Neutral Citation Number: [2020] EWCA Civ 579

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
(Arnold J and Judge Hellier)
[2018] UKUT 0069 (TCC) & [2018] UKUT 0413 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 30/04/2020

Before :

LORD JUSTICE PETER JACKSON
LADY JUSTICE ROSE DBE
and
SIR TIMOTHY LLOYD

Between :

Case nos. A3/2019/0836 & 0837

(1) INVESTEC ASSET FINANCE PLC
(2) INVESTEC BANK PLC **Appellants**

- and –

THE COMMISSIONERS OF HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

Case no. A3/2019/0864

THE COMMISSIONERS OF HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and –

(1) INVESTEC ASSET FINANCE PLC
(2) INVESTEC BANK PLC

Respondents

- -
- -

Jonathan Peacock QC and Michael Ripley (instructed by **Allen & Overy LLP**) for Investec Asset Finance plc and Investec Bank plc

John Tallon QC and James Rivett QC (instructed by **HMRC Solicitors Office**) for HMRC

Hearing dates : 4 and 5 March 2020

- -

Approved Judgment

Covid-19 Protocol: This judgment was handed down remotely by circulation to the parties' representatives by email, release to BAILII and publication on the Courts and Tribunals Judiciary website. The date and time for hand-down is deemed to be 10.30 a.m. on Thursday 30 April 2020

CONTENTS

Lady Justice Rose:

1. These appeals from the Upper Tribunal (Tax and Chancery Chamber) (Arnold J and Judge Charles Hellier) raise a number of important substantive and procedural issues arising out of a series of closure notices issued by HMRC to Investec Asset Finance plc ('IAF') and Investec Bank plc ('IBP') in respect of their liability for corporation tax in the accounting periods between 1 April 2006 and 31 March 2010. The substantive issues concern the relationship between the statutory provisions concerning the taxation of profits made by partnerships and the taxation of a company's business where that business includes owning interests in partnerships. Generally speaking, where a partnership is carried on by persons at least one of which is a company, it is not treated as a separate entity for tax purposes. According to sections 111 and 114 of the Income and Corporation Tax Act 1988 ('ICTA'), the profits of the partnership are first calculated for the purposes of corporation tax as if the partnership were a company but then those profits are taxed in the hands of the corporate partners according to their proportionate interests in the partnership. Where those partners are companies rather than individuals, those companies are also liable for corporation tax on their own business profits under section 42 of the Finance Act 1998.

2. The main substantive issue in this case is what happens when some of the income of the corporate partners' own business comprises profits of partnerships in which the companies own an interest. Should the profits made by the partnership that have already been taxed in the hands of the partners pursuant to section 114 be left out of account when calculating the profits of the partners' own businesses so as to ensure compliance with the principle that the same profits should not be taxed as income twice? If so, how does that principle apply in the instant cases?

3. The procedural issues concern first, how far HMRC can defend a challenge brought by a taxpayer in the tribunal against a closure notice, by relying on arguments that the proper tax treatment of the company's affairs should be something different from the conclusions HMRC set out in that closure notice. Secondly, there are procedural issues about how far HMRC can rely on new arguments before this Court in particular on an argument that was presented before the First-tier Tribunal and the Upper Tribunal as relied on only as a secondary, fall-back argument, in circumstances where they have achieved a measure of success in their primary argument.

4. The appeal before the Upper Tribunal ('UT') was from the decision of the First-tier Tribunal (Tax Chamber) (Judge Howard Nowlan and Elizabeth Bridge) dated 24 May 2016 [2016] UKFTT 356 (TC) ('the FTT Decision'). There are two judgments of the Upper Tribunal challenged before us. The first is the judgment of 4 April 2018 reported at [2018] UKUT 0069 (TCC) ('the First Decision'). At the end of that decision, the UT invited further submissions on two points that it had raised for the consideration of the parties. Following a second hearing in November 2018, the UT issued a further judgment on 19 December 2018 [2018] UKUT 0413 (TCC) dealing with those points ('the Second Decision'). The Second Decision resolved some points but remitted one issue back to the FTT for further fact-finding.

5. The UT granted permission to appeal to both parties. There are three appeals before us, two appellants' notices lodged in almost identical terms by IAF and IBP together, taking issue with aspects of the First and Second Decisions and an appellant's notice

lodged by HMRC challenging one aspect of the Second Decision. HMRC also served Respondents' Notices in the two IAF and IBP appeals.

1. BACKGROUND

(a) The Leasing Partnerships and the IAF and IBP interests in them

6. The series of transactions which preceded the tax assessments in these appeals were very complicated. They are summarised in paras. 2 onwards of the First Decision and described in more detail in a Statement of Agreed Facts appended to that Decision (the 'SOAF'). Fortunately, it is not necessary to go into much detail at least at this stage. There are seven partnerships at issue although it is agreed that five of them based in Hong Kong are all to be treated in the same way. We need therefore to focus only on three, the Forty-Sixth Hong Kong Leasing Partnership ('HKP') (which will determine the fate of four other transactions also involving Hong Kong leasing partnerships); the Garrard No 2 Leasing Partnership ('Garrard') and the Leasing Acquisitions General Partnership ('LAGP'), together referred to as 'the Leasing Partnerships'. Each of the Leasing Partnerships held assets which were leased out and which entitled them to receivables, for example in the form of annual rental payments or a final lump sum payment in respect of assets leased under a hire purchase agreement.

7. Through a series of transactions, IAF and IBP (to whom I will refer together as 'the Appellants') became partners in each of the Leasing Partnerships. They incurred costs referred to as the "Disputed Expenditure", disputed because one of the main issues in these proceedings is whether all or some of these costs are deductible when computing the profits of IAF and IBP for corporation tax purposes. The Disputed Expenditure was of two kinds. The first kind was the price that the Appellants paid to acquire the interests they bought in the Leasing Partnerships ('the Acquisition Costs'). Acquisition Costs were incurred by both IAF and IBP in respect of all seven of the Leasing Partnerships. The second kind of cost was Capital Contributions. This kind of cost was incurred by IAF and IBP only in respect of LAGP and Garrard. Both those partnerships received very substantial capital contributions from IAF and IBP once IAF and IBP had acquired their partnership interests. There was no capital contribution made to HKP; all the Disputed Expenditure in relation to HKP comprised Acquisition Costs. Shortly after the Appellants acquired their interests in the Leasing Partnerships, the Leasing Partnerships sold off their assets or otherwise terminated or disposed of the leases they held. As a result, the Leasing Partnerships all received large sums of money which generated profits in their hands. They paid over much of that money to the Appellants.

8. The Appellants, like most companies are subject to corporation tax on their profits pursuant to section 42 of the of FA 1998 which provides:

> "**42 Computation of profits of trade, profession or vocation**
>
> For the purposes of Case I or II of Schedule D, the profits of a trade, profession or vocation must be computed in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in computing profits for those purposes."

9. It is accepted that the no double taxation principle, if it applies, would be an adjustment required or authorised by law for the purposes of section 42.

10. The Appellants are also liable to tax because they are partners in a trade. Section 111 ICTA provides:

> "**111 Treatment of partnerships**
>
> (1) Where a trade or profession is carried on by persons in partnership, the partnership shall not, unless the contrary intention appears, be treated for corporation tax purposes as an entity which is separate and distinct from those persons."

11. Section 114 ICTA then provides as follows: (emphasis added)

> "**114. Special rules for computing profits and losses**
>
> (1) So long as a trade, profession or business is carried on by persons in partnership, and any of those persons is a company, the profits and losses (including terminal losses) of the trade, profession or business shall be computed for the purposes of corporation tax in like manner, and by reference to the like accounting periods, as if the partnership were a company … and without regard to any change in the persons carrying on the trade, profession or business … [*exceptions*].
>
> (2) A company's share in the profits or loss of any accounting period of the partnership, … shall be determined according to the interests of the partners during that period, and corporation tax shall be chargeable **as if that share derived from a trade, profession or business carried on by the company alone** in its corresponding accounting period or periods; and the company shall be assessed and charged to tax for its corresponding accounting period or periods accordingly …"

12. The trades carried on by IAF and IBP themselves, taxable under section 42 FA 1998 have been referred to in these proceedings as the "solo financial trades" to distinguish them from the trades carried on by IAF and IBP in their capacity as partners in the Leasing Partnerships. I refer to the trades that the Appellants as corporate partners are treated as carrying on by the phrase highlighted in section 114(2) above as the "114(2) trades". The solo financial trades and the 114(2) trades are in turn to be distinguished from the trades actually carried on by the Leasing Partnerships themselves.

13. IAF and IBP both argued before the FTT that their solo financial trade and the 114(2) trade were the same trade, albeit that they accepted there had to be two tax computations. That made it easier for them to argue that the Disputed Expenditure was deductible from their share in the profits chargeable under section 114(2). The FTT concluded at para. 52 of the FTT Decision that the Appellants were conducting their own solo financial trades and they were then participating in a separate trade in partnership. They were therefore each carrying two trades and not just one trade with

two computations. There was no appeal on that point to the UT (see para. 13 of the First Decision) and it is common ground between the parties before this court.

(b) The closure notices and the covering letter

14. HMRC issued eight closure notices, one for each Appellant for each accounting period ending 31 March 2007, 2008, 2009 and 2010.

15. The closure notice dated 3 April 2012 for the accounting period ending 31 March 2007 sent by HMRC to IAF said that as a result of the enquiries, HMRC had concluded that IAF's losses were overstated by £2,767,874. For the subsequent years, HMRC's stated conclusion was that the profits had been understated by £11,780,037 in respect of accounting period ended 31 March 2008; by £5,165,071 in the accounting period ending 31 March 2009 and by £4,822,231 in the accounting period ending 31 March 2010.

16. For IBP the closure notices all concluded that taxable profits had been understated: by £196,218,976 for the accounting period ended 31 March 2007; £54,345,650 in the accounting period ending 31 March 2008; £98,178,381 for the accounting period ended 31 March 2009 and £48,754,353 in the accounting period ending 31 March 2010.

17. Each closure notice amended the relevant tax return made by IAF or IBP to give effect to that conclusion. The reasons given for the adjustment to the tax return were the same in each closure notice, namely that the trade carried on by IAF or IBP was different from the 114(2) trade carried on as partners in the Leasing Partnerships. Therefore IAF's and IBP's profits assessable to corporation tax should comprise its share of the profits of the trade carried on in partnership with others computed under section 114 ICTA **and** any profits of its solo financial trade. However, HMRC regarded both the income received and the expenditure incurred by the solo financial trades from Leasing Partnerships as being for the Appellants' capital rather than revenue accounts. The effect of this was that there was no income and no deductible expenditure derived from the Leasing Partnerships for the purposes of the section 42 computation of the solo financial trades. Further, the Disputed Expenditure was not made wholly for the purposes of the solo financial trade and so not deductible from any income in the solo financial trades for that additional reason. Each closure notice also said:

> "You should note that, depending on the exact nature of any contention put forward on behalf of [IAF *or* IBP] to the contrary, HMRC may wish to advance additional grounds in support of amendment of the company's return."

