Mclaren Racing Limited v The Commissioners for Her Majesty's Revenue & Customs

Appeal number: TC/2010/6733

First-Tier Tribunal Tax Chamber

7 September 2012

[2012] UKFTT 601 (TC)

Tribunal: Judge Charles Hellier Nicholas Dee

Release Date:7 September 2012

Sitting in public at 45 Bedford Square, London WC1B 3DN on 12–15 March 2012

Representation

Alun James instructed by KPMG LLP for the Appellant.

Akash Nawbatt and Christopher Stone , instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents.

Decision

Charles Hellier

Introduction

1 This appeal raises the question as to when and whether penalties incurred by a trader may be deductible in computing its taxable trading profits.

2 In 2007 the Appellant ("McLaren") was required by the Federation Internationale de L'Automobile (the "FIA") to pay some £32 million and in addition to suffer a reduction in its gross income of some £34 million because, through its employees and agents, it had possessed and in some way used proprietary information belonging to Ferrari, and had thereby breached the rules of the FIA's International Sporting Code (the "ISC") to which McLaren was contractually bound. This penalty was not imposed by any statutory provision but under provisions to which McLaren was bound as a participant in Formula One racing.

3 HMRC do not dispute that the reduction in McLaren's gross income reduces its taxable profits to that extent, but argue that the £32m penalty was not deductible.

4 We had the misfortune to disagree about the deductibility of this penalty. Mr Hellier considered that it was deductible, and Mr Dee that it was not. Where a tribunal consisting of two members is not unanimous, regulation 8 of the First tier Tribunal and Upper Tribunal (Composition of Tribunal) Order 2008 SI 2008/2835 gives a casting vote to the presiding member. Mr Hellier exercised that vote in favour of allowing the appeal.

5 In this decision, the section "Facts" reflects the views of both of us; the section on the Law and the first part of the "Discussion" section represent Mr Hellier's views; Mr Dee's views are set out in the final part of that section.

The statutory provisions and the authorities

6 Section 74(1) TA 1988 provides that in computing trading profits no sum shall be deducted in respect of:

"(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade or profession;…

"(e) any loss not connected with or arising out of the trade or profession."

7 HMRC contend that the £32 million paid by McLaren falls within one or both of these prohibitions.

8 These separate prohibitions played mixed roles in the cases to which we referred.

9 At this stage we note that there are two limbs to (1)(e): the first relates to whether the loss was connected with the trade; the second to whether the loss arose out of the trade. The test posed by these limbs has some similarity with the test for whether a receipt is an emolument of employment, which is whether the receipt came "from" the employment. The language used in some of the older cases on employment income – the distinctions drawn between an employment being the sine qua non of the receipt rather than the causa causans – are to some extent mirrored in the cases on (1)(e) in which judges seek to differentiate between a loss which would not have arisen but for the trade and one which is truly connected with it. It may be that that distinction could have been drawn more clearly by reference to the second limb of (1)(e) – the 'arising out of' limb- which more closely parallels the "from" test for employment income.

10 In Strong v Woodifield 5 TC 215 the taxpayer was a brewer and innkeeper. A chimney fell on a guest at an inn and the company became liable for damages. Was the amount of damages deductible in computing the taxpayer's trading profits? In the House of Lords, Lord Loreburn dealt with the question mainly by reference to the rule in what is now (1)(e), finding that the damages were a loss, but that it did "not follow that if a loss was in some sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade or connected with something else as much or even more than the trade". Losses were connected in the sense of the statute only if they were "really incidental to the trade itself":

"they cannot be deducted if they are mainly incidental to some other vocation, or fall on the trader in some character other than that of trader. The nature of the trade is to be considered."

He said that although it was not possible to frame a formula precise or comprehensive enough to solve all the cases which arose, the loss (the damages) fell on the taxpayer in the character, not of a trader, but of householder.

11 In the same case Lord Davey dealt with the appeal by applying what is now the rule in (1)(a). He found that the payment of damages was not for the purpose of earning profits of the trade and therefore not for the purposes of the trade.

12 In CIR v EC Warnes & Co Limited 11 TC 227 (1919) , Rowlatt J held that a penalty incurred by the taxpayer as a result of section 5 Customs (War Powers) Act 1915 was not deductible. He reached this conclusion as a result of the rule in (1)(e), noting that the liability under the 1915 Act was of a penal character, and, sheltering behind Lord Loreburn's comment that it was impossible to frame a formula comprehensively to describe what sort of loss fell within (1)(e), held that "a penal liability of this kind cannot be regarded as a loss connected with or arising out of the trade". Such a loss had to be "in the nature of a loss which is contemplable and in the nature of the commercial loss"; this, by contrast, was a fine inflicted upon the trader.

13 CIR v Alexander von Glehn & Co 11 TC 232 (heard in the High Court by Rowlatt J some eight months after Warnes) also concerned a penalty under section 5 of the 1915 Act (the penalty was paid without judgement being entered against the taxpayer but this fact played no part in the reasoning). The Special Commissioners held that the penalty of £3000 was deductible "having been incurred in the

course of the taxpayer's trade and being incidental thereto". Rowlatt J allowed the appeal following his decision in Warnes . The Court of Appeal, in a judgement Lord Hoffmann later found "strangely inarticulate", found that the cost was not deductible.

14 Lord Sterndale dealt with the rules in (1)(a) and (1)(e). He said:

(1) that the penalty was not money wholly and exclusively expended for the purposes of trade; and

(2) although you could say that the loss was connected with the trade in the sense that it would not have been incurred if the trade had not been carried on, in the sense "connected with" the trade was used in the Act (the rule in (1)(e)) the penalty was so not connected: it was "a fine imposed upon the company personally … for a breach of the law which they had committed." There was a difference between a commercial loss and a penalty imposed for a breach of the law whilst trading.

15 Warrington LJ considered the issue of principle which arose to extend to any penalty incurred in breach of the law or of regulations to which a business was subject. It was not clear whether he was intending to include non-statutory regulations in this phrase. He said:

(1) that it was conceded that the loss arose out of the trade (so that it fell within the second limb of (1)(e)) but it was not connected with the trade because it was not a "commercial loss" and that was what the statute meant by a loss connected with the trade. It was a sum which arose because the people carrying on the trade had so acted as to render themselves liable to the penalty;

(2) the loss arose, not for the purposes of earning profits, but from an infraction of the law.

16 Scrutton LJ, having said that his first reaction was that the obvious answer to that question whether the taxpayer could deduct the cost was "Of course, he cannot", suggested at the end of his judgement that in some way the expenditure had to be necessary to earn profits. Mr. Nawbatt rightly accepted that this must have been a mistake.

17 In The Herald and Weekly Times Ltd v The Federal Commissioner for Taxation 48 CLR 113, the High Court of Australia considered the deductibility of expenditure incurred in paying and settling libel claims in relation to a statutory prohibition against the deductibility of expenses which were not incurred wholly and exclusively in the production of assessable income. By a majority the Court held that the costs were deductible: the question was to be determined by reference to the purpose for which the liability was incurred rather than the immediate reason for payment; the expense was a "regular and unavoidable incident" of publishing the paper and flowed from acts "done for no purpose other than earning revenue, acts forming the essence of the business".

