SOME REFLECTIONS ON TOWER MCASHBACK

by David Goldberg

In one of his books – I think "A Time of Gifts" – Patrick Leigh Fermor tells of the time when he was holding a captured German general in the mountains of Crete.

The general, while allowed out for a walk one day, observes the snow on the surrounding peaks and, adopting the Latin, says "*Vides ut alta stet nive candidum*" (You see how the mount stands out white with snow) which is, of course, the first line of Horace's Ode 1.9.

Major Leigh Fermor recited the rest of the ode; and the two men then looked at each other in silence until the general softly said "Ach so Herr Major".

I read this story about 40 years ago and found it memorable. It obviously has some meaning for me. Perhaps that is because the general's enigmatic words convey the thought that even enemies, in a struggle for life itself, look for and can find some sense of community; or perhaps it is only because the story tells us that, in war, as in litigation and, indeed, life, odd things happen.

In any event, the recent death of Patrick Leigh Fermor made me recall this story (some of which is also told in Stanley Moss's book "Ill Met by Moonlight" and in the film made from that book) and, for no particularly good reason, to think some more about the Roman poet Horace.

C.H. Moore's synopsis of Ode 1.9 is "The world is bound in fetters of snow and ice. Heap high the fire to break the cold. Leave all else to the gods; whatever tomorrow's fate may give, count as pure gain. Today is thine for love and dance while thou art young".

Is there an analogy between that summary of Ode 1.9 and *Tower MCashback*? Does the case heap more snow and ice on the warming fires of tax planning?

Or is another well-known line of Horace – this time from the Epistle to the Pisones – a better analogy?

The other line is, of course, "*Parturient montes, nascetur ridiculus mus*" ("The mountains will be in labour and will give birth to a ridiculous mouse"), a reference (as every pre-school child knows) to Aesop's fable "The Mountain in Labour".

A panel of 7 judges sitting in the Supreme Court heard *Tower MCashback* in February 2011.

It is unusual for 7 judges to hear any case, let alone a tax case, so there was some excitement at the prospect of the judgment to come: something profound was expected; and the expectation was increased by the 2½ months or so it took to produce the decision.

What was produced was one of the most boring and uninspired judgments to come out of the highest court in the land, a decision which leaves many tantalising questions unanswered and provides no new insight but merely reaffirms old ones.

As I am sure everyone will know, there were two points in the case, one of which may be called the procedural issue and the other of which may be called the substantive issue.

The procedural issue was whether the Revenue's ability to argue points on the hearing of the appeal was limited by the terms of the closure notice they had issued.

The closure notice terminated HMRC's inquiry into the affairs of the taxpayers and amended the relevant self-assessments; and the question was whether the Revenue were prevented from arguing any point which went beyond the scope of the closure notice.

That is an exceptionally boring point for two reasons.

First, when people bothered to read the closure notice, it did actually raise the point that HMRC were arguing about.

There was, accordingly, no real issue as to whether the Revenue were limited by the notice or not. Even if they were, they were raising a point which they were entitled to argue about.

Secondly, it is important to remember that judges tend to look at things very much more holistically than tax lawyers do.

That is a point that tax lawyers forget at their peril and it affects the attitude of judges to procedural and to substantive issues.

So far as judges are concerned, tax litigation is like any other form of litigation: there is no mystery about it to a judge; it is an exercise in the application of conventional judicial techniques to the problem in hand and one of those techniques is to use a certain amount of common sense.

In very general terms you are, in litigation, allowed to argue anything you want to argue so long as you do not unfairly take the other side by surprise. There is a mass of authority to that effect which covers many different types of litigation in many different common law jurisdictions.

The decision on the procedural issue, assuming it actually to arise, was that the Revenue may take any argument, outside the terms of the closure notice, so long as, by doing so, they do not unfairly prejudice the taxpayer.

The position does, of course, have to be the same the other way round: although it is best for a taxpayer to set out all his grounds of appeal in any notice of appeal, he is, in general, entitled to raise new points, again so long only as it does not prejudice unfairly the Revenue.

It has been suggested that there are two aspects to the procedural issue, one being the question of jurisdiction (are the Revenue entitled to raise this point?) and the other being the question of fairness (given that the Revenue are allowed to raise this point in theory, is it so unfair of them to raise it that they should not be allowed to do it?)

I cannot find in the judgments in *Tower MCashback* any support at all for this two-pronged approach: the matter is entirely one of fairness and that accords with every general principle of litigation and seems to me to be absolutely correct.

It not only seems to me to be correct, but inevitable given the nature of a tax appeal which is, essentially, not about principles, but about numbers: the ultimate question is **not** "By what process of reasoning has this figure been arrived at?"; it is "What figure should be in this assessment or amendment?"

