[2016] UKFTT 0356 (TC)

Corporation Tax – Purchase by financial dealers of substantial partnership interests in highly tax-positive leasing partnerships, followed by realisation or disposal of rental streams - Whether purchase price of partnership interests, and further contributions to the partnerships were income or capital expenditure and if not capital, whether they were incurred wholly and exclusively for trading purposes - Whether partnership profits distributed to the dealers were to be taken into account twice for tax purposes - closure notice issues - Double tax relief issues

TC05111

FIRST-TIER TRIBUNAL
TAX CHAMBER

APPEAL NUMBERS: TC/2013/02416 and 02418

INVESTEC ASSET FINANCE PLC **First Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

INVESTEC BANK PLC

Second Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: JUDGE HOWARD M. NOWLAN
ELIZABETH BRIDGE

Sitting in public at the Royal Courts of Justice in London on 1 to 10 December 2015
Jonathan Peacock QC and Michael Ripley, counsel, on behalf of the Appellants
John Tallon QC and James Rivett, counsel, on behalf of the Respondents

DECISION

Introduction

1. This was a very interesting and difficult case. It relates to the role of the two Appellants, both financial dealers in the Investec group, in participating in transactions that were doubtless designed to enable the former lessors (or their partnership successors) to exit from highly tax positive leasing partnerships (i.e. partnerships in which all the capital allowances had been taken such that continuing rentals were taxable in full) without being taxed on any receipts of rental income or balancing charge. As dealers, the Appellants' claim, having acquired the relevant partnership interests, was that they should be taxed on, and only on, the net profits from their activities, deducting thus the costs of purchasing the partnership interests from the rentals or the sale proceeds of the rentals received whilst they were the relevant partners. The Respondents contended either that the relevant costs were non-deductible, or that the Appellants should be taxed both on the net profits in their respective sole financial trades, and also on the entire partnership profits attributable to each Appellant.

2. In total these Appellants undertook seven different transaction.

3. The first transaction, generally referred to as the LAGP transaction, involved UK tax based leases of LNG tankers that had originally been written by companies in the National Australia Bank group. The majority of the Appellants' costs, following the purchase of the partnership shares from Merrill Lynch companies, involved contributing funds to the partnership, as required by the purchase terms with Merrill Lynch, to enable the partnership to retire the debt, owing to a company in the Merrill Lynch group that had indirectly funded the purchase of the leasing business. Following the acquisition of the partnership shares by the Appellants, the partnership immediately received payments (in fact secured and actually paid by two banks pursuant to letters of credit) of guaranteed residual value payments owed to the partnership by the original suppliers of the LNG vessels that had been the subject of the leases and the relevant receipts were then distributed to the partners, i.e. to the Appellants.

4. The second transaction was referred to as the Garrard transaction. This differed in that although a relatively modest Schroders leasing partnership was acquired by the two Appellants, that partnership was acquired more with a view to leasing companies in the Investec group disposing of relatively new leases (most on current account but some on capital account) to the partnership, with the partnership's apparent objective being to maximise the later third party sales prices by dividing the great majority of the rental income streams from the residual value of the assets and the entitlement to capital allowances, and by then selling each to different purchasers respectively keen to purchase (i) the rental streams alone and (ii) the roles as the substantial majority partners, those roles carrying the residual values and the hoped-for entitlement to the capital allowances, along with a small residue of rentals.

5. The third transaction involved the termination of a Hong Kong lease of an Airbus 340 in which the lessee was Cathay Pacific. This transaction had not previously been of any relevance for UK tax purposes, though for Hong Kong purposes by the time the relevant transaction was undertaken full capital allowances had been received by the lessors, and a Hong Kong ruling made it inevitable that on the sale of the aircraft or the receipt of further rentals, the entire amounts would suffer Hong Kong tax. The Appellants procured, before

they became partners in the leasing partnership, that there would virtually immediately be a payment of a fixed amount of accelerated rental (equivalent to the sales proceeds of the aircraft), and that that amount would be distributed to the partners (i.e. virtually entirely to the Appellants). Those steps were then undertaken and the residue of the partnership was sold to Cathay Pacific for 4 Hong Kong dollars. The key feature of this transaction was that the partners (i.e. substantially the Appellants) had to pay the Hong Kong tax pursuant to the ruling, and a significant issue is whether and how the Appellants can claim double tax relief in the UK for that tax.

6. We were not given any details of four other Hong Kong transactions but we were told that they were technically identical to the transaction just mentioned.

7. The Appellants' combined net profits from the three transactions mentioned in paragraphs 3 to 5 above were roughly £23 million, £3.25 million and £5 million (counting the profit in the Hong Kong case as the excess of the gross rentals, including the amount paid away in Hong Kong tax, over the Appellants' costs of purchasing their partnership interests). We were told that in total, presumably thus including the profits in the four further identical Hong Kong transactions, the Appellants' total profits were roughly £50 million. We were also told that on the various contentions advanced by HMRC, the Appellants' combined taxable profits would be approximately 16 or 17 times greater than the figures just given.

8. As requested by the Appellants we are going to decide these Appeals by making decisions of principle, rather than by seeking to indicate the amounts of assessable profits. We are adopting this course in part because we consider it inevitable that these Appeals will be the subject of further appeals to the higher courts. That is for the two reasons that the amounts at stake are very significant and also because we consider that the law (at least on the basis that we will decide the main issue) is far from clear.

9. There are 6 issues that we will have to decide in these Appeals, as follows:

1. The first is whether the Appellants' expenditure, of both purchasing partnership interests and, in two of the seven cases, of contributing further funds to the partnerships was, as the Respondents claim, capital expenditure.
2. The second is whether, if the answer to issue 1 is that the expenditure was not capital expenditure, the expenditure is nevertheless still properly to be disallowed because it was not incurred wholly and exclusively for trading purposes (again as the Respondents claimed).
3. The third issue is the closure notice issue of whether the Respondents are precluded by the closure notices that they issued from raising the fourth issue.
4. The fourth issue is the one that we consider to be the most difficult, namely the issue of whether the dealing expense of buying and funding the partnerships (assuming the first two issues to be decided in favour of the Appellants) can diminish the apparent and very significant taxable profits in the partnerships on the receipt or sale of rentals, such that, as the Appellants hoped and contended, the Appellants are taxable on, and only on, their net profits. This issue arises in two different forms, with the Appellant's claim in one being that they conducted only one trade (their sole financial trades encompassing their participations in the partnerships) and in the other that although they were conducting one sole trade and a second trade in partnership it was still permissible to deduct the same costs in the sole financial trades and then to offset

those costs against the partnership income so as to end up paying tax solely on the overall net profit.

5. The fifth is the further closure notice issue of whether the Respondents can challenge the basis on which the Appellants have claimed credit for Hong Kong tax.
6. The sixth is the substance of the foreign tax credit issue.

The four possibilities

10. The dispute in these Appeals basically revolved around the unclear issue of how the Appellants' taxable profits were to be calculated when the partnerships (the two Appellants then being the partners) either received all remaining rentals or termination sums, or the rentals were assigned to independent financial traders, and when the Appellants themselves, as financial traders, had incurred substantial expenditure in either buying the partnership interests or contributing further funds to the partnerships.

11. A helpful table was provided by the Appellants' counsel, designed to illustrate the four different tax results that might arise in such situations. The simple example figures that were used throughout the hearing were that the partnership income (on the receipt or sale of the entire income entitlement) was taken to be 100, it also being assumed that a broadly similar amount would be distributed to the partners with the partnership effectively being dissolved or left as an insubstantial shell following that distribution. It was then assumed that the Appellants had paid 90 in order to acquire the partnership interests or to contribute funds to the partnerships. Accordingly the net profits realised by the Appellants were 10, being 100 minus 90.

12. The Appellants' counsel outlined what he claimed to be the four possible tax outcomes of these transactions.

13. Under ***result A***, it was suggested that the partnership computation would simply be ignored, and that the Appellants would be taxed on 10. In their respective sole financial trades, they would bring in income of 100 (consisting either of a look-through to the partnership income, or consisting of the distributions received); the cost of acquiring or funding the partnerships of 90 would be deductible expenses in the respective sole trades of the two Appellants and the taxable profits would thus be 10. Little attention was given to this approach, though we were told that in the past HMRC had required taxpayers, including the present Appellants, to calculate their taxable profits in this manner. It is perhaps worth saying that this method does appear to be somewhat pragmatic and dubious in that it altogether ignores the requirement under section 114 ICTA 1988 to compute the partnership profits and to allocate them to the partners in accordance with their profit shares.

14. Under ***result B***, the Appellants would recognise the partnership income of 100 under section 114(2) ICTA 1988, but would then sustain the claim that the costs of 90 (incurred entirely outside the partnerships) were deductible, and that the partnership profits that had already been taxed under section 114 should not be taxed again by being included as receipts of the sole trades, such that the total taxable profits ended up as 10, i.e. 100 and (0 minus 90). This was the method adopted in their self-assessment returns by the Appellants. The Appellants' primary contention was that they each had only one trade that encompassed their partnership and their respective sole activities. There were thus two computations in calculating the profits of that one trade, but the outcome was still that there was just one trade and the profit in that trade was still 10. The secondary contention was that the same end

result would prevail even if the correct analysis was that they had two trades. The analysis would then be that they had to recognise the partnership profits of 100 under section 114(2) ICTA 1988, that costs of 90 incurred in their respective sole trades were still revenue expenses, and that in computing the profits of the sole trades, it was still inappropriate to recognise the income of 100 distributed to them because that income had already been taxed. Since the Appellants' principal contention was the former approach of claiming to have one trade in which there were two computations, it was never totally clear how, on the "two trade" analysis, the net costs of 90 would fall to be deducted. Presumably if there were sufficient other profits in the sole trades, the 90 would simply be deducted in those calculations. If there were not such other profits, then implicitly the loss of 90 in the sole trades could have been carried forward against later sole trade profits, group relieved or set sideways against the profits of the partners' partnership trades, following a claim (if made in time) under section 393A ICTA 1988.

15. ***Result C*** proceeded on the basis that the partners had respectively to recognise their share of partnership profits of 100 under section 114(2) ICTA 1988, but that HMRC would then have succeeded in disallowing the cost of 90 on the basis that it was either capital expenditure or that if not capital expenditure it was still an expense not incurred wholly and exclusively for trading purposes. Having disallowed the expenditure of 90, the resultant taxable profits became 100 rather than 10. HMRC made no further attempt to treat the receipt of distributions as income in the sole trades, presumably because the disallowance of the costs of 90 indicated that the acquisition of the role as partners in the partnership was an activity outside the ambit of the sole trades, and the Appellants had simply received the distribution of taxed income.

16. ***Result D*** again assumed that the partnership profits of 100 had to be allocated to the partners under section 114(2) ICTA 1988, with the Appellants succeeding in undermining HMRC's claims that the expense of 90 was either a capital expense or an expense that was not incurred wholly and exclusively for trading purposes. HMRC's fall-back contention was then that if the 90 constituted an expense of the sole trades, then the Appellants should be taxed on the profits of those trades as a separate and distinct matter from their liability to tax on the partnership profits under section 114(2). Accordingly the Appellants were subject to tax on both 100, pursuant to section 114(2), and then they were also taxable on the net profits made in their sole trades, i.e. 10 (distributions or see-through profits of 100 minus costs of 90), so that the total taxable profits were 110. Naturally the Appellants' response to this analysis was that the 100 could not be taxed twice, this contention being advanced both on the approach of saying that the Appellants just had one trade with two computations, albeit with the same result arising (i.e. of precluding the 100 being brought into account twice) even if the Appellants had two distinct trades.

17. Throughout this Decision we will periodically refer to the figures of 100, 90, 10 and 110 and they will obviously have the meanings assigned to them in the above paragraphs.

The facts in more detail

18. We were given an astonishingly full record of the facts, but will confine our summary below to those relatively few facts that we consider to be relevant to the disputes between the parties.

19. Both Appellants were financial dealing companies in the Investec group. We were told that the group had dual listings, the principal one being in South Africa, and the other in London. We were not given details of the dual-listed structure though we were certainly told that matters had been structured so that liabilities in one limb of the group could not undermine the solvency of the other limb of the group.

