TC02152

Appeal number: TC/2010/06887

CORPORATION TAX – trading profits – deductibility of expenses – contribution by UK member of group to legal costs of prosecution in United States of directors and US parent company for alleged violations of Cuban embargo – whether for purposes of UK company's trade – on facts, held no – whether decision to allocate costs as between US and UK companies taken by same directors solely in interests of UK company – no – held that expenditure not incurred wholly and exclusively for purposes of UK company's trade – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PUROLITE INTERNATIONAL LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE JOHN CLARK
GEORGE BARDWELL

Sitting in public at 45 Bedford Square, London WC1B 3DN on 14, 15 and 16 May 2012

Kevin Prosser QC and Zizhen Yang of Counsel, instructed by Grant Thornton UK LLP, for the Appellant

Aparna Nathan of Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

This version takes into account amendments proposed on behalf of the Respondents

DECISION

1. The Appellant ("PIL") appeals against the conclusion notified by the Respondents ("HMRC") in a letter dated 13 April 2010, subsequently upheld on review, that certain expenditure was not deductible in computing PIL's profits for the three accounting periods ending 31 December 2002, 2003 and 2004.

The factual background

2. The evidence consisted of two lever-arched files containing copy correspondence, together with additional materials in support of the parties' skeleton arguments. Witness statements were provided by Stefan Brodie and by Kevin Downey. Mr Brodie and Mr Downey both gave oral evidence, the latter by video link from the United States.

3. From the evidence we find the following background facts. Other parts of the evidence are considered later in this decision.

Corporate structure and trading relationships

4. Stefan Brodie (often known as Steve Brodie) and his brother Don Brodie each own 50 per cent of the share capital in Bro-Tech Corporation ("BTC"), a Delaware corporation which traded as "The Purolite Company". (In this decision, to avoid confusion, we refer respectively to "Steve Brodie" and "Don Brodie" rather than to "Mr Brodie".) Steve Brodie, Don Brodie and BTC each own one third of the share capital in Bro-Tech Limited ("BTL"), a UK company. At the material time, BTL owned 95 per cent of the share capital in PIL, the other five per cent being owned by the late Henri Bousquet (who died in or around 2007). PIL owns a number of overseas subsidiaries.

5. The board of directors of PIL consisted of Steve Brodie, Don Brodie, Edgar Berreby and Henri Bosquet. In practice, the decision-making process was largely conducted by Steve and Don Brodie.

6. Steve Brodie and Don Brodie were the sole officers of BTC. Steve Brodie was President and Treasurer of BTC, and Don Brodie was Vice-President and Secretary of BTC.

7. Until 2003, PIL's trade consisted of the manufacture of ion exchange resins. These are used for such purposes as water purification, pharmaceutical applications and in medical procedures, for example in dialysis units. Steve Brodie referred in evidence to other applications.

8. In 2003, PIL ceased to manufacture the resins, but continued to sell them.

9. The majority of PIL's supplies were made to the USA, generally through BTC; 50 per cent of PIL's trade was with BTC.

10. Between 1994 and 1999, PIL supplied resins to Cuba. Until the end of 1996 this was partly via BTC's representative office in Canada, but subsequently the supplies were made direct, but with BTC's assistance. An analysis of shipments to Cuba provided by PIL to HMRC shows that from 17 October 1994 until 18 December 1996, total sales to Cuba were US$804,704. Of these, US$389,259 (48 per cent) went directly from the UK. From 11 March 1997 until 31 July 1999, total sales to Cuba were US$899,304; all of these went directly from the UK.

Prosecutions by the US government

11. On 6 October 1999, BTC, Steve Brodie, Don Brodie and James Sabzali (who was BTC's sales manager) were notified that they were the subject of a US federal grand jury investigation. They then consulted US lawyers. (Steve Brodie referred in his witness statement to having consulted a particular named firm at that point, but that was not consistent with Mr Downey's evidence; we consider this below.) There was no specific documentary evidence of the nature of the instructions or the steps taken over the following period of several months.

12. Subsequently, by way of response to the notification, on 8 May 2000 the law firm Morgan Lewis & Bockius LLP submitted a "Declination Memorandum" to The Hon. James K Robinson, Assistant Attorney General for the Criminal Division, US Department of Justice. This sought an exercise of discretion by the US government to decline prosecution and resolve the matter administratively.

13. On 16 June 2000, Ed Dennis, a partner in Morgan Lewis and Bockius LLP, wrote to James Robinson referring to a meeting the previous week "to discuss the grand jury investigation of the Purolite Company (Purolite and Purolite International)". In this letter, Ed Dennis set out various arguments in support of an administrative resolution with a negotiated settlement of the matter as an alternative to prosecution.

14. Those requests for administrative resolution were unsuccessful. On 5 October 2000 the US government brought prosecutions against BTC, Steve Brodie, Don Brodie and James Sabzali in relation to a number of matters set out in the indictment, in particular the supplies of resins to Cuba. (One count of the indictment referred to another individual, John Dolan; all charges against him were subsequently dropped. There was no evidence as to the date on which he had previously been notified of the grand jury investigation.) The prosecution alleged that those supplies were made in violation of the Trading with the Enemy Act 1917 ("TWEA") and the Cuban Assets Control Regulations ("CACR"). All of the defendants (other than John Dolan) were indicted on one count of conspiracy between 1993 and 2000, and BTC, Don Brodie and James Sabzali were also indicted on 75 additional counts, each relating to a specific supply of resins during the period.

15. Following a trial in March 2002 lasting approximately a month, all four of those defendants were found guilty on the conspiracy count, and BTC, Don Brodie and James Sabzali were found guilty on some of the additional counts (44, 33 and 20

respectively) but acquitted on the others including in particular all of the counts relating to PIL's direct supplies to Cuba.

16. Subsequently the District Court granted Steve Brodie's motion for an acquittal on the conspiracy charge on the ground that there was insufficient evidence to convict; the prosecution appealed against this decision. The District Court denied the other defendants' motions for acquittal, but ordered a new trial in relation to all four defendants (in relation to Steve Brodie, this was conditional upon the prosecution's appeal being successful) because of certain prejudicial comments by the prosecution to the jury.

17. In February 2004, a plea bargain was struck in relation to BTC, Don Brodie and James Sabzali whereby they pleaded guilty to count 36 on the indictment (paying travel expenses of $4,187 in January 1996) and all of the other charges, including the conspiracy count, were dropped. DB and JS were fined $10,000 each and sentenced to one year's probation; BTC was fined $250,000.

18. In 2005, the Court of Appeals vacated the District Court's judgment of acquittal against Steve Brodie on the conspiracy count. However a plea bargain was struck whereby that count was dismissed and Steve Brodie pleaded guilty to a new charge of approving reimbursement of James Sabzali's travel expenses to Cuba on one occasion. Steve Brodie was also fined $10,000 and sentenced to one year's probation.

19. This outcome was seen by the defendants as an overwhelming success on the merits.

The bearing of the defendants' legal costs

20. As soon as they were notified that they were to be the subject of the grand jury investigation, Steve Brodie, Don Brodie, James Sabzali and BTC consulted US lawyers. Subsequently, all four of the parties subject to the investigation signed a joint defence pact, under which Don Brodie and James Sabzali used lawyers from different firms, while Steve Brodie and BTC were represented by different partners in one firm; all advice was "funnelled" through the latter firm.

21. From the time when they began to act until the time of the trial, the US lawyers addressed their bills only to Steve Brodie for their charges for representing him and BTC. They informed him that they wanted to issue their invoices to him personally, because it was customary in a US criminal case for law firms to bill their services to individuals rather than to companies. He understood that Don Brodie's lawyers and James Sabzali's lawyers respectively issued their invoices to them in the same way. Bills from all the firms involved were issued monthly.

