Case No: A3/2015/0418

Neutral Citation Number: [2016] EWCA Civ 385

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX & CHANCERY CHAMBER)
[2014] UKUT 454 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 21/04/2016

Before:

LADY JUSTICE ARDEN
LORD JUSTICE KITCHIN
and
SIR STEPHEN RICHARDS

- -

Between:

Fidex Ltd	**Appellant**
- and -	
The Commissioners for Her Majesty's Revenue & Customs	**Respondents**

- -
- -

Michael Flesch QC (instructed by **Clifford Chance LLP**) for the **Appellant**
John Tallon QC and Charles Bradley (instructed by **HM Revenue & Customs**) for the **Respondents**

Hearing dates : 2/3 March 2016

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Judgment

Lord Justice Kitchin:

Introduction

1. This appeal is concerned with a tax avoidance scheme called Project Zephyr. The object of this scheme was to create a loss of around €84 million in the hands of the appellant ("Fidex") which would be available for group relief throughout the BNP Paribas group of companies of which Fidex forms a part.

2. On 13 November 2014 the Upper Tribunal (Tax and Chancery Chamber) (the "UT") released a decision dealing with two appeals from the First-tier Tribunal (the "FTT"). The first was an appeal by Fidex from a decision of the FTT released on 7 November 2011 that the terms of a particular closure notice did not preclude the respondents ("HMRC") from arguing that paragraph 13 of Schedule 9 to the Finance Act 1996 (the "1996 Act") applied so as to deny Fidex the benefit of the loss which it claimed. The second was an appeal by HMRC against the decision of the FTT released on 2 April 2013 that, upon its proper application, paragraph 13 did not in fact deny Fidex the benefit of that loss.

3. The UT dismissed the first appeal but allowed the second. It held that the essential conclusion in the closure notice was that the debit corresponding to the claimed loss should not have been brought into account and that the paragraph 13 issue constituted an additional ground on which HMRC could seek to uphold that conclusion. It went on to hold that the debit in issue arose because of the Project Zephyr transaction and this constituted an unallowable purpose. In the view of the UT, the debit could only be attributed to that purpose and the FTT erred in principle in failing so to find.

4. Fidex now appeals to this court with permission granted by Sir Robin Jacob on the papers by order dated 18 March 2015. The appeal gives rise to two issues, namely:

    i) whether the terms of the closure notice precluded HMRC from raising the paragraph 13 issue (the closure notice issue); and

    ii) whether the UT fell into error in finding that the debit in issue was wholly attributable to an unallowable purpose (the paragraph 13 issue).

5. For reasons which I develop below I believe that the UT came to the correct conclusion on both issues and that this appeal must be dismissed.

The background

6. The background is set out in the decision of the UT from [2] to [19]. The following summary is drawn in large part and with gratitude from that decision.

7. Fidex and its holding company, Fidex Holdings Ltd ("FHL"), were established in about 1998 as an off-balance sheet group of companies sponsored by BNP Paribas. The shares in FHL were held by a charitable trust. Fidex acquired a diversified portfolio of highly rated bonds and issued its own commercial paper into the debt capital market.

8. In 2001 it became necessary to consolidate Fidex's debts and assets into the BNP Paribas group accounts and, as a result, Fidex's commercial paper issuance

programme was brought to an end. However, Fidex continued to hold a number of bonds with varying maturity dates extending to 2012 which were now entirely debt financed by BNP Paribas.

9. Against this background it was decided to refinance the Fidex group and bring it into the BNP Paribas group structure, and then to bring about an orderly disposal of the Fidex bond portfolio. As part of this restructuring and as a precursor to the disposal of the Fidex bond portfolio, BNP Paribas decided to adopt Project Zephyr, a tax avoidance scheme which had been proposed to it by Swiss Re. The object of the scheme was to create a tax loss in Fidex's 2005 accounting period and to enable that loss to be surrendered to companies in the BNP Paribas group. The BNP Paribas group decided to implement the scheme and paid Swiss Re a fee for its idea.

10. In broad outline, Project Zephyr involved the following steps. First, Fidex was brought back into the BNP Paribas group by the acquisition of FHL's shares by BNP Paribas.

11. Second, Fidex issued to Swiss Re four classes of preference shares, each of which had rights which matched those of four bonds which Fidex held. The terms of each of the classes of preference shares conferred on Swiss Re an entitlement to 95% of the amounts Fidex received from the bond to which those shares related. The economic effect of this arrangement was that Fidex had disposed of 95% of its interest in the bonds to Swiss Re.