20. More significantly we were told that in the period in which the disputed transactions were undertaken (2006 and 2007) the size, regulatory capital and net worth of the UK companies in the overall group were relatively modest. We were told that there had been a very marked expansion since the relevant period but that in that period, the two Appellants, and indeed all the companies in the UK part of the group, were unable to tie up regulatory capital in long-term positions. Accordingly where group companies participated in tax-based leasing transactions, this was often on the basis that the companies would enter into the transactions on current account and then seek to sell off the leases, once written, shortly after they had been entered into, and ideally another group company would retain the service function of managing the leases. Even where leased assets were acquired as capital assets, the assets and leases were often sold off in a similar manner. Consistently several of the companies in the group were forced, through shortage of capital and regulatory capital to participate in novel and highly-structured transactions. In other words the companies had to exploit their skill in dealing in complex and special situations, rather than make their profits simply by taking long-term positions, and tying up their capital, in straightforward deals. We were certainly told that the employees involved with the transactions that are the subject of these Appeals (described as the UK Structured Asset Finance team) fell into that category of being bankers well qualified to deal with novel and complex situations.

21. The second Appellant ("IBP") was the main financial trader in the group. It carried on a broad financial trade through various divisions. The first Appellant ("IAF") was, and is, a wholly-owned subsidiary of IBP. By the time of the relevant transactions, IAF had a broad financial trade and had on a number of occasions bought and sold portfolios of lease receivables as a natural extension of its lease finance business. It was doubtless selected to play its role in the relevant transactions because two Investec companies were required in order to sustain the partnership structure if none of the earlier partners remained partners at the time the transfers to Investec companies took place, and additionally IAF had the management ability to understand the relevant transactions.

The LAGP leasing transaction

22. This transaction resulted from the fact that the parties to a 1999 National Australia Bank leasing deal involving two LNG tankers wished to terminate the transaction. Little was known about the relevant circumstances in the National Australia Bank group, though it is reasonable to assume that, since the vast bulk of the capital allowances had been utilised and a guaranteed residual value payment of £248,302,590 (secured by letters of credit issued by West LB and CIBC) was to be paid to the lessor on termination by the original supplier of the vessels, the relevant lessor would have been minded to enter into transactions that might result in the guaranteed residual value payment being received by, and taxed (or ideally sheltered from tax) in the hands of some successor.

23. It appears that initially companies in the Merrill Lynch group intended to perform the role of acquiring the relevant leasing business and presumably then seeking to shelter the tax in some way on the receipt of the termination sum. To this end, Merrill Lynch companies

formed the partnership called the Leasing Acquisitions General Partnership or LAGP. It then seems that there was a change of policy at Merrill Lynch, and that it was decided that the Merrill Lynch companies were no longer ready to participate in the relevant transactions, and so they wished to sell the LAGP partnership that would either then hold, or be committed to acquire, the company that held the relevant leasing business to some substitute parties. Those substitute parties were the two Appellants.

24. Prior to the actual acquisition of the partnership interest by the Appellants, cross options had been put in place between the lessee and the lessor, making it certain that one or other party would terminate the leases.

25. Following a number of involved transactions, the Appellants ended up buying the LAGP partnership for the aggregate sum of £8,854,001and together contributing £226,181,882 as capital to the partnership. This sum was used to purchase roughly £4 ¼ 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. Following a transfer of the leasing business by that bridge company to the LAGP partnership, then composed of the two Appellants, the leases were terminated (in fact pursuant to the exercise of the lessee's option) and the residual value payments were paid to the partnership under the letters of credit. The vast bulk of those receipts was then paid to the Appellants as distributions. The LAGP partnership remained in existence, seemingly conducting the residue of a leasing business with the assets acquired for the £4 ¼ million just referred to. Quite why the decision was made to acquire those other assets and to retain them in the small residue of the leasing business of the partnership was not particularly material.

26. This transaction is accordingly the closest to a "plain vanilla" version of two finance dealing companies acquiring a leasing partnership, and seeking to set their cost of purchasing the partnership interests and contributing the additional capital to the partnership against the income realised on the termination of the leases. Applying ***result B*** above, the Appellants' claims were that they did recognise the partnership income in their tax returns, pursuant to section 114(2) ICTA 2006. They deducted £42,274,253 (treated as a disposal receipt for capital allowance purposes) from the gross receipt on termination of £248,302,590, and thus treated £206,028,337 as the aggregate income to be apportioned to the two partners under section 114(2) ICTA 1988. That figure was the 100 illustrated in ***result B*** above. In the sole trade calculations, they claimed deductions for the costs of acquiring the partnership interests, the cost of the further contributions and funding costs (the 90), and on the single trade analysis simply deducted those costs from the section 114(2) ICTA 1988 calculation and volunteered tax on the net profit, i.e. the figure of 10.

The Garrard transaction

27. The Garrard transaction was rather less straightforward and we will speculate as to the purpose and nature of some of the steps. It is not particularly material whether our speculation is correct, but it may assist in enabling any reader to better understand the transaction.

28. The Garrard transaction commenced with the purchase of a small leasing partnership that had been owned by the Schroders group. The acquired partnership held a lease of a

film that was leased to the BBC. The witnesses and the Appellants' counsel were not entirely clear whether this lease was in a positive tax-paying position though it eventually emerged that it probably was, but only to a small degree. The acquisition of the partnership took the form of the Appellants acquiring a 95% partnership interest from a former Schroders partner, and the purchase of a former Schroders company that held the remaining 5% interest. In due course 4% of that 5% of the partnership interest was acquired directly by IAF, IAF making a contribution to the partnership and that contribution being returned to the ex-Schroders company.

29. Some reference was made to why the Schroders partnership was acquired. It was certainly the case that Schroders was terminating or selling all its former leasing business and this particular transaction happened to constitute the last relevant sale in the closure of that business. It was conceivable that the partnership was acquired in order to sell off the BBC rental entitlement, in rather the way that this was the objective of the LAGP and the Cathay Pacific deals. This, in isolation, seems however most improbable because the figures would hardly have justified the complexity. Perhaps the more likely explanation for the purchase of the Schroders partnership was that a partnership was going to be needed in order to perform the roles to which we will now turn, and there was some suggestion that the Investec tax department had concluded that the transaction would be more commercial if it commenced with a purchase of an existing leasing partnership from third parties, rather than by the formation of a partnership by the Appellants themselves.

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. We were told that this company had written its leases on a current account basis and that most of the leases transferred were leases that had been written fairly recently. The third contribution of funds was applied in purchasing other leased assets from another Investec company, namely Investec Asset Finance (Capital) Limited. The assets transferred by this company had been acquired on capital account, though again most of the assets had only recently been acquired so that the leases were not in a wholly tax-positive position.

31. It will be obvious that all the various assets held and acquired by the Garrard partnership were rather different from the LNG tankers in the LAGP partnership in that they were very far from being in a wholly tax-positive position. One thing that was clear, however, was that it was certainly the intention that the vast majority of the entitlement to rental income in respect of all of the leases was to be assigned to the NatWest company Lombard, and we were told that one of the reasons for amassing such a substantial portfolio of leases (from various different sources) was that Lombard would not have been interested in taking an assignment of rentals in materially smaller amounts.

32. It also appears that another, possibly the major, objective of the Garrard transaction was that, whilst the vast majority of the future rental entitlement was to be sold to Lombard, and a return of capital was to be made to the partners out of the proceeds of that sale, the remaining interest in the partnership, carrying the entitlement to the residual value of some of the assets, and the hoped for entitlement to capital allowances, along with a minor interest in

retained rentals, was to be sold, by way of transfers of partnership interests, to several companies in the SMBC group. We were indeed told that much of the tax planning was apparently devised by the SMBC group.

33. The apparent appeal to the Appellants of the Garrard transaction therefore appears to have been that, provided their costs of buying the Garrard partnership and making the additional contributions to it were all deductible, so that the Appellants paid tax on, and only on, their overall net profit, the feature of selling the rentals to a party keen to acquire the rental streams alone and of selling the residue of the partnership interests to members of the SMBC group, was that the total proceeds receivable by the Appellants would have been enhanced by that feature of splitting the various elements of the business and selling each to the party prepared and keen to acquire, and ready to maximise the price for, the relevant slice of assets.

34. There was one feature of the Garrard transaction that occasioned dispute between the respective leading counsel, and this was the issue of whether the Garrard partnership itself acquired those assets purchased from Investec Asset Finance (No.1) Limited as capital or revenue purchases. There was no dispute that when the assets were held by Investec Asset Finance (No.1) Limited they had been held as current assets. Our understanding of the evidence of one of the Appellants' witnesses, Mr. Jenner, was that the partnership's acquisition was an acquisition as capital. Whilst this was perhaps slightly curious when the great majority of the rental entitlement was to be sold immediately, it seemed that the feature that the Garrard partnership was said to have disclaimed any capital allowances for the period during which it held the assets, and that SMBC were participating in the transaction in order to derive the benefit of capital allowances, did strongly suggest that the assets were acquired as capital. Mr. Peacock for the Appellants contended that his understanding was that the assets were acquired as current assets and that, although there would be no second acquisition of the relevant assets, it might still be open to SMBC companies, as the successor partners, to treat the acquisitions of the assets as having been capital acquisitions for capital allowance purposes, even if initially the partnership had treated the acquisitions on current account. We incline to the view, advanced by Mr. Jenner, and certainly shared by Mr. Tallon for the Respondents, that the partnership acquisitions were treated as capital acquisitions.

35. It seems to us that little depends on the doubt mentioned in the previous paragraph. We were certainly told that the Appellants were in no way warranting any particular tax outcome to the SMBC companies and that indeed the planning was SMBC's planning and not Investec's planning. Furthermore, it seems to us that if the Appellants succeed in these Appeals in the three fundamental issues (those numbered as 1, 2 and 4 in paragraph 9 above) the point of doubt mentioned in the previous paragraph would be largely irrelevant. If the Appellants do not prevail, then it would seem that the partnership profit (no longer sheltered by deductions if the Appellants lose on issues 1 or 2, and chargeable in any event if the Respondents succeed in establishing that ***Result 4*** was the correct basis on which to calculate the tax), the charge to tax on the Appellants would be less if the assets acquired from Investec Asset Finance (No. 1) Limited had been acquired as current rather than capital assets.

The Hong Kong transaction

36. As we indicated in paragraph 5 above, the Hong Kong transaction stemmed from a purely Hong Kong leasing transaction in relation to an Airbus 340. The lessors included two companies in the Cathay Pacific group, and by the time of the transaction with which we

are concerned, all or virtually all the capital allowances had been claimed and the position was that any future receipts of rentals or sales proceeds would be taxable in Hong Kong at 17.5%, pursuant to a ruling issued when the lease was entered into.

37. The lease originally made no provision for what was to happen at the end of the primary lease period (the point at which the present transactions were effected), the assumption presumably being that if the airline lessee wished to continue using the aircraft it would either have to purchase the aircraft or agree a new profile of rentals. Naturally the Appellants would not have purchased the partnership interests unless they were certain that a particular sum would be received by the partnership virtually immediately and to this end the lease was varied providing for replacement fixed rentals and for a prepayment of those rentals. The other change that was made was geared to the fact that if the Appellants became the principal partners in the leasing partnership the managing partner would remain one continuing, and independent, corporate partner with a very small percentage entitlement to rentals, and so the Appellants had to procure changes to the deed to make it inevitable that, following a receipt of the accelerated rental, there would immediately have to be a full distribution of those receipts to the partners, i.e. substantially to the Appellants.

38. Following the making of the changes just referred to, the Appellants purchased the partnership interests. In this transaction the entire cost suffered by the Appellants consisted of the price paid for the partnership interests, and nothing was paid by way of contribution to the partnership, following the step in which the Appellants became the dominant partners.

39. The points to note in relation to the Hong Kong transaction were first that prior to the involvement of the Appellants, the Hong Kong transaction had been an entirely Hong Kong transaction, with no UK tax implications for anybody. The second point is of course that when Hong Kong tax of 17.5% had to be paid by the partnership in respect of the receipt of the accelerated rental, the net amount to be distributed to the Appellants was less than the price paid by the Appellants for their partnership shares, so that the appeal of the transaction would revolve almost entirely around the manner in which double tax credit relief would be obtained in the UK for the Hong Kong tax charged. This is of course issue 6 of the issues mentioned in paragraph 9 above.

The legal issue of whether the Appellants, as both sole traders and partners in the various partnerships, were conducting one trade (albeit involving two calculations) or two trades

40. Notwithstanding that at this point we have not summarised the evidence given by the Appellants' three witnesses, and that the first fundamental formal question for us is whether the Appellants' expenditure in acquiring partnership interests and contributing further funds to the partnerships was capital or revenue expenditure, we consider it best first to consider the largely legal issue of whether the Appellants were conducting two trades or just one trade when becoming partners in the various partnerships. For this issue clearly has some bearing on the issue of whether the various costs were legitimate trading deductions.