18. The terms of the covering letter sent with the closure notices, dated 3 April 2012, are set out at para. 110 of the FTT Decision. The covering letter referred to the closure notices as reflecting HMRC's conclusion that the Disputed Expenditure "should be on capital account", that is to say that it was expenditure of a capital and not a revenue nature and hence not deductible in computing the profits of the solo financial trades. The covering letter went on:

> "As you will be aware from correspondence, there are other arguments as to the possible tax consequences. These are not properly part of the closure notice as these are not our conclusion, but we thought it proper to note that the legal issues involved may go down these routes depending on the arguments you raise, and depending on the direction taken by the Tribunal."

19. The covering letter then gave two examples of the routes that HMRC might go down before the Tribunal, the first of which is relevant for our purposes:

> "**Scenario 1**
>
> If it is determined that –
>
> a) the Company's involvement with the various partnerships did in fact represent trading transactions and
>
> b) that the payments made did in fact represent allowable deductions,
>
> we would argue that any trade of the Company of which these transactions are a part is separate from the trade carried on in partnership. The profits of each of those trades should be computed and assessed to corporation tax without reference to the other.
>
> The consequence in terms of the assessments would be a maximum of £42,653,788 additional profits chargeable to corporation tax for both companies over all years, over and above the additional profits chargeable to corporation tax outlined in the closure notices."

20. Thus HMRC raised in the covering letter an alternative argument that if the income and expenditure was for the revenue and not the capital account of the solo financial trades, their approach would not make any adjustment to reflect the fact that part of the trading income of the solo financial trades was in fact profit of the 114(2) trades taxed separately in the hands of IAF and IBP.

(c) The issues before the FTT and the UT

21. It is necessary to describe the issues that were dealt with by the FTT and the UT including those that are no longer contested before us since the Decisions at both levels refer to the issues by their original tags.

22. **Issue 1: the Revenue/Capital Issue.** The issue raised in the closure notices about the capital or revenue nature of the income and expenditure to be included in the tax computation for the solo financial trades had, by the time the case was heard by the FTT, resolved down to the issue whether the Appellants' Disputed Expenditure was properly to be treated as revenue expenditure or capital expenditure. The Appellants argued that it was all revenue expenditure so that it could be deducted from income to arrive at the profit on which they were liable to tax. HMRC argued that it was all

capital expenditure so that it could not be deducted from income. The FTT held in favour of the Appellants and against HMRC that both the Acquisition Costs and the Capital Contributions were revenue expenditure and not capital expenditure (and hence in theory at least capable of being deductible from income when computing profit for tax purposes). The UT upheld the FTT's decision that the Disputed Expenditure was all revenue in nature and not capital. HMRC have not appealed against that finding. The appeal before us therefore proceeds on the basis that all the Acquisition Costs and the Capital Contributions are revenue in nature.

23. **Issue 2: the Deductibility of the Capital Contributions.** This issue is whether, assuming that the Acquisition Costs and Capital Contributions are revenue expenditure, they were nevertheless not deductible from income because they were not incurred wholly and exclusively for trading purposes, as required by section 74(1) of ICTA 1988. The relevant "trading purposes" here are the purposes of the solo financial trades of IAF and IBP rather than the purposes of the 114(2) trades. The Appellants argued that they were all incurred wholly and exclusively for the purposes of the solo financial trades; HMRC argued that they were incurred in part for the purposes of the 114(2) trades. The FTT held that both the Acquisition Costs and the Capital Contributions were wholly and exclusively incurred for the purposes of the solo financial trades of the Appellants. They therefore decided this issue wholly in favour of the Appellants and against HMRC. The UT held that the Acquisition Costs were expenses incurred wholly and exclusively for the purposes of the solo financial trades of IAF and IBP but that the Capital Contributions made to Garrard and LAGP were made at least partly for the purposes of the Appellants' 114(2) trades. Before the UT therefore, HMRC were partially successful on Issue 2. The same did not apply to HKP because for HKP, the Disputed Expenditure comprised only Acquisition Costs and on that HMRC were unsuccessful on Issue 2 when the UT upheld the FTT's conclusion that all the Acquisition Costs were wholly and exclusively incurred for the purposes of the solo financial trades. Again, this is important for understanding why the distinction was made by the UT in the Second Decision between Garrard and LAGP on the one hand and HKP on the other.

24. Before this court, the Appellants challenge the UT's conclusion that the Capital Contributions were not wholly and exclusively incurred for the purposes of their solo financial trades. HMRC has not appealed against the UT's decision that the Acquisition Costs were wholly and exclusively incurred for those trades. It is therefore common ground before us that at least the Acquisition Costs are a deductible expense from any income of the solo financial trades in order to compute the taxable profits of those trades. If we allow the Appellants' appeal on this point in respect of the Capital Contributions, that will mean that HMRC have been wholly unsuccessful on Issue 2 in respect of all the Leasing Partnerships.

25. **Issue 3: the Scope of the Closure Notice Appeal**. This is the procedural issue about the scope of an appeal in respect of a closure notice issued by HMRC. As I mentioned earlier, when HMRC issued the closure notices which are the subject of this appeal, they sent a covering letter which set out an alternative analysis of IAF's and IBP's tax affairs which would in fact lead to more tax being due than was asserted by the adjustment to the figures in the tax returns. The case law makes clear and the Appellants accept that HMRC can put forward different legal arguments which support the making of the adjustment contained in the closure notice and can rely

before the tribunal on alternative ways of justifying a particular adjustment to the figures in the tax return. At issue here is whether HMRC can put forward alternative adjustments to the figures; one adjustment which is included in the closure notice but then also alerting the taxpayer to HMRC's possible future reliance on an alternative construction of the law which would lead to a figure being included in the taxpayer's return which is different both from the figure that the taxpayer included when it lodged the tax return and from the adjustment figure that HMRC included in the closure notice. The Appellants accept that they were given adequate notice of the alternative analysis and that there was no procedural unfairness to them in letting HMRC rely on the alternative point. But they say on the proper construction of the statutory provisions governing the issue of closure notices and the jurisdiction of the FTT on an appeal challenging a closure notice, it is not open to HMRC to argue for a different adjustment from the one made by the closure notice.

26. The FTT held that there was no statutory bar on HMRC raising the alternative argument even if it led to a different adjustment from the one made by the closure notice. The UT upheld the FTT's decision that it was able to consider an alternative conclusion and an alternative amendment, as set out in the covering letter. The Appellants' appeal on Issue 3 was therefore dismissed. Before us, the Appellants appeal against this aspect of the UT's decision and submit that it is not open to HMRC to raise the alternative analysis set out in the covering letter.

27. **Issue 4: Double Taxation Issue.** This is the most complicated issue and I shall deal with it here in brief outline only. This is the alternative "Scenario 1" analysis that was set out by HMRC in the covering letter. It can be summarised as whether HMRC were right to suggest in the covering letter that, assuming that all the income and expenditure to be included in the solo financial trades and deriving from the 114(2) trades is revenue in nature, are the tax computations of the two trades to be entirely separate or does there need to be some adjustment to prevent the corporate partner effectively being taxed twice on the same income? HMRC initially disputed that the no double taxation principle had any application here. They argued (as they had explained in the covering letter) that if there were two trades, each had to be taxed separately and the no double taxation principle was not engaged by the fact that the profits on which IAF and IBP were taxed in their capacity as partners in the Leasing Partnerships also made their way into the solo financial trades as income and so needed to be included in computing the taxable profits of those solo financial trades. The FTT and the UT both held in favour of the Appellants that the no double taxation principle did apply here. Putting it neutrally they held that the principle operated to leave some or all of the money that the solo financial trades derived from the Leasing Partnership trades out of account when the profits of the solo financial trades were being computed for tax purposes.

28. HMRC do not now contest that conclusion as a matter of principle. The argument has shifted to whether the UT was right to go on to raise questions and make decisions about whether some of the money received by the solo financial trades from the Leasing Partnerships was of a kind that did not engage the no double taxation principle. The argument has also shifted to focus on whether the UT was right to remit this issue to the FTT for further fact finding in respect of HKP but not in respect of LAGP and Garrard.

29. **Issues 5 and 6: Foreign tax credits.** Issue 5 was an argument similar to Issue 3 above as to whether it was open to HMRC to rely on an analysis (relating to foreign tax credits) which was different from the analysis set out in the closure notices. Issue 6 was the substantive argument about the foreign tax credits. These issues were decided by the FTT at paras. 150 – 157 of the FTT Decision. The issues were not appealed to the UT (see para. 20 of the First Decision) and have now fallen away because of the now uncontested conclusion that there were two trades (that is that the solo financial trades were separate from the 114(2) trades) and not one single trade carried on by each Appellant. Issues 5 and 6 do not form part of the appeal before us and I need say no more about them.

2. THE DEDUCTIBILITY OF THE CAPITAL CONTRIBUTIONS

30. The first issue for this court is that raised by IAF's and IBP's appeals, formerly Issue 2, namely whether their Capital Contributions to LAGP and Garrard were expenditure incurred wholly and exclusively for the purposes of their solo financial trades.

(a) Capital Contributions: the facts

31. The extent of the Capital Contributions is as follows: the paragraph numbers in square brackets refer to the paragraphs of the SOAF annexed to the First Decision.

32. **LAPG** IAF and IBP bought the LAGP partnership for £8.8 million on 21 August 2006: [18]. Following that, IAF made a contribution of capital of £11.3 million and IBP made a contribution of capital of £215 million. The contributions were used to pay stamp duty on the purchase of a leasing business and to repay debts owed by the partnership to its former Merrill Lynch partner under an earlier credit agreement facility letter: [20].

33. **Garrard** IBP bought its partnership interest in Garrard in April 2007 for £5 million: [36]. A few days later IAF also acquired an interest in Garrard in return for contributing £200,000 of capital to Garrard: [41]. Garrard called for a further capital contribution from its partners in order to acquire certain commercial vehicles for leasing. For this purpose IAF contributed £29,000: [43]. In May 2007 Garrard made a further call for additional contribution to enable it to buy more machinery, vehicles and plant for leasing out. IBP made a capital contribution of £49 million and IAF made a contribution of £2 million: [47]. In July 2007 IBP made an additional capital contribution of £20 million and IAF an additional capital contribution of £862,000: [54]. On 21 August 2007 the partners in Garrard executed a deed by which they agreed that Garrard would pay £62.5 million to IBP by way of a return of capital contributed by IBP: [61]. In September 2007 a further £260,000 was returned by Garrard to IBP: [63].

34. **HKP** In December 2007 IAF and IBP bought interests in the HKP for HK$31 million and HK$ 600 million respectively: [93] and [102]. There were no capital contributions from IAF or IBP to HKP.

(b) Capital Contributions: the law

35. Section 74(1)(a) of ICTA (subsequently s 54(1) Corporation Tax Act 2009) provides that in computing the profits to be charged to corporation tax, no sums shall be

deducted in respect of expenses which are not wholly and exclusively laid out or expended for the purposes of the trade. The double negative means that only sums which **are** wholly and exclusively incurred for the purposes of the trade can be deducted. The parties agree that the test as to whether an item of expenditure is wholly and exclusively incurred for the purpose of a particular taxpayer is that set out by the Court of Appeal in *Vodafone Cellular Ltd v Shaw* [1997] STC 734 ('*Vodafone*'). That case concerned the deductibility of a payment made by the taxpayer in order to bring to an end an onerous fee agreement to which it was a party and which was likely to generate a heavy drain on the taxpayer's annual income. On the question of whether the payment was made wholly and exclusively for the purposes of the taxpayer's trade, Millett LJ (with whom Hirst LJ and Sir John Balcombe agreed) said that the question whether a payment was wholly and exclusively incurred for the purposes of the taxpayer's trade was a question of fact for the Commissioners and the court could only interfere with that finding if the Commissioners made an error of law in reaching their conclusion. At p. 742, Millett LJ derived the following principles from the leading modern cases, in particular *Mallalieu v Drummond* [1983] AC 861:

> "(1) The words for the purposes of the trade mean to serve the purposes of the trade. They do not mean for the purposes of the taxpayer but for the purposes of the trade, which is a different concept. A fortiori they do not mean for the benefit of the taxpayer. (2) To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment. (3) The object of the taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment. (4) Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made."