22. None of the three individuals involved made any personal contribution in respect of the legal fees. Steve and Don Brodie considered that the costs resulted from the actions of the group companies. It therefore seemed appropriate to them that BTC, the corporate defendant, should pay all of the costs. They therefore decided, in their capacity as the sole shareholders of BTC, that BTC should do so.

23. As a result, all of the defendants' legal costs were in the first instance borne by BTC. Steve Brodie took legal advice as to the responsibility for payment of fees in such circumstances. Under section 145 of the Delaware General Corporation Law a company is obliged (subject to preconditions which it is not necessary to set out here) to reimburse legal costs incurred by its officers (including costs of defending a criminal prosecution) arising out of acts done in the service of the company, to the extent that the defence is successful. We were informed that it is common practice in the USA for the company to meet the costs in the first instance, and only to seek to recover them if the defence fails. We accept that statement as to the practice in such cases. BTC acted in accordance with that practice; it appears that the plea bargain charges were ignored as being minimal in the context.

24. At a subsequent point, a decision was taken that BTC should not be the sole party to bear the legal costs and that PIL, as BTC's trading partner, should bear an appropriate share of those costs. The precise timing of that decision, and of the arrival at the allocation, were matters of dispute before us, and are considered later in this decision. However, HMRC do not seek to challenge the basis on which the recharge of a percentage of legal fees was computed as a result of discussions between BTC and PIL.

25. The result of the allocation of that percentage was that £3,445,253 was borne by PIL for the year ended 31 December 2002, £149,101 for the year ended 31 December 2003 and £212,940 for the year ended 31 December 2004. The total amount charged to PIL was therefore £3,807,294.

The GEC Capital/PML Loan

26. Under section 8.1(k) of a Term Loan Agreement made as of 25 November 1997 between the lenders GEC Capital Corporation and Principal Mutual Life Insurance Company and the borrowers BTC, BTL, PIL and Purolite (Deutschland) GmbH, the following was an "Event of Default":

> "Both Don Brodie and Stefan Brodie cease for any reason whatsoever (other than as a result of their deaths) to be actively engaged in the management of Borrowers."

HMRC's enquiry and subsequent events

27. On 27 October 2004, HMRC opened an enquiry into PIL's tax return for the year 2002. Lengthy correspondence and discussions ensued. On 13 April 2010, HMRC gave notice of their intention to issue a closure notice; their letter set out their decision that no deduction was due for the amounts borne by PIL in respect of legal fees relating to trade with Cuba.

28. On 13 May 2010 PIL's accountants (Grant Thornton) wrote to HMRC to appeal on PIL's behalf against HMRC's decision dated 13 April 2010, and requested a review of the decision. On 29 July 2010 HMRC's Review Officer wrote to PIL with the result of the review, which was that the decision should be upheld.

29. On 25 August 2010 PIL's Notice of Appeal was sent to the Tribunals Service.

Arguments for PIL

30. Mr Prosser submitted that the expenditure had been incurred by PIL wholly and exclusively for the purpose of PIL's trade, and accordingly was deductible in computing its trading profits for corporation tax purposes. In support of this submission, he made the following broad points. (His detailed submissions on the facts are considered under "Discussions and Conclusions" below.)

(1) The expenditure was clearly of a trading nature in that it arose from the carrying on by PIL of its trade: the expenditure was a contribution towards costs of defending a prosecution brought in respect of supplies of resins made by PIL in the course of its trade;

(2) Steve Brodie and Don Brodie, who were the sole officers of BTC and also the decision-making directors of PIL, had decided to defend the prosecution for the purposes of BTC's and PIL's trades, and not for non-trading purposes such as to keep individuals out of prison. Mr Prosser referred to BTC's obligation under the Delaware Corporate Law to meet the legal costs of its officers;

(3) If in 2000 BTC had asked PIL to contribute towards the legal costs, on the ground that they were being incurred by its trading partner in order to benefit PIL trade as well as that of BTC, PIL would undoubtedly have agreed that it was only fair and equitable to do so. The mere fact that PIL was under no legal obligation to contribute did not mean that such a contribution would have a non-trading purpose; Mr Prosser referred to the equitable principle of community of interest mentioned by Vaughan Williams LJ in *Bonner v Tottenham and Edmonton Permanent Investment Building Society* [1899] 1QB 161 at p 174. The fact that PIL had agreed in 2002 to make the contribution, after most of the legal costs had been incurred by BTC, could not make any difference. [Note that this 2002 date was questioned in evidence; see below.]

(4) It followed that there was no duality of purpose in relation to this expenditure. PIL had not agreed to contribute to the legal costs in order to benefit BTC, BTC's officers, or PIL's own directors. In particular, the mere fact that the legal costs related to the defence of Steve Brodie and Don Brodie did not matter, because BTC had had to incur those costs in any event. And the fact that the costs had been incurred in the first instance in the interests of BTC's, as well as PIL's, trade did not prevent PIL from saying, correctly, that it made its 77% contribution to those costs wholly and exclusively for the purposes of its own trade.

31. He made the following legal submissions:

(1) The only provision being relied on by HMRC was s 74(1)(a) of the Income and Corporation Taxes Act 1988 ("ICTA 1988"). This required a factual enquiry. There were two parts to s 74(1)(a). These raised the questions what the money had been spent for, and whether that was a trade purpose. The word "wholly" referred to the amount being spent. The word "exclusively"

examined whether the purpose was a trade purpose and no other purpose. HMRC's case was that there was a non-trade purpose.

(2) In examining what the money was spent for, it was necessary to look into the mind of the taxpayer and see what his objective was in expending the money. This was a purely subjective test. In the case of a company, this required looking at the mind or minds of the individuals who took the decision. In the present case, in reality, it was Steve Brodie and Don Brodie who took the decisions. Mr Prosser emphasised that the question was what the taxpayer believed, whether right or wrong, reasonable or unreasonable. He referred in general terms to the VAT case of *Ian Flockton Developments Ltd* [1987] STC 394. His fundamental submission was that the matter turned on whether the Tribunal believed the evidence of the director, Steve Brodie.

(3) Looking into the mind of the person concerned usually involved looking at "articulated" objects, but objects could be non-articulated, as shown by *Mallalieu v Drummond* [1983] 2 AC 861. Mr Prosser submitted that Lord Brightman's comments at 870A to 871A were clear law. The Tribunal should look into the mind of the taxpayer to see the object of the expenditure, and distinguish this from the effects of the expenditure. He referred to Lord Brightman's example of the medical consultant spending a week in the South of France and the relevant matters to be considered in answering the question whether the journey was undertaken solely to serve the purposes of the medical practice. The object of making the expenditure had to be distinguished from the effect of the expenditure.

(4) The case of *McKnight v Sheppard* [1999] STC 699 re-emphasised the distinction between the object and the effect of the expenditure, as shown by Lord Hoffman's speech at 672 to 673. It was therefore possible to have something which was an effect and not a purpose. In the context of a company with directors who were directors of an associated company, those directors could have the object of benefiting the taxpayer while knowing the beneficial effect for the other company.

(5) HMRC were relying on *Garforth v Tankard Carpets* [1980] STC 251. Mr Prosser referred to Walton J's comments at 258*a-c* concerning the approach to be taken where directors of two associated companies were involved. He submitted that these comments were inconsistent with the approach considered by Lord Hoffman in *McKnight v Sheppard* when referring to the example of the consultant travelling to the south of France. Lord Hoffman had not said that one should rule out the possibility of the taxpayer benefiting himself. Walton J had been assuming that the minds of the directors were concerned with objects rather than effects. It was for the Tribunal to decide what the objects were.

(6) The next part of the process was to examine whether the object was a trade object. This was not for the taxpayer to decide. Mr Prosser referred to *Morgan v Tate & Lyle* (1954) 35 TC 366, HL. If the taxpayer's sole object was to preserve his own trade, this satisfied the wholly and exclusively test.