41. The contention by the Appellants that they were conducting one trade that nevertheless involved two computations was understandable for the pragmatic reason that the one trade analysis would obviously make it easier to contend that the income realised by the partnership, when either receiving a guaranteed residual value payment or accelerated rents in the LAGP and Hong Kong transactions or the distributions paid out of the proceeds

received for an assignment of the right to the rents in the Garrard case (i.e. the 100) should not be taxed or brought into account twice.

42. Relatively little argument was advanced on behalf of the Appellants, however, as to why the right analysis was that there was only one trade, the main point being advanced being that section 114(2) ICTA 1988 did not necessarily produce this result. In other words that provision simply attributed the appropriate proportion of the partnership profits to each partner and charged corporation tax as if that share derived from a trade carried on alone by the partner, but it did not necessarily require the apportioned amount to be treated as the profits of a separate trade, as distinct from being included in the one sole trade being conducted by the partner.

43. We refer below to the two authorities referred to by the Appellants' counsel that allegedly confirmed that a partnership trade could be treated as one trade along with the other activities of a sole trade conducted by the corporate partner. We deal first, however, with the one trade/two trades issue on general principles.

The one trade/two trades issue on general principles

44. In this context we accept that there is nothing in section 114(2) that is conclusive in relation to this issue but we still conclude on general grounds that for tax purposes the Appellants' roles in the partnership trades were distinct from their other sole trades, and that they thus had two separate trades.

45. The first reason for this conclusion is that when considering the ambit of a trade there will almost inevitably be a relationship between the costs and the gross income of the trade. The costs will be incurred in order to generate the gross income.

46. In the present cases, and the point is particularly obvious in the case of the LAGP and all the Hong Kong transactions, the costs incurred by the Appellants had nothing whatever to do with the generation of profits in the partnership leasing trades. In the LAGP case, the partnership gross receipts were to consist of the guaranteed residual value payment, and while the Appellants' costs might have accounted for why that receipt would inevitably flow to the Appellants, the Appellants' costs had nothing to do with the generation of, or the quantification of, that receipt by the partnership. Exactly the same point applied in all the Hong Kong cases. The Appellants would have calculated the discounted amount that they paid for the partnership interests by reference to the amount that the lessee and lessors had calculated to be the appropriate amount to be paid by pre-payment of rental (the Appellants' discount profit resulting largely from the Appellants' roles in sheltering the receipts from tax) but the partnership's entitlement to that amount derived from its ownership of the aircraft and not from the fact that the Appellants had incurred costs in purchasing the partnership interests.

47. It is also realistic to regard the activities in the sole trades of the two Appellants as being inherently distinct from the leasing activities that had been conducted by the partnerships. Again the points are particularly compelling in the LAGP and the Hong Kong transactions in that in those transactions the partnership interests were only acquired after it was inevitable that the leasing activities would effectively (or substantially) be terminated very shortly after the Appellants became the partners. We will deal later with the continuance of the LAGP partnership and the role in relation to the few assets acquired and leased that we mentioned in paragraph 25 above, but the cross options certainly ensured, prior

to the Appellants acquiring the relevant interests in the LAGP partnership, that they would have no meaningful role in relation to the major leasing transaction, and that the partnership would simply be bound to receive the guaranteed residual value payment. The Appellants' costs were thus incurred to obtain the right to that payment. Exactly the same applied in all the Hong Kong transactions. The pre-payment of rentals and the distributions to the partners had all been pre-wired, and the Appellants incurred their costs simply to derive the rights to the distributions.

48 These steps illustrate to us how coherent and self-contained the above steps were in the context of the Appellants' sole trades, and how the acquisition of the partnership was simply a means to obtaining the various distributions from the partnerships, and of course an essential step in the overall tax planning.

49. The analysis is not immediately so obvious in the case of the Garrard partnership, since the contributions to the partnership were indeed all made to acquire further assets that were either already leased, or that were to be leased. As a factual conclusion, however, we do entirely accept the Appellants' evidence that all the various transactions were directed to maximising the receipts on the disposals of the various interests. We accept in other words that assets were acquired and leased essentially to generate a sufficient volume of rental income to persuade Lombard to pay for the assignment of 95% of the rentals, and the feature of retaining 5% of the rental entitlement, the residual value of assets (where leases attracted some entitlement to residual values) and the entitlement to capital allowances were all retained within the partnership in order to maximise the receipt given by SMBC companies for the partnership interests. The clear objective of the Appellants in acquiring the Garrard partnership and of all the transactions in relation to it were not directed to conducting the leasing trade but to maximising the two receipts consisting of the partnership distributions made following the sale of rentals to Lombard and the receipts on assigning the partnership shares to the SMBC companies.

50. Another factor that supports the analysis that the Appellants' sole trades were distinct from their role in the partnership trades is the fact that the partnership trades were conducted by "the partners in common". For computation purposes, section 114 ICTA 1988 provides that the profits are to be computed as if the trade in common was conducted by a company and the proportionate shares of profits and losses are then attributed to the partners. Although each partner's share in the profits or losses is then charged to corporation tax ***as if*** the share derived from a trade carried on by the partner company alone, this is only a deeming notion for the purposes of charging corporation tax. Nothing changes the legal reality, reflected in the very first phrase of section 114(1) ICTA 1988, that the trade is actually carried on in partnership, i.e. by the partners in common. It accordingly seems very difficult to treat one trade conducted by a company on a sole basis as including an activity where the trade is carried on by two or more companies "in common".

51. A good example of the inevitable feature that there will be a distinction between a sole trading activity and that activity conducted in partnership is provided by the treatment of a company conducting a leasing trade on its sole account. If such a company then forms a partnership designed to conduct leasing activities in common with others, one would inevitably judge when the partnership leasing trade commenced by addressing the steps undertaken by the partners. It would be incoherent to suggest that if an asset was to be purchased by the partnership with expenditure being incurred over a long period, that the

partner conducting the sole leasing trade could be treated as actually conducting the partnership leasing trade before the occasion on which the partnership as a whole would be treated as having commenced that trade.

The conclusion on general principle

52. Our conclusion is that in these Appeals the Appellants were conducting their own sole financial trades, and they were then participating (indeed in a technical but rather minor manner) in a separate trade in partnership. There were two trades and not just one trade with two computations.

The limited significance of the authorities

53. We must now address the two main authorities quoted by the Appellants' counsel that were asserted to support the proposition that a corporate partner's share in a partnership trade could be treated as being part of the activity of one trade that the partner was conducting on a sole basis outside the partnership.

54. We consider that neither case is a compelling authority for the proposition that a partner ***can*** be treated as having one trade, including both sole trading activities and the partner's share of partnership activities, but we also conclude that even if that proposition was tenable on appropriate facts, the facts in the present cases would not sustain that conclusion.

55. In the case of *J J Farrel (Surveyor of Taxes) v. The Sunderland Steamship Company, Limited,* 4 TC 605, the company had owned and operated one vessel for some time, and in 1900 the company purchased 59/64ths of another vessel and took over the management of that vessel and kept its accounts. The three year averaging basis on which profits were then computed induced the company to contend that its activity in relation to the partly owned and recently acquired vessel was simply an extension of its one trade. Mr. Justice Ridley's decision was that, even if as a general matter it was appropriate to treat the new activity as an extension of the one trade, for tax purposes when a trade was conducted by persons jointly, the results of that joint trade had to be reported separately from the results of any sole trade. The contention in the present case was that the point about separate reporting under the then different tax rules was irrelevant to the analysis in the present case and that the material point was that the judge had decided that as a more general legal matter it was appropriate to conclude that the two activities were simply the activities in one trade.

56. Our observations on this contention are first that it was not expressly decided that the two activities were all encompassed within one general trade as a general legal matter. The judge essentially said that even if that was so, the conclusive point for tax purposes was that the results of the trade conducted jointly still had to be reported separately for tax purposes. Beyond that, we also observe that when the activity in both the sole and the joint trades was identical, and indeed the appellant company had the management responsibility for both vessels, it was far more tempting and realistic to treat there as simply being an extension of the one trade when the new activity and the 59/64ths interest in the new vessel was added to the company's earlier activity. The facts in the present case, where the Appellants wanted no involvement in the former leasing activity; where they simply needed to be clear that the full rentals or termination sums would be received, and the partnership essentially closed down were most certainly not similar activities to those that had been conducted for years by the

former lessors or partners. As suggested in paragraph 47 above, the sole trading activities and the partnership activities were quite different.

57. In the other case of *Leach v. Pogson (HM Inspector of Taxes)* 40 TC 585, an individual had conducted the trade of operating driving schools in partnership, and he then found it more profitable to set up numerous driving schools; operate some of them in partnership with other people who also gave the driving lessons, and then in about 30 cases the businesses were incorporated and profits made in selling off the shares of the resultant companies. We accept that had the facts been more carefully explained in the decision or had they been analysed more carefully, it is possible that this case might have had some bearing on the issue of there being one trade in which the driving lessons provided in a partnership context might have been considered to be part of one trade along with the appellant's sole activity of selling companies that conducted such trades. The point that was actually in dispute in this case was, however, nothing whatever to do with that one trade/two trade point and that was barely referred to. By the time the case came before Mr. Justice Ungoed-Thomas, the appellant had conceded that the sale of all the companies with the exception of the first had been sales made in the course of a trade of forming and selling companies. The only issue was whether the sale of the first company also fell to be so treated. It was held that it was permissible to pay regard to the later events in considering the appropriate treatment of even the sale of the first company, and it was accordingly held that the first sale was also made in the course of trade.

58. When the decision in this case had nothing to do with the issue of whether the appellant's earnings from actually giving driving lessons in partnership and the other activity of selling off driving tuition companies constituted the activities of one trade or two trades we are certainly not inclined to treat this case as being particularly instructive in relation to an issue where we actually consider the two trade analysis plainly to be correct on general principles.

The evidence given on behalf of the Appellants and findings of fact based on that evidence

59. Evidence on behalf of the Appellants was given by Mr. Alastair Crowther, Mr. Jo Jenner and Mr. Kevin Chong. All three witnesses were clearly honest and had a full recollection of the relevant transactions. Mr. Crowther gave general evidence that was material to all three transactions and Mr. Jenner dealt with the LAGP and Garrard transactions, while Mr. Chong dealt with the Hong Kong transaction.

60. There were two main threads to the evidence given by all three witnesses. One stressed all the points concerning the shortage of regulatory capital, the inability for Investec companies to tie up capital in long term positions and the feature that it was considered essential that the group companies should make their profits by short term roles in often complex and novel transactions. The other related thread was that each of the witnesses, as bankers, viewed the relevant transactions as transactions where in substance the Appellants bought, and then realised, receivables. The wrappers in which the receivables might have been held were largely irrelevant to the bankers. Of course accounting, legal and tax specialists would have to consider the technical position and confirm that none of those factors would pose any problem in the context of the realisation of the receivables. Such factors might thus preclude a transaction from being undertaken, were they to create insuperable difficulties in achieving the basic aim. Once the verification exercise with accounting, legal and tax specialists had indicated that none of the factors should create a

material difficulty or risk, the bankers said that they then viewed the transactions as short-term transactions in which they bought receivables at a discount and thereby made a trading profit. Their objective was moreover not to avoid any tax in the sense that they were expecting and intending to pay tax on what they regarded as the profit that they sought to make.

61. The Appellants' witnesses also stressed the point that considerable attention was paid to the credit risk involved in participating in the transactions, in that having incurred the costs of acquiring the partnership interests, the Appellants were then reliant on the due payment by the two banks mentioned in paragraph 22 above to pay the residual value payment owed in the LAGP transaction and the credit standing of Cathay Pacific to pay the agreed pre-payment of rental in the Hong Kong transaction. We accept that the Appellants gave attention to these credit risks but do not find this point particularly significant in relation to the present dispute.

62. In this section of our Decision, we will consider some of the contentions in relation to whether the above short summary of the objectives was realistic, in order to reach material findings of fact. In the following sections we will consider the legal issues of whether our findings of fact lead to the conclusions that the costs of acquiring partnership interests and injecting additional capital into the partnerships were revenue expenses of the Appellants' respective sole trades for tax purposes, and expenses wholly and exclusively incurred for trading purposes.

Findings of fact

63. The Respondents' counsel challenged the proposition effectively advanced by the witnesses to the effect that they were simply buying receivables, and the slightly different point that any acquisition of the partnership interests was irrelevant.