18 In Fairrie v Hall 28 TC 200 (1947) Macnaghten J held that damages assessed against a sugar broker for malicious libel against a rival were not deductible from his sugar broking profits. The libels were "actuated by enmity towards Mr. Rook" and the taxpayer published them "for the purpose of injuring Mr. Rook and obtaining his dismissal". It was a case of gross malice. Macnaghten J dealt with the question of deductibility mainly under rule (1)(e). He acknowledged that apart from the taxpayer's desire to injure Mr. Rook he also wished to increase his own profits and that in that sense there was a connection to his trade, but he held that:

"the loss fell upon the Appellant in the character of a calumnator of a rival sugar broker. It was only remotely connected with his trade as a sugar broker:…The case seems to me to be plain beyond all possible doubt … it would be preposterous if the Appellant were allowed to deduct these sums and thus be enabled to share … [the loss] with the public revenue … ".

19 Fairrie v Hall seems to evince both a simple approach to the rule in (1)(e) and one inspired by public policy. The simple approach is that the loss was visited upon the taxpayer because of his personal malice and was thus insufficiently connected with his trade to escape (1)(e). (It might also have been said that the malicious personal purpose meant that the expense fell foul of (1)(a) as having a dual purpose.) However, in the reference to sharing the loss with the public revenue, it also echoes the "Of

course he cannot" language of Scrutton LJ in Glehn , and is, in part, reflected in part of Lord Hoffmann's later formulation of a public policy test in relation to the nature of the expense.

20 Robinson v CIR [1965] NZLR 246 was a New Zealand case. It concerned a fine imposed by the disciplinary committee of the New Zealand Law Society. The disciplinary committee was established by statutory authority and its powers were statutory powers. Tompkins J said that "the only difference between these fines and those imposed by the Courts is that the former are inflicted by a specially created statutory tribunal". The relevant statutory question was whether the fine was "a loss exclusively incurred in the production of assessable income". He said: "in my opinion there is no distinction in principle between the claim to be entitled to deduct from assessable income a fine imposed by the disciplinary committee and a fine imposed by a court … it is inflicted on the offender as a penal liability; it is a fine imposed on the offender for professional misconduct; it is inflicted on the offender as a personal deterrent and a punishment."

21 This case to my mind shows reasoning which looks to the policy of the legislation imposing the penalty to assess whether it is designed to punish the person or his business. The judge indicates that the fine arises not from the trade but to the trader personally: it was not incurred in the production of assessable income.

22 The difference between something personal and something connected with or arising out a trade may perhaps be easier to see if the punishment is imprisonment: imprisonment is the cost of being the person who did the act which constituted the offence, not an expense of the trade.

23 McKnight v Sheppard 71 TC 419 (1999) concerned fines imposed on a stockbroker by the Stock Exchange and the legal expenses incurred by him in defending before the Stock Exchange the charges made against him. At that time the Stock Exchange was a gentleman's club and not regulated by statute. This was a case therefore where the fine did not arise under statutory provisions.

24 The Special Commissioner held that the fine was not allowable but that the legal expenses were. Lightman J held that neither were allowable. He was reversed by the Court of Appeal in relation to the legal expenses, and in the House of Lords the conclusion of the Special Commissioner was upheld. The appeal to the Court of Appeal and the House of Lords was limited to the deductibility of the legal expenses. In the House of Lords Lord Hoffmann gave the only speech. Both the judgement of Lightman J and the speech of Lord Hoffmann were the subject of much scrutiny before us.

25 In the context of a submission that the expense must arise from the "proper scope of the trade", Lord Hoffman discussed Glehn . He had no doubt that the decision was correct but found the reasoning difficult.

26 He explained Glehn in policy terms thus:

"But there would have been no [illogicality similar to that in Smith's Potato Estates Ltd] in treating the penalty in von Glehn as a trading expense. It was, as the Court of Appeal accepted, incurred in the course of the company's trade. There must therefore have been something in the nature of the expense which prevented it from being deductible. I think with great respect that the Court of Appeal had difficulty in identifying exactly what this was because they were looking in the wrong place. They hoped to find the answer in the broad general principles of what counts as an allowable deduction. But the reason in my opinion is much more specific and relates to the particular character of a fine or penalty. Its purpose is to punish the taxpayer and the court may easily conclude that the legislative policy would be diluted if the taxpayer were allowed to share the burden with the rest of the community by a deduction for the purposes of the tax. This, I think, is what Lord Sterndale MR meant when he said that the fine was imposed "upon the company personally".[Italics added – see following paragraph.]

27 In this passage Lord Hoffmann calls attention to the policy of the statute by which the penalty is imposed but his reference to sharing the burden and the dilution of the legislative policy might also be considered to have some regard to the policy of one statute affecting the interpretation of another. These are in principle different approaches. Under the first the policy of the statutory provision imposing the penalty is to be considered to determine the nature of the penalty. The second – the dilution concern —

requires consideration of the proper application of the penal statute and the taxing Act taken together: the policy apparent from one may affect the proper interpretation or application of the other. However in the italicised words above Lord Hoffman combines these two approaches indicating to my mind that both “punishment” and “dilution” are necessary before one can conclude that the penalty should not be deductible — although a “dilution” conclusion may follow easily from a “punishment” one. And conversely a compensatory imposition may be regarded as not being punishment or not diluted by deductibility.

28 In this context we were referred to the Canadian case 65302 British Columbia Ltd v Canada [1999] 3SCR 804 . This related to the deductibility of a penalty under Canadian provisions which limited deduction to expenses incurred for the purposes of earning income. Those provisions are plainly different from those in (1)(a) and (e), but the approach of the Court, which was referred to the English cases, was illuminating. One judge, Bastarache J, found the penalty was not allowable “for the simple reason that to so allow would operate to frustrate the legislative purpose of other [added italics] statutes” but that purpose had to be considered carefully because if the penalty is “primarily compensatory, its operation would not generally be undermined by the deduction of the expense”. In that he seems to me to be reflecting the second part of Lord Hoffman's formulation in which he may be suggesting that the policy of one statute might affect the interpretation of another. The majority of the Court, however, were reluctant to embrace unexpressed notions of public policy in the guise of statutory interpretation. They drew attention to the apparent policy of the taxing Act that only limited categories of expense should be disallowed, and also asked which jurisdiction's public policy was relevant.

29 In McKnight , Lord Hoffman continued:

“By parity of reasoning, I think that the Special Commissioner and the Judge were quite right in not allowing fines to be deducted. It does not however follow that the costs were not deductible. Once it is appreciated that, in a case like this, non-deductibility depends upon the nature of the expenditure and the specific policy of the rule under which it became payable, it can be seen that the relevant considerations may be quite different. This explains the divergent answers given by the courts in the various cases on fines, penalties, damages and costs.”

30 In the case of penalties which are not imposed under the authority of Parliament there is no statute competing with the tax statute whose policy can be considered. Yet Lord Hoffmann says that, “[b]y parity of reasoning”, he thought that the Special Commissioner and the Judge were right in disallowing the Stock Exchange fine. It is clear that, in saying this, he must have been considering the policy behind the penalty. But were other policy considerations relevant as they are with statutory penalties: is it necessary or consequential also to be able conclude that a policy would be diluted by deductibility? It seems to me that the answer is yes: “Parity of reasoning ” indicates that the policy behind the penalty must be one which more general policy considerations dictate should not be diluted. That is also apparent from the following paragraphs of his speech.

31 In those following paragraphs he makes clear that considerations of policy were relevant to the application of the statute even where the cost did not rise under a specific statutory provision: he considered it relevant whether there was a policy which would bar the deduction of ordinary libel damages, and in his decision on the issue of the legal expenses of Mr. Sheppard he rested on the fact that he found that the entitlement to defend oneself was a relevant consideration and saw no “clear policy [which] would be infringed by allowing the deduction of the legal expenses”. Thus a central part of his reasoning on the specific issue which was before the House of Lords embraced policy considerations. That reasoning must be binding on us in relation to the rule in (1)(a) which Lord Hoffmann stated was at issue at the beginning of his speech. But the reasoning is more general and is applicable to (1)(e) as well. His consideration of Glehn and of Lord Sterndale's remark in relation to (1)(e) — that the fine was imposed upon the company personally — reflect that.