Arguments for HMRC

32. Ms Nathan submitted that PIL was prevented by s 74(1)(a) ICTA 1988 from deducting the legal expenses recharged to it, because those legal expenses were not incurred by PIL wholly and exclusively for the purposes of its trade.

33. She referred to the judgment of Millett LJ in *Vodafone Cellular Ltd and others v Shaw* [1997] STC 734, which set out the propositions of law which the facts must satisfy in order for the expenditure to be deductible. She highlighted Millet LJ's comments at p 742 concerning "the other purpose" within a group of companies.

34. Where groups of companies were concerned, it was necessary to determine whether the expenditure sought to be deducted was incurred for the purposes of the company seeking the deduction. Guidance was provided by Walton J in *Garforth v Tankard Carpets Ltd* (1980) 53 TC 342 at 349, and in *Robinson v Scott Bader Co Ltd* (1980) 54 TC 757 at 765. Ms Nathan also referred to the judgment of Waller LJ in the Court of Appeal in the same case ((1981) 54 TC 757 at 771).

35. In relation to legal expenses, Lord Hoffman had provided useful guidance in *McKnight v Sheppard* [1999] STC 669 at 673-675. This case confirmed that there were no policy reasons which prevented legal expenses from being deductible expenses, provided that the statutory requirements for deductibility were satisfied.

36. Ms Nathan also referred to various other authorities concerning the deductibility of legal costs. The first was the decision of the Special Commissioners in *AB (a firm) v Revenue and Customs Commissioners* [2007] STC (SCD) 99, which derived a number of principles from the earlier authorities, and indicated the basis on which those principles should be applied to the facts. Another authority was the decision of the First-tier Tribunal in *MA Raynor (Deceased) and Mrs BC Raynor* [2011] UKFTT 813 (TC). In the third case, *Duckmanton v Revenue and Customs Commissioners* [2012] SFTD 293, [2011] UKFTT 664 (TC),the First-tier Tribunal held that no deduction was allowable for the legal expenses incurred in defending a charge of gross negligence manslaughter.

37. The *Raynor* decision at paragraph 40 showed that the onus of proof remained with PIL to show that the expenditure was incurred wholly and exclusively for the purposes of PIL's trade.

38. The cases (*Mallalieu v Drummond*, *MacKinlay v Arthur Young McClelland Moores & Co* [1990] 2 AC 239, and *Vodafone Cellular v Shaw*) indicated that it was necessary to ascertain PIL's purpose at the time that the expenditure had been incurred and that it was the subjective purpose of PIL which had to be ascertained. The enquiry was not limited simply to PIL's conscious motives, but also the unconscious, unarticulated but nevertheless inextricably linked motives.

39. The focus in the present case was the real purpose of the recharge. Could it be said on the facts that the real purpose was to benefit the trade of PIL?

40. Mr Prosser had referred to *Ian Flockton Developments Ltd*. Ms Nathan drew attention to the comments of Stuart-Smith J at p 399. She submitted that the case did not ask the Tribunal to accept reasonably held but fanciful motives as being the purpose of the taxpayer; the stated motives, however reasonably held, must be tested against the standard of what an ordinary businessman would think, and if the motives expressed were so outside the scope of what an ordinary businessman would think, the Tribunal should approach those motives with caution.

41. Ms Nathan made detailed submissions on the facts, considered together with those of Mr Prosser in the next section of this decision.

Discussion and conclusions

The law

42. Section 74(1)(a) ICTA 1988 provides:

> "**74 General rules as to deductions not allowable**
>
> (1) Subject to the provisions of the Tax Acts, in computing the amount of the profits to be charged under Case I or Case II of Schedule D, 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, profession or vocation; . . ."

As it was common ground between the parties that the expenditure in question in this appeal was of an income nature, the sole question is whether that expenditure was incurred wholly and exclusively for the purposes of PIL's trade.

43. A summary of the principles to be derived from the various authorities on the application of s 74(1)(a) ICTA 1988 is set out in *AB (a firm) v Revenue and Customs Commissioners* at paragraph 86:

> "86. From the authorities cited to us by the parties we have identified the following legal principles. First, that the question whether an expense of the firm is incurred wholly and exclusively for the purposes of the profession is a question of fact. Secondly, that the expenditure has to be made for the purpose of enabling the trade to earn the profits of the trade; *Strong & Co of Romsey Ltd v Woodifield (Surveyor of Taxes)* [1906] AC 448 at 453, 5 TC 215 at 220 and *Smith's Potato Estates Ltd v Bolland* (Inspector of Taxes) [1948] AC 508 at 517, 30 TC 267 at 288. Thirdly, that the business (or professional) purpose must be the sole purpose; *Bentleys, Stokes & Lowless v Beeson (Inspector of Taxes)* (1951) 33 TC 491 at 504. Fourthly, that the distinction between furthering the business interests of the firm on the one hand and the essentially private purposes of the partners on the other can be a fine one; *MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co* [1989] STC 898, [1990] 2 AC 239. Fifthly, that in determining the purpose it is necessary to look at the taxpayer's subjective intentions and although these are determinative

> they are not limited to conscious motives in his mind at the time of payment; consequences which are inevitably and inextricably involved in the payment must be taken to be a purpose for which the payment was made; *Vodafone Cellular Ltd v Shaw (Inspector of Taxes)* [1997] STC 734 at 742. And, finally that if the taxpayer's only conscious motive at the time of the expenditure is a business motive then the expenditure is deductible; *McKnight (Inspector of Taxes) v Sheppard* [1999] STC 669, [1999] 1 WLR 1333."

44. In addition, we accept that there is a distinction between the object of the expenditure and the effects of the expenditure, as considered in *Mallalieu v Drummond* and *McKnight v Sheppard*. Whether something amounts to an effect of the expenditure in question, rather than being the object, is a matter of fact to be determined from the evidence.

45. Ms Nathan referred to *Garforth v Tankard Carpets* as giving guidance on the question whether, in the context of groups of companies, the expenditure sought to be deducted was incurred for the purposes of the company seeking the deduction. In that case, Walton J commented (at p 349) on the finding of the Commissioners that the interests of all three companies concerned had been considered together when decisions were made. He concluded that in the light of this finding the "wholly and exclusively" test could not possibly, realistically, be held to have been satisfied. He continued (at p 349-50):

> "Although the point does not, in view of this finding of primary fact, arise, it must in the nature of things be extremely difficult for any directors of two associated companies in the position of Carpets and JLT to be certain in whose best interests - or, rather, in whose exclusive interests - any step which they take is being taken. Obviously, there is nobody but themselves to say what was in their own minds; and obviously, again, it must require a superhuman effort of mind (of which extremely few persons, if any, are capable) to rule out entirely from consideration the possibility of benefit to one's other company when concentrating on the exclusive requirements of just one of them. In my judgment, Commissioners should be extremely slow in coming to any conclusion that the act was done solely for the benefit of the trade of one of the companies concerned and should in general do so only where there are wholly separate finding of primary fact not depending on the say-so of the directors concerned. I cannot resist the impression that in 99 cases out of 100 the correct primary fact to find will be that which was in fact found in this case; namely, that in such a situation as the present the interests of all the companies were considered together. This is in accord with all the probabilities in the present and, indeed, most foreseeable cases."

46. Mr Prosser submitted that Walton J had been wrong to suggest that the taxpayer must rule out from consideration the possibility of benefit to himself or another company or to another company as the case may be. The suggestion was an obiter dictum; further, it was inconsistent with *McKnight v Sheppard*. It was not possible to overturn an obiter dictum, but it was possible to ignore it, which the courts had certainly done. Mr Prosser accepted that as a matter of common sense it was right to

look for external evidence if there was any, but there was no rule that the evidence of the taxpayer himself could not be accepted.