36. To those propositions Millett LJ added one more:

> "The question does not involve an inquiry of the taxpayer whether he consciously intended to obtain a trade or personal advantage by the payment. The primary inquiry is to ascertain what was the particular object of the taxpayer in making the payment. Once that is ascertained, its characterisation as a trade or private purpose is in my opinion a matter for the Commissioners, not for the taxpayer."

37. Having stressed that the matter was a question of fact for the Commissioners and that the important factor was the subjective intention of the directors, Millett LJ nevertheless overturned the conclusion of the Commissioners because they had erred when applying the law to their findings of the primary facts. The Commissioners had found that the evidence showed that the directors of the taxpayer did not distinguish in their own minds between the business of the taxpayer and the business of its subsidiary companies. The directors thought of the group as a single trading entity. Further, the burden of paying the fees under the onerous agreement would more likely fall on the subsidiary companies than on the taxpayer because the taxpayer was entitled under the arrangements between the taxpayer and its subsidiaries to be reimbursed by its subsidiaries for any payments made under the fee agreement. Those factors meant that the payment made by the taxpayer to the third party to terminate the fee agreement was incurred not only for the purposes of the taxpayer's trade but also for the purposes of the trades of the other companies in the group.

38. Millett LJ said that where the taxpayer is a company forming part of a group, it is likely that one purpose of what it does will be the purpose of the trade of one or more of the other companies in the group. One must still distinguish between the purpose of the trade of the parent company and that of the subsidiaries because they are different taxable persons. Millett LJ held first that there was no evidential basis for the Commissioners' finding of fact that the subsidiaries were liable to reimburse the taxpayer for the fees that the taxpayer paid to the third party. That was an error that could be corrected applying the *Edwards v Bairstow* test. That finding had not been critical to the determination of the Commissioners. It was the oral and documentary evidence before the Commissioners that the directors of the taxpayer company regarded it and its two subsidiaries as one functioning trading entity that had been critical to the Commissioners' conclusion that the purpose of the directors of the taxpayer company in agreeing to make the cancellation payment was to benefit the trading position of the whole group.

39. Millett LJ disagreed. He held at p 744h that the Commissioners had confused the *purposes* of the taxpayer company's trade with the *benefit* to the taxpayer company. The object the directors were seeking to achieve was the cancellation of the fee agreement. It was only the taxpayer company that was liable under that fee agreement to the third party; "ergo, the directors' intention, whether articulated or not, was exclusively to serve the purposes of the taxpayer company's trade". The true and only reasonable conclusion from the facts found by the Commissioners contradicted their determination and the appeal was therefore allowed. Hirst LJ in a short concurring judgment also emphasised that the Commissioners are the judges of fact and that the scope for interfering with their decision was strictly circumscribed. However, he was also satisfied that the court could and should intervene in that case. The correct approach was to examine the findings of primary fact to see whether they were sufficient to support the conclusion which they eventually reached. For the reasons given by Millett LJ, he agreed that they were not.

(c) Capital Contributions: the decisions below

40. The FTT held that the Capital Contributions were wholly and exclusively incurred for the purposes of the solo financial trades of IAF and IBP: see paras. 96 – 100 of the FTT Decision. The FTT thought that the conclusion they arrived at followed inevitably from the earlier findings that the Appellants had never intended that the

Leasing Partnership trades would be conducted for any stand-alone benefit. The FTT summarised the evidence of the witnesses (para. 60). The evidence was that the Appellants were only interested in short-term roles in complex and novel transactions. For those in the banking department within the Appellants, the way in which the receivables might be held was irrelevant. They saw themselves as buying receivables at a discount and making a trading profit. At para. 64 the FTT recognised that it was unrealistic to regard the acquisition of the partnership interests (as opposed to acquiring the lease assets directly) as being irrelevant; on the contrary it was a crucial part of the tax planning designed to avoid IAF and IBP being paid the various receivables directly. At para. 65, however, the FTT accepted the evidence from the Appellants' witnesses as "fundamentally realistic". Their sole aim in all the transactions was to effect the pre-planned and pre-contracted steps by which the value of the partnership assets would be realised and distributed to them. The FTT said at para 98: (emphasis in the original)

> "The capital contribution made in the LAGP case was essentially part of the purchase price of the partnership interests and not a contribution made to discharge "*existing liabilities* ***incurred in the course of the pre-existing partnership trade***" and while matters were rather more involved in the case of the Garrard partnership, it is still clear that every step, the acquisition of existing leases from the two Investec group companies and the purchase of assets and leased assets from third parties, was all entirely directed to the purpose, within the appellants' solo trades."

41. The UT dealt with this point at paras. 46 – 63 of the First Decision. They noted that it was common ground that this is an issue of fact and therefore the FTT's decision could only be overturned on *Edwards v Bairstow* grounds. Before the UT, HMRC were challenging the FTT's decision in respect of both the Acquisition Costs and the Capital Contributions arguing that none of this money was wholly and exclusively incurred for the benefit of the solo financial trades of IAF and IBP. The UT held that as regards the sums paid to acquire the partnership interests, there was no flaw in the FTT's reasoning: para 56. But the position was different for the sums paid by way of Capital Contributions. The Capital Contributions made by IAF and IBP as partners of Garrard were made to enable the *partnerships* to purchase assets which were either already leased or leased subsequently or to pay off loans. The UT accepted that the FTT was entitled to find as a fact that the Appellants' ultimate objective in making the Capital Contributions was that IAF and IBP would profit in their solo financial trades once the leasing businesses were all brought to an end. However, the UT went on:

> "62. … It nevertheless appears to us to be inescapable that the capital contributions were made by Investec at least partly for the purposes of Garrard's and LAGP's businesses, which the FTT found to be distinct from those carried on by IAF and IBP. This was not an incidental consequence, it was central to the way in which the Garrard and LAGP transactions were carried out. In the case of Garrard, it was the capital contributions by the partners which enabled the partnership to acquire assets which enable distributions and profits to be made in the case of

> LAGP, it was the capital contributions by the partners which enable the partnership to acquire the leasing business. The FTT held (at [98]) that these contributions were "effectively part of the purchase price of the partnership interests", but the leasing business was acquired subsequently effectively using the capital provided by IAF and IBP. In both cases, therefore, the FTT erred in law, because its conclusion was contrary to its own findings of fact."

(d) Capital Contributions: discussion

42. The Appellants say that UT erred in finding that the Capital Contributions were not wholly and exclusively incurred for the purposes of the solo financial trades, thereby overturning the decision of the FTT on the point. First, they submit that there was no *Edwards v Bairstow* challenge by HMRC when appealing to the UT from the findings of fact by the FTT. Since *Vodafone* establishes that the question whether expenditure is made wholly and exclusively for the purposes of the taxpayer's trade is a question of fact, it was not open to the UT to overturn this in the absence of such a challenge. Secondly, IAF and IBP submit that the UT was wrong to hold the Capital Contributions were incurred partly for the purposes of the Leasing Partnership trades – or at least for the purposes of the 114(2) trades - in light of the evidence given by the witnesses and accepted as truthful by the FTT. That evidence was that the Appellants' intention all along was to realise the assets of the Leasing Partnerships very rapidly after they acquired their partnership interests.

43. In my judgment these criticisms have no merit because the UT's decision was not based on a disagreement with the FTT over the facts. The FTT set out a detailed narrative of the factual background to the case. As regards LAGP, the FTT's findings were mostly set out at para 25 of the FTT's Decision:

> "Following a number of involved transactions, the Appellants ended up buying the LAGP partnership for the aggregate sum of £8,854,001 and together contributing £226,181,882 as the capital to the partnership. This sum was used to purchase roughly £4¼ million worth of assets that were leased to various third parties, with the vast majority of the capital contributed being applied indirectly in repaying to the Merrill Lynch lender amounts that had earlier been advanced to fund the outstanding liability of a bridge company that had acquired the leasing business but left the consideration for it outstanding."

44. So far as Garrard was concerned, the FTT's narrative records:

> "30. Following the acquisition of the partnership, the Appellants contributed substantial further capital to the partnership on a number of occasions, and that further capital was applied by the partnership in three different ways. First, some of the capital was applied in purchasing assets from unconnected third parties and leasing those assets to third parties. Most of the capital was applied in acquiring a fairly substantial portfolio of leased assets from the Investec

> company, Investec Asset Finance (No 1) Limited. … The third contribution of funds was applied in purchasing other leased assets from another Investec company, namely Investec Asset Finance (Capital) Ltd."

45. The UT was right, in my judgment to hold that on those findings of fact, the Capital Contributions were not wholly and exclusively incurred for the purposes of the solo financial trades. There is no need to disturb any finding of fact by the FTT in order to arrive at that result. It is undoubtedly true as the FTT found that:

    i) the Capital Contributions were paid to LAGP and Garrard and then used by them in their businesses, either to acquire additional assets for leasing, or to acquire a third party's leasing business to add to their own, or to pay off debts that they owed.

    ii) IAF and IBP were not interested in being long-term partners in leasing businesses and expected and arranged to realise the value of those businesses as soon as possible after they acquired their partnership interests.

    iii) The putting together of the 'wrapper', by which IAF and IBP acquired interests in the partnerships rather than direct interests in the lease receivables was absolutely vital to the tax planning, however uninterested the banking people at IAF and IBP may have been in that aspect of the transactions.

46. The question for the UT and now for us is whether, given those facts, the Capital Contributions were, as a matter of law, wholly and exclusively incurred for the purposes of the solo financial trades. In my judgment they clearly were not. The analogy with the facts in *Vodafone* is helpfully close. The attitude of the banking staff as found by the FTT here has the same relevance or lack of it as the Vodafone directors' attitude regarding the corporate group as a single trading entity. Certainly the ultimate objective of IAF and IBP was to make some money quickly; that could best be achieved by the structure that the people at IAF and IBP or its counterparties created which involved the lease receivables being owned by the Leasing Partnerships and not by IAF and IBP directly. The fact that the FTT did not describe the evidence of the witnesses as being as to their "ultimate objective" does not prevent that being the only reasonable conclusion to arrive at.

47. The Appellants have an alternative argument if those first submissions fail. Even if, in general, the Capital Contributions are to be regarded as incurred partly for the purposes of the 114(2) trades, the Capital Contributions made to LAGP were made pursuant to a clause in the contract under which IAF and IBP purchased their interests in LAGP. For some reason that the Appellants were not able to explain, the vendor of the partnership interests stipulated in the contract for sale that the debt owed by LAGP be paid off by the new owner. These costs should therefore be regarded as Acquisition Costs. The same does not apply to the Capital Contributions to Garrard since there was no such contractual requirement. I do not consider that the fallback position in relation to the LAGP contributions assists the Appellants. The contractual obligation to make the Capital Contribution to pay off LAGP's debts may or may not explain why it was made but it does not assist in determining the purpose of the payment when it was made.