12. Third, Fidex undertook to Swiss Re not to dispose of its interest in the bonds while Swiss Re remained the holder of the related preference shares.

13. Fourth, Fidex decided that, for the year ending 31 December 2005, it would change the accounting principles used in making up its accounts from UK Generally Accepted Accounting Practice ("UK GAAP") to International Financial Reporting Standards ("IFRS").

14. Fidex's 2004 accounts, prepared under GAAP, showed both the preference shares and the bonds on its balance sheet. However, in Fidex's 2005 accounts, prepared under IFRS, neither the preference shares nor 95% of the bonds were shown on its balance sheet since the terms of the preference shares and the economic qualities of the bonds cancelled each other out and the IFRS accounting policy required them to be "derecognised".

15. Paragraph 19A of Schedule 9 to the 1996 Act provided that if such a change in accounting policy in drawing up a company's accounts from one period to the next created a difference in the accounting value of an asset representing a loan relationship of the company at the end of the earlier period and the beginning of the later period then a corresponding debit or credit had to be brought into account in the later period. The bonds were a loan relationship and the reduction in their value was €84 million. So in its tax return for 2005 Fidex claimed a debit of €84 million, giving rise to a corresponding trading loss.

16. As the UT explained, the magic of Project Zephyr was that the existence of the preference shares coupled with the change in accounting policy would deliver a

trading loss equal to the reduction in value of the bonds, without any economic loss being suffered by Fidex.

17. On 3 September 2007 HMRC opened an enquiry into Fidex's tax return for 2005. They disputed the way in which the four bonds had been accounted for. They argued that the value of 95% of the bonds was nil both at the end of 2004 (when UK GAAP applied) and the beginning of 2005 (when IFRS applied). In other words, they challenged the way the bonds had been treated in the earlier period under UK GAAP. They maintained there was no difference in value under paragraph 19A(3) of the 1996 Act and so also no paragraph 19A(3) debit. Correspondence on this issue continued for nearly three years.

18. On 2 August 2010 HMRC issued a closure notice. I must return to the precise terms of this notice later in this judgment but for present purposes it is sufficient to say that in the notice HMRC reduced the amount available for Fidex to surrender as group relief by €84 million. A review upheld that conclusion.

19. There followed an appeal by Fidex to the FTT. In their statement of case for the FTT hearing, HMRC raised, for the first time, an alternative case that the debit should not have been brought into account for tax purposes by reason of paragraph 13 of Schedule 9 to the 1996 Act. They sought to argue that Fidex had an unallowable purpose in being party to a loan relationship within the meaning of paragraph 13 and it was therefore denied the benefit of any debits that arose under paragraph 19A.

20. Fidex thereupon applied to the FTT to strike out this new case. That application came on for hearing before Judge Sir Stephen Oliver QC on 10 October 2011. It argued that the Tribunal's jurisdiction was limited to the conclusion in the closure notice that, having regard to the proper application of paragraph 19A, the debit to be brought into account did not include the €84 million. The operation of paragraph 13 was not mentioned in the closure notice and so, Fidex continued, the FTT had no jurisdiction to hear any argument based upon it. By his decision dated 7 November 2011 (TC/2010/08369) Sir Stephen Oliver refused the application. He held that the conclusion stated in the closure notice was that there was no loss in the sum of €84 million; and that the expressed ground for that conclusion was that there was no paragraph 19A(3) difference or debit.

21. The substantive appeal was heard by the FTT (Judges John Walters QC and John Robinson) over five days in May 2012. Fidex again sought to bring the debit of €84 million into account pursuant to paragraph 19A. This was resisted by HMRC on two grounds: first, that there was no paragraph 19A difference because UK GAAP did not allow the bonds to be recognised in the accounts for 2004; and second, that the debit was attributable to an unallowable purpose within the meaning of paragraph 13.

22. In its decision dated 2 April 2013 (TC/2010/08369), the FTT found in favour of Fidex on both issues. So far as the second was concerned, it held that Fidex did have an unallowable purpose in 2004 but this purpose was achieved at the end of that year when the paragraph 19A debits crystallised. Further, if and in so far as Fidex did have a tax avoidance purpose in 2005, it was only for a *scintilla temporis*; that during this *scintilla temporis* the tax avoidance purpose was a main purpose; that because this *scintilla temporis* did not amount to "times" this purpose was not an unallowable purpose; but if that was wrong then Fidex did have an unallowable purpose in 2005.