47. We do not read Walton J's comments as laying down any principle of law. It appears to us that he was referring to the question of the burden of proof in cases where directors might or might not be looking exclusively at the interests of a particular group company in circumstances where they happened also to be directors of other group companies to which their decision for that first company might have some relevance. It was common ground between the parties in the present case that the burden of proof fell on PIL. The issue of the burden of proof was considered by the House of Lords in the case of *In Re B* [2009] AC 11. Both Lord Hoffman and Lady Hale referred to the notion of inherent probabilities. They emphasised that these should be taken into account, where relevant, in deciding where the truth lies. We interpret Walton J's comments in *Garforth* as indicating that tribunals should be aware, when considering the facts of an individual case, of the factual issues to be considered in determining as a matter of inherent probability whether the object of particular expenditure, in the minds of the directors of a taxpayer company who were also directors of related companies, was purely the object of that company and not of any of the other companies for which they had responsibility.

48. In considering the evidence, we apply the principles mentioned in *AB (a firm*) and bear in mind the comments of Walton J in *Garforth*, which we see as merely a reminder to look carefully into the minds of the directors to determine exactly what their object was in deciding to incur the expenditure. We also take into account Millet LJ's reference in *Vodafone Cellular v Shaw* to "the other purpose" in the context of a group of companies.

The issues of fact

49. In considering the factual issues underlying this appeal, it is necessary to appreciate the nature of the decision-making process in the context of PIL and the wider group of companies of which it forms part. Steve Brodie's evidence in his witness statement was that Don Brodie and he travelled continually for the business and that although they spoke at least once a day no matter where they were in the world, "most business decisions are made informally and verbally". (We construe the latter adverb as meaning "orally".)

50. In cross-examination, Steve Brodie stated that if he needed to refer back to what had been decided, he had not had a problem with memory. He emphasised that a wide range of individuals within the business were empowered to make decisions. Ms Nathan asked him how he kept the interests of the various companies separate. He explained that he and Don Brodie each ran things separately. They knew what each other was thinking. They did not take notes.

51. We accept, in the context of a business which was set up by two brothers working closely together but has since developed into a large international operation consisting of a substantial number of companies, that the decision-making process may well be less formalised than in many comparable international groups of

companies. For much of the time, this may be a reasonable way in which to manage the business. However, it gives rise to difficulty in establishing evidence as to the decisions taken and the times at which they were taken, and for which company or companies they were taken. In the present case there is no evidence in the form of formal minutes or informal notes recording the dates of decisions and their details, or indicating the policy thought process and the conclusions of that process arrived at for individual companies. We are placed in the position of having to decide whether we are persuaded by Steve Brodie's evidence, which of necessity is based on his recollection without the assistance of any contemporaneous records of company decisions.

The sequence of decisions

52. Before considering which decision or decisions are relevant to PIL's claim to deduct the allocated proportion of the amount spent on legal fees, we set out details of the decisions taken.

53. Steve Brodie's evidence showed that there had been a sequence of decisions. The first was to instruct lawyers following notice of the grand jury investigation. The second was that all the legal costs should be paid by BTC. The third, taken at a later stage, was that (according to his witness statement) "there would have to be some kind of allocation between different group companies according to their involvement in the alleged breaches of the embargo". The fourth was the decision on the method of allocation, and the amount to be allocated to PIL. The issue of the timing of all these decisions is considered below.

54. We find that the first decision was taken by Steve and Don Brodie both in relation to their positions as individuals and in their capacity as the directors and sole shareholders of BTC. We further find that this first decision was taken shortly after 6 October 1999. Although Steve Brodie's evidence in his witness statement was that the legal firm instructed was Williams & Connolly, we are not satisfied that this firm was instructed at this stage. Our reasons are, first, that the analysis of legal costs included in the evidence shows that no legal costs were incurred with that firm in 1999, and secondly that the evidence of Mr Downey, a partner in Williams & Connolly, as to his firm's involvement (considered below) shows that this did not begin until a much later stage.

55. The timing of their second decision is not clear from the evidence before us, but we find on the balance of probabilities that it must have been made soon after the first decision, as invoices from the law firms involved were being issued monthly, and those firms would have required prompt payment of their invoices as a precondition to continuing to act for their clients.

56. The timing of the third decision was a matter of dispute at the hearing before us. In paragraph 11 of his witness statement, Steve Brodie had stated that this decision was taken in about June 2002:

> "However, in about June 2002, when it became apparent that this was going to be a major piece of litigation, we realised that it would not be appropriate for BTC to bear all of the costs, so that there would have to be some kind of allocation between different group companies according to their involvement in the alleged breaches of the embargo. With preparation for the trial requiring so much of our time and attention, we did not sit down and decide how the allocation should be made until after the trial itself."

57. The date had been stated as June 2002 in a draft of his witness statement sent to HMRC with an opinion of Mr Prosser in December 2009. That opinion, and Mr Prosser's skeleton argument for the hearing before us, also referred to the date as being 2002. However, in the course of his oral evidence, Steve Brodie said that this was incorrect. The date should have been 2000. He stated that, looking at the analysis of the legal costs, by 2000 the amount of legal costs had reached $1.5 million. The date of a letter from the US legal firm Morgan Lewis and Bockius to the Assistant Attorney General seeking resolution of the matter without resort to prosecution also tied in with this, as it was written on 16 June 2000.

58. Mr Prosser submitted that the June 2000 date must be correct. The sequence of events covered by a number of the following paragraphs of Steve Brodie's witness statement, concerned events in 2000; the reference to 2002 would have been out of sequence. Important first steps in the litigation process were taken in 2000, namely the Declination Memorandum and the letter to the Assistant Attorney General, and the indictment had subsequently been issued in October 2000, as mentioned in paragraph 12 of Steve Brodie's witness statement immediately following his reference to 2002 in paragraph 11.

59. Mr Prosser also submitted that June 2000 had been the time when the seriousness and probable expense of the litigation became apparent, and had also been the time when PIL's involvement in the sales to Cuba had been very much in focus, PIL being referred to in the Declination Memorandum and the letter to the Assistant Attorney General. (We deal separately below with the issue of PIL's involvement.) Mr Prosser argued that it would have been appropriate for attention to be turned at that point to the question whether PIL should contribute towards the legal costs.

60. Ms Nathan submitted that the Tribunal should treat with some caution the statement that the reference to 2002 in paragraph 11 of Steve Brodie's witness statement was a "typo". She referred to the draft sent to HMRC in 2009 and to the corresponding references in Mr Prosser's 2009 opinion and his skeleton argument. This appeared to have been missed by everyone for a very lengthy period; it was "not just any date", given its importance. She also mentioned that Steve Brodie had sought in his evidence to change two dates (the other being considered below).

61. We do not find entirely persuasive Steve Brodie's reference to the amount of the costs having reached $1.5 million as at June 2000. The legal fees analysis shows a total for 1999 of $282,249.81 and for 2000 a total of $1,539,941.41. There is insufficient evidence to show the amount of the costs incurred up to June 2000, but the combined total for the whole of those two years is $1,822,191.22. If the aggregate

total had already reached $1.5 million by June 2000, the amount of the costs for the remainder of 2000 would have had to be limited to just under $283,000. We regard that as improbable, given that the prosecutions commenced with the release of the grand jury indictment on 5 October 2000, and that significant costs would have been incurred from that point onwards. We think it more probable that Steve Brodie's recollection in relation to the amount of costs incurred up to June 2000 is less than accurate; at best, he would have been conscious by June 2000 that substantial legal costs had already been incurred. We consider it unlikely that he would have had in front of him full and accurate information about those costs at that stage if that was in fact the point at which he was taking the decision as to allocating part of them to PIL.