Since that is what a tax appeal is always about, any argument which assists the appellate body to find the "right" number must be open to either party, otherwise the appeal is not about the very issue which is before the tribunal.

Accordingly, there is nothing odd about the way the Supreme Court decided the procedural issue: the oddity is that some of the judges who heard the case in the lower courts, and who might have been expected to dismiss the taxpayers' argument on the procedural issue out of hand, decided it in favour of the taxpayer.

Odd things happen in litigation: as the summary of Ode 1.9 has it, "whatever tomorrow's fate may bring, count it as pure gain" or "Ach so, Herr Major".

The substantive issue is no more exciting and no more surprising than the procedural.

The argument being put forward by the taxpayers was that they had laid out a lot of money supposedly for software which attracted capital allowances.

There was, however, a finding that the software had a market value less than the price supposedly paid for it, a finding which, by the way, was very plainly right.

If you pay £1 million for something which has a market value of tuppence, it is probable that the £1 million is not expended on the thing which is only worth tuppence: that is not rocket science or neurosurgery, but applied common sense.

There was a finding of fact by the Special Commissioner that the money laid out by the taxpayers was not spent on software, and, given that the market value of the software was considerably below the price ostensibly paid for it, that finding seems inevitable.

There was no basis for an appellate court to disturb the finding of fact and there was no reason why an appellate court should want to disturb the finding of fact, other than an adverse reaction to the extreme way in which the Special Commissioner

expressed his views.

A problem with circular transactions of the kind undertaken in *Tower MCashback* is not that, because they are circular, there is no money, or that, because they are circular, nothing happens.

The problem with circular transactions is that, if they involve the transfer of an asset and payments for the use of the asset, the pricing of the asset can be artificial: you do not necessarily pay for the asset, but for the income flows which the asset is to generate.

In some cases the income flows have a genuineness to them which lends commercial reality to the transaction.

In others, they are fixed solely for the purpose of enabling a particular price apparently to be paid for the asset.

On the facts of *Tower MCashback*, it was particularly easy to say that the money supposedly laid out on the purchase of software was not spent on acquiring software: it was the price for hoped-for capital allowances or, as it might be put, a tax scheme.

It is because the Supreme Court's decision is peculiarly fact-dependent that it is really of no great general interest.

But perhaps I am being a little unfair here: perhaps the case is not as dull as all that. It may be that it says something really quite interesting about the principles to be applied in tax cases.

On the surface, of course, all it does is to reaffirm and adopt both the principles stated in *BMBF v Mawson* (which was, by the way, undoubtedly a real commercial transaction, where the cash flows had a genuineness to them not at all shared by those in *Tower MCashback*) and also the epigrammatic expression of the principles produced by Ribeiro PJ in his judgment in *Arrowtown*.

It is necessary to apply the statute, construed purposively, to the facts, viewed realistically.

The big issue – the issue so far relatively unexplored in the cases rather than the newspaper sold on street corners – is the function of the realistic view of the facts.

How far does it allow a court to say that what actually happened is different from what happened when the matter is analysed in terms of its ordinary legal characteristics.

It is now clear beyond any doubt that, in *Ramsay,* all that Lord Wilberforce said he was doing was to apply the statute to the facts.

However, there is no doubt whatever that, in all the cases, there has been a very heavy factual element.

One thing that *Tower MCashback* has reinforced is that the factual element is not that expressed by Lord Brightman in *Furniss v Dawson*: issues as to whether there was a pre-ordained series of transactions, while they may still be relevant, are by no means dispositive; but Lord Hoffmann told us that in *MacNiven*, so there is nothing new here.

It is, however, still necessary to analyse what happened – the facts – with a very critical eye.

In *Ramsay* and in *Burmah*, as in *Tower MCashback* itself, the taxpayer allegedly paid a large sum for something which, for one reason or another (which reason may have included a pre-ordained scheme) was not worth or not going to be worth what the taxpayer paid for it.

It was absolutely certain that the shares in *Ramsay* and the shares in *Burmah* were never going to be worth what the taxpayer paid for them, because the money put into them was destined to be used to satisfy another obligation, the existence or satisfaction of which either prevented value from going into the shares in the first place or was intended to take value out of the shares shortly after they were acquired.

It is not difficult in cases like that to say that there is no loss: that is not to say that "loss" is being given some extraordinarily strained meaning; it is only to say that, when you put money into the shares, the money did not simply purchase the shares but purchased an increase (immediate or expected) in the value of some other asset.