32 But the nature of the policy being considered differs. In relation to a statutory penalty it is the policy of the penal Act and the object is to glean from that policy: (1) the nature of the penalty and to conclude (2) whether that Act's policy would be diluted by deduction. In relation to the expenses Lord Hoffman looks to wider considerations than the dilution policy (for example the entitlement to defend oneself) although he prefaces his invocation of that policy by indicating that the answer depends upon “the specific policy of the rule under which it became payable”.

33 It seems to me however that although the purpose or policy behind a non statutory penalty may illuminate its nature, considerable caution is required in extending to a non statutory field, policy considerations originally emanating from the consideration of statutes so as to apply the second "dilution" limb of the policy argument. The policies relevant to the non statutory field cannot be derived from the legislative policy of the penal provisions, but may only be derived from more general and often less precisely defined policies. If such a policy is to colour the application of the taxing statute, it must at least be the sort of policy which gave rise to Scrutton LJ's remark that "of course he cannot" deduct the cost, or MacNaghten J's comment that to deduct was "preposterous".

34 In McKnight the Special Commissioner said he could see no rational difference between a civil penalty of the type in Glehn and "a fine imposed by a professional body for a breach of its rules, particularly where those rules were designed to protect the investing public" [my italics]. That to my mind indicates the type of costs which "of course" should not be deductible or to which a "dilution" policy might be relevant. There must be a serious public concern to be protected.

35 Thus in the non statutory context, where the actions which gave rise to a penalty could otherwise be said to have been for the purpose of the trade, in my view it is only if the nature of the penalty is to punish a person and if there is a serious public policy which would be diluted by deductibility that the penalty should not be regarded as an expense of the trade. For this reason I would hold that, for example, a non compensatory penalty for late completion imposed in a building contract made under the laws of a jurisdiction which made such a penalty enforceable could be a deductible expense

36 Lightman J considered (1)(a) and (1)(e) separately. In his consideration of (1)(a) he broke the tests imposed by the section into three parts:whether the fine was an expense, what its purpose was, and whether there was a sufficient degree of connection between the expenditure and the business. Nourse LJ in the Court of Appeal said that this last part could not be supported: there was no authority for the proposition that expenditure had to be sufficiently connected with the earning of profits in the single test posed by (1)(a). The second requirement was only an aid to establishing whether the first was satisfied.

37 This, as Mr. Nawbatt suggested, may have failed to give full credit to Lightman J's statement that his third principle was often elided with his second, the Purpose text; it may also be that this test is of more relevance to (1)(e). But it seems to me that, both in connection to the question of the fine and in relation to the legal expenses, some care is needed in the application of this part of Lightman J's judgement. Mr. Nawbatt rightly says that insofar as it relates to the Stock Exchange fine it was the last word because the appeal to the Court of Appeal related only to the legal expenses. But our concern is with the reasoning, not the conclusion, and there is no distinction in the judge's reasoning between its application to the fine and the legal expenses; and none in Nourse LJ's criticism of that reasoning.

38 Mr. Nawbatt notes that Nourse LJ's "decisive objection" to the judge's decision was that the connection test had not been argued before the judge. He commends this part of Lightman J's judgement to us. He notes that, after identifying examples where damages were deductible he said, at 441C:

"If however the risk and liability arise outside (and not as an incident of) the conduct of the trader's normal profit earning activities the expenditure will not qualify for deduction … what is clear is that, if the trader has deliberately undertaken a course of conduct outside the ordinary course of the conduct of his trade and thereby incurs or is occasioned liabilities or expenditure … the expenditure [is] not deductible."

39 And later in relation to legal costs, Lightman J says that the deductibility

"must depend on whether the act or omission occurred in the ordinary course of his trade. If it involves some serious departure from standards, procedures and rules of conduct required of the trader, the expense is likely to be disallowed. If the trader has deliberately committed a serious breach of the rules, and in particular if he has been dishonest, then no question of deduction can arise. He has stepped outside the ordinary course of trade … "[our italics].

40 Mr. Nawbatt accepts that the test espoused is more obviously relevant to (1)(e) than to (1)(a), but nonetheless says that it is relevant given the overlap between the two provisions and their interpretation.

He draws our attention to the fact that the judge focuses on the conduct of the trade rather than whether the fine is imposed by some form of public body.

41 But the words of the statute contain no references to the “normal” or “ordinary” trade, or to the “proper conduct” of the trade. These are aids or glosses on the statutory words deriving from the attempts to explain why expenses might not be deductible. In the case of a person whose trade or profession is based on trust and probity, a breach of those principles is a departure from the business he is engaged in because it strikes at the nature of that business: these words help in that context. But their usefulness depends on the nature of the business.

42 The emphasis on conduct seems to me to point in the direction of the second limb of Lord Hoffman's approach to policy: it is a way of construing or applying the statute so that what is “obviously wrong” does not fall within it. Seriously wrong conduct is the type of conduct which could give rise to a denial of a deduction on policy grounds. But for public policy to apply the conduct must be wrong in a public sense: for such conduct to ignite a policy it matters not whether it is morally obnoxious but whether it is something in which there is a serious public interest — and that would generally be conduct which would be regarded, in the light of that interest, as seriously wrong.

43 I apply the following principles:

(1) in the case of a statutory penalty one must have regard to the policy of the statute imposing it in order to determine its nature. In so doing one seeks an answer to the question: is this penalty like imprisonment: the cost or expense of (or punishment for) being the person who committed an act; or is it instead a cost of doing the act as it would be if it were compensatory or confiscatory.

(2) The answer to that question will affect the application of both paragraph (1)(a) and paragraph (1)(e). In relation to (1)(e) if the penalty arises from being the person who commits the act it will not arise out of the trade and will be not connected with the trade: in the same way that, if it were a gift to an employee, it would not have come “from” an employment.

(3) A consideration of the policy of a penal statute, where the policy of the penal statute would be diluted by deductibility, may inform the interpretation or application of the tax statute. That may be the case where to permit deduction would be preposterous.

(4) Where the purpose of the penalty is to punish so that the policy of the penalising statute would be diluted by deductibility, the expense or loss falls foul of (1)(a) and (1)(e).

(5) Where a penalty arises in nonstatutory circumstances the policy of the rule under which the penalty became payable will also be relevant to whether it is, like imprisonment, designed to punish the individual but considerations of policy are also relevant.

(6) In the nonstatutory case however the policy considerations which may affect the interpretation or application of taxing statutes are different. The proper understanding of the tax statute cannot be affected by the nonstatutory policy, although more general policy considerations can have a part to play where they can be identified. But this exercise requires great caution. It is not permissible to say that a fine should not be deductible because the policy of a private body imposing it would be diluted. There must instead be such a public interest in the nature of this conduct that it would be wholly preposterous for the cost to be shared with the body of taxpayers.

(7) In the non-statutory case, if the penalty arose from actions taken for the purpose of the trade, it will only be if it was imposed to punish the individual and if it would be contrary to a serious public interest to permit its deduction, that the penalty should be treated as not having been incurred for the purpose of the trade.