48. I would therefore dismiss this ground of IAF's and IBP's appeal and uphold the conclusion of the UT that the Capital Contributions are not deductible as an expense from the income of the solo financial trades because they were not incurred wholly and exclusively for the purpose of those trades.

3. THE SCOPE OF THE CLOSURE NOTICE APPEAL

49. This issue in IAF's and IBP's appeal raises the former Issue 3, that is the question whether HMRC are precluded from relying on Issue 4 at all in respect of any of the Leasing Partnerships because the adjustment that would result from Issue 4 is not the adjustment that was referred to in the closure notice or the result of the conclusions set out in the closure notice. The adjustment proposed by Issue 4 derives instead from Scenario 1 in the covering letter sent to the Appellants with the closure notices.

(a) Scope of Closure Notice Appeal: The law

50. The first set of relevant provisions are set out in Schedule 18 to FA 1998. Para. 3 empowers HMRC to require a company to deliver a company tax return which must include a declaration by the person making the return that the return is correct and complete to the best of his knowledge. The company tax return must include a self-assessment of the amount of tax payable taking into account any relief or allowance for which a claim is included in the return (para. 7 of Sch 18). HMRC may enquire into a company tax return by giving notice to the company of their intention to do so. A return which has been the subject of a notice of enquiry may not be the subject of another such notice, unless that second enquiry is prompted by an amendment of the return made by the company (para. 24). An enquiry into a company tax return extends to anything contained in the return or required to be contained in the return, including any claim included in the return or any amount that affects or may affect the tax payable (para. 25). After notice of enquiry has been given, HMRC may amend the self-assessment before the enquiry is completed if they form the opinion that the amount of tax payable according to the company's self-assessment is insufficient and that delay may lead to a loss of tax to the Crown. An appeal may be brought against an amendment of a company's self-assessment in those circumstances (para. 30). When an enquiry is ongoing, any question arising in connection with the subject matter of the enquiry may be referred to the tribunal for determination; this can happen more than once during the course of an enquiry (para. 31A).

51. An enquiry is completed when HMRC serve a closure notice informing the company that they have completed their enquiry and stating their conclusions (para. 32(1)). Para. 34(2) provides that the closure notice must either state that in the officer's opinion no amendment is required or must "make the amendments of that return that are required to give effect to the conclusion stated in the notice".

52. An appeal may be brought against an amendment of a company's return made under subparagraph (2) (para. 34(3)). Notice of appeal must be given to HMRC in writing within 30 days of receipt of the closure notice (para. 34(4)). For what happens after that, one must move to the provisions of the Taxes Management Act 1970 ('TMA') which apply to appeals against a Schedule 18 closure notice by virtue of section 48 TMA. Where a notice of appeal has been given to HMRC under para. 34 of Schedule 18, the appellant may ask HMRC to review the matter in question or may straightaway notify the appeal to the tribunal (s 49A(2)). Where, as happened here,

HMRC carry out an internal review but uphold the result, the appellant may then notify the appeal to the tribunal (section 49G(2)).

53. The task of the tribunal at that point is important for our purposes. If the appellant notifies the appeal to the tribunal, "the tribunal is to determine the matter in question" (section 49G(4)). The "matter in question" is defined as meaning "the matter to which an appeal relates" (section 49I(1)(a)).

54. The powers of the tribunal on an appeal notified to it are set out in section 50(6) and (7) TMA:

> "**50 Procedure**
>
> …
>
> (6) If, on an appeal notified to the tribunal, the tribunal decides:
>
> (a) that the appellant is overcharged by a self-assessment, ...
>
> the assessment … shall be reduced accordingly, but otherwise the assessment … shall stand good.
>
> (7) if, on an appeal notified to the tribunal, the tribunal decides:
>
> (a) that the appellant is undercharged to tax by a self-assessment; …
>
> the assessment … shall be increased accordingly."

55. The first case to which the parties referred us was *D'Arcy v Revenue and Customs Commissioners* [2006] STC (SCD) 543, a decision of Dr John Avery Jones CBE when he was a Special Commissioner. The case concerned a closure notice issued under section 28A TMA which deals with the closure of an enquiry into a self-assessment tax return filed by an individual rather than a company. Section 31(1)(b) TMA provides that an appeal may be brought against any conclusion stated or amendment made by such a closure notice. This wording is different from that in para. 34(3) of Schedule 18 which refers only to an appeal being brought against the amendment of the company's return. I mention this to explain the wording of some of the passages from the judgments cited to us although the Appellants did not rely on the distinction as part of their argument in favour of the narrow ambit of the FTT's jurisdiction.

56. The closure notice in *D'Arcy* stated HMRC's very specific conclusion that a claim for income tax relief was disallowed applying the Ramsay principle because a series of transactions in £31 million nominal value gilts should be treated as circular and self-cancelling. Before the Special Commissioner, HMRC abandoned that position and sought to argue that the relief was allowable but that a similar amount was taxable under the accrued income scheme in section 713 of ICTA. The taxpayer contended that the Revenue could not change the basis of their conclusion as stated in the closure notice. HMRC argued that the duty of the Commissioners under section 50 TMA was to determine the amount of tax due and that could be higher than the amendment

HMRC had made to the return. The Commissioners must determine the correct figure and were not required to adjudicate on the reasons given in the assessment.

57. Dr Avery Jones noted that the introduction of self-assessment had made a major change to the system of appeals. Under the previous regime, appeals against assessments could raise any new issue subsequent to the assessment, subject only to the constraints of proper case management. Self-assessment was different. He also noted at para. 10 that the stipulation in section 31(1)(b) that an appeal may be brought against the conclusion or amendment in the closure notice and the wording of section 50(6) and (7) requiring the appeal commissioner to determine whether the taxpayer is over or undercharged did not appear to fit well together. That did not, however, mean that the Commissioners should consider the overall tax result arising from the whole of the return. The logical end of that contention would be that if the Revenue came to a conclusion about a trading profit which the taxpayer appealed, there was nothing to prevent the Revenue from contending that the taxpayer was liable to more tax on something quite different, such as rent. That was not the correct reading of the provisions. Parliament had enacted a system under which the Revenue had to state a conclusion and make an amendment against which an appeal could be brought, necessarily limited to that conclusion or amendment:

> "10 …. It follows that by starting an appeal, while the taxpayer is still at risk of having the figure in the amendment increased, this is limited to an increase in the figure related to the conclusion or amendment. …"

58. Dr Avery Jones went on to hold that the scope of an appeal against the conclusion or amendment made by closure notice will depend on the facts. He described the conclusion in the closure notice before him as having been very specific, so that the scope of the appeal concerned the particular transactions in gilts "and nothing else" (para. 11). As to the law, he considered that it was inherent in the appeal system that the Commissioners must form their own view of the law without being restricted to what the Revenue stated in their conclusion or the taxpayer stated in the notice of appeal. Either party could change their legal arguments subject to the Commissioners using their case management powers to prevent an ambush. He decided therefore that although he took a narrower view than that contended for by the Revenue, the Revenue were permitted to raise a new argument of law "related to the facts identified by the closure notice" (para.15).

59. The next case the parties relied on was *Tower MCashback LLP 1 and another v HMRC* [2011] UKSC 19, [2011] 2 AC 457 ('*Tower MCashback*'). In that case HMRC had rejected a claim for a capital allowance in respect of the taxpayer's purchases of software pursuant to section 45 of the Capital Allowances Act 2001. The allowance applied to expenditure incurred by a small enterprise on IT software. Subsection 45(4) precluded such an allowance if the expenditure was incurred with a view to granting another person the right to use the software. During the course of an enquiry, HMRC argued that the allowance was disallowed by subsection 45(4). The taxpayer pressed HMRC to close the enquiry. The subsequent closure notice stated simply that the claim for relief under section 45 CAA was excessive and amended the partnership return substituting a nil capital allowance and a nil allowable loss. The covering letter sent with the closure notice stated that the allowance was disallowed by section 45(4).

60. On the taxpayer's appeal before the Special Commissioner, HMRC abandoned their reliance on subsection 45(4) and argued instead that the expenditure had not been "incurred" within the meaning of section 45 because of the particular features of the scheme involved. The Special Commissioner concluded that he had jurisdiction to consider grounds other than the ground on which the inspector had relied. Henderson J allowed the appeal concluding that the scope of any appeal was confined to the question whether section 45(4) applied and that the Special Commissioner was not entitled to refuse the allowance on any other basis: [2008] EWHC 2387 (Ch), [2008] STC 3366. He arrived at this conclusion despite his acknowledgement of what he referred to as the "venerable principle":

> "There is a venerable principle of tax law to the general effect that there is a public interest in taxpayers paying the correct amount of tax, and it is one of the duties of the Commissioners in exercise of their statutory functions to have regard to that public interest. … For present purposes, however, it is enough to say that the principle still has at least some residual vitality in the context of section 50, and if the Commissioners are to fulfil their statutory duty under that section they must in my judgment be free in principle to entertain legal arguments which played no part in reaching the conclusions set out in the closure notice. Subject always to the requirements of fairness and proper case management, such fresh arguments may be advanced by either side, or may be introduced by the Commissioners on their own initiative.
>
> That is not to say, however, that an appeal against a closure notice opens the door to a general roving inquiry into the relevant tax return. The scope and subject matter of the appeal will be defined by the conclusions stated in the closure notice and by the amendments (if any) made to the return."

61. On the appeal in *Tower MCashback*, ([2010] EWCA Civ 32, [2010] STC 809) Moses LJ identified the question for the court as being the extent to which the conclusion stated in the closure notice limits the jurisdiction of the Commissioners exercised according to the procedure identified in section 50 TMA. Like Dr Avery Jones in *D'Arcy*, Moses LJ contrasted the current system with the earlier system before self-assessment when everything covered by an assessment was within the scope of an appeal and the assessment could be increased on account of something not in contemplation at the time it was made. By contrast, a self-assessment constitutes the final determination of liability to tax except for limited circumstances such as where the taxpayer amends his return or the Revenue opens an enquiry and amends the return in accordance with the closure notice. The new regime of self-assessment greatly limited the Revenue's power to impose additional tax liabilities or recover excessive reliefs. Moses LJ noted the rejection in *D'Arcy* of a submission from HMRC that once there is an appeal, the Commissioners' jurisdiction is unconfined. It is implicit in the statutory scheme, he held, that an appeal is confined to the subject matter of the conclusions and any amendments stated in the closure notice. These provisions underlined the finality of the self-assessment.

