Film partnerships - a recent tax case won by the taxpayers

A tax avoidance case in which a film partnership was found to never have been trading, so the anti-avoidance provision did not apply.

Date published: 13.12.2024

Film tax relief has been around longer than any other creative relief in the UK. The original film tax relief was introduced in 1992 (Section 42 of the Finance (No. 2) Act 1992). And much has changed, even since the introduction of the current iteration of film tax relief, introduced in 2007.

In the First-tier Tribunal (FTT) case of Hoyle, Jarman and Forsyth (TC09359), Mr Chris Hoyle was a member of the Avondale Film Partnership LLP, Dr Trevor Jarman was a member of both the Chamberlain Film Partnership LLP and the Repton Film Partnership LLP and Mr Alistair Forsyth was a member of the Downing Film Partnership LLP. They invested in these LLPs between 2004 and 2006, with the advice and assistance of Scotts Atlantic London Limited.

Each LLP acquired film rights using capital contributions made by its members and leased the film rights to a lessee company which was typically a special purpose vehicle set up by a film studio - a sale-and-leaseback arrangement. The members funded around 80% of their capital contributions using borrowings from the Bank of Ireland, which were arranged by Scotts Atlantic London Limited, and the remainder from their own personal resources.

The loans were made on a “full recourse” basis; repayments and interest were to be met from the members’ drawings from the LLP but, if they were insufficient, the members would have had to meet the shortfall from their own resources.

Each LLP (a) claimed film tax relief in respect of its expenditure on the relevant British qualifying films under s 48 Finance (No.2) Act 1997 and s 42 Finance (No.2) Act 1992 on the basis that it carried on a trade of the exploitation of film rights, and (b) allocated what was considered to be the resulting trading loss to the members in accordance with their profit shares in the LLP. The members claimed relief for their share of the loss against their other income (under what is known as sideways loss relief) and against their capital gains.

The rentals paid under the leases were structured so that the members could fully repay their Bank of Ireland loans over a 15-year period. The rental receipts were taxable as income, while the interest payments on the loans were eligible for tax relief. The rental rose over time so that, over the full 15 years, a member would broadly pay back the tax relief which had been obtained initially – the overall value of the arrangement was a deferral of tax. HMRC largely allowed the tax relief on the cost of the interest payable on the loans.

The arrangements, however, did not run for the full anticipated 15-year span. In January 2013, the members assigned their capital accounts in the LLPs to a non-UK company in exchange for a price which enabled them fully to pay off their loans to Bank of Ireland.

In April 2013, a company resident in Ireland acquired their residual interest in the LLPs for a token €2.

When the initial investments were made, it was understood by both the members and HMRC that the LLPs were carrying on a trade – it was on that basis that the tax reliefs were made available.

However, in 2017, the Court of Appeal found (in Samarkand) that this type of sale-and-leaseback film partnership should not be characterised as carrying on a trade – it constituted instead "the payment of a lump sum in return for a series of fixed payments over 15 years" (which, to me at least, sounds more like an annuity than a trade).

If that had been known to be the law in 2006, HMRC would never have allowed the members to claim loss relief. Nonetheless, that was exactly what had happened in 2006, and it was far too late for HMRC to make assessments to recover the tax reliefs granted.

Now, all that HMRC could rely upon was an anti-avoidance provision in Part 13, Chapter 5 of ITA2007. Specifically, s797 exists "in effect, to claw back the benefit of losses/reliefs obtained under structures such as these, where the partners/members enter into arrangements designed to enable them to exit the structure early without any further tax charge and without disturbing the losses/reliefs." To trigger s797, there are three conditions…

1. A "relevant claim" – an individual makes a film-related loss in a trade for which the individual claims sideways income tax loss relief against their other income or claims loss relief against their capital gains;

2. A "relevant disposal" – the individual disposes of a right to profits arising from the trade; and

3. An "exit event" – essentially the receipt of any non-taxable consideration for a relevant disposal.

HMRC submitted that if the members were found to be correct that Chapter 5 of ITA2007 does not apply so that the purchase price is not subject to income tax, the purchase price is subject to capital gains tax.

The members' appeals to the FTT were, therefore, in respect of income tax computed under Chapter 5 of Part 13 of ITA 2007 or capital gains tax which HMRC sought to impose on sums received by the members on the sale of their capital accounts, and the FTT judge had to consider three crucial issues…

- Was Chapter 5 of ITA2007 applicable at all?

- If it was applicable, was there a "relevant disposal" and "exit event"?

- If Chapter 5 of ITA2007 was not applicable, was there an exposure to capital gains tax?

The anti-avoidance legislation refers to situations where "an individual makes a film-related loss...in a trade for which the individual claims sideways relief or capital gains relief (a "relevant claim")."

The members argued that, since "it was established in cases such as Samarkand that an activity of the kind they carried on is not such a trade", Chapter 5 of ITA2007 could not apply.

However, HMRC argued that "it suffices for these provisions to apply that the LLPs and the appellants acted on the basis that the LLPs were trading at the relevant time and successfully claimed that the LLPs had made a trading loss and claimed the appellants' reliefs for those losses".

The judge did not agree with HMRC, saying: "To interpret the provisions, as HMRC argue for, would involve a contortion of their meaning and we can see no proper basis for doing so on a purposive interpretation of the provisions notwithstanding the unfortunate overall result that gives in the particular circumstances of this case. The specific reference to a loss "in trade", as a term with an established meaning, as viewed in the context of the overall provisions of chapter 5 and the relevant provisions in ITTOIA, indicates that the legislature intended these provisions to apply only where an individual makes a loss in the course of carrying on activities which constitute a trade, in accordance with the usual meaning of that term, as a matter of fact and law."

The judge also considered that there could be no capital gains tax charge, citing the following reasons...

- As HMRC did not appear to dispute, the LLPs were transparent for tax purposes on the basis that they were carrying on business with a view to profit;

- As the members were treated as effectively owning the assets of the LLP, they could not also be treated as making a disposal of their capital interest in the LLP and as being liable to capital gains tax in respect of that capital interest. A partner's or member's capital account is not an asset for capital gains tax purposes.

The judge therefore allowed the members' appeals.

020 7183 3931
www.riskassured.co.uk