(8) In relation to (1)(a) in the context of a nonstatutory penalty, the question is whether the expense was wholly and exclusively incurred for the purposes of the trade. In addressing that question there is no test of sufficient connection to be applied: one is not required to ask whether the expense did or did not arise from the normal or ordinary course of trade: the statutory question is simply whether it was incurred

wholly and exclusively for the purposes of the trade. If an expense is regular and unavoidable it may well be for the purposes of trade, but that does not mean that an unusual or avoidable expense will not be.

The Facts

44 We heard no oral evidence. That may have been due to McLaren's unwillingness to expose its affairs to public scrutiny. The evidence before us was limited to the contents of documents. We find as set out below. To the extent these findings relate to the legal effect of certain agreements they are, of course, matters of law.

45 McLaren's principal activity was “participating in Formula One [or “F1”] motor racing events throughout the world. This includes the design, development, manufacture and racing of Formula One cars.” (Directors Report) It derives its income from sponsorship, advertising and from the payments under the Concorde Agreement described below. Its turnover in the year to 31 December 2007 was some £127 million, but in that year, largely as a result of the sanctions imposed on it, it made a loss of £35 million; in 2008 it made a profit of £5 million, and in 2009 a profit of £50 million.

46 The Federation Internationale de L'Automobile (the “FIA”) is a French non profit making body whose members are national and other motoring associations. The members organise motor sport in their relevant territories. In 2001 the FIA adopted statutes which state that its objects include: promoting of motoring and motorsport, coordination between its members, and dealing with disputes between its members. The President (then Max Mosley) described it as the world governing body of the sport.

47 The FIA operates through a General assembly of all members, a committee called the World Motor Sport Council (“WMSC”), various other committees and an appellate body. The members of these committees, its President and other officeholders are generally elected by the General assembly.

48 The WMSC consists of the President of the FIA (who at the relevant time was Max Mosley), eight members by virtue of another office held in FIA, and 17 members elected by the General assembly. It was not a body comprised of Formula One competitors.

49 The FIA's statutes assigned to the WMSC responsibility for the enforcement of the statutes and its International Sporting Code (the “ISC” or the “code”). This code is the document by which the FIA (through the General assembly) prescribes rules for the conduct of its motor sports events. Article 27 of the FIA's statutes provide that the WMSC “may directly impose the sanctions provided for” in that code.

50 It appears that by the adherence of its members to the statutes, the ISC takes effect as an agreement among the FIA's members. The code confers on members the right to issue licences to participate in those motor sports competitions whose governance they accept is subject to the code. The code provides that a licence holder must comply with it.

51 A notice published by the European Commission, in connection with its concerns that the FIA was using its powers under its statutes and other documents to block the organisation of competing races, indicates that “by accepting a licence the holder agrees to be bound by the provisions of the code and the provisions” for its enforcement in accordance with the FIA statutes. We did not have evidence which supported or transversed this contractual analysis, but the code provides that the applicant for an International super licence (for participation in international championships organised by FIA such as Formula One) is to sign an application form. We concluded that such persons would thereby have expressly agreed to become subject to the code.

52 The European Commission action arose because it was concerned that the FIA was using its regulatory powers and its contractual rights under the Concorde agreement to block the organisation of competing events. It illustrates that whilst the FIA exercised a form of regulation over much motor sport, it also operated in the commercial sphere. As a result of the action the FIA agreed to the separation of its commercial activity (which devolved principally on FOA) from its regulatory functions. The Commission notes that standards of safety were essential and it was appropriate for the FIA to impose rules to guarantee the maintenance of those standards. We accept that in relation to the safety of events the FIA had a role which was in the public interest.

53 The code details the technical rules under which many varieties of motor races organised by the FIA members are to be conducted (competitors, starting procedures, construction of cars and such matters), and has appendices laying down detailed specifications for matters relating to cars and drivers.

54 Chapter XI of the code provides for penalties for breach. Regulation 152 provides that penalties may be inflicted by the stewards of a meeting and by the national motoring organisations. Regulation 153 provides for a scale of penalties ranging through reprimand, fines, time penalties, exclusion, and suspension to disqualification, and in relation to the Formula One championships provides that a penalty of the withdrawal of points may be imposed.

55 Article 155 provides that:

“until further notice, published here or in the Official Bulletin, the maximum fine that shall be inflicted is US$50,000.”

56 We find that McLaren made an application for an International super licence and in so doing agreed in return for its issue to be bound by the ISC.

The Concorde agreement (of 1998).

57 The Concorde agreement is an agreement between the FIA; Formula One Administration limited (FOA), a company engaged in the promotion of the FIA Formula One championship; and 11 bodies which at that time fielded Formula One teams (the “Teams”). The Commission accepted, in the notice referred to above that the Concorde agreement was necessary for the organisation of a complex commercial activity and the arrangement of the commercial exploitation of broadcasting rights.

58 In broad monetary terms the Concorde agreement is an agreement to get money from Formula One racing and to divide it up between the participants. The FIA organises the races, the Teams enter the cars, FOA collects money from television and other exploitation, and the money is divided up between the parties. Without the championship, the Teams would have no Formula One racing income, and without the Teams, there would be no championship to exploit.

59 Under the agreement the Formula One teams acknowledge that the Formula One championship is the property of the FIA, agree for the duration of the agreement to participate in the Formula One Championship each year, agree to participate in each event organised by the FIA for the Formula One championships for each season and agree not to take part in any other event which carries the Formula One name; and FOA agrees to make payments to the competitors in accordance with schedule10 to the Agreement. In particular the Concorde agreement provides:

(1) that the teams cede to FIA promotional and advertising rights in relation to the commercial exploitation of Formula One other than the teams' rights to obtain sponsorship and advertising of their own participation;

(2) that FIA grants the commercial rights to FOA on condition that FOA exploits them;

(3) that the teams will do nothing prejudicial to the image of Formula One racing;

(4) that each team will enter two cars in each event and do their best to enter additional cars if the total number of cars would otherwise fall below 20;

(5) that FIA agrees that if a team submits an entry for a season's championship it will be accepted;

(6) that the teams agree to very detailed technical regulations specified under the agreement;

(7) that the parties agree to accept the Sporting Regulations of the Formula One championship laid down by the FIA and “further agree that the Sporting regulations shall not be changed by the FIA in any year unless unanimous agreement is obtained”. Regulation 3 of those regulations provides that all

competitors undertake to observe all the provisions of the ISC and that each team pay a fee for a superlicence to FIA to meet FIA's management expenses of the championship;

(8) that all clauses of a regulatory nature in the agreement shall be deemed to be imported into the ISC, and as a result such clauses shall prevail over any other regulations so that in the case of conflict between the ISC and the agreement the agreement shall prevail; and

(9) that it is governed by English Law.

60 Substantial sums of money are involved in Formula One racing. The development and deployment of cars is expensive, and large amounts accrue from the exploitation of advertising, television and other rights. Schedule 10 to the Concorde agreement provides for a prescribed and very substantial amount, some of which is directly related to the commercial exploitation of Formula One rights, to be shared between the participating teams. FOA agrees that in return for the undertakings given by the teams to participate in the championships it will make a payment to each team comprising two portions. The first portion is dependent upon participation in the prior year and having been in the top teams in a number of previous years, and the second portion by reference to the place the team achieved in the championship in the previous year. The place a team achieves is determined by the number of points scored during the season. A substantial part of McLaren's income is derived from these payments.

61 McLaren submitted an entry form for the 2007 F1 championship on 3 November 2006. In that form it expressly agreed to be bound by, and to observe the 2007 sporting regulations and the ISC.