62. Another issue, which is considered further later in this decision, is the justification for allocating a proportion of the legal costs to PIL. In relation to timing, the question is whether in June 2000 there would have been an apparent reason for such an allocation. As Steve Brodie stated in his witness statement, the notification of the grand jury investigation was given to BTC, Don Brodie, Steve Brodie and James Sabzali. Thus PIL was not one of the persons subject to the investigation. In a much later document, the Reply Memorandum submitted on 19 April 2002 in support of Steve Brodie's motion for judgment of acquittal (the result of which is described at paragraph 16 above), the following statement appeared:

> "From April 1993 to May 2000, the time period of the alleged conspiracy, Steve Brodie in good faith believed that transactions conducted between [PIL] in the United Kingdom and Cuban entities, which did not involve the United States, were perfectly lawful."

63. Thus if Steve Brodie had been informed that transactions involving PIL and Cuban entities, but not the United States, were not lawful, this information could only have been provided to him after some date in May 2000. The Declination Memorandum was submitted by Morgan, Lewis & Bockius LLP on 8 May 2000. PIL was named as one of the parties on whose behalf it was submitted. It set out reasons why the sales from PIL should be regarded as legal as a result of the enactment of "blocking orders" by the UK in response to the US embargo of Cuba. Reference was made to the possibility of PIL itself being a possible subject of prosecution in the United States, but it was submitted that there were no grounds for the exercise of jurisdiction over PIL. No reference was made to the possible "blacklisting" of PIL by the United States government.

64. Other than the Declination Memorandum, we have no evidence of any advice being given to Steve Brodie at any time up to June 2000 in relation to the possibility of any prosecution of PIL. Although Steve Brodie mentioned in evidence that PIL had received a "target letter", there was no such document included with the evidence; we would have expected such an important letter to have featured prominently in the evidence (and in the earlier correspondence with HMRC). We are not satisfied that potential prosecution of PIL was in his mind at the point when decision (3) was made. In oral evidence, he described the advice given by Ed Dennis that PIL and Purolite Canada should be outside the jurisdiction of the US as having been "blatantly wrong", and stated that the reason that they had not ultimately been prosecuted was that the US did not want to get a subpoena of foreign entities. In his witness statement, when

referring to the indictment issued on 5 October 2000, he indicated that there were no indictments against PIL; he had been advised that this was because PIL was outside the jurisdiction and consequently was not subject to US law. (Whether any advice in respect of blacklisting had been given by May or June 2000 was a matter of dispute, to which we return below.) At most, on the basis of what was subsequently stated in the Reply Memorandum in 2002, Steve Brodie can only have become aware in May or June 2000 at the earliest that the involvement of PIL in the transactions was likely to give rise to difficulties for it as a result of the application of US legislation in relation to transactions in which there had been no US involvement. On the question whether he might have been aware before then of potential difficulties in relation to transactions in which there was a US involvement, we had no documentary evidence sufficient to satisfy us that he was.

65. We find the arguments as to the timing of the "in principle" decision concerning allocation of costs to be quite finely balanced. The most persuasive part of the evidence is Steve Brodie's reference to it having become "apparent that this was going to be a major piece of litigation". If the reference to June 2002 were to be taken as correct, a great deal of that litigation would already have happened; the trial was in March 2002, three months before that point, and the preparation for the trial would have been continuing since the issue of the grand jury indictment in October 2000. On balance, we accept that Steve Brodie's reference to the date having been June 2002 was erroneous, being an incorrect recollection. The difficulty in establishing this date illustrates the problems arising from the informal policy approach of not keeping records of decisions, and relying on recollections after the event.

66. Turning to the timing of the fourth and final decision for consideration, the decision on the method of allocation of the legal costs, Steve Brodie stated at paragraph 19 of his witness statement:

> "In July 2002, Don and I sat down with Jim Downy, BTC's Chief Financial Officer, to discuss precisely how we would apportion the costs to PIL and the other group companies."

67. In oral evidence, Steve Brodie stated that this reference to 2002 had also been incorrect; the decision to make an allocation had been made in June 2000, and the decision as to the method had been taken in July 2000. The idea that there should be an allocation had come from Jim Downy.

68. Ms Nathan suggested to him in cross-examination that the reference to July 2002 was more consistent with the following paragraphs of his witness statement, which referred to the details of the method adopted; the invoices related to the trial, rather than to preparation for the trial. The costs had been recharged to PIL in September 2002, which appeared to be more consistent with the July 2002 date. Steve Brodie chose not to answer Ms Nathan's question on the latter point.

69. In her submissions on the facts, Ms Nathan argued that there were some difficulties with amending the July date to 2000. This would have been before the charges had been issued; it was a logical impossibility to apportion costs before

charges had been made. She emphasised that amending the date to 2000 resulted in internal inconsistencies between elements of Steve Brodie's witness statement.

70. Mr Prosser accepted in his reply submissions that Steve Brodie must have been mistaken in thinking that the reference to July 2002 in paragraph 19 of his witness statement was an error. July 2002 was shortly after the end of the trial, and so was consistent with paragraph 21, the description of the basis on which the allocation calculation had been carried out. Further, as HMRC had submitted, paragraph 19 said that the allocation was by reference to PIL's involvement in the counts in the indictment, and therefore it must have been after October 2000.

71. We are satisfied that the date of July 2002 in paragraph 19 of Steve Brodie's witness statement is correct, for the reasons referred to by Ms Nathan and Mr Prosser.

72. Thus the sequence of decisions was:

(1) Decision in October 1999 to instruct lawyers following notice of the grand jury investigation;

(2) Decision shortly thereafter that all the legal costs should be paid by BTC;

(3) Decision in June 2000 that there would have to be some kind of allocation between different group companies according to their involvement in the alleged breaches of the embargo;

(4) Decision in July 2002 as to the method to be adopted for such allocation.

73. In the light of the latter decision, taken in the course of a meeting between Steve Brodie, Don Brodie and Jim Downy but not recorded in writing, the allocation calculation was subsequently made. Steve Brodie stated that in addition to the discussion at that meeting, he also discussed the allocation with Henri Bousquet, who at the time was the managing director of PIL, who "was content with the decision we reached". Steve Brodie emphasised that the discussion with Henri Bousquet was not a formality, as he was so integral to the business, and his only stake in the group was an interest in PIL. We find that the discussion with Henri Bousquet must have taken place in July 2002 or shortly thereafter, as according to Steve Brodie's witness statement the allocation calculation took over two months to complete, and the costs were recharged to PIL in September 2002. (We accept Steve Brodie's evidence in this respect.)

74. The result of the allocation exercise was that 76.77 per cent of the total cost of defending all the charges brought in the United States was allocated to PIL, and the remainder of the costs were charged to BTC. The allocation was made on the basis that 59 out of the 77 counts of the indictment related to the shipment of resins from PIL to various end users in Cuba.

75. We have reviewed the method of calculation of the proportion of the legal fees attributable to the shipments from PIL, and accept it on the basis that the underlying assumptions, which we have not checked in full and specific detail, are correct. HMRC have made clear that they accept the method of allocation, so we do not find it necessary to make any further investigation of the methodology.

Which decisions need to be considered in relation to PIL's claimed expenditure?

76. For PIL, Mr Prosser submitted that the relevant decision was decision (3) (paragraph 72 above); this followed from his initial submission that the relevant expenditure was a contribution towards costs of defending a prosecution brought in respect of supplies of resins made in the course of its trade. That decision was separate from the decision to defend the prosecution. He emphasised that the expenditure in question was a partial contribution towards the costs of defending the US government's prosecution, and not the legal costs themselves. PIL believed that it was in its interest that the prosecution should be defended in order to avoid blacklisting, that it was therefore in its interests to assist with the defence by contributing towards the legal costs, and that it was appropriate that PIL should do so, having regard to its involvement. It was not PIL's case that the expenditure was deductible merely because PIL had caused the prosecution.