64. We agree that it is unrealistic to say that by buying the partnership interests, the Appellants actually acquired the receivables (albeit that they did of course jointly acquire a substantial interest in the receivables, subject to the terms of the partnership agreement), and equally unrealistic to say that the acquisition of the partnership interests, "the wrapper", was irrelevant. So far as the tax planning was concerned, the crucial point was that the purchase of the partnership interests was designed to avoid any realisation in the hands of the former partners of the various receivables, whilst the Appellants still hoped to be able to set their costs of buying the partnership interests against the rental profits within the partnerships so as to end up being taxed only on the net profits, i.e. the profit of 10. In this regard, the formal feature of buying the partnership interests was absolutely vital to the tax planning.

65. While we thus make the obvious point that it was central to the tax planning that the Appellants purchased the partnership interests, we nevertheless find that the factual claims made by the Appellants' witnesses were fundamentally realistic and we accept them.

66. It was first realistic to say that the regulatory capital constraints in the Investec group made it essential that the transactions had to be very short term transactions. They were intended to be, and although the Garrard transaction encountered some unforeseen issues that slightly increased the period of exposure, it is still the case that the Appellants' three transactions were effected in 9 weeks in the case of the LAGP transaction, 6 months in the case of the Garrard transaction and 2 weeks in the Hong Kong transaction.

67. Beyond it being the aim, and indeed the outcome, that the transactions were short-term transactions, the Appellants only entered into the transactions when they had made prior arrangements that would ensure that the rentals or termination sum would be received if they acquired the partnership interests, and that distributions would immediately be made to them.

68. In the case of the LAGP transaction, prior to any involvement on the part of the Appellants, the lessee acquired the right to terminate the leases on a date in mid-October 2006 and if the leases were not terminated pursuant to that option, the lessors had the right to terminate the leases on 31 October.

69. In the case of the Hong Kong transaction our understanding is that the primary period of the lease had ended or was imminently to end at the date of the transactions with which we are concerned, and that the original lease had made no provision for the continuance of the use of the aircraft or for any further payments of rental after that point. In order to enable the Appellants to incur the expenditure in buying the partnership shares, and then to be confident that the partnership would receive pre-arranged amounts very shortly after they had acquired the partnership shares, the lease was changed to provide for further rentals and indeed for all those rentals to be pre-paid. In addition, since the managing partner, with a very minor share of the profits, was to remain a non-Investec company, the partnership deed also had to be varied to require a full distribution to each of the partners as soon as the pre-payment of rentals had been received. Once these changes had been made the Appellants acquired the partnership interests, the partnership received the pre-payment of rentals; the partners reserved the required amount out of the pre-payment to pay the Hong Kong tax of 17.5% of the receipts, and then distributed the balance to the partners. The final pre-arranged step was for the Appellants to sell back to Cathay Pacific their partnership shares for 4 Hong Kong dollars, the receipt of which, not surprisingly, the Appellants waived.

70. In dealing above with the issue of whether the Appellants conducted one or two trades, we dealt with the slightly more involved circumstances of the Garrard transaction in which of course the capital contributions were made in order to acquire further assets and leased assets. For the reasons given in paragraph 49, however, we still consider it clear that all the steps in the Garrard transaction were entirely directed to maximising the eventual receipts, i.e. the distributions by the partners following the sale of the rental entitlement to Lombard, and then the sale of the partnership shares to the SMBC companies for a price reflecting the residual values and the hoped for entitlement to capital allowances.

71. Our conclusions in relation to the realistic facts are therefore that although in all three transactions the Appellants acquired partnership interests and those partnerships were conducting leasing trades, the Appellants had not only no interest in conducting the leasing trades, but their sole aim in all the transactions was to effect the pre-planned, and effectively pre-contracted steps of terminating the leases (or the significant lease in the LAGP transaction) so as to receive the distributions or (in the case of the Garrard transaction) to receive the distributions from the sale to Lombard and the proceeds for selling the remaining partnership interests to the SMBC companies. These transactions and the profits made in these short term transactions were the reasons why the transactions were effected. The Appellants had not the slightest interest, or indeed in the LAGP and Hong Kong cases, even the opportunity, to participate as active partners in the leasing business.

Applying the law to the facts in relation to whether the costs incurred by the Appellants were revenue or capital costs for tax purposes

72. In considering the law as to whether the costs were capital or revenue costs and if revenue costs, whether they were incurred wholly and exclusively for trading purposes, it is immaterial for us to refer to the relevant and very well-known case law authorities in relation to these subjects. In general terms, it is clear that the transactions had most of the required characteristics of trading transactions. They were conducted by companies that carried on financial trades and the transactions were short-term transactions in which the Appellants had no interest in making a capital acquisition and drawing income from investments over a period of time. It is realistic to treat the transactions as ones where, whatever the mechanics, the aim was to make a dealing profit by indirectly acquiring receivables at a discount (the discount of course largely reflecting the function or service of enabling the former partners to realise the bulk of the value of the receivables without suffering the tax liability) and then realising those receivables at full face value.

73. The Respondents' counsel's basic attack on the transactions was that it was the "how" the Appellants implemented the transactions that undermined the claim that the costs were incurred on revenue account.

74. The most fundamental point, advanced by the Respondents' counsel, for suggesting that as a matter of law, the costs incurred by the Appellants were not revenue expenses of the Appellants' trades, was that the expenditure was incurred in acquiring partnership interests, and since partnership interests were either never or only rarely acquired on trading account this indicated that their acquisition involved capital expenditure. It was said by the Respondents' counsel that *"It is the inherent enduring quality of the asset that matters whether or not the partner in fact retains his interest for a long or a short time (see Knight v. Calder Grove Estates 35 TC 447 and Lion co v. HMRC (2009) UKFTT 357. Indeed the Appellants remained partners in LAGP for some years after 2006 and HMRC note that Guinness Mahon Leasing (another company in the Investec group) remained a partner in Garrard after the sale by the Appellants to the SMBC group"*.

75. We do not dispute that the nature of an asset acquired may have some bearing on whether the expenditure incurred on its acquisition is revenue or capital expenditure, but attention must also be paid to the economic and business reality. Countless examples make the obvious point that the nature of the expenditure is very much influenced by the reasons for the acquisition. A motor trader that buys numerous cars in order to sell them obviously acquires them as trading stock, and a taxi driver who purchases a taxi incurs capital expenditure. Even assets such as land, shares, companies and indeed partnership interests can be acquired as revenue assets.

76. We are not swayed by the two authorities referred to by the Respondents' counsel mentioned in paragraph 74 above.

77. In the case of *Knight v. Calder Grove Estates* a freehold interest in 10 acres of land was acquired in 1947 for £2,000 by a partnership conducting the business of open-cast mining, the purchase containing a requirement that when the coal had all been extracted the partnership would reinstate the land, and could then require the former owner to buy it back for £500. It was duly sold back in 1952. The fact that the court concluded that that purchase was a capital purchase was obvious. The land was acquired in order to enable it to be exploited for the purpose of the appellant's trade for the entire period during which coal could be extracted. The land would be of no further use to the trader once the reserves had been extracted, and therefore the land would inevitably have been disposed of when the

taxpayer had no further use for it. The fact that this was effected under a contract agreed when the land was purchased was merely a sensible way of realising the asset when it was of no further use, and certainly did not indicate that the land was acquired and disposed of in some sort of trading transaction. We conclude that this case was obviously correctly decided and that it in no way suggests that the Appellants' purchase of the partnership interests were capital purchases.

78. The other case that was relied on by the Respondents' counsel, namely the *Lion* case was, in our view, a rather more borderline case, though again we conclude that it has little or no bearing on the present dispute.

79. In that case, a company purchased a house; retained the house for some months while expensive changes were made to the house and then, as was presumably always intended, transferred the house to a director. The value of the house at that point was considerably less than the total costs that had been incurred on buying and modifying the house. The director was doubtless charged to tax on the value of the house at the point of transfer, but the company lost its appeal for claiming an income deduction for the costs that it had incurred.

80. In the *Lion* case, the company was naturally not a land dealer and HMRC's rejection of the claim that an income deduction should have been available for the costs was partly based on the fact that land is generally held as an investment, save when dealt with by land dealers. We assume however that the decision was influenced by the period for which the land was held by the company and by the feature that the company itself dealt with the land, in the sense of improving the property and making various alterations. We note that in the period when bonuses were periodically provided to employees in the shape of coffee beans, gold Napoleons and other such assets, it is inconceivable that the cost to the company of buying the various items held transiently by the company would not have been treated as revenue expenses of delivering bonuses. Similarly if a company purchased and provided a car to a director as a bonus or indeed purchased and immediately transferred a house to a director we find it inconceivable that the relevant costs incurred by the company in those examples would not have been treated as realistic revenue costs of delivering a bonus. We conclude therefore that there is most certainly no authority, and no logic, for saying that revenue deductions can only be available in relation to the cost of buying say land or shares when purchased by land dealers and share dealers. One must consider the economic and business rationale for the transaction in question.

81. We also observe in the present case, as the Appellants' counsel pointed out, that the present Appellants were, and indeed remain, financial traders, for whom dealing in receivables and, where appropriate, even dealings in partnership interests could very easily rank as revenue transactions. We note indeed that in the case of the LAGP transaction, Merrill Lynch formed and then sold to the Appellants the very partnership interests at issue in the Appellants' appeals in relation to the LAGP transaction and we would be astonished if the Merrill Lynch companies that formed and sold the partnership interest, and indeed sold them, we believe, at a profit, were not treated as making trading profits on those transactions.

82. Turning thus to the reality of the present transactions, we accept that the Appellants purchased partnership interests. The economic reality of the LAGP and Hong Kong transactions was, however, that the Appellants were teaming up with the former lessors at a time when all the relevant leases (of the LPG tankers and the Airbus) were about to be brought to an end, and the Appellants, as financial dealers, were considered by all parties to

be the entities (possibly alongside various tax exempt entities, the only entities) that could purchase the partnership shares and immediately effect the termination transactions envisaged and avoid (or hope to avoid) the tax on the rental income or termination sums by offsetting their dealing costs against those receipts and claiming that they should only be taxed on their net profits. The Appellants were not remotely interested in the leasing activities, save that they wished to be insulated from them and wished to be certain that the leases could, by virtue of earlier termination options or revisions to the lease, be terminated with certainty. The economic reality was that the Appellants were purchasing the mechanism that would deliver to them the pre-arranged termination sums payable under the leases, and not any active interest in the leases as an on-going matter.

83. We consider it largely irrelevant to consider the issue of whether in the hands of the Appellants the partnership interests were stock. They would rank as somewhat strange stock in trade if they were stock but this issue has little bearing on the fact that the costs were revenue costs of short-term transactions in which the Appellants hoped to make their profits by assisting the former owners to avoid the realisation of taxable profits in relation to highly tax positive leasing profiles.

84. The Garrard transaction was somewhat different, and since the partnership acquired numerous assets and leases from the two Investec companies and from third parties, it is superficially tempting to say that in the case of the Garrard partnership the Appellants were more directly involved with the leasing activities. We do however accept the evidence to the effect that:

- the assembly of numerous leases and thus sources of rental income in Garrard was required because Lombard would only be prepared to enter into a transaction of taking an assignment of rentals if the amounts of rental income justified the complexity of the transaction;
- the feature of assembling all the assets and leases in the Garrard partnership was dictated not by the fact that the Appellants wished to conduct and expand a leasing trade in partnership, but by the feature that it was only by this course that the rentals could all be assigned to Lombard and the residue of the partnership transferred (along with the right to a few rentals, the residual values in the case of some leases and the entitlement to capital allowances) to SMBC so as to maximise the sales proceeds for the separate streams; and finally
- the Appellants made the short-term profit that was the entire purpose of the transactions..

85. The facts just indicated justify the conclusion that the motivations behind the Garrard transaction were substantially the same as those in relation to the LAGP and Hong Kong transactions. All the costs of both purchasing the partnership and more materially contributing capital to it were revenue costs.

86. We should specifically address two further minor points. The first is to record that we consider it irrelevant that there were not total disposals of the partnership interests in one, and tenuously in two, of the transactions. In the LAGP transaction we have already indicated that the minor assets that we mentioned in paragraph 25 above were retained. We were not clear why they were retained, though one suggestion (that we failed to understand) was that they needed to be retained until the present dispute with HMRC had been concluded. Whatever the reason, we consider that the vast realisation, and distribution to the partners, of

the guaranteed residual value payment for the LPG tankers amply justifies the conclusion that the acquisitions were made for trading purposes of the Appellants' sole trades.

87. In the Garrard transaction, one very minor partnership interest was for some reason retained by an Investec company carrying the old Guinness Mahon name. The interest was extremely minor and for that reason we reach the same conclusion as in the previous paragraph. There is of course the additional point in the case of the Garrard partnership that it is the tax treatment of the two Appellants (that did dispose of the totality of their partnership interests) that matters and that fact is not remotely affected or influenced by the fact that the Investec company with a minute share of partnership profits retained its interest.