62. Moses LJ regarded the retention of section 50 in terms which closely followed those of its predecessor as "a powerful indication that Parliament did not intend to change the jurisdiction of the Commissioners in as dramatic a fashion as the introduction of a system of self-assessment might have suggested": para. 28. The public interest in determining the amount on which the taxpayer ought to be taxed had, he said, in no way been altered by the introduction of self-assessment. However, section 50 must be read in the context of the new provisions - it all depends on what one means by the "subject matter". There is likely to be controversy as to how one draws the boundaries of the subject matter of the conclusion stated in the closure notice. He went on:

> "37. Parliament has not chosen to identify some legal principle defining the limitations on the scope and subject-matter of an enquiry and consequently an appeal. In those circumstances, I think it would be wrong for the court to attempt to do so. Any statement of principle is likely to condemn both taxpayer and the Revenue to too rigid a straitjacket. It might prevent a taxpayer from advancing a legitimate factual or legal argument which had hitherto escaped him or deprive, on the other hand, the public of the tax to which it is entitled.
>
> 38. With those nebulous observations, I would leave it to the Commissioners and now the First-Tier Tribunal to identify the subject-matter of the enquiry and thus the subject-matter of the conclusions. In doing so, the First-Tier Tribunal will have to balance the need to preserve the statutory protection for the taxpayer afforded by notification that the Inspector has completed his enquiries and the need to ensure that the public are not wrongly deprived of contributions to the fisc."

63. Moses LJ was fortified in his conclusion by the case management powers conferred on the Special Commissioners and on the FTT which replaced them. He concluded that the statute looks to the FTT to identify the subject matter of the enquiry. The appeal is confined to the subject matter of the enquiry and of the conclusions but the jurisdiction on appeal is not limited to the issue of whether the reason for the conclusion is correct. Having described the correspondence and the closure notice issued to the taxpayer, Moses LJ concluded that although the issue that had arisen under section 45(4) was the issue that had prompted the inspector to issue his closure notice, that issue was not the subject matter of the enquiry nor the conclusion stated in the closure notice. Accordingly the closure notice did not have the effect of limiting the appeal to that single issue: para. 53. The subject matter of the appeal as identified by the Special Commissioner was whether the claim under section 45 was excessive. Scott Baker LJ agreed with Moses LJ, stating that his analysis met the point that in principle the taxpayer ought to be taxed to pay the correct amount of tax. A narrower construction of what is in play in an appeal against a closure notice is likely to create some situations in which the taxpayer is either unfairly penalised or is not taxed as the legislation intended. Arden LJ came to a different conclusion and would have dismissed the appeal on this point.

64. Tower MCashback appealed to the Supreme Court which sat as a panel of seven Supreme Court Justices ([2011] UKSC 19, [2011] 2 AC 457). Lord Walker of

Gestingthorpe gave the lead judgment. He approved of the statement by Henderson J that there is no requirement for an officer to set out in the closure notice the reasons which have led to his conclusions. He also approved Henderson J's reference to the venerable principle of tax law to the effect that there is a public interest in taxpayers paying the correct amount of tax. But he preferred the approach of Moses LJ, particularly approving Moses LJ's reference to the importance of leaving it to the fact-finding tribunal to determine the subject matter of the closure notice. Lord Walker sounded a note of caution:

> "18. This should not be taken as an encouragement to officers of HMRC to draft every closure notice that they issue in wide and uninformative terms. In issuing a closure notice an officer is performing an important public function in which fairness to the taxpayer must be matched by a proper regard for the public interest in the recovery of the full amount of tax payable. In a case in which it is clear that only a single, specific point is in issue, that point should be identified in the closure notice. But if, as in the present case, the facts are complicated and have not been fully investigated, and if their analysis is controversial, the public interest may require the notice to be expressed in more general terms. As both Henderson J and the Court of Appeal observed, unfairness to the taxpayer can be avoided by proper case management during the course of the appeal."

65. Lord Hope of Craighead also said that it was desirable for the statement by the HMRC officer of his conclusions to be as informative as possible because of "the function that the terms of the notice will serve in identifying the subject matter of any appeal": para. 83. He also stressed that closure notices must be read in their context and that context included the previous indications during the enquiry of "the points that have attracted the officer's attention". He said at para. 84:

> "In these circumstances it does not seem unfair to the LLPs to hold that the issue as to their entitlement to the allowances claimed should be examined as widely as may be necessary in order to determine whether they are indeed entitled to what they have claimed. Furthermore, while the scope and subject matter of the appeal will be defined by the conclusions and the amendments made to the return, section 50 of TMA does not tie the hands of the Commissioners (now the Tax Chamber) to the precise wording of the closure notice when hearing the appeal."

66. Finally we were referred by the parties to the four principles set out by Kitchin LJ in *Fidex Ltd. v Revenue and Customs Commissioners* [2016] EWCA Civ 385, [2016] 4 All ER 1063 ('*Fidex*'). That case was, like the present case, concerned with a closure notice issued under para. 34 of Schedule 18 FA 1998. In his judgment, with which Arden LJ and Sir Stephen Richards agreed, Kitchin LJ reviewed the decisions in the *Tower MCashback* proceedings and summarised the propositions to be derived from that case as follows: (para. 45)

> "i) The scope and subject matter of an appeal are defined by the conclusions stated in the closure notice and by the amendments required to give effect to those conclusions.
>
> ii) What matters are the conclusions set out in the closure notice, not the process of reasoning by which HMRC reached those conclusions.
>
> iii) The closure notice must be read in context in order properly to understand its meaning.
>
> iv) Subject always to the requirements of fairness and proper case management, HMRC can advance new arguments before the FTT to support the conclusions set out in the closure notice."

(b) Scope of Closure Notice Appeal: the decisions below

67. The FTT dealt with this Issue at paras. 101 – 129 of the FTT decision. The FTT recorded that the Appellants had not been taken by surprise when HMRC raised this point in defending the appeal because the arguments now advanced by HMRC had been extensively discussed after being raised in the covering letter. At para. 115 the FTT noted that the scope of the subject matter of the adjustments in the closure notice was implicitly a "somewhat broader topic" than the adjustments themselves. The present case was a good example of the significance of that distinction. The Appellants argued for a narrow ambit of matters that may be disputed. The FTT went on:

> "117 The alternative is that it is for the First-tier Tribunal to decide what the subject matter of the closure notice happens to be; that the circumstances may demonstrate that the subject matter is slightly broader than the particular conclusion and adjustments addressed in the closure notice and that it is open to HMRC to mount different arguments in any appeal, even for instance occasioning greater adjustments to the taxable profits, provided of course that the different arguments all deal with the same identified or obvious subject matter."

68. The FTT thought that if the Appellants were right in their submissions that the statutory machinery did not provide a way for HMRC to advance different arguments producing different and possibly greater tax adjustments, that would be a defect in the statutory provisions. They concluded that they should if possible construe the provisions so as not to be defective. They therefore held at para 126:

> "… We consider that when the closure notice identifies the subject matter and the closure notice does what it must do, which is to indicate one conclusion and related adjustments, if provisions in both the closure notice and the covering letter both make it absolutely clear to the taxpayer the arguments and contentions that HMRC may be forced to resort to, and they all relate to the perfectly obvious subject matter of the dispute,

> then the terms of the present closure notices do not preclude HMRC from raising other arguments such as those envisaged in Scenarios 1 and 2 in the covering letter."

69. The UT dealt with this issue at paras. 64 – 75 of the First Decision. The UT was not convinced that this was really an issue of the FTT's jurisdiction but assumed in favour of the Appellants that it was. The UT also referred to the need to construe the closure notices in context. A key aspect of that context was the covering letter and those two documents read together made clear that if HMRC were unsuccessful on their argument that the Disputed Expenditure was not deductible, they would raise Issue 4 in the alternative. They held that the FTT had been right to hold that it had jurisdiction to entertain HMRC's case on Issue 4.

(c) Scope of Closure Notice Appeal: discussion

70. I accept the point made by the Appellants that this case is different from the *Tower MCashback* and *Fidex* cases because Issue 4 is not a different argument in support of the adjustments made to their tax returns to implement the conclusion set out in the closure notices. I would also go part of the way with the Appellants in accepting that the FTT does not have an unlimited discretion when determining what is "the matter to which an appeal relates" for the purposes of section 49I(1)(a) TMA or "the matter in question" for the purposes of section 49G(4) TMA. In their covering letter HMRC could have indicated that they might open up entirely different areas of the Appellants' tax returns if the closure notice were appealed to the tribunal. The fact that the Appellants had been warned about those potential challenges being raised would not, in my view, empower the FTT to treat those issues as within the scope of the appeal. According to para, 34(3) of Schedule 18 FA 1998, an appeal may be brought against an amendment of a company's return. It seems to me that "the matter to which the appeal relates" for the purposes of section 49I(1)(a) must be that amendment and the amendment is therefore the "matter in question" which the tribunal is required to determine by section 49G(4) TMA. That then restricts the ambit of the appeal at the conclusion of which the tribunal may decide that there has been an overcharge or an undercharge and so make a reduction or an increase in the assessment pursuant to section 50(6) or (7) as appropriate. There is a limit on the jurisdiction of the FTT which is not simply a matter of ensuring procedural fairness. Any purported exercise by the FTT of a broader power to consider matters beyond that would be an error of law.

71. The authorities do not support a narrow construction of those key phrases in sections 49I and 49G and they establish that the FTT is the appropriate stage at which the scope of the matter in question in the appeal is to be determined. The FTT is a specialist tribunal and an appellate court should not interfere with that decision unless it is clearly outside the scope of the statutory provisions. There are, as Moses LJ recognised, likely to be boundary issues whatever the test to be applied. Those issues are much more likely to be problematic and time-consuming if a narrow view is adopted. This became apparent during argument when trying to establish the limits of any appeal in this case. Mr Peacock had to accept that legal arguments can be deployed which were not referred to in the closure notice. He also had to accept that the outcome of any particular appeal may be that the tax liability is something different from the figure for which either side was contending if, as in the present case, the tribunal accepts some but not all of one party's arguments. He insisted

however that the taxpayer should be able to challenge a closure notice without taking the risk that he would end up paying more tax than the adjustment made by the closure notice. That cannot be right, not least because as Mr Peacock was pushed to submit, it might lead to a situation where HMRC considered there were two possible constructions of the relevant legislation and were forced to adopt a closure notice based on the construction that resulted in the most tax being payable, even if they thought the arguments in support of that construction were far weaker than the arguments in favour of the construction leading to a lower adjustment. Such a construction of the provisions would simply multiply the number of appeals.

72. The possibility of HMRC putting forward a case on appeal seeking a greater tax liability than that set out in the closure notice does not create an unfair imbalance between the interests of the Revenue and the taxpayer. *MTower Cashback* and *D'Arcy* show that despite the major change to tax law when the self-assessment regime was introduced and the importance of the finality of the self-assessment, the statutory provisions are not intended dramatically to narrow the scope of appeals. There are other checks and balances in the scheme here designed to protect the taxpayer. Those protections are the time limit imposed on HMRC in opening an enquiry, the fact that only one enquiry can be opened into any one tax return and the ability of the taxpayer to seek a direction for the issue of a closure notice. A narrow confinement of the subject matter of the appeal is not intended to be one of the protections conferred on the taxpayer. The "venerable principle" is also an important underlying factor in any tax matter. I accept HMRC's submission that proceedings before the FTT are not simply a dispute between two private parties and the venerable principle has a role to play here as the courts have found in the three cases which were cited to us.

73. I would conclude that the description of the scope of the matter in question in para. 117 of the FTT's decision is a useful and practical one. It is for the First-tier Tribunal to decide what the subject matter of the closure notice is within the bounds I have described. They are best placed to determine whether the context of the closure notice and the surrounding circumstances demonstrate that the subject matter is broader than the particular conclusion and adjustments addressed in the closure notice. If that is the case, it should be open to HMRC to put forward arguments in any appeal even if they result in a larger amount of tax being due, provided that the different arguments all deal with the same matters in question identified in the closure notice. Although it is accepted that this case goes beyond the point decided in *Tower MCashback* and *Fidex*, I do not regard those cases as requiring a bright line to be drawn. I would therefore dismiss the Appellants' appeal on Issue 3.