77. HMRC's submissions were made on the basis that the relevant decision was decision (1). (We deal below with the matters covered by Ms Nathan's wider submissions.)

78. On the basis of the timings of the various decisions considered above, we consider that Mr Prosser's reference to the decision to defend the prosecution is not entirely accurate. Decision (1) was to incur expenditure by way of legal costs in reacting to the grand jury's investigation, once this had been notified to the four parties involved being subjected to that investigation. A decision to defend the prosecution could not have been taken until the indictment had been issued, and this did not happen until 5 October 2000. We have accepted on balance that decision (3) was made in June 2000, so the decision to defend the prosecution cannot have had any part in the decision to allocate some proportion of the costs to PIL. We accept that Mr Prosser's point may equally relate to decision (1); if so, the question which this raises is why PIL should decide to become involved at a subsequent stage in the costs of proceedings to which it was not a party, in circumstances where (on the basis of our findings on the evidence provided to us) it had not been notified that it was subject to the grand jury investigation. Had PIL been notified of the grand jury investigation at the same time as BTC, Steve Brodie, Don Brodie and James Sabzali, the probability is that a decision by PIL to incur legal expenses on defending the charges would have been made at the same time as decision (1), rather than being left until a later stage.

79. We comment below on the various reasons given by Steve Brodie and in correspondence between PIL's advisers and HMRC for the decision to allocate a proportion of the costs to PIL. Steve Brodie referred in his witness statement to information received from Williams & Connolly following the issue of the indictment. They commented that, in addition to the question of jail sentences and fines, there were other commercial sanctions which could be applied in the case of conviction. That firm retained Steptoe & Johnson, a leading commercial law firm, to provide advice in relation to this.

80. His evidence in his witness statement was:

> "The advice given was that, if convicted of the charges, there was a very serious threat that goods sent from PIL to the US could be blacklisted, even if the goods were imported into the US via Canada or BTC. I had a telephone conversation with Ed Krauland at Steptoe & Johnson in 2002 to discuss the blacklisting issue. The advice given was along the lines of that set out in Ed's letter of advice dated 15 June 2005, written to me when we had to revisit the issue at the time of my plea bargain."

81. He stated in cross-examination that the telephone conversation of 7 June 2005 referred to in Ed Krauland's letter was not the first conversation on the subject, but the last and concluding conference. Conversations relating to the exposure had taken place far earlier, with Williams & Connolly. We note that there is no documentary evidence recording the telephone conversation with Ed Krauland said to have taken place in 2002, nor any documentary evidence of any conversations with Williams & Connolly on this subject.

82. When Ms Nathan questioned him as to the specific matters covered in the 15 June 2005 letter, he indicated that he was unable to give a legal opinion, and commented that when informed that PIL's export privilege might be revoked, he was going to respond. The only company which he had been told was at risk was PIL, and therefore the only company which he considered to be at risk was PIL.

83. Although his witness statement made no reference to PIL being involved at the time when the lawyers had been consulted following notification of the grand jury investigation, he stated in oral evidence that this had certainly been the concern.

84. The position of PIL had been considered; the litigation had been undertaken on behalf of PIL. Had it failed, there would have been a risk of PIL being blacklisted. He indicated that "we" (ie he and Don Brodie) looked at each "venue" individually, both for taxation and for commercial purposes. Although PIL had not been named as a defendant, more than 50 per cent of its business was with the United States; its actions had resulted in the parties in the United States becoming involved in the proceedings.

85. Mr Kevin Downey, who had been a partner in Williams & Connolly since 2000, stated in evidence that Williams & Connolly had started in 2000 to give advice about the risk of trading restrictions and other adverse administrative consequences being imposed on BTC and also upon PIL in the event of a guilty verdict being reached. He referred to specialist advice as to this issue being sought by Steve Brodie in 2005 from Steptoe & Johnson in connection with his guilty plea, and to the letter of advice from that firm dated 15 June 2005, but did not mention any earlier specialist advice from Steptoe & Johnson.

86. We have referred above to the statement in the 2002 Reply Memorandum that Steve Brodie had believed until May 2000 that transactions between PIL and Cuba, not involving the United States, were perfectly lawful. Mr Downey's evidence was that his firm had represented Steve Brodie from July 2000 to July 2005, and BTC from February 2002 to February 2004, in relation to the charges for alleged violation of the Cuban embargo law. Mr Downey did not specify a precise date in 2000 when

his firm started to give advice as to the implications for BTC and PIL. It appears to us, on the balance of probabilities, that such advice would have followed the indictment, rather than being given on a speculative basis before the results of the grand jury's investigation became known. The approaches by Morgan Lewis & Bockius LLP in June 2000 to the Assistant Attorney General had been made with a view to seeking some alternative resolution of the matter without need to resort to a prosecution; time for his consideration of those approaches would have had to be allowed before it became appropriate to consider the risks which would follow any decision to proceed with prosecution.

87. On the basis of Mr Downey's evidence as to the timing of his firm's involvement, we do not think that Steve Brodie could have discussed the blacklisting issue with Williams & Connolly before decision (3) was taken in June 2000. (The discussions with Ed Krauland came much later, and there was no documentary evidence of the 2002 telephone conversation referred to by Steve Brodie in his witness statement.) Although Steve Brodie stated in oral evidence that the advice from Williams & Connolly had been given at about the time when the Declination Memorandum had been sent in, that event predated the beginning of that firm's involvement. We do not accept his evidence on the timing of that advice. There was no evidence as to any advice from other sources having been given to Steve Brodie after May 2000, the date subsequently mentioned in the Reply Memorandum. It is therefore unclear why his belief as referred to in that document would have changed almost immediately after the end of "the period of the alleged conspiracy". If he was conscious before June 2000 of a risk that the transactions which had been carried out by PIL through the United States, as opposed to direct shipments from PIL to Cuba, could result in blacklisting, this was not apparent from his evidence. We are not persuaded that the blacklisting issue was in his mind at the time of decision (3).

88. We find that there is a logical difficulty with Mr Prosser's submission that the relevant decision is decision (3). He argued that the relevant expenditure was a contribution towards the costs, and not the legal costs themselves. For the present, we leave aside the basis on which the expenditure was described in PIL's Financial Statements (see below), and address the principle. If there is a decision by a person ("A") to contribute to expenditure on legal costs incurred by another person ("B"), B has already made the decision to incur the expenditure. As a result, that other expenditure will have been incurred, and continue to be incurred, by B whether or not A contributes anything. If A chooses to contribute, what does A obtain by making his contribution that he would not have obtained in the absence of any contribution? If the contribution makes no difference, how can it be described, in terms of s 74(1)(a) ICTA 1988, as "money wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation"? We do not consider that Mr Prosser's submission based on Vaughan Williams LJ's dictum in the *Bonner* case provides an answer to this question. There was no evidence that decision (3) had had any influence on the progress of the litigation in the United States, or on the amount of costs being incurred; it was not suggested that the decision to make the allocation had enabled any steps to be taken that would not have been taken in the absence of that decision.

89. In our view, the relevant decision is not what we have referred to in the previous paragraph as "a decision to contribute", ie in the present case decision (3), the decision that there would have to be some kind of allocation between different group companies according to their involvement in the alleged breaches of the embargo. Instead, we find that the relevant decision is decision (1), taken in October 1999, to instruct lawyers following notice of the grand jury investigation. We accept that decision (2), that the legal costs should be borne by BTC, may be regarded as combined with decision (1), because of the specific Delaware General Corporation Law provision referred to above.