88. The second point that we should address is that in addition to expenditure having been incurred on the purchase of the partnership interests, in the LAGP and Garrard cases, the Appellants incurred expenditure in contributing further funds to the two partnerships. In the LAGP case this was to enable the partnership to discharge the debt to the Merrill Lynch company that had made the loan that we mentioned in paragraph 25 above. In the Garrard case, the contributions were made to fund the acquisitions of the assets and leases.

89. We were told that it was indeed a term of the purchase from Merrill Lynch that the further contributions would be made to discharge the relevant debt, and that fact is indeed fortuitous because had the Merrill Lynch debt been discharged out of the termination sums paid by the lessee, this would have diminished the costs incurred by the Appellants and the distributions to be paid to the Appellants and the resultant vast reduction in the dealing costs would have undermined the key feature of the transaction. Nevertheless we consider it clear that the costs of purchasing the partnership interests and the costs of contributing the additional capital in order to discharge the Merrill Lynch debt were of the same nature. Both were revenue costs required to enable the Appellants to make their profits. The costs incurred in making the contributions were not incurred to make or increase partnership profits.

90. The same point in relation to contributions arose in the Garrard case, though we have already dealt with this in paragraphs 83 and 84 above.

91. The final point that we make in relation to whether all the Appellants' costs were revenue costs involves our quoting two of the summaries made by the Respondents' counsel designed to support the Respondents' contention that the costs were really incurred to buy valuable partnership interests and that they should be regarded as capital expenditure for that reason. We consider that the resultant summaries of the transactions by the Respondents' counsel were so remote from reality that the unreality of these summaries gives further support to the Appellants' claim that their expenditure was revenue expenditure, and not capital expenditure.

92. One contention on the part of the Respondents' counsel was as follows:

> *"What did they get for their expenditure? They got a partnership interest, which they accept is something that has very valuable rights attached to it, the ability to carry on the trade in common with others, a right to share in the profits and a right to a share of the net profits after payment of debts on a dissolution. It was an existing trade they bought into, it could have continued; the fact that they chose to exit is neither here nor there."* (Transcript Day 6, page 44 lines 12 to 20)

93. We disagree. In the case of the LAGP and the Hong Kong partnerships, prior arrangements had rendered it certain that the major lease would be terminated in the LAGP situation whether the Appellants desired this result of not, and the pre-payment of rentals and distribution of proceeds to the partners was also pre-wired in the case of the Hong Kong transaction. We do not dispute that partnership interests were acquired, and that that step was utterly vital to the tax planning, but to suggest that the Appellants had the remotest interest in conducting the leasing trades, or indeed even the theoretical opportunity to conduct the partnership trades was unrealistic. All that they could do and all that they ever intended to do was to effect the pre-agreed steps and receive the relevant distributions.

94. Another summary of the facts and intentions that we consider to be unrealistic was as follows :

> *"They [the Appellants] say in 67: the statutory test looks to the subjective intention of a taxpayer and here the taxpayer had had no interest in the partnership per se. That's nonsense. Of course they did. Of course they had an interest in the partnerships. That's why they got into them. They didn't get into them for fun. They got into it so that they could become, through LAGP, effectively, the owner of two boats. The hire purchase agreement effectively gave them the entire economic interest because it was a purchase option for $10,000."* (Transcript Day 6 page 57 lines 15 to 24)

This summary again ignores the fact that prior to any acquisition by the Appellants, there were cross options, one or other of which would inevitably lead to the termination of the leases. We accept that the hire purchase transaction had earlier resulted in the lessors having effective ownership of the two vessels, but the effect of the cross options was that by the time the Appellants acquired the partnership interests, the partnership had the right to the termination sum, and in reality nothing else.

95. Our decision is that the Appellants' expenditure in acquiring partnership interests and contributing further capital to the partnerships in the LAGP and Garrard cases was all revenue expenditure, made in order to further their short-term venture of co-operating with the former owners and partners of the leases to terminate, or substantially terminate the leases and make the profit resulting from the pre-intended distribution to the Appellants of the proceeds of those terminations, and thereby to make the profits for which the transactions were all undertaken. This conclusion is reinforced by the fact that the two Appellants were financial trading companies, periodically dealing in receivables and of course that both companies conducted seven very similar operations in the very transactions with which we are concerned.

The secondary argument to the effect that the expenditure was still to be disallowed on the basis that it was not wholly and exclusively incurred for trading purposes

96. The Respondents contended that if we concluded that the Appellants' expenditure was revenue expenditure, we should still conclude that it was not deductible because it could not have been incurred wholly and exclusively for the purposes of the Appellants' respective sole trades. This point was said to be particularly compelling were we to decide (as we have done) that the sole financial trades were distinct trades from the partnership trades. For when that was so, the expenditure would have to be seen to be incurred in part for the purposes of the partnership trades *"since the purpose of the expenditure [was] precisely to*

enable each Appellant to engage in the carrying on of a separate trade in common with others." It was also suggested that the fact that capital contributions were made in the case of the LAGP and Garrard partnerships also indicated that the expenditure could not be wholly and exclusively incurred for the purposes of the sole trades of the two Appellants. For at least part of the purpose of these contributions was to benefit the trade of the partnerships, in the one case by enabling the LAGP partnership to discharge existing liabilities incurred in the course of the pre-existing partnership trade and in the Garrard case by providing the necessary finance to allow the partnership to engage in further leasing activities.

97. In contrast the Appellants contended that if we had decided that the expenditure was trading and not capital expenditure of the sole trades, essentially the same reasoning would undermine the Respondents' present contention. We agree.

98. We simply repeat the points that when the Appellants became partners in all the various partnerships, there was never an intention that the trades would be conducted for any stand-alone benefit within the leasing trades. In the LAGP and all the Hong Kong situations it was clear that the Appellants could do nothing to prevent the effective termination of the trades and of course that is precisely what they intended to do. 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' sole trades. That purpose was to amass sufficient aggregate rental income to induce Lombard to take an assignment of 95% of the rentals, and to amass, on the instigation of SMBC, sufficient retained assets, carrying the hoped for continuing entitlement to capital allowances to sustain the attractive price to be paid by SMBC for the partnership interests, following the sale of 95% of the rentals.

99. A simple example that adds little but appears to us to support this analysis is the case of a corporate raider that acquires a company, solely for the purpose of breaking it up, probably in a pre-determined manner, so as to maximise value by transferring trades, parts of trades and assets to various purchasers such that the aggregate price for the parts exceeds the purchase price given for the company, and enables the asset stripper to make its intended profit. When the asset stripper is:

- anyway taxed as a financial instrument and share dealer;
- the operations have been undertaken on seven occasions, all with success and with the profits always intended being made;
- all the transactions have been short-term transactions, and
- the asset stripper had no interest in the activities and trade of the target company, other than to enable it to make the eventual profit,

we find it difficult to doubt that expenditure incurred on acquiring the company could be anything other than revenue expenditure incurred wholly for the trading purpose of the asset stripper.

100. Our conclusion is accordingly that all the disputed expenditure incurred by the Appellants in the present case was not only revenue expenditure but also expenditure incurred wholly and exclusively for the purpose of each of the sole trades of the Appellants.

The closure notice Issues

101. We referred in paragraph 9 to the fact that the Appellants contended that the terms of the closure notices precluded HMRC from raising the fall-back argument, referred to as issue 4 in paragraph 9 above should HMRC lose the Appeals on issues 1 and 2 in paragraph 9, and in the case of the Hong Kong transactions the terms of the closure notices also precluded HMRC from raising points in relation to restrictions on the claim for double tax relief if again HMRC failed to sustain its contentions in relation to disallowing all the Appellants' costs.

102. The merits and issues in relation to the closure notice points are the same in relation to the liberty of HMRC to raise issue 4 and issue 6 and we will accordingly deal with both together.

103. The closure notice points are interesting, and materially different from those that have been litigated in the cases of *Tower MCashback LLP v. HMRC* [2010] EWCA Civ 32 and [2011] UKSC 19 and *Fidex Ltd v. HMRC* [2014] UKUT 454 (TCC). In those cases, HMRC sought to support the conclusions and adjustments made by the closure notices by raising points that they had not initially considered or advanced. Admittedly in the *Tower MCashback* case the actual conclusion and adjustment in the closure notice was wide enough to encompass the newly-raised ground, but it was still the case that the underlying reason for denying the capital allowances in the first place and giving the conclusion and adjustment in the closure notice had been a much narrower point. In any event, however, HMRC were able to rely on different reasoning in both the *Tower MCashback* and *Fidex* cases because the different reasoning still supported the same adjustments and conclusions.

104. The closure notice point in the present Appeals is very different, and as the Appellants' counsel indicated, it is almost the mirror image of the points raised in the earlier cases.

105. There was absolutely no issue in the present Appeals of HMRC having failed during the enquiries into the taxpayers' returns to raise all the relevant points. All had been extensively discussed and the covering letter sent with all the closure notices referred to the other points (referred to in this Decision as issues 4 and 6) and suggested that in some circumstances, these points could well become relevant. It appears that the reason why they were not addressed in the closure notices themselves was that the machinery for opening and concluding enquiries into returns, and issuing closure notices when the enquiries were completed essentially contemplates that HMRC must reach one conclusion and make one adjustment to the figures to reflect that conclusion. The reason for this is that if the taxpayer does not appeal against the conclusion in the closure notice, the adjustments made in the closure notice indicate the amount of tax that is owed. Accordingly there must just be one conclusion and a matching adjustment. Were there to be a number of different conclusions in the closure notice, and quite possibly different adjustments to deal with each, the taxpayers who were going to accept the adjustments would not know which adjustment was meant to prevail and it is also difficult to see how different conclusions and adjustments could be ranked in some sort of order, since there would be no relevant machinery for choosing between them.

106. In the present Appeals, HMRC's primary contentions in relation to all the cases were that all the costs were not deductible. Were the Respondents to have won the appeals on those grounds, the taxable profits in the LAGP and Garrard cases would have been the 100, and for the reason given in paragraph 15 above there would have been no issue of HMRC seeking to raise the total taxable profits to 110, and in other words no remote need to raise contention 4 in paragraph 9 above. And in the Hong Kong case, if again all the costs of buying the partnership interests had been disallowed, the taxable profits would have been 100, the net receipt of course being 82.5 after the payment of Hong Kong tax at 17.5%, and the Respondents would have readily conceded that full double tax credit relief would have been granted, such that with a 20% rate of Corporation Tax, the tax payable in the UK would have been 2.5.

107. The covering letter sent by HMRC with all the closure notices made it absolutely clear that the closure notices themselves addressed only the "capital" and "non-deductible expense" points, though it was clear that the other points had neither been forgotten nor abandoned. Indeed it was expressly stated that depending on the outcome before the Tribunal of the "capital" and "non-deductible expense" points it might become relevant to raise points 4 and 6. Since, however, there could only be one adjustment and one conclusion in the closure notices, there was no coherent way in which these other points could be addressed in the actual closure notices. They were, however, very clearly flagged in the covering letter.

108. We should also add that in addition to points 4 and 6 having been clearly referred to in the covering letter, there were referred to in the final paragraph quoted in paragraph 111 below in the actual closure notices; all the points had been extensively discussed by the parties; both Skeleton Arguments, while also raising closure notice points, also dealt fully with the merits of issues 4 and 6, and the closure notices themselves clearly sought to label everything to do with the challenged transactions as the relevant "Subject Matter". We interpret "Subject Matter" to mean not just "the subject matter of the enquiries" but as the Respondents would doubtless suggest with credibility, "the subject matter of the conclusions in the closure notices".

The points that we will address in order to reach our conclusions

109. We will of course quote the relevant terms of the covering letter and one of the closure notices below and will also refer to the relevant case law authorities and statutory provisions. First, however, it is worth setting down the questions that we aim to address in seeking to reach our conclusions. They are:

- Are the Respondents right to say that closure notices must contain one conclusion and one matching adjustment, or is there some way in which closure notices could deal with different contentions, possibly with different resultant levels of taxable profits, with some indication of the order in which different conclusions should be addressed?
- Would "add-on" or secondary conclusions and adjustments be irrelevant if the closure notice must contain simply one conclusion and adjustment, and would the standing, therefore of various different contentions and calculations, in the event that there were different contentions that could be advanced, be of no more standing if slotted into a letter purporting to be a closure notice than if inserted in a covering letter?
- In the light of many indications that it is for the First-tier Tribunal to dictate the relevant "subject matter" of the conclusions and adjustments, and that this exercise

can pay regard to the general context of the enquiries and the content of the covering letter, is it appropriate to concede a wider compass to the subject matter of the closure notice (the extent of which in the present case is perfectly obvious) or is it incumbent on us to treat the subject matter as simply extending to the conclusion chosen by HMRC as the primary contention and conclusion, and the adjustments addressing that conclusion alone?