4. THE APPLICATION OF THE NO DOUBLE TAXATION PRINCIPLE IN THIS CASE

(a) The no double taxation principle: the decisions below

74. The precise content of this issue has been difficult to pin down and has evolved during the various stages of these appeals from the brief description of "Scenario 1" in the covering letter. The FTT identified four "key steps" at para. 133. The most important step for our purposes is the second step: is it right when calculating the profits and losses of the solo financial trades to include as gross income of those trades the same taxable profits as have been treated as taxable profits of the 114(2) trades? The FTT referred to various authorities the most pertinent of which is *IRC v F*

S Securities (formerly Federated Securities Ltd) [1965] AC 631 ('*F S Securities*'). The taxpayer in that case, F S Securities, carried on the trade of a finance company buying and selling shares. It bought the entire share capital of three companies whose assets consisted almost entirely of cash resources. It caused the companies to transfer those assets to it by way of dividend from the accumulated profits which had borne tax and then, since the shares fell in value as a result of that transfer, FS Securities sold the shares at a loss. In drawing up the profit and loss account for income tax purposes for its own business, F S Securities left out of account the dividends received. The Commissioners allowed the deduction of the loss but then issued a direction that the income of the taxpayer could be deemed, in the particular circumstances of the company, to be the income of its members and apportioned to them accordingly. Whether the Commissioners were entitled to do that turned on whether F S Securities was indeed an investment company; that turned on whether the dividends received by F S Securities were investment income or were trading receipts of its business to be charged to tax under Schedule D Case 1. Before the House of Lords therefore it was HM Revenue arguing that the dividends should be left out of the trading receipts of F S Securities when computing its Schedule D liability because if they were not trading receipts, they had to be investment income and if they were investment income then F S Securities must be an investment company and could be made the subject of an apportionment direction.

75. Lord Reid noted that the earlier case of *Cenlon Finance Co Ltd v Ellwood* [1962] A.C. 782 established that a capital dividend which is not paid under deduction of income tax must enter the profit and loss account of a dealer who has bought the shares in the course of his trade. The issue before the Appellate Committee was whether the same rule must apply to dividends that had been paid under deduction of tax. Lord Reid recognised that if the words of the Income Tax Act were applied literally the result would be double taxation of the same income, but, he observed, "it has been said again and again that the Act cannot be so read as to authorise that" (p. 644E). He held that the dividends did not enter into the computation of F S Securities profits for the purposes of Schedule D; they were not charged to tax under Schedule D and must therefore be investment income.

76. Viscount Radcliffe posed the question whether, if the dividends had borne tax in the hands of the paying company, did the income tax code authorise the Revenue to enter them as a receipt in the trading account of the receiving shareholder for the purpose of assessing it to tax on a separate taxable subject, that is the receiving shareholder's trading profit? He concluded: (p. 650G and 652G):

> "To my mind, to allow it do so would be to recognise double taxation in its most obvious form: not the less so, as I see it, because on the one side dividends are taxed as an aliquot share of a fund of profit and on the other they would be brought in as "mere" contributors to establish the balance of the trading profit of the individual recipient.
>
> …
>
> Dividends that had borne tax or suffered deduction of tax — I see no difference in this context between the two ways of putting it — before receipt are, to use Lord Dunedin's phrase,

> "exhausted as a source of income," and the general principle applied to the construction of the provisions of the Income Tax code prevents their being brought in again, directly or indirectly, as a subject of taxation in the form of another class of taxable income."

77. Viscount Radcliffe also distinguished *Cenlon* on the grounds that the dividends considered there were capital dividends, distributed by a company out of a fund of profit that had not been taxed in its hands or taxed by way of deduction against the shareholders. Lord Hodson, Lord Guest and Lord Upjohn agreed.

78. Applying those principles to the instant cases, the FTT concluded that the double taxation of which the Appellants were complaining was "relatively clear-cut double taxation": para. 144. This was particularly obvious in the case of LAGP and HKP because the Appellants calculated the profits of their solo financial trades by:

> "looking through to their share of partnership profits. i.e. the very profits that we have already concluded are plainly to be brought into account under section 114."

79. The FTT did not explain further in their Decision what they understood to be the "look through" basis of accounting. The FTT concluded from the decision of the House of Lords in *F S Securities* that the answer to the question whether the partnership profits should be brought again into the Appellants' solo financial trade computation was that they should not be so brought into account. The FTT realised that this led to an odd result when put together with their conclusion that all the Disputed Expenditure was deductible when computing the profits of the solo financial trades. If there was little if any income in the solo financial trades apart from the profits of the 114(2) trades, and if those profits were to be left out of account, the deduction of the Disputed Expenditure in the solo financial trades would result in a substantial loss for those trades. This might need to be carried forward or possibly surrendered as group relief. That awkwardness did not dissuade the FTT from their conclusion.

80. The UT in its First Decision broadly agreed with the FTT's analysis. They described the issue as "whether the partnership profits should be subjected to tax assessments?": see the heading to para. 76. The UT noted that it was accepted by HMRC that all of the relevant accounts were prepared in accordance with generally accepted accounting practice. A complicating factor when trying to understand the accounts and the tax computations was that the accounting treatment of LAGP and HKP differed from that of Garrard. In the case of LAGP and HKP the appropriate shares of the partnership profits were brought into account in the solo financial trades on a "look through" basis whereas in the case of Garrard the distributions were brought into account on a "non-look through" basis. Like the FTT, the UT did not explain further what they thought this meant in practice.

81. The UT cited the same authorities as had been cited by the FTT and set out the FTT's reasoning encapsulated in para. 144 of the FTT Decision. At para. 91 of the First Decision the UT said:

> "In our judgment the FTT was correct to hold that profits which had been taxed in the hands of the Leasing Partnerships did not fall to be taxed again in the hands of IAF and IBP. As the FTT said, to hold otherwise would be a clear case of double taxation, and particularly so in the case of LAGP and HKP. We accept that the *FS Securities* case is factually different from the present case, but we agree with the FTT that the principle applied in that case is equally applicable here. We do not accept that the source doctrine has the effect contended for by HMRC in the present case, because the source doctrine does not justify taxing the same income twice over. We accept that, given that there were two trades in each case, there needed to be two tax computations, but it does not follow that the same income needed to be brought into account in both computations."

82. The UT then identified two problems which caused them to hold back from simply dismissing HMRC's appeal on Issue 4. In para. 92 of the First Decision they recorded a concern that had arisen during the writing of their Decision about the nature of some of the monies paid by Garrard to IBP. In their skeleton argument HMRC had noted that some of the moneys paid by Garrard to IBP were by way of repayment of the Capital Contributions and these were of a different character and quality from the trading receipts. As I read that paragraph, HMRC were not at that stage arguing that the outcome of the appeal on this point might be different for the two kinds of payment. The UT picked up that it might be arguable that a distinction needed to be drawn between capital repayments and profit distributions for the purpose of applying the no double taxation principle. I refer to that distinction as the "repayment/distribution distinction".

83. By the time of the second UT hearing, it was common ground between the parties that the repayment/distribution distinction did not affect the position of LAGP because it accounted for its interest in the partnerships using the "look through" method. Again, that common ground was recorded by the UT but not explained further. It was also accepted by HMRC at the second hearing that the repayment/distribution distinction was only an 'academic' point as regards Garrard and LAGP. This was because Issue 4 had only been presented by HMRC as a fall back argument if they failed on Issue 2 but they had succeeded in part on Issue 2 when the UT held that the Capital Contributions were not deductible. Considering the 'academic' matter briefly, the UT decided that there was a distinction. They referred to the Capital Contribution of £62.7 million made to IBP by Garrard and concluded at para 13:

> "13 … The question, as we see it, is whether the receipt by IBP of the capital repayment constitutes the same income as the income of Garrard from the receivables sale so as to attract the double taxation principle. In our view it does not. It may help to illustrate the point by two examples. First, suppose Garrard had used the £62.7 million to buy assets from IBP which cost IBP £60 million. IBP's accounts would show a profit of £2.7 million. But on Investec's argument IBP would be treated as making a loss of £60 million for tax purposes because its receipt of £62.7 million would be disregarded. Secondly,

> suppose that IBP had previously lent Garrard £62.7 million and Garrard used the £62.7 million in question to repay that loan to IBP. On Investec's argument IBP's receipt of £62.7 million would again have to be disregarded. What these examples show, we think, is that it is not sufficient that the money received by IBP derived from money received by Garrard which contributed to Garrard's taxable profits."

84. Although the UT's view was that HMRC was in principle right that the repayments of capital did not engage the no double taxation principle, the UT still dismissed HMRC's appeal in respect of Garrard. This was because they held that it was not legitimate for HMRC to pursue Issue 4 in respect of Garrard because they had succeeded in part on Issue 2.

85. The second concern raised by the UT at the end of the First Decision related to the different accounting methods used for LAGP and HKP on the one hand and for Garrard on the other. At para. 93 of the First Decision the UT said:

> "Where Investec adopted look through accounting, the nature of the receipts and deductions appearing in the accounts might be such that they could be said to reflect only its participation as a partner and so should be merely replaced by the section 114 result, that being required by law for the purposes of section 42. There being no other accounting entry for the solus trade, section 42 would then have the effect that, for that trade, the taxable profit was nil; and since the profits or income of the partnerships had not been brought into account in arriving at that figure of nil, there would be no requirement to deduct any amount on the basis that it was profit which had already been taxed."

86. The UT concluded that they were unsure as to the extent to which this issue was rendered academic by the decision on Issue 2. They invited the parties to restore the appeal for further argument. In the Second Decision, in relation to the difference of accounting treatment, the UT identified what appeared to be a discrepancy between the description of the accounting treatment for LAGP in the SOAF and the FTT's conclusions at para. 144 of the FTT Decision. The FTT appeared to have thought that 'the very profits' that had been brought into account for the 114(2) trades were, by reason of the look through method, also brought into account in the solo financial trades. This seemed to be at odds with the description of the look through method in the SOAF which referred to the profit earned by each company being 'the excess of the fair value of the lease receivables over the aggregate of the cost of its partnership interest and the cost of its capital contributions". The UT recognised that the apparent mismatch might have arisen because the issue of precisely what was recorded in the accounts had not been raised either before the FTT or the UT. The issue could not be resolved because it required a factual determination which the FTT had not made. The matter would have to be remitted to the FTT if it needed to be resolved. However, because HMRC had been partially successful on Issue 2 in relation to LAGP, the UT considered that HMRC was precluded from relying on Issue 4 as regards LAGP. As regards HKP, the discrepancy between the SOAF and the FTT's findings arose in relation to HKP as they arose in relation to LAGP and could not be

resolved by the UT. HMRC had been wholly unsuccessful on Issue 2 in relation to HKP so were entitled to rely on Issue 4. The outcome of the Second Decision was therefore that:

i) As regards Garrard and LAGP, HMRC's appeal on Issue 4 was dismissed because HMRC had conceded that the point was academic because the UT had held in HMRC's favour on Issue 2 that the Capital Contributions were not deductible from the income of the solo financial trades.

ii) As regards LAGP, HMRC's appeal on Issue 4 was dismissed for the additional reason that HMRC conceded that the repayment/distribution distinction made no difference in the case of LAGP because IAF and IBP accounted for that partnership on the "look through" basis.

iii) As regards HKP, the repayment/distribution distinction was irrelevant because there were no capital contributions to or repayments from HKP and the point was not academic because HMRC was not precluded from arguing Issue 4 in relation to HKP. The appeal was therefore remitted to the FTT in respect of HKP for the FTT to make further findings of fact in relation to the statutory accounts of IAF and IBP in respect of HKP.

