent, and not merely provide advice to, the taxpayer.".

439. The UK LLP obtained external advice from PwC as to the tax position of the individual Appellants. However, the UK LLP did not represent the individual Appellants. It merely arranged for advice to be provided to the taxpayers. We consider that this is too far removed to fall within the types of active engagement described in *Hicks* as falling within the term "acting on his behalf". HMRC have not argued that PwC was careless.

Hypothetical officer

440. Again the only relevant assessments are those issued in relation to the tax years 2013/2014 and 2016/17 for the same reasons as explained for the UK LLP's returns (i.e. HMRC need to show carelessness for the other periods).

441. The enquiry window in respect of MDPs' self-assessment tax returns for 2013/2014 expired on 15 December 2015. The hypothetical officer would have had little if any information regarding the Capital Interests by 15 December 2015. Ms Lemos recognised the difficulties in her concession.

442. The enquiry window in respect of MDP's self-assessment tax returns for 2016/2017 expired on 31 January 2019. The assessments were issued on 26 March 2021. The burden of proof to show the hypothetical officer test is met rests on HMRC. HMRC has done remarkably little to make their case in relation to this part of the appeals in relation to the assessments applying to the disposals of Capital Interests in particular. In their Statement of Case HMRC state that the Appellants have not explained what information was provided which would have made clear to HMRC that the receipts were income. Clearly this is failing to recognise where the burden of proof lies. In Mr Baldry's skeleton argument it is simply stated that the explanations provided before 31 January 2019 were not sufficient for the hypothetical officer to be alerted to the understatement. At the hearing Mr Baldry focused on the application of the test to the assessments raised on the basis of the allocation of profit rules and the lack of information regarding the retention of funds by BCG Ltd for the LTCV.

443. We agree with Mr Grodzinski that it is not enough for HMRC to merely assert that the test is met without proper reference to, and analysis of, the relevant documents. There is very little engagement in HMRC's case with the position regarding the "disposal" assessments.

444. However, for the avoidance of doubt we conclude that the evidence before us shows that the hypothetical officer test would not have been met in relation to the 2016/2017 discovery assessments raised in relation to disposals of the Capital Interests. Therefore those assessments were not validly made. By that stage (i.e. 31 January 2019) the hypothetical officer would have had the following information as found earlier:

(1) The descriptions of the Capital Interests in the UK LLP's accounts alerting the officer to a description of payments made for services and potentially of an income nature;

(2) The 9 November 2018 package of information from PwC which included a schedule of Capital Interests; a schedule of grants of Capital Interests; a slide deck explaining profit allocation methodology, written resolutions of the Remuneration Committee, profit allocation statements and PwC's letter of advice dated March 2011. Mr Taylor says that it was upon reviewing these papers that he discovered the value of the Capital Interests allocated to each individual; and

(3) The disposal values for "sales" of the Capital Interests which would have been included in the MDPs' self-assessment tax returns albeit on the basis of disclosing the disposal of assets chargeable to tax on a capital gains tax basis.

445. We therefore conclude that by 31 January 2019 the hypothetical officer would have had such information that he could have been reasonably expected to have been aware of the actual insufficiency of tax in the relevant MDPs' self-assessment returns relating to the disposals of the Capital Interests. Consequently, HMRC have not shown that the hypothetical officer test is met in relation to those 2016/2017 discovery assessments.

446. In relation to the discovery assessments raised in relation to the allocation of profit (assuming that both s850 or s850C apply and the adjustment is not correctly dealt with by the amendments under s30B TMA) we conclude that our conclusions regarding the hypothetical officer in the context of the s30B TMA amendments apply equally here. Therefore the discovery assessments in relation to profit allocation made in relation to 2016/2017 would have been validly made.

CONCLUSION

447. We therefore conclude as follows:

(1) the UK LLP's appeal of the discovery amendments raised by HMRC against UK LLP in respect of its partnership tax return under section 30B TMA, in respect of each year within 2012/13- 2016/2017 is ALLOWED;

(2) in respect of the individual Appellants' appeals of discovery assessments made under s29 TMA where those relate to the allocation of profit to the individuals under s850 and/or s850C the appeals are ALLOWED:

(3) in respect of the individual Appellants' appeals of discovery assessments made under s29 TMA where those relate to the tax on disposal of the Capital Interests:

(a) those issued by HMRC outside of the ordinary time limit of 4 years for raising such assessments, pursuant to section 34 TMA are ALLOWED as HMRC has not shown that errors in those returns were careless;

(b) those issued by HMRC in relation to the tax year 2013/2014 are DISMISSED;

(c) those issued by HMRC in relation to the tax year 2016/2017 are ALLOWED as HMRC has not shown that the errors were brought about carelessly or the hypothetical officer test has been met.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

448. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JUDGE TRACEY BOWLER
TRIBUNAL JUDGE

Release date: 23rd JANUARY 2024