62 The preamble to the ISC provides that the Concorde agreement contains modifications to the code applicable to Formula 1 and that the Concorde agreement should prevail in the case of differences.

The Events giving rise to the fine

63 In its decision of 13 September 2007(at paragraph 7.3) the WMSC said:"teams have great interest in each other's technology and go to considerable lengths (within the rules) to study each other's designs and innovation through direct observation, photographic evidence, and other means.".We had no doubt that in the commercial and competitive world of Formula One racing it will be the case that each team will take an interest in the construction of its competitors' cars. Much time would be spent in viewing recordings of races and in seeking to discover the details of their construction. At the September hearing before the WMSC (see below) there was an exchange between Mr. Tozzi (who appeared for Ferrari) and Mr. Lowe of McLaren: Mr. Tozzi said:

"Thus, when you say the [Ferrari] dossier of [was of] so little use, this must be put in the context of an operation that spends millions of dollars constantly and legitimately spying on competitors' cars. Yet, you say that if you were to receive the dossier it would be of little use. Is that your evidence, Mr. Lowe?"

64 Mr. Lowe replied:

"It is a question of relative value. On aerodynamics, for instance there is a lot of interest. But in most cases, if not all the data actually proves to be of no value."

65 We also have no doubt that each team would take whatever practical and legal steps it could to keep its designs secret. From the transcript of the WMSC meeting (and from the Renault decision referred to below) we gathered that some of the teams might seek to engage persons employed by other teams, sometimes no doubt in the hope or expectation of the discovery of some details of their competitors' cars or methods.

66 In 2006 Mr Stepney, an employee of Ferrari (another Formula One team), started corresponding with Mr. Coughlan, the chief designer at McLaren. He passed on information about Ferrari. Later on he provided more detailed plans and information about Ferrari's cars. Copies of the plans were retained by Mr. Coughlan.

67 In 2007 Ferrari commenced proceedings against Mr. Coughlan in the High Court in relation to these documents. Some 780 pages of information belonging to Ferrari were recovered from Mr. Coughlan's house. Ferrari wrote to the FIA inviting it to consider an investigation.

68 In July 2007 McLaren was requested to, and did, attend a meeting of the WMSC at which it was asked to respond to the allegation (the "charge") that it had breached article 151c of the ISC because it had unauthorised possession of information belonging to Ferrari in relation to the construction of its cars. Article 151c of the ISC provided:

"Any of the following offences in addition to any offences specifically referred to previously shall be deemed to be in breach of these rules:

(a) all bribery…

(b) any action having as its object the entry or participation in a competition of an automobile known to be ineligible….

(c) any fraudulent conduct or any act prejudicial to the interests of any competition or to the interests of motorsport generally."

69 At that meeting McLaren were represented by Ian Mills QC and made written submissions in advance. It was not disputed that Mr Coughlan had the information, but McLaren argued that it was not disseminated within its engineering team, and that Mr. Coughlan's possession of the information was not authorised by McLaren. At the end of the meeting Mr. Mosley reported that it was the unanimous view of the council that McLaren:

"were in possession of Ferrari secrets or Ferrari information, by virtue of Mr. Coughlan's possession thereof, irrespective of other elements. We therefore find [McLaren] in breach of article 151c. However the evidence of any use of this material in a manner calculated to interfere with the Formula 1 World Championship is insufficient for us to impose any penalty. Should in the future evidence emerged showing that the Formula One World Championship was prejudiced in any way by the possession of this information by [McLaren] either in 2007 or 2008 … we reserve the right to invite the team back … where they would be faced with the possibility of exclusion … ".[We note the possibility of exclusion.]

It seems to us that the breach of Art 151c must in these circumstances have been considered by the WMSC to have been an act prejudicial to the interests of the competition or of motor sport, but not fraudulent.

70 After this further information came to light and there was another meeting of the WMSC on 13 September 2007. Ferrari and McLaren were represented by counsel at that meeting and there was cross-examination of witnesses. The WMSC's decision (dated 13 September 2007) was that:

(1) there was evidence that two of McLaren's drivers had received confidential Ferrari information via Mr. Coughlan. This information related to various design issues and to Ferrari's "stopping strategy";

(2) there was evidence it was likely that there was a systematic flow of Ferrari confidential information to Mr Coughlan "leading to the conclusion that the illicit communication of information was very likely not limited to the transmission of the Ferrari dossier discovered at Coughlan's home on 3 July 2007";

(3) at least some of the information received by Mr. Coughlan was communicated to others within McLaren (e.g. the two drivers);

(4) the nature of the information was such that if used or in any way taken into account it could confer a significant sporting advantage on McLaren;

(5) there was a clear intention on the part of a number of McLaren personnel to use some of the Ferrari confidential information in McLaren's own testing. If this was not carried into effect it was only because there were technical reasons not to do so;

(6) Mr. Coughlan's role within McLaren put him in a position in which his knowledge of the secret Ferrari information would have influenced him in the performance of his duties;

(7) it seemed unlikely that Mr. Coughlan confined his activities to sharing Ferrari's information solely with one of the McLaren drivers;

(8) no effort was made within McLaren to stem the flow of information from Mr Stepney, to investigate the matter, or to make disclosures to the FIA

(9) therefore "a number of McLaren employees or agents were in unauthorised possession of, or knew or should have known other McLaren employees or agents were in unauthorised possession of, highly confidential Ferrari technical information [and] there was an intention on the part of a number of McLaren personnel to use some of the Ferrari confidential information in its own testing".

71 All this led to WMSC concluding that some degree of sporting advantage was obtained by McLaren "although it might forever be impossible to quantify the advantage in concrete terms". The decision did not specify the sporting advantage. That in turn led the WMSC to an appreciation of the gravity of McLaren's breach which was different from that reached in its 26 July decision. On that basis it believed a penalty was merited:

"The WMSC therefore, in accordance with the provisions of the International Sporting Code, imposes the following sanctions [in] relation to the 2007 FIA Formula One World Championship:

— a penalty consisting of exclusion from and withdrawal of all points are awarded to McLaren in all rounds of the 2007 constructors' championship …

— a sum of USD 100 million (less any sum that would have been payable by Formula One Management Limited on account of McLaren's results in the 2007 constructors championship had it not been excluded)."

72 The effect of the decision was that, because it lost its points, it lost that share of its income under the Concorde Agreement which depended on its place in the championship. That resulted in a loss of $35.6m. The balance of the penalty was $100m less that lost income. That was therefore $64.5m or £32,313,341.

73 In addition the WMSC required an investigation of the work by McLaren on its 2008 car with a view to determining whether that car incorporated any Ferrari confidential information. The WMSC considered the report on this issue on 7 December 2007. Following discussions, McLaren gave undertakings not to use three specific technologies in its 2008 car. McLaren issued an apology and the WMSC proceedings were thereafter closed.

74 The FIA issued a press release following its September decision in which it said:

"One hundred million dollars is a large sum of money but in such a serious case any fine has to be large enough to deter similar behaviour in future whilst remaining proportionate to the resources of the team .[Our italics]

"Just over half the money from this fine will go to the competing Formula One teams [because they would get the championship money which McLaren would otherwise have received]. Each competing team will move up one place with McLaren now taking 11th position in this year's championship. The World Motor Sport Council will be invited to distribute the remainder to the FIA's national sporting authorities worldwide for them to spend on helping young drivers to progress in circuit racing and rallies. This will be the first time the FIA has had such a budget available."