- Is it the case in these Appeals that there would be no remote prejudice to the raising of issues 4 and 6, in the sense of the Appellants being hijacked by last minute new contentions?
- Finally does it appear in this case that HMRC, far from having missed the crucial points that they wish to raise at the last minute, appear to have thought very carefully about the best mechanics for issuing a closure notice with one conclusion and adjustment, then indicating that the subject matter is wide enough to address other contentions and possibly different levels of adjustment if the first asserted conclusion is rejected by the Tribunal?

The actual relevant terms of the covering letter and of one of the closure notices

110. The covering letter read as follows, this letter and all the attached closure notices being dated 3 April 2012.

> ***"Investec Bank and others***
>
> ***Enquiries into transactions involving partnerships***
>
> *Please find attached closure notices for Investec Bank Plc and Investec Asset Finance Plc for the accounting periods ending 31 March 2007 to 31 March 2010. These reflect our conclusion that the treatment of the amounts paid and received in respect of the transactions involving partnerships (LAGP, Garrard and the 5 Hong Kong transactions) should be on capital account.*
>
> *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.*
>
> *For example*
>
> ***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.

Scenario 2:

If it is determined that:-

> *(a) the involvement with the various partnerships did in fact represent trading transactions,*
>
> *(b) the payments made did in fact represent allowable deductions and*
>
> *(c) the profits of each trade should be computed with reference to each other*

Then I consider that, in the case of the transactions involving Hong Kong partnerships where Double Taxation Relief has been claimed, the expenditure incurred by the Company must represent to some extent an amount to be considered in computing the amount of Double Taxation Relief due under s.798A Income & Corporation Taxes Act 1988. The exact amount and effect of this conclusion cannot be known prior to the findings of a Tribunal following an appeal by the Company.

The consequence in terms of the assessments would be a maximum of £31,224,905 reduction in Double Taxation Relief due.

If you have any questions regarding any of the above points, please do not hesitate to contact me on the number given above."

111. An example of one of the closure notices, ignoring the Schedule of adjustments to the profits, was as follows, this one dealing with IAF and its role in the LAGP partnership. It read as follows:

"Investec Asset Finance Plc ("the Company")

closure notice under Paragraph 32 Schedule 18 Finance Act 1998 and amendment of return (after enquiry) under paragraph 34 Schedule 18 Finance Act 1998

Accounting Period ended 31 March 2007

I am writing to advise you that I have now completed my enquiry into the company tax return submitted by the Company for the above period and have concluded that the Company's losses surrendered as group relief are overstated by £2,767,874.

The calculations are set out in the schedule attached

This notice amends the return to give effect to my conclusion.

SUBJECT MATTER

The closure notice relates to the tax treatment of amounts paid and received (and the transactions relevant to such payments and receipts) in respect of a partnership in the accounting period –

Name of Partnership	*Paid*	*Received*

LAGP	*£11,847,692*	*£12,405,182*

REASONS FOR THE ADJUSTMENT

The trade carried on by the Company alone ***("the Solo Financial Trade")*** *and the trade carried on by the Company in partnership with others are in law separate trades (as you have agreed in correspondence).*

Accordingly, the reason for the adjustments is that the profits of respectively the Company's Solo Financial Trade and the separate trade carried on by the Company in partnership with others should be computed separately and assessed to corporation tax separately.

Therefore, the Company's profits assessable to corporation tax should comprise (1) its share of the profits of the trade carried on in partnership with others computed under Section 114 ICTA 1988; and (2) the profits of the Company's Solo Financial Trade. Further, the payments made by the Company in respect of the above partnership were either capital in nature because they related to the acquiring of an interest in, and the financing of the trade carried on by, the partnerships (and therefore could not by virtue of Section 74(1)(f) ICTA 1988 be deducted from its income profits) and/or were not made wholly for the purposes of the Company's Solo Financial Trade) and therefore could not by virtue of Section 74(1)(a) ICTA 1988 be deducted from its income profits).

The effect of this conclusion is that the partnership transactions which are fully reflected in the £557,490 partnership profits included in the P&L should be left out of account and the original adjustment in respect of the partnership distributions should be reversed.

CONSEQUENTIAL EFFECTS

The amount of losses originally surrendered as group relief was £10,760,078. The amount available as a result of my conclusion is £7,992,204. The difference of £2,767,874 will be recovered from the relevant group companies.

You should note that, depending on the exact nature of any contention put forward on behalf of the Company to the contrary, HMRC may wish to advance additional grounds in support of amendment of the company's return.

Appeals

[Paragraphs concerning Appeals and postponement of tax payments]"

112. Before dealing with the points in dispute we should make one point in relation to the terms of the closure notices. Insofar as they made the point that the profits of the sole trades and the participation in the partnership trades should be computed separately and then that the taxable profits should comprise (1) the share of the partnership profits and (2) the profits of the Solo Financial Trade, it might be thought that even if HMRC lost their contention that the deductions in the solo financial trades should be disallowed, the closure notices might still suggest that the taxable profits were the increased figure of 110, rather than 100. We accept, however, that the adjustment made was all geared to increasing the taxable profits to 100, not

110 and that the attention given to the distinct nature of the two trades was directed to claiming that the deductions in the solo financial trades should be disallowed. It was in other words directed to sustaining what we have described as ***Result 3*** and not directed to sustaining ***Result 4.*** Although some of the wording of the closure notices was slightly confusing in this regard, we accept, as both parties did, that the intended effect of the closure notice was simply to advance HMRC's primary contention, namely that the costs should be disallowed, and that the partnership profits attributable to each partner under section 114 ICTA 1988 should constitute the total relevant taxable profits. The reason why no addition was made for any profits in relation to the "transactions" in the solo financial trades was doubtless that volunteered by us in paragraph 15 above.

113. Addressing now the statutory provisions that govern the required content of a closure notice, paragraph 32 Schedule 18 RA 1998 provides that:

> *"An enquiry is completed when the Inland Revenue by notice ("a closure notice") inform the company they have completed their enquiry and state their conclusions",*

and paragraph 34 Schedule 18 FA 1998 then provides, in the case where the outcome of an enquiry is that the taxpayer's return is to be amended, that:

> *"the notice .. must make the amendments of that return that are required to give effect to the conclusions stated in the notice".*

Paragraph 34 also provides that:

> *"An appeal may be brought against an amendment of a company's return ….."*

114. It is of course well established that closure notices only have to provide conclusions and amendments, and not necessarily the reasons for conclusions and it is also well established that HMRC can sustain the conclusions and adjustments made in a closure notice by reference to different reasons than those originally advanced (assuming that reasons were given or that it was obvious in the context of the notice that particular reasons had led to the conclusions and adjustments).

115. There has been considerable debate in the relevant authorities as to whether the matters that may be disputed in appeals against the conclusions and adjustments in closure notices are precisely limited to what are expressed to be the conclusion and adjustments, or whether they can relate to the topic, implicitly the somewhat broader topic, of "the subject matter of the conclusion and adjustments in the closure notices". The present case affords of course a very good example of the significance of that distinction.

116. Following on from the issue clarified in paragraph 112 above, and particularly when we refer back to the crucial second paragraph of the covering letter (a paragraph on which naturally the Appellants' counsel placed much reliance) it is clear that if the narrower ambit of matters that may be disputed in relation to closure notices referred to in the previous paragraph is the correct reading of paragraphs 32 and 34 to Schedule 18 then while HMRC can seek to sustain their conclusions and adjustments in the closure notice on quite different grounds, the result of the different arguments must still be to sustain the original conclusion and adjustments.

117. The alternative view 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.

118. As we have said, the present case provides an excellent example of the distinction between the two approaches.

119. For the Appellants it was contended that paragraphs 32 and 34 Schedule 18 are clear and that in any appeal against conclusions and adjustments in a closure notice, HMRC can advance any reasons to sustain the conclusion and the adjustments, but they simply must be seeking to support the relevant conclusion and adjustments. Accordingly, in this case the Appellants' counsel said that the closure notice itself essentially disallowed the claimed trading deductions, such that ***Result 3*** was the result that HMRC had to sustain in the Appeal. This was said to be made abundantly clear by the fact that the second paragraph of the covering letter expressly said that the arguments mentioned in Scenarios 1 and 2 in the covering letter were not *"properly part of the closure notice as these are not our conclusions"*. Of course the sentence in fact went on to indicate that *"we thought it proper to note that the legal issues involved may go down these routes* [i.e. of Scenarios 1 and 2] *depending on the arguments you raise, and depending on the direction taken by the Tribunal."*

120. Ignoring the last sentence of the previous paragraph, the Appellants' counsel of course contended that this was a clear case where contentions designed to sustain ***Result 4*** were in fact nothing to do with different reasons for supporting the actual conclusions and adjustments made in the closure notice and that accordingly we could not entertain them in these Appeals. He went on to say, in somewhat extreme terms, that if we concluded that HMRC could seek to sustain conclusions and adjustments dictated by ***Result 4*** in this case then this would undermine the taxpayer protection intended to be available by having defined the issues at stake in the closure notice and that there would never be a case where HMRC would be precluded, in an appeal, from contending anything that they chose to contend.

121. HMRC, in contrast, had, it seems to us, given very considerable thought to how they could and should address matters in the closure notice and in the covering letter when they wished to advance a primary argument of simply disallowing the expenses, such that the profits ended up at 100, and such moreover in the case of the Hong Kong transactions (assuming the disallowance of the deduction for the costs) that they would happily concede full credit relief for the Hong Kong tax. HMRC's difficulty was the issue of how they could raise other and different contentions, all in relation to the same transactions, particularly as some of those contentions could lead to greater tax adjustments.

122. The first point to make in support of HMRC's approach is that their approach was certainly absolutely clear. Whether HMRC might have achieved less contentious results by some different documentation (for instance by putting all the points in the closure notice itself), there is absolutely no denying that everybody, including obviously the Appellants, must have realised that HMRC had a primary argument (i.e. of ***Result 3***), and that was the point addressed in the conclusion and adjustments in the closure notice, but they clearly wished to treat the subject matter of the adjustments as relating to anything to do with the

relevant transactions, and in the clearest terms they indicated to the Appellants that depending on how matters proceeded they still wished to contend for ***Result 4*** and in certain circumstances they would wish to limit the Appellants' claim for double tax credit relief.

123. We broached the point in the previous paragraph that there might have been some sounder method by which HMRC could have phrased their closure notices and covering letters in order to achieve the result that they very sensibly sought to achieve, without being exposed to the challenge that they might later be seeking to advance different points that did not specifically constitute reasons for the actual conclusion and adjustments. We fail, however, to see how they might have achieved this. We accept that because the conclusion and adjustments in the closure notice had to provide for one fixed adjustment that would govern the tax payable if there was no appeal, we are unable to see how HMRC could have arranged for alternative conclusions to be incorporated in the closure notice. Nothing furthermore would have been achieved by expressly inserting the text of Scenarios 1 and 2 from the covering letter into the letter expressed to be the closure notice because they would have no different standing had they been included in the one and only letter and notice. The document that constitutes the closure notice is the document that contains the conclusion and the adjustments at the end of the enquiry, but alternative arguments and different resultant calculations would not constitute "**the** conclusion" or the "adjustments to reflect **the** conclusion" and they would not be elevated in status by simply being inserted into the same document as the actual conclusion and adjustments that alone would constitute the relevant content of the closure notice.

124. Our two conclusions at this stage are accordingly that the two letters generated by HMRC made HMRC's intended approach absolutely clear, and there is no way that has occurred to us in which HMRC could have retained the liberty to raise the additional arguments, and the opportunity to make other and possibly greater adjustments, that would have been immune to the present challenge by the Appellants.

125. Beyond the possibility that we may have failed to identify some mechanic that would have achieved HMRC's intended structure without the risk of attack by the Appellants, the two conclusions just given in the previous paragraphs appear to give us a choice of concluding either:

- that the statutory machinery is just defective and that it provides no way of drafting a closure notice with one conclusion and related adjustments that then enables HMRC to advance different arguments, quite possibly producing different and greater tax adjustments, but all of course totally related to the same Subject Matter of the enquiries and the primary conclusion;
- or that it is permissible to pay regard to the full information provided in the two letters, each of which notably cross refers to the other, and permissible to pay regard to the obviously deliberate text in the closure notice that seeks to define the "Subject Matter" as essentially anything to do with the various identified partnership transactions.