In cases like that, upon an analysis of the facts, the money laid out did not acquire just shares, but acquired shares and something else; and, where the sum paid was not just for the shares, there will not be a loss realised when the shares are sold for less than that sum.

The something else acquired with the money may, of course, be a tax scheme: it was in *Tower MCashback*.

Two issues remain.

The first is that *Tower MCashback* affirms that *Ensign Tankers* remains good law.

However, the approach in *Ensign Tankers* and the approach in *Tower MCashback* appear to be different.

There is no denial in *Tower MCashback* that there was expenditure incurred: the only question is what it was on.

In *Ensign*, however, the House of Lords seemed to say that there was no expenditure.

If *Ensign* is still authority for the proposition that there was no expenditure in that case, then it seems to me to be inconsistent with the decision in *Tower*

MCashback.

However, I believe that it is possible to reconcile the two decisions by saying that the true decision in *Ensign* was that there was no expenditure on the film, not that there was no expenditure at all.

Nonetheless and whatever the status of *Ensign*, it is important that the Supreme Court accepted that there was expenditure incurred in *Tower MCashback*.

The acceptance of that point emphasises that, since *Furniss v Dawson*, the highest UK court has not been willing to say that a transaction which, analysed according to its legal characteristics, has a particular effect, has another, different, effect for tax purposes.

The second issue arises from *Mayes*.

In that case Mummery LJ refers to Lord Hoffmann's remark in *Carreras* that courts nowadays have a tendency to look at transactions which have a commercial unity to them as a whole.

It is possible to see that approach adopted in *Tower MCashback* itself: the cash flows were followed in their entirety as part of the reasoning leading to the conclusion that the expenditure was not on software.

But although the Court, in *Mayes*, referred to that remark, did it adopt it?

In *Mayes*, the vendor to the taxpayer had paid a premium on an insurance policy and had then withdrawn it, by making a partial surrender of the policy.

These transactions have a commercial unity to them: there was no doubt that, once the premium had been paid on the policy, there were going to be partial surrenders.

Why does the Court not say that these two transactions have a commercial unity so that they should be looked at as a whole, the conclusion being that nothing happens?

The answer is that, although they have a commercial unity, they make changes in the "real" world; and by the "real" world I mean here the world determined by a proper or conventional legal analysis.

The premiums paid on the policy enhanced the rights under the policy: those rights were reduced by the partial surrenders.

It is not possible to find here some other destination for the money paid by way of premium: it was not paid to enhance the value of another asset, as was the case in, say, *Ramsay* and *Burmah;* and it was not paid in an endeavour to make it look as if the policy was worth more than it actually was, because, once the premium was paid in, the policy was worth the same as, or more than, the amount of the premium.

That approach accords well with that adopted in *MacNiven*: it was not possible there to say, despite the circularity, that the money which paid the interest in that case had not paid the interest.

It was not possible to say that because, as a matter of law, the liability to pay the interest had completely disappeared.

Indeed, I cannot think of a case in the House of Lords or in the Supreme Court in the UK where a taxpayer has lost purely on the basis of what might be called a wholly artificial construction of a statute or on the basis of what might be called a wholly unrealistic view of the facts.

Of course, cases like *Furniss v Dawson* (in any event rather heavily frowned on by Lord Walker in *Tower McCashback*) and *Scottish Provident* were a bit of a shock when decided, but looked at calmly with the benefit of time to think about them, are either of them anything other than the application of judicial common sense? Does anyone seriously contend that Greenjacket got control of the target company or that Scottish Provident had a right to acquire gilts?

I think the Courts would not have reached a different conclusion in those cases if they had not been tax cases and, viewed in that light, we can see that, ever since *MacNiven*, the highest appellate court here has made plain that the ability of Courts to denature or re-characterise transactions is very limited. *Tower MCashback* does nothing to change that: indeed, it rather emphasises it.

However, the First Tier Tribunal and, so far, the Upper Tribunal has certainly so far failed to recognise the limitations imposed by recent superior court decisions, especially in the cases concerning NI and PAYE; and, of course, the Court of Final Appeal in Hong Kong went further than that in *Arrowtown*, making shares disappear by what was, undoubtedly, a conjuring trick, as the Privy Council made the debenture disappear in *Carreras*.

I do not think *Tower MCashback* tells us very much about what is going to happen when *Mayes* gets to the Supreme Court or when the NI and PAYE cases ascend the curial ladder.

I am, however, prepared to say that the current state of jurisprudence is that intermediate steps cannot be ignored simply on the basis that they are steps which are pre-ordained and on a route to somewhere else.

These are interesting times: odd things happen in litigation. "Ach so Herr Major".