75 McLaren could have appealed against the ruling. It did not. In December it issued a statement in which it acknowledged that it had become clear that the Ferrari information was more widely disseminated than was previously communicated and indicated that it wished to make a public apology. In a letter of 5 December 2007 (after the report) to FIA McLaren said:

"we accept the central conclusion that some pieces of Ferrari information may have been disclosed via Nigel Stepney and Mike Coughlan, directly or indirectly to individuals within McLaren other than [the two drivers]…It is a matter of deep regret for us that our understanding of the facts has improved as a result of the FIA inspection rather than our own prior investigations. We apologise unreservedly … ".

76 Mr. James asked us to consider a later WMSC hearing in relation to Renault, another F1 Team, which took place in December 2007. McLaren had discovered that confidential information from McLaren had been taken by an ex employee when he joined Renault. The information had been uploaded onto Renault's computer and distributed within Renault. The WMSC held that Renault was in breach of article 151c but imposed no penalty:

"In these circumstances, although a number of very unsatisfactory elements were noted during the deliberations, in assessing the gravity of the breach, the WMSC concluded that there was insufficient evidence to establish that the information was used in such a way as to interfere with or have an impact upon the championship."

77 Mr James notes that the difference between this case and that of McLaren is that in McLaren's case some element of sporting advantage was found to have been obtained by McLaren. We accept that submission. We note also the prevalence of obtaining other team's design ideas.

78 Given the WMSC's findings and McLaren's apology, we find that McLaren did possess and did, through its employees, use in some way (however limited) Ferrari's confidential information, and that it achieved some commercial advantage thereby.

The Parties' arguments

79 Mr. Nawbatt said:

(1) the penalty was a "loss" to which (1)(e) could apply;

(2) if the conduct which gave rise to the penalty was outside the course of McLaren's trade, then (1)(e) applied: the loss did not arise out of, and was not connected with the trade;

(3) the penalty arose from McLaren's interference with Ferrari's intellectual property: such interference was not part of McLaren's trade or incidental thereto. The legitimate gathering of information was part of its trade but the illicit gathering of information was not. McLaren had said as much in its submissions to WMSC in the July hearing;

(4) the penalty was for the conduct of McLaren's employees and their gathering of, and intention to use, the Ferrari information;

(5) that conduct was prohibited by Mr Coughlan's contract of employment. It was thus outside McLaren's regular business

(6) the penalty was not incurred in the capacity of trader, but as a punishment for McLaren for a serious breach of the rules. Such a penalty did not arise from trade or was not connected with it;

(7) any sporting advantage was addressed through McLaren's later agreement not to use three particular technologies in its 2008 car.. The penalty was not a correction of a sporting advantage: it was not compensatory, it was to punish and deter. It was a fine of unprecedented magnitude;

(8) the policy behind the sanction was the wider protection of motorsport. The WMSC represented a public interest in motorsport;

(9) whilst there was a spectrum ranging from a commercial penalty to issues of public concern such as safety which could give rise to different understandings of the policy of the penalty, this penalty lay at the public concern end.

80 Mr. James said:

(1) when Lord Hoffmann said “by parity of reasoning” he was considering bodies with a duty to protect the public such as the Law Society or the stock exchange. That duty affects the “nature” of the cost at which Lord Hoffman directs his reasoning;

(2) there is a difference between the nature of the penalty levied by bodies such as the stock exchange, which have a public function to protect the public, and the nature of a contractual payment such as that paid by McLaren. There is a spectrum: at one end public policy is engaged and a fine can be seen to be levied on a person; at the other end the loss is of a different nature;

(3) this fine was incurred because of the actions of McLaren's employees even if they were unauthorised: it was thus incurred in the course of its trade. It was not deliberate conduct outside the course of its trade. There was no finding of misconduct;

(4) the fine was for the use rather than the possession of the Ferrari information. That was shown by the difference between WMSC's conclusions in July, and those in September. In July a fine was not levied; in September a large fine was. The difference lay in the new information the WMSC had about the dissemination of information within McLaren and its conclusions about its possible use. This is made even clearer by the Renault decision in which no fine was imposed;

(5) the fine was not a punishment for McLaren personally; it was more of a commercial deterrent to others;

(6) this cost was an inherent risk of this trade.

Discussion

The liability to the penalty

81 The Concorde agreement was governed by English Law. The Statutes of FIA were under French Law. No governing law was stipulated in the ISC. We had no licence before us and could not determine whether the effect of applying for a licence was to submit to English law or otherwise.

82 It is a well known principle of English contract law if a contract stipulates a penalty for its breach, that the amount which may be recovered may be limited to the amount required to compensate for the breach.

83 There may have been a difference between the removal of McLaren's points and the payment of the balance of £32,313,341. The former could be seen as an adjustment to McLaren's rights under the contract; the latter may have been a penalty under the contract. Nevertheless McLaren paid it. We suspect that even if it had been advised that it was a penalty which could not be recovered under English Law, it would have been commercially impossible for McLaren not to pay given that its income was inextricably linked to participation in Formula One racing.

84 We have noted the provision of the ISC which limits the amount of a financial penalty which may be imposed under the ISC to $50,000. We have also noted that FIA's statutes permit the WMSC to impose the sanctions permitted by the code. (Art 27). We were not shown any provision of the code, the Concorde agreement, the licenses or the statutes which abrogated the limitation of monetary penalties

to $50,000. At the meeting of the WMSC of 26 July Ian Mills QC accepted that Art 27 enabled the WMSC to impose sanctions provided for under the ISC.

85 Whilst we accept that by its acquiescence in the meeting of 27 July, McLaren was probably prevented from arguing that the WMSC could not impose sanctions on it pursuant to the Code (the argument to the contrary being that the provision of FIA's statutes conferring authority on WMSC was not part of the Code and thus not part of the contractual matrix to which it was subject), we could not conclude on the documents available to us that McLaren was liable to pay any more than $50,000 of the £32,313,341 it did pay, although we accept that its right to income under the Concorde agreement was reduced.

86 If that is the case then the only conclusion is that McLaren paid this sum because it felt commercially obliged so to do. A letter from McLaren to FIA after the second WMSC meeting indicates that the continuing investigation was having a “morale sapping” consequence and that affected the ability to “continue to generate investment”. Whilst the power to impose a fine in excess of $50,000 may be doubtful, there is no doubt that the WMSC could have excluded McLaren from events: at the July meeting the FIA had warned of this possibility. That could have been more costly than the fine: at the September hearing Mr Mills submitted that “You will destroy McLaren if you exclude us.” That possibility may well have motivated McLaren's acceptance of this penalty although there was no direct evidence before us as to this point, and we can therefore make no certain finding.

87 Mr James told us however that McLaren were contractually bound under English law to pay the penalty. We proceed on that basis.

The Statutory Prohibitions

88 The penalty incurred by McLaren can in our view properly be described as either an expense or a loss. As a result either or both of (1)(a) and (1)(e) could apply to cause it not to be deductible

89 I consider separately the prohibitions in (1)(a) and (1)(e). Although these prohibitions and their terms have often been considered together and may to some extent pursue common tests, they are different. One deals with expenditure, the other with a loss: a theft from a till maybe a loss but will not be expenditure; one deals with the subjective purpose of the taxpayer, the other with objective connection: a taxpayer is unlikely to have an object for the theft from his own till, and no amount of connection to the trade will save an expense which was made for a non trade purpose.

90 I address in relation to (1)(a) the questions of policy and whether the penalty was imposed upon the company personally because that is how Lord Hoffman approached (1)(a). But those questions originally arose form the words of (1)(e) and the answers to them are applied in relation to the discussion of (1)(e).