(b) The no double taxation principle: developments before this Court

87. Neither party was happy with the outcome of the Second Decision in this respect. In their appeals, IAF and IBP argued that the UT erred in law in widening the scope of Issue 4 to cover additional matters not argued by HMRC before the FTT, namely the repayment/distribution distinction and the significance of the look through or non-look through basis on which the Appellants accounted for the different partnerships. The UT had recognised that the second matter at least require further evidence and fact-finding and so, the Appellants say, it was wrong for the UT to raise them. On the substance, the Appellants also argue that the UT was wrong in para. 13 of the Second Decision to hold that the no double taxation principle was not engaged in respect of the capital repayments made by Garrard. The UT was also wrong, they say, to conclude that the method of drawing up the statutory accounts for the solo financial trades had any relevance to the proper tax computations. Mr Peacock described the point remitted to the FTT as a non-question because the accounting concepts adopted in the drawing up of the companies' accounts as required by the Companies Act are entirely different from the tax computations. The statutory accounts did not for example distinguish between the solo financial trades and the 114(2) trades at all. It was irrelevant to ask the FTT, as the UT appeared to ask, which tax computations were reflected in the statutory accounts.

88. HMRC's single ground of appeal and the only point raised in their Respondents' Notices was that the UT had erred in law in so far as it decided in the Second Decision that it was not open to HMRC to rely on Issue 4 in respect of Garrard and LAGP because HMRC had succeeded in part on Issue 2 in respect of those two partnerships. The relief they sought in their notice of appeal was that Issue 4 be remitted to the FTT in relation to all the Leasing Partnerships, not just HKP.

89. At the opening of the first day of the hearing Mr Peacock handed up what he described as an agreed list of issues in terms which followed the structure of the

grounds of appeal. However, on the second day as he started his submissions, Mr Tallon handed up a speaking note which he then used to structure his submissions. This presents a very different case from the agreed issues provided the previous day. Under the heading "HMRC's Primary Contentions" the speaking note focuses entirely on the accounting treatment adopted by the Appellants in respect of LAGP and HKP. HMRC contend that their analysis of the "look through" accounting method adopted by the Appellants shows that the income derived in the solo financial trades "did not consist of the same income as the actual rental income realised by them qua partners", that is to say the income included in their 114(2) trades tax computation. Turning to Garrard, HMRC say that they agree with the conclusion in the Second Decision that the solo financial trade accounts accurately record the only real profit arising on the Garrard transaction, that is the receipts of the sale of assets by Garrard to Lombard. The receipt by IBP of the repayment of capital from Garrard was, HMRC say, a completely discrete transaction from the receipt of cash by Garrard from Lombard on the sale of the assets.

90. HMRC then turn in their speaking note to the consequences of their primary contention. What emerges is that the shift to calculating the solo financial trades taxable profit by reference to the statutory accounts, taken together with the fact that the statutory accounts calculate that profit as being the difference between the costs of acquiring the partnership assets and the fair value of those assets means, HMRC submit, that the value of the Capital Contributions is in effect deducted from income. They are part of the purchase costs which are deducted from the fair value to give the accounting profit. In para 49 of the speaking note HMRC therefore say that the consequence of their primary contention is that:

> "49. … (i) the present holdings of the UT that the capital contributions of the Appellants to Garrard were not made wholly and exclusively for the purposes of the solo trades of the Appellants cannot stand and the appeal of the Appellants on Issue 2 must be allowed and the same result must follow in the case of LAGP and [HKP] if the costs of acquisition of the partnership interests (and the capital contributions in the case of LAGP) are regarded as deductible amounts for tax purposes…"

91. If that is right then, HMRC say, they would have been unsuccessful on Issues 1 and 2 and are therefore not precluded from relying on Issue 4 in respect of any of the Leasing Partnerships. On that basis they seek to rely on their reformulation of Issue 4, now described as their primary contention.

92. The HMRC speaking note then considers the "Alternative Contentions of HMRC". These paragraphs set out HMRC's arguments in support of the UT's conclusion that the Capital Contributions were **not** made wholly and exclusively for the purposes of the solo financial trades and so were not deductible – the case that HMRC had been pursuing all along.

93. The upshot of this is that HMRC now appear to disown the position which the Appellants had thought they were espousing by seeking to rely on both Issue 2 and Issue 4, namely that the Capital Contributions were not deductible and that there was no need to adjust the income of the solo financial trades by leaving the profit of the 114(2) trades out of account when carrying out the section 42 tax computation for the

solo financial trades. Instead their position now seems to be that the amount to be brought into tax is the 114(2) trade profit plus the profit figure taken from the statutory accounts of the Appellants so far as it relates to the Leasing Partnerships albeit that HMRC accept that this approach requires us to treat all the Disputed Expenditure as deductible from the income of the solo financial trades, including the Capital Contributions.

94. At the end of the hearing, I asked the parties to produce a joint note setting out figures in tabular form showing how profits in the solo financial trades would be computed depending on the success or failure of the various grounds of appeal. In the event the parties were unable to agree and we received two rival sets of tables and two post-hearing notes explaining the parties' respective contentions.

95. HMRC did not show the profits of the 114(2) trades in their tables because they said that these were not contentious. They appended to their post-hearing note calculations which showed how they arrived at the profits of the 114(2) trades by making certain adjustments to the profit and loss accounts of the partnerships. The figures they arrived at were the same as shown in the Appellants' tables as the profit from the 114(2) trades (that is to say, profits of £206 million for LAGP, £48 million for Garrard and £47 million for HKP). HMRC's tables and post-hearing note dealt only with the computation of the profit for the solo financial trades. Their tables however did not show the potential results depending on the conclusions that we might reach on each of the grounds of appeal before us, in particular on the question whether the no double taxation principle applied. Rather, HMRC's tables showed the results generated by following their new primary contention whereby the solo financial trades computation should take the figures from the statutory accounts and make certain adjustments to those profits to arrive at a Total Case 1 loss or profit for the solo financial trades.

(c) The no double taxation principle: discussion

96. Having carefully considered the earlier judgments and the parties' submissions during the hearing and in their post-hearing notes, I consider that Issue 4 now boils down to a few points which I consider in turn.

(i) Should HMRC be permitted to argue the repayment/distribution distinction point now in relation to Garrard?

97. HMRC did not argue before either the FTT or the UT that a distinction should be made between income received by IAF and IBP by way of distribution of profits on the one hand and repayment of capital contribution on the other hand. It was a point that was raised by the UT itself during the course of writing the First Decision. It was accepted by HMRC at the second hearing that the repayment/distribution distinction was only an 'academic' point as regards Garrard and LAGP. This was because HMRC had succeeded in their argument on Issue 2 that the Capital Contributions were not deductible because they were not wholly and exclusively incurred for the purposes of the solo financial trades. Despite the point being academic, the UT acceded to HMRC's request to decide the issue as regards Garrard in case the UT's conclusion on the wholly and exclusively issue was overturned by this court on appeal. Understandably in light of HMRC's concession, the UT dealt with the matter very briefly, in para. 13 which I have set out above. One would have expected a

much fuller analysis if the point had been a live one, bearing in mind that the sum at stake in relation to Garrard is substantial - £62.7 million.

98. If my Lords agree with my conclusion that we should uphold the UT's decision on Issue 2, the contingency in anticipation of which the UT considered the point would not have occurred and the point would remain 'academic'. HMRC now say, although they certainly did not express it in these terms, that they want to withdraw the concession they made before the UT that Issue 4 does not arise if they succeed in part on Issue 2. But the point they want us to decide is not the point that was previously defined as Issue 4 namely whether the no double taxation principle applies to exclude the 114(2) trade profit from the income of the solo financial trades. It is an entire recasting of Issue 4 into their new primary contention set out in their speaking note and post-hearing note, including a reversal of the position they adopted in the closure notices and before the FTT and UT that the Capital Contributions are not deductible expenses.

99. In my judgment, it would be wrong to allow HMRC to take that course in respect of Garrard for three reasons. First, as I have explained in my discussion of Issue 2, applying the test in *Vodafone*, it is clear to me that the Capital Contributions were not incurred wholly and exclusively for the purposes of the Appellants' solo financial trades. I do not see how one can arrive at a different answer to that question simply by adopting what is now HMRC's primary contention. HMRC have not explained why the consequence of that primary contention is that the appeal on Issue 2 must be allowed in relation to all the Leasing Partnerships. I am concerned that the speaking note does not truly set out a defensible approach but is designed to justify HMRC jettisoning their success on Issue 2 because they have now decided that they prefer their primary contention. It appears that HMRC accept, for the purposes of these appeals at least, that the statutory accounts drawn up by the Appellants properly treated all the Disputed Expenditure as deductible revenue expenses. That must always have been the case and yet HMRC have, thus far, asserted that the Capital Contributions were not deductible for the purposes of the tax computation.

100. Secondly, HMRC point to the 'venerable principle' that there is a public interest in the correct amount of tax being collected and to the requirement imposed on the tribunal under section 50 TMA to arrive at the right amount of tax. They argue that these principles combine to brush aside any procedural problems arising from them changing their case. I agree those principles are important - that is why I would dismiss the Appellants' appeal on Issue 3. But those principles cannot be pushed too far. They do not entitle HMRC to change their case at will and resile from concessions that were common ground before the UT. It was clear at the hearing that Mr Peacock had had no warning of the significant shift of position contained in the HMRC speaking note and his submissions on the first day of the hearing were directed at the agreed list of issues. Mr Tallon then argued a different case leaving Mr Peacock to respond as best he could in the short time left for his reply at the end of the hearing. It would not be fair on the Appellants for HMRC to be allowed to re-focus the case in this way.

101. Thirdly, HMRC argue that it is inconsistent on the one hand to decide Issue 3 in their favour on the basis that there was no unfairness to the Appellants in allowing them to rely on Issue 4 but yet then prevent them from relying on this alternative argument. I do not agree that there is any inconsistency. The potential scope of the appeal is, as I

have concluded under Issue 3, determined by the FTT within the bounds I have described. But the identification of the issues to be decided at any particular stage of that appeal is affected by the arguments that the parties put forward, the facts that are agreed and presented to the tribunal and any concessions both sides make along the way.

102. Finally, HMRC argue that they should be allowed to change tack because the proceedings so far have only been deciding issues of principle. The FTT was only invited to make a decision in principle that the no double taxation principle applied. It did not determine the application of that principle in the present case. Since the FTT is still seized with the appeals and will need to consider the detail of the application on the facts, there is no harm in allowing the case to be reargued in a different manner on remittal. I do not accept that argument. It is true that the FTT stated at para. 8 of their decision that they were deciding issues of principle rather than seeking to decide the amounts of assessable profits. But they recorded at para. 159 that what remained was for the parties to agree the detailed figures. If the parties were unable to agree the detailed calculations, then a further hearing might be needed. That does not indicate to me that the FTT thought it was leaving open significant issues of contention. One cannot decide whether the no double taxation principle operates entirely in a vacuum; the FTT's decision was that it did apply on the basis of the facts and arguments presented to them as pertaining to these particular partnerships. It is not open to HMRC now to argue that the application of the principle, which they now accept, has no practical effect here because of arguments that they did not put forward at those earlier stages of the proceedings.