90. By way of illustration, we find it helpful to consider an analogy. Two friends ("D" and "E") meet by chance in the street. To continue their conversation, they decide to have lunch at the nearest restaurant. Before they place their orders for their meals, they agree that there will have to be some fair basis for splitting the cost between them, but as they do not yet know how many courses each of them will choose to have and what each menu choice will cost, they do not specify what the method of dividing the bill is to be. Their primary decision is to incur the expense of eating at the restaurant. There can be no allocation or contribution until the initial decision has been taken to purchase meals at the restaurant.

91. To extend the analogy, if another friend ("F") joins them at the end of the meal for a discussion but chooses not to have anything to eat or drink, and F decides to pay a substantial proportion of the bill for all three of them, this cannot affect the pre-existing contractual relationship between D and E and the restaurant under which D and E between them are responsible for paying for the cost of their meals. In this sense, F's contribution is made "after the event".

92. We accept that all analogies are imperfect and cannot always cover exactly the circumstances under examination; they should not be stretched too far. However, we regard the decision that there would have to be some form of allocation (decision (3)) as logically dependent on, and subject to, the earlier decisions to incur the expenditure. This requires us to consider on whose behalf the earlier decisions were taken. We also consider the process of arriving at the other decisions.

On whose behalf were the decisions taken?

93. Decisions (1) and (2) were taken by Steve Brodie and Don Brodie. The parties to which these decisions related were Steve Brodie, Don Brodie, James Sabzali and BTC, being the persons notified of the grand jury investigation. There was no suggestion at the time when decision (1) was taken that PIL was to be regarded as being involved. PIL was not mentioned until Morgan, Lewis & Bockius LLP submitted the Declination Memorandum in May 2000. In the light of the 2002 Reply Memorandum already mentioned, Steve Brodie believed until May 2000 that transactions between PIL and Cuban entities not involving the United States were perfectly legal. Further, (as already considered above) the advice in relation to potential blacklisting of PIL came much later than decisions (1) and (2). We find that those decisions related only to the four persons notified of the grand jury investigation, and not to PIL; the object of those decisions was to protect the parties

charged, and not PIL. If there was any question at the time concerning protection of the business, this would have related to the business of the BTC group as a whole. No decisions were taken by PIL in 1999.

94. Decision (3) was made in general terms by Steve Brodie and Don Brodie, without referring to any specific company or companies (see paragraph 56 above). At the stage when it was made, ie June 2000 as found above, it could not (on the evidence before us) have been known for certain what the alleged breaches were (or, therefore, which companies were likely to be regarded as implicated), as the breaches and parties involved were not specified until the indictment was issued in October 2000. Steve Brodie may have been aware in general terms of the respective companies' involvement in transactions with Cuba, but his knowledge of the circumstances was not sufficient to enable the basis for the allocation to be considered at that stage. In the light of the uncertainties at that point as to the future progress of the grand jury's investigation, we are not satisfied that sufficient information would have been available in June 2000 to enable the directors of PIL to take a separate and independent decision to enter into a commitment to make a contribution to the costs of the litigation. As far as any potential prosecution of PIL was concerned, in the Declination Memorandum submitted in May 2000 by Morgan Lewis & Bockius LLP, it had been argued that there were no grounds for the exercise by the US of jurisdiction over PIL.

95. If, despite our findings above, it is not correct to treat the combination of decisions (1) and (2) as the relevant decision, we do not consider decision (3) to have been taken solely by PIL. Steve Brodie described it at paragraph 11 of his witness statement (see paragraph 56 above). Based on that description ("some kind of allocation between group companies according to their involvement in the alleged breaches of the embargo"), we find that it was taken as a decision for the group as a whole, having regard to the interests of the respective group companies involved. It was a decision in principle, taken for the group business as a whole and not for PIL alone. We are not satisfied that the only object in the minds of Steve Brodie and Don Brodie in taking it was to defend or protect the trade of PIL.

96. Decision (4) was taken by Steve Brodie, Don Brodie and Jim Downy. Jim Downy's role was that of BTC's Chief Financial Officer. The process of deciding the method of allocation clearly took into account the respective interests of the group companies involved. In agreeing the method to be adopted, we find that Steve Brodie and Don Brodie were considering the positions of both of the companies involved in the shipments, rather than taking separate decisions in respect of each company.

97. Steve Brodie explained in his oral evidence that allocation had been "the right thing to do". He emphasised that attribution of costs to PIL had resulted in a tax disadvantage; had they been paid in full by BTC, the whole of the costs would have been deductible in computing BTC's taxable profits, with a higher corporate tax rate in the United States than that in the UK. The "differential" was 5 per cent. He confirmed that BTC's tax computations showing its share of the cost had not been questioned by the IRS; BTC had not had an "examination" for a number of years.

98. We do not regard the "tax differential" as a sufficient reason to view decision (4) as having been taken purely on behalf of PIL. That decision, and the process following it, was designed to arrive at an appropriate balance of interests as between two group companies. Any tax advantage or disadvantage resulting from the exercise was purely an incidental consequence, and would not have formed part of that exercise itself. The allocation was designed to produce a fair result as between the two companies.

The various reasons given for PIL bearing part of the legal costs

99. Ms Nathan drew attention to the differing reasons given at the time when the expenses were recharged to PIL as compared with those given at the hearing. She submitted that the fact that the reasons were changing throughout the correspondence suggested strongly that PIL had no clearly determined purpose for incurring the expense but instead was doing what it had been asked or told to do by its parent. PIL contributed to BTC's resources for no reason other than that it had been asked to do so. This failed the test in s 74(1)(a) ICTA 1988.

100. On the evidence available to us, the starting point for the recording of information concerning PIL's contribution was the respective Financial Statements of PIL for the years ended 31 December 2002, 2003 and 2004. These contained notes referring to the legal costs. The note for 2002 stated:

> "During the year, legal costs were incurred to ensure the continued availability of the services of Mr Stefan Brodie and Mr Don Brodie. The costs arose out of a legal case in the US relating to the company trading with Cuba. The costs were incurred to preserve the current banking facilities of [PIL] that are dependent on the continued service of the directors."

101. For 2003, the note was similar, with the addition of the following sentence:

> "The legal case was settled in 2003."

102. The note for 2004 was:

> "The legal costs of £212,000 (2003: £149,000) relate to costs incurred in securing the continued services of the group directors Mr SE Brodie and Mr DB Brodie."

None of these notes referred to the expenditure as being a contribution to legal costs, as described in Mr Prosser's argument. Nor was any reference made to seeking to preserve PIL's trade by ensuring that no blacklisting occurred.

103. Steve Brodie made no reference to these matters in his witness statement. In oral evidence he mentioned two types of loan. One was from GE Capital; the $52 million lent had been apportioned between BTC and PIL. The second was a revolving loan from Fleet Capital Corporation, based on current assets. As the loans were "cross-defaulted", there had been a default on both. He and Don Brodie had convinced the lawyers acting for the banks that the 77 counts in the indictment following the grand jury's investigation were an "overcharge". As a result, a

"Forbearance Agreement" had been entered into. This had had the effect of cutting PIL's available capital, and the interest rates had been increased; both these matters had been of concern to PIL.

104. Although reference had been made in the correspondence between Grant Thornton and HMRC to the question of a potential default under the GE Capital Loan Agreement if there had been an event of default within section 8.1(k) (set out above), Steve Brodie accepted in cross-examination that there had already been a default on the issue of the indictment, and that following the Forbearance Agreement there was no further risk of the loans being withdrawn by reference to the defence of the charges under the indictment.

105. Another reason given in evidence by Steve Brodie for the recharging of the legal expenses was that, without BTC's order book, PIL would not be able to sustain itself. PIL was the company which had the most to lose commercially if the prosecution had been successful. It was dependent on its export sales to the United States.