91 Indeed it seems to me that in this appeal the issues of punishment and policy may be of more relevance to (1)(e) than to (1)(a). That is because when considering (1)(a) there seems to me to be a difference between an expense which arises directly from actions taken for the purpose of the trade under a contract entered into for the purposes of the trade, and a penalty imposed by a third party regulator of a trader (as was the case in McKnight). In the latter case the nature of the penalty may be more relevant to the determination of the “purpose” for which it was incurred. When considering (1)(e) by contrast the nature of the penalty may more easily be seen to illuminate the connection to the trade. I proceed however on the basis that questions of nature and policy are directly relevant to (1)(a) even if the actions giving rise to it were only for the purpose of the trade.

92 Both (1)(a) and (1)(e) require some consideration of what was McLaren's trade. I discuss that question as part of the discussion of (1)(a) but the same conclusions apply in relation to (1)(e).

(1)(a) Was the expense of the fine money laid out wholly and exclusively for the purposes of McLaren's trade?

93 Unlike the equivalent employment income test, the statutory words do not address the question of why the expenditure was “incurred” but why the money was “laid out”. The incurring of the expenditure

may precede the laying out of the money. But it is clear that the test is not addressed solely to the point at which cash is paid out. When a builder eventually pays for the sand he has incorporated into a building, or an insurer pays out to meet a claim he is contractually obliged to meet, he may be paying to avoid an action for damages, but there would generally be no question as to the trading nature of the expenditure. It is possible and proper to determine the purpose of the expenditure from the purpose of the incurring of the liability to make payment or even to equate the two events.

94 I ask what was McLaren's purpose in incurring the expense? On the assumption that the fine was contractually due, the expense was incurred because of:

(1) McLaren's entry into the Concorde agreement;

(2) the actions of McLaren and its employees in relation to the Ferrari material;

(3) the decision of WMSC.

If the purpose of (1) and (2) was wholly and exclusively for McLaren's trade, and the action of WMSC was not to impose a penalty personally on McLaren which should not, as a matter of public policy be diluted, then (1)(a) is no bar to deduction.

95 It was clear that McLaren's income arose from its participation in Formula one racing. The only way it could participate in such racing was through the agreement with the FIA and the other 10 teams. The Concorde agreement provided it directly with a major source of its income and the activity through which it derived the remainder. There was no doubt that McLaren entered that agreement and thereby agreed to incur the liabilities that arose under it only for the purpose of, and for the purpose of earning profits in, its trade. Therefore (1) was for the purposes of its trade.

96 But that does not mean that every liability incurred under that agreement was incurred for the purpose of its trade. A builder might have an agreement with a sand supplier for the supply of sand, but if he orders some for his daughter's sandpit, the expense is not incurred for the purpose of his trade. Thus it remains to ask whether the actions in (2) were taken for the purpose of McLaren's trade. That in turn requires some consideration of what that trade was.

97 One description of McLaren's trade is “trying to make money from the design and racing of Formula One cars”: on that description the actions of McLaren's employees might fall within it. Another is “trying to make money by participating in Formula One racing subject to any rules imposed in the Concorde agreement”: on that description the employees' action could not be for the purpose of that trade.

98 I prefer the first formulation. That is because: (1) it was an ordinary part of McLaren's activities to seek information on its competitors' designs and strategy; (2) employing other teams' employees, and correspondingly taking steps to ensure that the damage which could result as the result of an employee defecting, were part of that activity; (3) Renault did the same; and (4) the WMSC held that McLaren, by the activities of its employees, had obtained a sporting advantage – namely an advantage in the activity which gave rise to its income. I do not regard any contractual prohibition in Mr Coughlan's contract as conclusive of McLaren's trade. In my view the profit making activity carried on by McLaren was not limited to acting within the confines of the Concorde agreement and could include “cheating”. That activity was its trade.

99 I then ask whether, if as a matter of fact McLaren's trade was not limited to acting within the confines of the Concorde agreement, there was any legal reason why it should not be described as I prefer. Was this a case where one might say, as was suggested in Golder v Great Bolder 33 TC 33 93, that it was no part of the taxpayer's trade to be fraudulent or deceitful, that no part of McLaren's trade could consist in breaching the Concorde agreement or that no part of its trade could be cheating? That might be possible if either reasons of policy dictate it, or if, as a matter of law, “trade” cannot encompass an act which is an infringement of the civil law rights of another person.

100 Whilst I can understand that fraud or deceit might be found not to be part of a trade which depended on probity or trust, I can see no compelling reason for finding that McLaren's trade was so limited.

101 So far as concerns whether a trade can encompass the contravention of another person's civil rights, I do not consider that “trade” is so limited. If it were, the profits from such an activity would not fall to be assessed to tax: a taxpayer could say “I'm not taxable on that profit even though my activities bear all the hallmarks of trade because it involved the contravention of another's right.” In Herald the libels committed by the paper were contraventions of the civil rights of those libelled, but there was no suggestion that, as a matter of the definition of “trade”, this meant that they were not part of the paper's trade.

102 Thus I conclude that there is no reason of policy or law to limit the description of McLaren's trade to the second of the formulations in paragraph 97 above.

103 Mr. Nawbatt asked us to decide whether the activities which gave rise to the penalty were a normal or ordinary part of McLaren's trade. We find that they were not. Whilst there was no evidence directly on the point, the WMSC's response and Mclaren's apology suggest at best that this degree of “cheating” was rarely uncovered (and was thenceforth to be strongly discouraged).

104 But even if these activities were not normal or ordinary they were activities so closely associated with mainstream of McLaren's trade that I cannot say that they were not part of it.

105 Therefore in my opinion the impugned activities could form part of McLaren's trade, and, since I cannot believe that attempting to obtain a sporting advantage was not for the purposes of the trade, I find they were undertaken wholly and exclusively for the purposes of that trade. As a result unless it can be said that (a) the policy of the rule under which the penalty was imposed shows that the penalty was in the nature of a personal punishment and (b) there is a public policy argument which requires the penalty not to be shared with the general body of taxpayers, I must hold that the penalty was incurred for the purpose of the trade.

The Policy under which the penalty became due

106 At para 43(7) above I set out two principles applicable to the case of a non statutory penalty. The first was whether the policy of the rule under which the penalty became payable indicated that it was, like imprisonment, designed to punish the individual; and the second whether there was such a public interest in the nature of the conduct that it would be wholly preposterous for the cost to be shared with the general body of taxpayers.

The rule under which the penalty was imposed

107 Were there any considerations in relation to the imposition of the penalty which indicate that the penalty was akin to a criminal penalty: in the nature of something imposed as a punishment for being the person who took certain actions?

108 The WMSC gave no consideration to the quantification of the commercial effects of McLaren's action. I therefore accept that, although the comparison with Renault indicates that a penalty was levied only because McLaren had in some way used the information, the fine was not assessed so as to redress any advantage obtained by McLaren: it was not compensatory or designed to confiscate McLaren's advantage.

109 During the course of the September hearing, and after the WMSC had come to the conclusion that McLaren had breached article 151c, there was a discussion about the size of a penalty. During the course of that discussion Mr. Mosley said:

“We have to take a longer view and consider the credibility and legitimacy of our championships. If we allow wholesale transfer of information from one team to another, without the consent of the team from which that comes, this calls into question every issue of fairness. Sponsors, the television and the public would conclude that Formula 1 has gone down the same road as cycling or athletics. We must make sure this does not happen.”