126. We consider it sensible, if possible, to seek to reach a conclusion that does not lead to an incoherent result and suggest that the statutory provision is simply defective. 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.

127. The suggestion by the Appellants' counsel that a conclusion along these lines would destroy the intended protections of the closure notice machinery is incorrect. There may have been numerous other transactions undertaken by either of the Appellants and it is clear that none of them would have anything to do with the subject matter of the closure notices. They would not, therefore, be the possible subject of adjustments, save by assessments under the limited provisions of section 29 TMA 1988.

128. We should finally confirm, of course, that the Appellants did realistically concede that they had not been taken by surprise by the alternative arguments being advanced by HMRC and, as we have said, both parties' Skeleton Arguments dealt with them in full.

129. Our conclusion is that HMRC can seek to sustain the various contentions that occasion ***Result 4*** and where relevant they can advance arguments to limit Double Tax credit relief. We also record that we consider that we have now addressed each of the issues that we flagged in paragraph 109 above.

Issue 4 - the question of how the Appellants' profits should be calculated if, as we do, we have concluded that all the costs of purchasing the partnership interests and contributing funds to the partnerships were revenue deductions

General observations

130. We consider this to be the most difficult issue in this Appeal. There was no authority directly in point. The Respondents contended that if we decided that the Appellants had two trades then the fundamental point was that the taxable profits from each separate source had to be calculated separately, with the result that there would be taxable profits of 100 in the Appellant's deemed trade in relation to the partnership activity and taxable profits of 10 (i.e. 100 minus 90) in the sole trade. The Appellants, in contrast, contended that the fundamental point was that in several contexts there were precedents establishing that profits should be taxed once and not subjected to double taxation. Particularly therefore in the case of the LAGP and Hong Kong partnerships, where the Appellants computed their sole financial trading profits in relation to the transactions by looking through to their share of partnership income and to the very income taxed under section 114, it was wrong, as involving offensive double taxation, for the same 100 to be included as the gross income in the sole trading profits.

131. One clear point, albeit not a point that turns out to be very material, is that the Respondents accepted that if we decided that all the costs were revenue expenses (as we have done) and if we also decided that there was only one trade with the Appellants' share of partnership profits simply being treated as profits within the sole financial trade, then the costs would indeed be deductible from the gross income and the taxable profits would be 10 (i.e. 100 minus 90). While we obviously record that, it seems to us to be irrelevant because we have decided that the Appellants must be treated as having had two trades.

132. Another factor that we should mention is that we consider that the outcome of the present difficult point must revolve around trying to derive the correct technical solution to

how the profits should be taxed and not by reference to broader issues of policy and supposed purposive analysis of the provisions and what we might presume that Parliament would have intended. The Appellants' counsel suggested to us that it was unthinkable that Parliament should have intended or contemplated that one strand of profit should have been taxed or taken into account twice. Whilst that may be right, it is equally improbable that Parliament would have been that enamoured of the feature that finance leasing transactions accelerated tax reliefs and deferred taxable income, only to be met at the end of the lease periods with the lessors entering into transactions with dealers that meant that the vast majority of the deferred income would never attract tax. In that context it is, however, worth observing that in the strand of cases that we consider to be by far the most material in relation to the technical position in these Appeals, namely the cases relating to the "dividend stripping" transactions that were undertaken in the late 1950s, the judgments both criticised the artificiality of the transactions but then accepted that the technical position was that the dealers were entitled to loss relief and thus to repayments of income tax. We will explain those points in full shortly, particularly as we consider the House of Lords decision in *FS Securities Ltd v. HM Commissioners of Inland Revenue* 41 TC 666, is the single most important case law authority in relation to the correct treatment of the present dispute. Reverting to the point about the judges in the dividend stripping cases showing their disapproval of the dividend stripping operations, it is just worth quoting the following remark by Sellers L.J. in the Court of Appeal judgments in the *FS Securities* case:

> *"If the facts are to be accepted as establishing a "trading" or any loss, a more fictitious or home-made loss it would be hard to devise in business affairs."*

Notwithstanding that most of the judges adopted the same stance, the House of Lords' decision did confirm that the loss was available, and that the relevant repayment of tax was properly due to the trading company.

The key steps in arriving at the decision in relation to the fourth issue

133. We consider that there are four key steps in the reasoning, as to how the Appellants' profits should be taxed in this case on the dual assumptions that all the costs were revenue costs of the Appellants' sole trades, but that the Appellants did have two separate trades. Those steps are:

1. Is it right that the Appellants are first to be treated as having taxable profits of 100 under section 114 ICTA 1988 in relation to their shares in the partnership trades?
2. In then calculating the profits and losses of the sole trades, is it right to include the same 100 as gross income, such that there is a sole trade profit of 10, or should the share of the partnership income be left out of account, in order to avoid double taxation, such that there is a loss in the sole trade of 90?
3. If the partnership income should not be included in the sole trade calculations, but the Appellants still claim deductions for revenue costs of 90, is the result that the Appellants have losses in their sole financial trades or that at least the deduction of 90 goes to reduce other profits in those sole trades?
4. If, in the sole financial trades, it is appropriate to recognise deductions for the 90, what is the fate of that 90 if there are not sufficient other profits in the sole financial trade to absorb the relief for the costs of 90. This question appears to us to have more significance in relation to the double tax relief question that we will have to deal with after the present topic.

134. The answer to the first question just posed is that the starting point must be that the Appellants are rightly to be treated as having profits of 100 in the separate deemed trade reflecting their share of the partnership profits. Our understanding is that both parties agreed this proposition.

135. Various authorities were referred to in support of the proposition that in calculating the profits of the sole financial trades, the 100 should not be included again. Some of the authorities related to very different situations and we will ignore them. The cases that seem to us to be most instructive are the three cases of *Fry v. Salisbury House Estate Limited* [1930] AC 432, *Hughes v. Bank of New Zealand* [1938] AC 366 and *FS Securities.*

136. In the *Salisbury House* case the appellant owned and let out what sounded to be, in more modern terminology, numerous serviced offices in Salisbury House. Because there were leases of land, the appellant was taxed under the then Schedule A on the annual value of the properties; it was also taxed as a trader on its trading function of servicing the offices, and the key question was whether, and if so how, it should be taxed under Schedule D Case I on its income from the lettings, as distinct from the income for the provision of services. It is not entirely clear why the relevant income was not held to be property investment income and not trading income at all, but it appears to have been assumed that the income would be chargeable under Schedule D Case I, save for the feature that tax under Schedule A had already been imposed. The two contentions were, for the Revenue, that the appellant should be taxed under Schedule D Case I, but with a credit and deduction against the tax under that Case for the tax charged under Schedule A, and for the Appellant that the Schedule A tax should preclude the income from the letting being taken into account again. The decision was that the latter contention was correct. For present purposes it is worth bearing in mind the two points, first that the Schedule A charge had not been on the income at all but on the annual value, and secondly that the ground for excluding the appellant from tax under Schedule D was simply that, as a matter of obvious general principle, the appellant should not be double taxed. No statutory provision expressly provided for this result.

137. The *Bank of New Zealand* case involved the bank's London branch in receiving four categories of income that were expressly exempt from tax, with the bank having incurred various costs in deriving that income. The questions were whether the London branch should be taxed in its Case I trade on the income, even though the income was said to be exempt, and if it should not be taxed, should it then still be able to claim a deduction for tax purposes for the costs. It was held that the income was not taxable but that the costs were still deductible. The costs were still wholly deductible expenses of the trade even though the income that they generated was exempt from tax.

138. The *FS Securities* case appears to us to be manifestly the most relevant of any of the cases in the present context. It related to a financial trader's role in dividend stripping transactions, in which the shareholders of three companies, pregnant with dividends and cash surpluses, sold the companies to the appellant dealer. The aim of the transaction, so far as the vendor shareholders were concerned was that in the days before the introduction of any tax on capital gains, the shareholders' net receipt would have been far greater on selling shares than on having received the dividends themselves. The shareholders' position was thus somewhat similar to that of the former partners that sold their partnership shares to the Appellants in the present case.

139. So far as the dealers were concerned, their hope and expectation was that the taxed dividends would not fall to be included in their Schedule D Case I calculations, because the dividends had been paid out of profits that had already borne income tax (in the hands of the companies that paid the dividends) and that the receipt of very significant dividends would occasion losses for the dealers in that the purchase costs would have greatly exceeded the written down value of the shares following the receipt of the dividends., with the dividends themselves being ignored in this calculation. The dealer's claim in the dividend stripping cases was thus relatively similar to the Appellants' present claims, with both seeking to exclude income already taxed (dividends, deemed to be tax paid because paid out of a taxed fund in the one case, and the share of partnership profits in the present case) from being included again in a Case I computation.

140. The *FS Securities* case was in fact rather involved because it involved two different issues and strictly speaking only the second was in issue. The first issue was that just dealt with in the previous paragraph, relating to the dealer's Case I treatment. On this issue, the dealer had claimed its loss and the Revenue had refunded to the dealer in excess of £400,000 being tax suffered in respect of the dividends.

141. None of the above was initially in issue in the *FS Securities* case. The actual issue in the case was that the dealing company in question happened to be controlled by fewer than five persons so that under the close company and shortfall provisions, the company's income fell to be attributed to its shareholders for the purpose, not of charging income tax at the basic rate, but for the purpose of charging surtax. The shortfall provisions then distinguished between trading income and investment income of closely held companies. There was only an apportionment of trading income if the company failed to establish that retentions were required for business purposes. In the case of investment income, 100% of the income fell to be apportioned and subjected to surtax.

142. As the case proceeded through the courts there were various contentions as to how it might be said that the dividends received were not investment income. In the House of Lords the dealing company had obviously concluded that the only way to block the surtax assessments was to do a total "about-turn" in relation to the basis on which it had initially recovered the income tax. The original approach had of course been that the dividends should be left out of account in its trading calculation and that it could recover the income tax deemed to have been paid in respect of them by claiming relief for its dealing loss on the severe downward revaluation of the shares. Without actually offering to refund the repayment of more than £400,000 that had already been paid to it, the appellant contended that the dividends **should** have been included as dealing income; there would not thus have been a dealing loss at all, and the dividends would have ranked as trading income rather than investment income so that the surtax charge would have been eliminated or materially diminished.

143. The present significance of the *FS Securities* case is that the House of Lords then proceeded to review the basis of the original loss claim, in order to see whether there was a case for saying that the dividends should have been recognised as trading income in the first place. The very pertinent conclusions were that:

- there was no statutory provision that excluded the dividends from being included as trading income;

- it had always been the practice, however, that dividends received by a share dealer were not included in the dealer's Case I calculations;
- this practice resulted from the general offence of income being taxed again or included as the gross receipts of a trade when paid out of the dividend paying company's profits that had suffered income tax: so that
- it had indeed been right to exclude the dividends in the Case |I calculation.

144. Reverting to the facts of the present case, it is noteworthy that the double taxation of which the present Appellants are complaining is relatively clear-cut double taxation. This is essentially the position in all seven transactions but it is particularly obvious in the case of the LAGP and Hong Kong partnerships because the Appellants calculated their sole trading profits 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. In the *FS Securities* case the respect in which the dealing company originally claimed its tax loss and repayment (i.e. the analysis of the transaction that the House of Lords eventually confirmed), was that it was the dividend paying company's income tax on its profits that were later paid to the dealing company by way of dividend that led to the exclusion of the dividends from ranking as receipts in the dealer's Case I calculations. Notwithstanding that the relevant transaction in respect of which the tax was originally paid was rather more remote than the situation in the present case, it was still held that the dealer should exclude the dividends received from its Case I calculations.

145. We will now quote a very long passage from Lord Reid's decision. The reason for doing this is to demonstrate how it expressly confirmed the three points just addressed in paragraph 143 above. The contentions being advanced by the two parties and being considered by Lord Reid prior to the paragraphs that we will now quote were as follows. The dealing company was contending that the proper course was for the dealer to bring in the dividends in its Case I calculations, but claim a credit for the tax charged on the dividend paying company's profits. The Revenue were claiming that the practice had always been to leave tax paid dividends out of account in the dealer's Case I calculations.