The FTT continued that if Fidex did have an unallowable purpose in 2005 then, on a just and reasonable apportionment, none of the debit could be attributed to it.

23. Fidex appealed to the UT against the decision of 7 November 2011 and HMRC appealed against the decision of 2 April 2013, although only in relation to the paragraph 13 issue. The appeals were heard together by the UT (Barling J and Judge Charles Hellier) over three days in May 2014. The UT released its decision on 13 November 2014 ([2014] UKUT 0454) and, as I indicated at the outset of this judgment, it (i) upheld the decision of the FTT (Judge Sir Stephen Oliver) that it did have jurisdiction to hear HMRC's argument based upon paragraph 13, and (ii) allowed HMRC's appeal from the decision of the FTT (Judges John Walters QC and John Robinson) concerning the application of paragraph 13 to the transactions in question.

24. So far as HMRC's appeal was concerned, the reasoning of the UT may be summarised as follows. The FTT was right to find that Fidex had an unallowable tax avoidance purpose in holding the bonds at the end of 2004 but the FTT fell into error in holding that this purpose was achieved at the end of that year. The tax avoidance purpose could not be achieved unless the bonds were held at the beginning of 2005. Moreover, a purpose held for only a single moment in time might be an unallowable purpose and in light of the FTT's other findings, the only conclusion open to it was that Fidex held the bonds for an unallowable main purpose in 2005. Finally and as to attribution, the debit could only be attributed to that purpose and the FTT had erred in principle in failing so to find.

25. Fidex now appeals to this court against the decision and consequential order of the UT (i) upholding the decision of the FTT that it did have jurisdiction to hear HMRC's argument based upon paragraph 13; and (ii) allowing HMRC's appeal from the decision of the FTT concerning the application of paragraph 13 to the transactions in question. So far as the application of paragraph 13 is concerned, Fidex originally sought to argue that (a) the debit could not be attributed to any purpose held by Fidex in 2005 and the UT erred in law in holding otherwise, and (b) the UT erred in law in holding that the debit could only be attributed to Fidex's unallowable tax avoidance purpose. However, in its replacement skeleton argument in support of its appeal, Fidex abandoned argument (a) and indicated it was only pursuing argument (b).

26. It is in this way that the appeal to this court gives rise to the two issues I identified at the outset of this judgment, namely whether the FTT had jurisdiction to hear HMRC's argument based upon paragraph 13 in light of the terms of the closure notice; and whether the UT fell into error in finding that the debit in issue was wholly attributable to an unallowable purpose.

27. I will deal with these issues in turn but before doing so must set out the legal framework.

The legal framework

Loan relationships

28. The 1996 Act contained a code for the taxation of companies' loan relationships, as defined. The details of this scheme are not in dispute and are explained in clear terms

in the decision of the UT from [20] to [24]. For the purposes of this appeal, they may be summarised as follows. The code required the identification of loan relationships; the determination in accordance with accounting practice of the debits and credits arising in respect of those loan relationships in any period; and the treatment of those debits or credits as taxable or deductible. If, as here, those loan relationships were held for the purposes of trade then the debits or credits would form part of the computation of trading profits.

29. Special rules dealt with the case where a business adopted a change in accounting policy from one period to another so as to ensure that trading losses or profits arising from the change in policy were not left out of account. These were contained in paragraph 19A of Schedule 9 to the 1996 Act which read, so far as relevant:

> "(2) This paragraph applies, in particular, where –
>
> (a) the company prepares accounts for the earlier period in accordance with UK general accepted accounting practice and for the later period in accordance with international accounting standards …
>
> (3) If there is a difference between –
>
> (a) the accounting value of an asset or liability representing a loan relationship of the company at the end of the earlier period, and
>
> (b) the accounting value of that asset or liability at the beginning of the later period,
>
> a corresponding debit or credit (as the case may be) shall be brought into account for the purposes of this Chapter [Chapter 2, Finance Act 1996] in the later period.
>
> (4) In sub-paragraph (3) "accounting value" means … the carrying value of the asset or liability recognised for accounting purposes…"

30. This was, however, subject to paragraph 13 of Schedule 9 which made provision for the exclusion of debits and credits properly attributable to an unallowable purpose of a loan relationship:

> "(1) Where in any accounting period a loan relationship of a company has an unallowable purpose, –
>
> (a) the debits, and
>
> (b) the credits in respect of exchange gains,
>
> which, for that period fall, in the case of that company, to be brought into account for the purposes of this Chapter shall not

include so much of the debits or credits (as the case may be) as respects that relationship as, on a just and reasonable apportionment, is attributable to the unallowable purpose.