106. A further reason was that, at the initial stages, PIL could have been a defendant.

107. In relation to the loans, the reasons given in PIL's Financial Statements for the three relevant years appear to be inconsistent with the position as described in evidence by Steve Brodie. The claims for deduction of expenditure, as reflected in PIL's corporation tax returns, must have been made on the basis of those Financial Statements. On the basis of Steve Brodie's evidence, the reasons given for deducting what were described as "legal costs" were not correct, in the light of the terms agreed in the Forbearance Agreement. We should emphasise that no copy of that agreement was included in the evidence, nor had its existence been disclosed before the hearing. As it was clearly not reached until after the indictment, we do not think that it can have played a part in decision (3), which, as we have found, was made in June 2000 and thus before the indictment.

108. Steve Brodie stated in his witness statement that he never considered a custodial sentence as a real or likely threat. He had been advised, when the charges were first made, that there had been only two previous cases in which breach of the CACR had resulted in imprisonment. The circumstances in these cases had been very different from those in relation to those in the indictment affecting him and the other parties. One case had involved illegal substances, and the other had involved classified restricted military materials.

109. The notes in PIL's Financial Statements were written long after the time of the indictment. Those notes do not reflect the prior knowledge of the directors that there was no realistic prospect of imprisonment. Even in the absence of the Forbearance Agreement, we consider that those notes provide no valid justification for deducting the amounts paid in the relevant accounting periods in respect of legal costs (or contributions towards legal costs).

110. A further issue in relation to the possible event of default under the GE Capital Loan Agreement is that any default would have affected all parties to that agreement, not merely PIL. Any payment by PIL in respect of the costs associated with seeking to prevent a default would have the object of keeping in being the financing for the group as a whole. We do not consider it correct to regard the consequences for other group members of PIL making that payment as being mere effects of that expenditure. We do not find it necessary to consider in detail the question of possible cross-default as between the Fleet financing and the GE Capital loan, as this does not affect our conclusion as to the object of the expenditure. Whether the position is considered as at the time of decision (3), or subsequently in the light of the Forbearance Agreement concluded after the indictment, the issue of potential default does not form a valid basis for PIL's claim to deduct the expenditure as a trading expense.

111. We have already considered the question of the likelihood or otherwise of a prosecution of PIL. We are not satisfied that there was at any time a realistic prospect of this occurring. The Declination Memorandum expressed the view, which subsequently turned out to be correct, that such a prosecution would be inappropriate. Williams & Connolly advised following the issue of the indictment that the reason for the absence of any indictments against PIL was that PIL was outside the jurisdiction and so was not subject to US law. Kevin Downey's evidence was that it would have been after the indictment, and had probably been in 2001, when the United States government had confirmed that it had decided not to prosecute PIL.

112. The other reason, the potential effect on PIL's business, appears to bring together two issues. The first is whether there was a risk of BTC ceasing to operate, so that PIL's business with the United States might have been lost. The second is the question of possible blacklisting of PIL's exports to the United States. We have already concluded that the latter could not have been in contemplation at the time when decision (3) was taken. In relation to the potential effect on BTC of being prosecuted, we do not think that at the time of decision (3) there was a realistic prospect of it ceasing to operate; the Declination Memorandum submitted in May 2000, shortly beforehand, argued that there should be no prosecution and that there should be an administrative resolution of the matter. Further, Steve Brodie stated in evidence that, as BTC did not export, he and Don Brodie knew that it would be able to survive following a prosecution, in contrast to the effect that a prosecution of PIL would have had on PIL's business.

113. We are not satisfied that any of the reasons given for PIL's payments in respect of legal costs is sufficient to establish that the expenditure was incurred wholly and exclusively for the purposes of its trade. Further, as Ms Nathan submitted, the reference to a range of reasons for PIL having incurred that expenditure reinforces the view that there was no clear purpose in the minds of PIL's directors when arriving at the decision that part of the legal costs should be allocated to PIL. As concluded above, decision (3) was taken on a group basis and not merely on behalf of PIL.

Summary of our conclusions

114. Our conclusions as to the facts are:

(1) The decision to defend the charges was taken in October 1999, the only parties involved being Steve Brodie, Don Brodie, James Sabzali and BTC. (We ignore the one count relating to John Dolan.) The object of this decision (and the following decision) was to protect the parties charged, and not PIL. We are not satisfied that there is any evidence of PIL having been involved in any way at that stage.

(2) The decision that BTC should bear the legal costs was taken shortly afterwards.

(3) The decision that there would have to be an allocation of costs as between the companies involved was taken in June 2000.

(4) We are not satisfied that there was any realistic prospect at or before June 2000 of PIL being prosecuted for its involvement in the transactions with Cuban entities.

(5) As at June 2000 there was insufficient information available for PIL to have made an independent decision to accept the obligation to bear a proportion of the costs.

(6) The issue of possible blacklisting of PIL's exports to the United States was not in the minds of its directors in June 2000 when the "in principle" decision as to an allocation was made.

(7) There was no real prospect in the minds of Steve Brodie and Don Brodie of BTC ceasing to operate as a result of what in June 2000 was merely the potential prosecution of BTC.

(8) The default provisions in the loan agreements do not amount to a justification for PIL making a contribution to BTC in respect of the legal costs.

(9) The decision in June 2000 that there should be some form of allocation of the costs between group companies was taken by Steve Brodie and Don Brodie on a "group business" basis, and not separately and independently on behalf of PIL.

115. On the facts which we have found, we regard it as inherently improbable that Steve Brodie and Don Brodie would have taken the decision with only PIL in mind. We have referred above to the comments of Walton J in *Garforth* as being merely a "pointer" in such cases, but linked to the issue of inherent probability or improbability. In *Vodafone*, Millett LJ referred at p 742 to the "other purpose", in the context of a company forming part of a group, as being "likely to be the purpose of the trade of one or other companies in the group". We accept that this comment presupposes a finding of a wider object. In considering the facts, it would have taken very strong evidence to satisfy us that, as directors of both PIL and its ultimate parent company BTC, they took the decision to incur the expenditure with the sole object of protecting PIL's trade. Not only was there no such strong evidence; because of the way in which they ran the companies, there was no evidence at all, other than the recollection of Steve Brodie. As we have found, that recollection has been shown to have been unreliable in various respects, even if typing errors are ignored.

116. Ms Nathan submitted that as there was no extant threat to PIL's business, the contribution to the legal costs was not made for the purposes of its trade but was simply an allocation of its profits already earned. As indicated above, there is no evidence of the contributions made by PIL having had any effect on the legal proceedings in the United States. For the reasons which we have set out, we do not consider that the contributions were made wholly and exclusively for the purposes of PIL's trade. We have considered the various threats to PIL's business put forward as reasons for PIL making the contribution; none of these amounted to sufficient reasons for PIL entering into the obligation to contribute. Further, the "in principle" decision in June 2000 was made with the respective interests of the companies involved in the shipments in mind, and not simply as a decision by PIL. There was thus duality of purpose in that decision. We consider that the actual allocation was a mechanical process, following the "method" decision in July 2002; that decision was also taken on a group basis, and not solely by reference to the interests of PIL.

117. For all these reasons we find that PIL's expenditure in making a contribution to the legal costs was not wholly and exclusively for the purposes of its trade.

118. We acknowledge that the decision to arrive at an allocation as between the companies involved in the alleged breaches of the embargo is entirely understandable as a commercial matter. However, that is not sufficient to establish, for UK corporation tax purposes, that PIL's attributed share of the costs is deductible in computing the profits of its trade.

119. We therefore dismiss PIL's appeal. As PIL has given notice, pursuant to Rule 10(1)(c)(ii) of the Tribunal Rules, of exclusion of these proceedings from potential liability for costs and expenses, we make no order as to costs.

Right to apply for permission to appeal

120. 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.

JOHN CLARK
TRIBUNAL JUDGE

RELEASE DATE: 25 July 2012

Amended pursuant to rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 16 November 2012.