103. I would therefore hold that given the way the case has developed, it is not open to HMRC to opt now to abandon its case on Issue 2 in relation to the deductibility of the Capital Contributions. It is not open to HMRC to reformulate Issue 4 at this stage and seek to rely on it in addition, rather than as an alternative, to Issue 2.

(ii) If it is open to HMRC to argue the repayment/distribution distinction, what is the answer?

104. In the light of that conclusion, I do not need to determine whether it makes any difference to the application of the no double taxation principle that some of the payments made by IBP to Garrard were described as repayments of capital rather than as distributions.

105. I would say only that I regard the conclusions of the UT in para. 13 of the Second Decision as doubtful and I do not endorse that analysis. There is force in the argument made by the Appellants that the two examples given in para. 13 are not proper analogies. If the money had been paid by Garrard to IBP not as repayment of capital but either as the purchase price for an asset sold by IBP to Garrard or as the repayment of a loan previously made by IBP to Garrard then the treatment of that money both in the tax calculations in respect of Garrard's trade under section 114 and in respect of IBP's solo financial trade would have been different. It might then have been argued that the money was not coming from a taxed fund in the hands of Garrard so that the no double taxation principle explained in *F S Securities* did not apply. That is not what happened and I do not see how those two other scenarios cast light on the current position.

106. HMRC's new argument on the repayment/distribution distinction is set out in para 46 of their speaking note. They say that the main income in the statutory accounts of Garrard was the receipt of £63.3 million from the sale to Lombard of the bulk of Garrard's lease receivables. That was income in Garrard's hands but thereafter, they say, "its nature as income is spent and it simply represents a receipt of cash by Garrard". When Garrard repaid the capital to IBP that was, HMRC submit, a completely discrete transaction which cannot be the same income.

107. If HMRC's argument were right, the result in *F S Securities* would have been different. The dividends that were in dispute in that case derived from income of the three companies in which the taxpayer had bought shares (one of which appears to have been a wool merchant). Those three companies earned that income presumably in the course of a myriad of transactions with third parties. It fed into the calculation of their profit which was then taxed in their hands and the franked dividends were then paid to the taxpayer. The payment of the dividends was a completely different transaction between different parties from the transactions by which the income had been earned but the House of Lords still held that the no double taxation principle applied and the dividends were not taxable as income in the hands of the taxpayer shareholder.

108. I would therefore dismiss HMRC's appeal in relation to Garrard and allow the Appellants' appeal to that extent. There is no basis for remitting the Garrard transactions to the FTT. The outcome of these proceedings so far as the tax treatment of Garrard is concerned is that the no double taxation principle applies to exclude from the computation of the income of the Appellants' solo financial trades the amount of the profit that is already taxed in their 114(2) trades. In computing the profit of the solo financial trades the Capital Contributions made by IAF and IBP to Garrard are not deductible from any other income in the solo financial trades for the purposes of the section 42 tax computations but the Acquisition Costs are deductible.

(iii) Is it open to HMRC to argue that the treatment of LAGP and HKP in the statutory accounts of IAF and IBP means that the no double taxation principle does not apply?

109. The speaking note handed up by Mr Tallon during the hearing before us also set out HMRC's case as to why there is no double taxation in the case of LAGP and HKP. They acknowledge that the relief sought in their appeal is limited to remitting **all** the partnerships back to the FTT for further fact-finding. They now recognise how unsatisfactory that course would be, particularly since Judge Howard Nowlan has now retired. HMRC say therefore that "there is a very strong argument" that there is sufficient material for this court to find in HMRC's favour in respect of all three Leasing Partnerships.

110. Again, the primary contention set out in HMRC's speaking note disputes the suggestion that there had been **any** income in the hands of IAF or IBP on which the no double taxation principle can bite. This is their contention despite the fact that they have not challenged the application of the no double taxation principle in this case in their appeal and they did not present arguments to us as to why the UT had made any error of law in its application of the *F S Securities* case. HMRC argue now that the effect of the "look through" basis of statutory accounts was this. As soon as the partnership interests in LAGP and HKP were acquired by IAF and IBP, an immediate, Day 1, profit was recognised in IAF's and IBP's profit and loss accounts.

That profit was not a distribution or other payment made by the partnership but rather the difference between the fair value of the assets in the partnerships (presumably determined by an appropriate valuation exercise) and the (lower) price paid for those interests by IAF and IBP to the previous retiring partners. That fair value of the receivables was then taken to the balance sheet. When actual distributions were made, their value was also taken to the balance sheet to set against the fair value. That reflected the fact that the fair value had now been converted into cash. HMRC wish to argue that the "look through" method therefore records a different item in IAF's and IBP's statutory accounts; it is the value of the underlying receivables rather than the profits made by the partnerships when they receive the rental income under the leases. There is nothing in the solo financial trades accounts therefore that reflects the profit made in partnership.

111. This seems to me to be a very different description of the look through method from how the FTT and the UT understood it to work. Mr Tallon suggested in his submissions that the UT had been describing the correct position in paras. 21 and 22 of the Second Decision but I do not accept that. Neither the FTT nor the UT explained what they understand the "look through" method to require. They appear to have assumed that the result of the "look through" method was that the Appellants' accounts would reflect the receipts of the partnership businesses in precisely the same way as the partnership's own accounts did. On this point, therefore I agree with the Appellants that it was wrong of the UT to raise this point and that it would be wrong for this court to allow HMRC to rely on the primary contention put forward for the first time in the speaking note and post-hearing note.

112. It is clear that HMRC's new approach is highly contentious. HMRC themselves refer in their speaking note to "fundamental differences between the parties". These are not just differences about what numbers to include from the SOAF or from the accounts but methodological arguments and factual disputes. As HMRC put in their post-hearing note:

> "15. In summary, HMRC and the Appellants hold fundamentally different views as to the effect of the look through method: the Appellants assert that it leads to the result that they are taxed in their solo financial trades on the same income taxed under s. 114; whilst HMRC say that it ignores all and any partnership transactions (save to recognise in their Balance Sheets actual distributions from the partnerships as being the equivalent of converting their existing asset on the Balance Sheet into cash)."

113. Secondly, this is not an argument that can be run without further findings of fact. The SOAF only dealt briefly with the accounting treatment. This is not surprising as the content of the SOAF was determined by what the parties believed was relevant given the issues that they wanted the tribunal to resolve and the arguments that they put forward. There was no expert evidence either agreed or contested about the statutory accounts and their relationship with the tax computations under sections 114 and 42. Mr Peacock told us that there had been a discussion before the FTT as to whether there was going to be a dispute about accounting treatment. The Appellants had told HMRC that if they were going to take points about the accounting, the Appellants

would want to lead expert evidence. HMRC had confirmed that they were not pursuing points on the accounts so that no expert evidence was needed.

114. HMRC have sought to supplement the SOAF by taking us to some underlying correspondence between the parties and some responses given by the Appellants in 2009 to questions posed by HMRC about the accounts. They also pointed to some brief descriptions of the accounting process in the Appellants' written material, drafted before this became a significant issue. An appellate court would be very rash to rely on such a rapid and piecemeal walk through the documents. Even so, there are indications in HMRC's speaking note of unanswered questions about the formulation of the statutory accounts. For example, HMRC say they do not understand why the loss of £304,000 recorded in the statutory accounts for Garrard was entirely allocated to IBP rather than split between IBP and IAF: para 4. HMRC note that the information they have about statutory accounts entries for LAGP is less detailed than that given for HKP. HMRC submit that this court should "assume" that the LAGP accounting treatment mirrors that of HKP and say that "it is reasonable to suppose" that the distributions to LAGP will have been taken to its balance sheet in the same way as those for HKP. I do not see that we can make that assumption given that HKP raised other issues about foreign tax credits that we have not had to consider (former Issue 6). Moreover, the tax computations made by IAF and IBP were drawn up on the basis that they were correct in their original contention before the FTT that they carried on one trade rather than two. Although the Appellants did not appeal against that part of the FTT's Decision, there has been no proper examination of how those computations would need to be unpicked if one were now going to compare them with the statutory accounts, which Mr Peacock told us were drawn up on a two trade basis so that they could elect to set the loss in their solo financial trades against the 114(2) trade profit.

115. Mr Peacock referred us to the decision of the House of Lords in *Yuill v Wilson (Inspector of Taxes)* [1980] 3 All ER 7. In that case the Court of Appeal had remitted the appeal to the Commissioners to make further findings of fact on a point that the Crown had raised. Viscount Dilhorne held that they should not have done so. It was not right to remit the case for further findings of fact when the Crown could have raised the issue at the hearing before the Commissioners if they had thought fit to do so: see p. 14h. Lord Russell of Killowen agreed that it would be wrong to remit the case and "oppressive of the taxpayer to enable the Crown to reopen an alternative approach on new evidence after deliberately declining to put forward that approach": p. 23.

116. In my judgment the same reasoning applies here. Although the statutory provisions section 114 ICTA and section 42 FA 1998 have been in operation for many years, HMRC's approach to how to apply them is still, to put it kindly, 'work in progress'. What the primary contention put forward by HMRC amounts to is that if they were now starting from scratch in deciding how to tax the Appellants, they would adopt a completely different approach; different both from the approach they adopted in the closure notices and from the case they presented to the FTT, to the UT and in their written submissions prior to the appeal before us. This approach generates a series of new and contentious issues about (i) the nature of "look through" accounting and the relationship between the 114(2) trades and section 42 tax computations; (ii) the

treatment of the partnerships in the statutory accounts and the relevance of that; and (iii) the purport of the correspondence between the parties in September 2009.

117. We are not starting from scratch and it is too late to embark on this entirely different course now. The UT was no doubt right to surmise at the end of para. 22 of the Second Decision that the reason why there was so little detail in the FTT's decision about how the statutory accounts had been drawn up and how they related to the tax computations was that the issue was not raised before them. Where the UT went wrong in my judgment was in holding that the proper response to that state of affairs was to remit the matter to the FTT. The proper response was to proceed on the basis of the case that had been presented to the FTT and to the UT which was that the difference in treatment of the different partnerships in the statutory accounts did not affect the outcome of the case.

5. CONCLUSION

118. I would therefore dismiss the Appellants' appeal on Issues 2 and 3. I would dismiss HMRC's appeal on Issue 4 in relation to LAGP and Garrard and allow the Appellants' appeal in relation to the remittal of Issue 4 to the FTT as regards HKP. The result for all the partnerships will be:

    i) The amount on which IAF and IBP are charged to tax as a result of the s 114(2) trade tax computations for the Leasing Partnerships falls to be left out of account as income in the section 42 tax computations on the basis of the no double taxation principle.

    ii) The Capital Contributions made by IAF and IBP to LAGP are not deductible from any other income of the solo financial trades but the Acquisition Costs incurred in buying the LAGP and HKP interests are deductible.

Sir Timothy Lloyd

119. I agree.

Lord Justice Peter Jackson

120. I also agree.