146. The relevant and long extract is as follows, the highlighting indicating our emphasis:

> ***"Neither view can be derived directly from any provisions of the Income Tax Act. If the words of the Act were applied literally the result would be double taxation of the same income, but it has been said again and again that the Act cannot be so read as to authorise that.*** *If the [dealer's] view is right, it is necessary to bring in some form of equitable adjustment after the assessable profit has been determined. Let me suppose that a trader in stocks and shares has received £5,000 net in dividends which have borne tax. The [dealer's] counsel concedes that in order to make the scheme work it is necessary to bring in not the net sum which the trader actually received but the gross amount of the dividends. If the standard rate were 10s in the pound, the gross amount would be £10,000 and it is that sum which the [dealer] says must be brought into the account. Then suppose that apart from such dividends the trader has made a profit of £4,000. On the [dealer's] view, the profit and loss account will show a profit of £14,000 and tax on that at such standard rate would be £7,000. But that would plainly involve double taxation of the same dividends. He would have suffered deduction at source of £5,000 and he would have to pay another £5,000 by reason of the gross dividends having swollen his profit and*

> *loss account. So the [dealer] says that the trader must be entitled to deduct from the £7,000 tax assessed under Schedule D Case I, the sum of £5,000 which has already been deducted as tax before he receives the dividend. That would reduce the tax payable under Schedule D to £2,000,* ***but there is no statutory warrant whatever for making that deduction.***
>
> *If the Crown's view is right the proper procedure is much simpler. In the case I have supposed, the trader would simply leave the dividends out of his profit and loss account, which would then show a profit of £4,000, and he would pay £2,000 on that profit, so if there is a profit apart from the dividends it makes no difference which view is adopted. But it does make a difference if, apart from the dividends, the trader's operations show a loss. How great a difference that can be is shown by the present case.*
>
> *Your Lordships must now choose between those two methods* ***without any authoritative guidance.*** *I have no hesitation in preferring the Crown's method, for a number of reasons. In the first place, it is in accord with long-standing practice and it has never been challenged: the matter was only considered incidentally in the Cenlon case, and I do not think that it was the subject of any detailed argument. Secondly, it is much simpler and more direct. Thirdly, it avoids the fiction of having to regard the trader's trading receipts as including not only the net dividends which he actually received but also the tax deducted by the company paying the dividends which the trader never did or could receive. And, fourthly,* ***it appears to me to carry out more reasonably the principle that money once taxed cannot again be subject to Income Tax. It appears to me more reasonable to say that dividends which have already borne tax shall not be brought into any further Income Tax calculation than to say, as the [dealer] does, that they can be brought in so as to swell the assessment of profits under Schedule D, Case I, but that then there shall be an abatement not authorised by the Act.***
>
> *I can find nothing to recommend the [dealer's] method. It seems to be true that if it had been adopted earlier it would have prevented the abuse of dividend stripping. But the fact that it never seems to have occurred to the highly skilled advisers of the Crown to try to combat the abuse in that way is sufficient in itself to make me look on the method with great suspicion. Instead of trying to adopt it, Parliament had to be asked to pass complicated legislation on the assumption that the method then in use was correct."*

147. It followed of course from this analysis that the dividends, not having been recognised in the Case I calculations, were investment income and accordingly the shortfall and surtax assessments were all confirmed.

148. We conclude that this House of Lords case is by far the most relevant authority in relation to the question as to whether the partnership profits should be brought again into the Appellants' sole trading calculations and that the answer is that they should not be so brought into account. We also consider it clear, as a result of the *New Zealand* and the *FS Securities* cases, that the dealing costs should still be recognised. On the basis that there are two trades in the present case, the result of this is that the loss of 90 could be set against other sole trade profits. If the other profits in the sole trades of the two Appellants were insufficient to absorb the relief for the dealing costs, the losses could either be carried

forward in the sole trades; possibly surrendered as group relief, or set, by virtue of section 393A, against the income that we know the respective Appellants actually had, namely the section 114 partnership profits. Unless protective claims had been made for such offset, when the Appellants' initial calculations were all based on the "one trade" analysis, it appears that the 2-year time limit for making claims under section 393A may preclude a claim now for such relief, unless "the Board" extends the period for making the claim. None of these consequential issues were aired during the hearing.

Our conclusion in relation to the fourth issue

149. Our conclusion in relation to the fourth issue is that the partnership profits taxed under section 114 should not be brought into account again in the sole trade calculations, but that the dealing costs remain deductible. We accept that the *FS Securities* case had nothing to do with partnership profits, but we regard it as the case that governs the outcome in relation to point 4 in the present case because:

- that case and the present case share the common feature that earlier taxpayers were seeking to avoid tax on income by selling shares or partnership shares to financial dealers in the expectation that the dealers would be able to shelter the tax on the relevant income, to the extent of the dealing costs of acquiring the income;
- just as in the present case, the dealer's costs consisted not directly in buying dividends but in purchasing shares, with the loss resulting from the down-valuation of the shares following the receipt of the dividends, which somewhat mirrors the way in the present case in which the Appellants' expenses were incurred in buying or contributing to the partnership, rather than in directly buying the receivables;
- the *FS Securities* case contains numerous references, particularly in the House of Lords, to the offence of income being taxed twice;
- those references repeatedly acknowledge that the objection to income being taxed twice did not derive from any express statutory provision but from a fundamental principle that was simply assumed to be so evident that it had to be respected, even though, as Lord Reid's excerpt quoted above acknowledges, the income would have been taxed twice if the statutory provisions had been construed literally; and
- it is highly relevant that the tax that had initially been charged in the dividend stripping cases was the tax on the dividend paying company's profits that franked the dividends, whereas in the present case it is far more obvious in all 7 cases, and particularly in the LAGP and Hong Kong cases that it is the same partnership profits that are being included in the sole trade calculations. The double taxation is in other words far more evident in the present cases than it had been in the dividend stripping cases.

Issue 6 - The double taxation credit relief issues

150. The double taxation issue relates only of course to the Hong Kong transactions.

151. The Appellants contended that on their analysis that the Appellants each had only one trade, they were still entitled to full double taxation credit relief for the Hong Kong tax (i.e. of 17.5 so far as the example partnership profit of 100 was concerned) notwithstanding that for UK purposes if the Appellants' succeeded in their "one trade" argument and their argument that all the costs were deductible, the UK profits would only have been 10, and the UK tax on those profits, prior to double tax relief, only 2.

152. Prior to dealing with the Respondents' contentions in relation to the limitation on credit relief in relation to the assumed facts in the previous paragraph, we need to deal with the fact that on the basis of the decision that we have reached in relation to the "one trade/two trade" issue, the double tax relief issues are almost irrelevant. The reason for this is that the Respondents conceded that full double tax relief would be available once the "two trade" analysis was confirmed, whether or not the costs were deductible. It is of course obvious why that acceptance was made if the costs were disallowed. For then the partnership profits in that separate trade would have been 100. Nothing would diminish that calculation for UK purposes and so there would be no objection to conceding credit relief for the 17.5, such that the balance of UK tax would have been 2.5. In the alternative case where the costs had been allowed, it still followed on the "two trade" analysis that nothing as such would diminish the partnership profits below the figure of 100 so that again there was no objection to full credit relief being conceded for the Hong Kong tax of 17.5.

153. Although the Respondents conceded that full double tax credit relief would have been available on the "two trade" analysis even if the costs had all been deductible, we do have one qualification to make in relation to that conclusion. It certainly appears to us to be right if the deduction for the costs of 90 in the sole financial trades was obtained against other sole trade financial profits, or by way of carry forward against later profits in the same trade, or indeed surrendered by way of group relief. None of those forms of relief would appear to reduce the profits of 100 in the partnership trades.

154. No attention was given to the issue of whether the Appellants would be able to surrender sole trade losses of 90 against profits of the same period in the separate partnership trade. We have already touched on the issue that it seems improbable that a claim for such relief will already have been made either fully or on a protective basis because of course the Appellants' assumptions have always been that each Appellant had only one trade. If, however, the ultimate decision remains (as is the outcome under this Decision) that the costs were deductible but there were two separate trades, and if then in some manner a claim could be made to offset the losses of the sole trade against the partnership profits, then we do consider that a restriction of double tax credit relief would have to be considered. For the outcome of the claim under section 393A is still that to the extent that the sole trade losses were offset against the partnership profit shares, those profits (i.e. the partnership profits) are *"treated as reduced by the amount of the loss"*. Taking the simplest, and perhaps the most likely, example of assuming that there was a claim to offset the entire loss of 90 against the partnership profits of 100, the result would appear to be that those partnership profits would then be treated as profits of 10. The UK tax on profits of 10 would have been 2, so that when section 797 ICTA 1988 provides that the credit for foreign should not exceed the corporation tax attributable to the income, it would appear that on the example above, credit for the Hong Kong tax would be limited to 2.

155. We will give no further consideration to the point just made because it was never considered in the hearing and we have no idea whether the Appellants would or could have made claims for sideways offset of sole trade losses if the two trade analysis was confirmed.

156. The double tax credit issue that we should deal with relates to the limitation of credit relief in the event that (contrary to our decision) it is held that the Appellants each had just one trade. The Appellants claimed that in this situation there would still be no limitation on full double tax relief for the 17.5 whereas the Respondents claimed that in that event, the

dealing costs would be deducted from the profits, and the corporation tax on the resultant profits treated as 10, such that the limitation on double tax relief would have been 2 not 17.5.

157. The material provisions in relation to the difference of view just indicated are section 797 and section 798A ICTA 1988. They effectively provide that the limit on credit for foreign tax in relation to income is the corporation tax attributable to the income and that in the case of trade income, the amount of corporation tax attributable to trade income is to be calculated by taking into account *"deductions or expenses which would be allowable in the computation of the taxpayer's liability."* We consider that on the one trade analysis this provision would require the foreign tax credit to be limited to 2. The Appellants appeared to contend that by virtue of their argument, although there was only one trade, there were still two distinct computations and it was appropriate to treat the expenses as not diminishing the profits in the separate computation of the partnership profits. Our decision, notwithstanding that it is actually irrelevant because we consider that there were two trades in any event, is that the relevant expenses were still expenses in the one trade, wholly attributable to the partnership profits and that the double tax credit relief should still have been reduced to the figure of 2.

Overall conclusions

158. Our overall conclusions are accordingly that:

1. both Appellants conducted two trades, one being their sole financial trades and the other being their share of the partnership profits treated as the profits of a separate trade;
2. all the Appellants' costs of purchasing the partnership interests and making further contributions to the partnerships were all deductible revenue expenses in the sole trades;
3. having regard to the "subject matter" of the conclusion in the closure notices, viewed in the context of all the discussions between the parties and the very clear references to potential other issues made in both the closure notices and the covering letter, HMRC are not precluded in this case from raising other contentions in relation to the subject matter in issue (the treatment of the partnership transactions) and particularly the issues identified as Scenarios 1 and 2 in the covering letter;
4. in calculating the profits of the Appellants' sole trades it was appropriate to deduct from the gross income the amount already taxed under section 114 ICTA 1988, such that the sole trade calculations would generate expenses of 90 without any matching gross income;
5. relief for those expenses or losses in the sole trades could be obtained in the way that we summarised in paragraph 148 above;
6. on the basis of our "two trade" analysis, there was no limitation on double tax credit relief in relation to the Hong Kong tax charged in the Hong Kong transactions, save for a reduction in the event of the Appellants being able to make claims for sideways offset of the sole trade losses against the partnership profits under section 393A ICTA 1988; and
7. if we are wrong and the correct analysis is that the Appellants had only one trade but the expenses were all still deductible, we decide that the limit for double tax credit relief would have been to the figure of 2, rather than 17.5.

The decision in principle

159. As requested by the Appellants, we have given a decision in relation to the principles in dispute. We record that the parties accepted that if they were both to accept the decisions on all points but were then unable to agree the detailed figures, the parties would revert to us for further consideration of the resultant detailed calculations.

Costs

160. Both parties applied for their costs if successful. We will leave over the issue of costs for two reasons. Firstly, we consider it highly likely that one or possibly both parties will appeal against some aspect of this decision, making it more appropriate for costs to be dealt with when the final outcome is known. Secondly, even if both parties accept the present decisions on the various issues, and notwithstanding that the Appellants have prevailed in relation to the issues numbered 1, 2 and 4 in paragraph 9 above, the fact that we have concluded that the Appellants were to be treated as carrying on two trades may severely limit the available relief for the relevant expenses for reasons touched on briefly in paragraph 148 above. There is accordingly no clear-cut conclusion as to who won these Appeals. In the event therefore that these decisions are not to be the subject of further appeals to the higher courts, we invite the parties to make written representations, or to request a short Costs hearing in order to resolve the Costs issue.

Right of Appeal

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

HOWARD M. NOWLAN
TRIBUNAL JUDGE

RELEASE DATE: 24 MAY 2016