110 By its decision the WMSC was thus;

(1) defining the limits of what was thenceforth acceptable rather than, or as much as, applying an existing definition: a purpose was to send out a fresh message,

(2) deterring other team members from doing similar things in the future;

(3) doing this for the commercial benefit of the teams and the FIA. That is seen in Mr. Mosley's reference to “sponsors” and “television”. In other words the penalty was assessed with the commercial interests of the participants at heart; and

(4) having regard to fairness and public perception of motor racing.

111 The WMSC concluded that McLaren's actions were prejudicial to the Formula One competition or the interest of motorsport within Art 151c (there was no indication that it regarded what had happened as fraudulent). It was clear that it thought that this sort of activity had to be deterred. A penalty had to be large enough to do that.

112 The penalty was huge. In the setting of the penalty WMSC took account of “the resources of the team” and also the need for the penalty to be large enough to “deter similar behaviour in the future”.

113 In my view: in the nature of the penalty as an alternative to exclusion from its trading activity, in the commercial motivation for the penalty, in having regard to the resources of the team, and in requiring part of the penalty to be taken as removal of points, the policy behind the penalty can be seen as intended to affect McLaren in its trade rather than as a person. The penalty was set so as to deter others from the same course of action in the pursuit of their trades, but the deterrence of others does not of itself point to a policy of personal punishment for McLaren.

114 Thus, in my view, the penalty was a commercial penalty designed to affect McLaren in its commercial activity. It was not of a like nature with a statutory penalty designed to be suffered by an individual. It shared with criminal penalties the object of deterrence, but its motivating policy was not principally to punish McLaren in its person.

Public policy

115 Last I ask whether, even if the penalty was personal punishment of McLaren, there was that kind of public interest in the nature of the conduct of motor racing as to be able to say that the penalty was in respect of a wrongdoing in which there was such a serious public interest as to prompt the response that it would be preposterous to allow this penalty to be shared with the general body of taxpayers. I do not think there was. The safety, health or well being of the public were not at issue. It is no more preposterous that an amount paid as part of a private commercial arrangement should be deductible than it is that an amount not received as part of the same commercial arrangement should be shared by the taxpayer. I conclude that the consideration of public policy does not require the penalty to be considered as disallowable. It was not levied for the protection of the public but mainly for the regulation of commercial activity.

116 I conclude that para (1)(a) does not apply to prohibit the deduction of the penalty.

Does paragraph (1)(e) apply?

117 Was the loss connected with the trade? There is no doubt that had McLaren not traded the penalty would not have been incurred. In that limited sense there is a connection with its trade. But it also seems to me that this was not a penalty imposed on McLaren personally but one which arose in the course of its trade: it was connected to, and part of, the very mechanism by which McLaren earned it income.

118 Did the loss arise out of the trade? The loss arose from McLaren's trade because it was intimately bound up with its only source of income. There was no difference in quality between the loss of points (and thus the loss of gross income) and the obligation to make the payment. Both had the same source; both arose from McLaren's trade.

119 The policy considerations are the same as those in relation to (1)(a) above.

120 As a result I conclude that paragraph (1)(e) does not apply.

Summary

121 This cost was not one imposed on McLaren, but one which it was contractually obliged to pay under contractual obligations undertaken for the purposes of its trade; it did not result from the action of an external regulator, but from a body to whose dictates it had agreed to submit as part of its trade and in order to gain income; it arose from the action of employees in pursuing a course of conduct normally for the benefit of its trade, not from actions unconnected with its trade; the penalty was motivated by commercial policy and was structured by reference to McLaren's trade; the body imposing the penalty had commercial considerations more than the public interest in view; the protection of fairness in motor sport organised by FIA does not carry the same sort of public interest as that protected by a regulator of a profession based on trust. The penalty was something which arose from its trade, was connected with its trade and was incurred wholly and exclusively for the purposes of its trade.

Mr Dee's Opinion.

122 I start by asking what was the penalty for; why was it made; and how was it calculated or made up. In considering the answers to these questions one can then formulate a view as to whether the payment is deductible according to the relevant law.

123 The rationale for making the payment can be found in the written decision of the WMSC issued in a Press Release on 14 September 2007 where paragraphs 8.8 to 8.11 contain the findings of fact which led to its conclusions. As we heard no witnesses as to the facts, we can only rely on the written material that was supplied. These findings specifically reject many of the claims by McLaren that there was only an isolated breach of the rules and there was no dissemination of the tainted data.

124 As a result the WMSC clearly intended to punish McLaren, and from McLaren's own submissions regarding sanctions, ejection from the championship that year was a distinct possibility. To avoid this McLaren were prepared to go to great lengths of contrition. In the words of Ron Dennis “If there is a punishment let it fit the crime”. The President then raised the issues of credibility and fairness in the sport, in relation to sponsors, television and the public.

125 In framing the penalty the President made it clear that while McLaren would not be excluded from the championship, a very substantial fine would be imposed calculated as the difference between $100 million and the value of the Constructors Championship points lost for 2007; which came out at the £32 million to which this appeal relates.

126 So it is clear that this was an issue which affected McLaren's very existence. They did not appeal the overall penalty, though this was open to them. (Their reasoning does not concern us, though it can be taken as acceptance of their misconduct).

127 I find it hard to believe that the huge sum intended to punish such serious misconduct constitutes an expense laid out wholly and exclusively for the purposes of the trade. It was paid to secure their continuing existence, F1 being crucial to this. No part of their trade could encompass what their employees or agents had done in view of the WMSC findings.

128 Much was made of the relationship between McLaren and the FIA being contractual. I do not think this assists the taxpayer. Those contractual arrangements merely lay out how various matters will be dealt with in F1. They cannot legislate for the punishment of misconduct as such, and penalties are usually not permitted in contract law. I think we are dealing with a different set up here; and where it could be said that McLaren fundamentally breached the contract anyway.

129 In McKnight the fine was held to be non deductible by both the Special Commissioner and the Chancery Division. Lord Hoffmann specifically approved of their view. He went on to allow the professional fees, because as he states the relevant considerations may be different between fines and

fees. As he says on page 453 “The issues are different.” and he then goes on to explain why: his reasoning on page 452E is instructive in addressing “…the nature of the expense which prevented it from being deductible.”.

130 He goes on to say that “the reason [for disallowing] in my opinion is much more specific and relates to the particular character of a fine or penalty. Its purpose is to punish the taxpayer and a court may easily conclude that the legislative policy would be diluted if the taxpayer were allowed to share the burden with the rest of the community by a deduction for the purposes of tax”.

131 Firstly therefore one has to look at the nature of the expense – as explained above it was a punishment.

132 Next Lord Hoffmann refers to a fine – usually statutory – and a penalty. Often the latter is non-statutory, and may cover many differing sanctions. As in McKnight this appeal concerns a non-statutory situation, as the misconduct and charges in that case were in 1984 and akin to club rules, before the Stock Exchange deregulation following “Big Bang”.

133 For these reasons I would disallow the payment of £32 million as not being laid out wholly and exclusively for the purposes of the trade within s74 (1) (a).

134 This penalty could in my view equally be disallowed on the grounds that it is a loss not connected with or arising out of the trade in s74(1)(e). The reasoning would be similar. Indeed it is even more apparent to me that the penalty was imposed because the conduct of McLaren fell way outside any normal and acceptable way of conducting their trade, as found by the WMSC.

135 If McLaren were seeking to preserve the whole structure of their profit making apparatus, it could be argued that the payment is tantamount to one of capital. I do not pursue this point, having not heard Counsel's views. But it does go to the nature of the payment.

Conclusion.

136 The appeal is allowed

Rights of Appeal

137 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.