(2) For the purposes of this paragraph a loan relationship of a company shall be taken to have an unallowable purpose in an accounting period where the purposes for which, at times during that period, the company—

(a) is a party to the relationship, or

(b) enters into transactions which are related transactions by reference to that relationship,

include a purpose ("the unallowable purpose") which is not amongst the business or other commercial purposes of the company…."

Closure notice

31. Schedule 18 to the Finance Act 1998 contains a set of detailed provisions dealing with company tax returns, assessments and related matters including enquiries by HMRC into a company's tax returns.

32. Paragraph 24 of Schedule 18 provides that HMRC may, if they give notice, enquire into a company's tax return. Such an enquiry is brought to an end by the issue of a closure notice. In that connection paragraph 32 of Schedule 18 says:

> "An enquiry is completed when [HMRC] by notice (a "closure notice") inform the company that they have completed their enquiry and state their conclusions."

33. More detailed requirements as to the form and contents of a closure notice are set out in paragraph 34 of Schedule 18 of the Finance Act 1998. As it applied at the time, this read, so far as relevant:

> "(1) This paragraph applies where a closure notice is given to a company by an officer.
>
> (2) The closure notice must–
>
> (a) state that, in the officer's opinion, no amendment is required of the return that was the subject of the enquiry, or
>
> (b) make the amendments of that return that are required–
>
> (i) to give effect to the conclusions stated in the notice, and
>
> (ii) in the case of a return for the wrong period, to make it a return appropriate to the designated period.

(2A) …

(3) An appeal may be brought against an amendment of a company's return under sub-paragraph (2) ….,"

34. The effect of a closure notice in defining the scope and subject matter of an appeal was considered by the Supreme Court in *Tower MCashback LLP v Revenue and Customs Commissioners* [2011] UKSC 19, [2011] 2 AC 457. Tower MCashback, a limited liability partnership, claimed capital allowances under s.45 of the Capital Allowances Act 2001, as amended, in relation to the expenditure it incurred on a software licence agreement. HMRC opened an enquiry in which it focused on s.45(4) of that Act which withholds first-year allowances for expenditure on software rights "if the person incurring it does so with a view to granting another person a right to use or otherwise deal with any of the software in question". In due course HMRC issued a closure notice under s.28B of the Taxes Management Act 1970 stating "As previously indicated my conclusion is: The claim for relief under s.45 [of the Capital Allowances Act 2001] is excessive". The closure notice was sent with a covering letter which stated "….I am satisfied that the MCashback scheme fails on the section 45(4) [of the Capital Allowances Act 2001] point alone…"

35. At the hearing before the special commissioner, HMRC abandoned their original ground for rejecting the claim and relied instead upon a new argument based upon s.45 of the 2001 Act, namely that MCashback had not incurred the expenditure in buying the software licence because the members had borrowed over 75% of the funds needed against security provided by the vendor on uncommercial terms. The special commissioner ruled that he had jurisdiction to consider the new argument.

36. On appeal before Henderson J ([2008] STC 3366 at 3411), the decision of the special commissioners on the procedural issue was reversed on the ground that the appeal would not then be an appeal against the conclusion stated in the closure notice. The Court of Appeal, by a majority (Scott Baker and Moses LJJ, Arden LJ dissenting), reversed Henderson J on the procedural issue ([2010] STC 809). On further appeal to the Supreme Court, the decision of the Court of Appeal on this issue was upheld.

37. In the course of his judgment Henderson J made the following observations with which the Supreme Court expressly agreed. At [113] he said this:

> "There is no express requirement that the officer must set out or state the reasons which have led him to his conclusions, and in the absence of an express requirement I can see no basis for implying any obligation to give reasons in the closure notice. What matters at this stage is the conclusion which the officer has reached upon completion of his investigation of the matters in dispute, not the process of reasoning by which he has reached those conclusions."

38. A little later, in another passage expressly approved by the Supreme Court, he continued:

> "115. … There is a venerable principle of tax law to the general effect that there is a public interest in taxpayers paying

> the correct amount of tax, and it is one of the duties of the commissioners in exercise of their statutory functions to have regard to that public interest…. For present purposes, however, it is enough to say that the principle still has at least some residual vitality in the context of section 50, and if the commissioners are to fulfil their statutory duty under that section they must in my judgment be free in principle to entertain legal arguments which played no part in reaching the conclusions set out in the closure notice. Subject always to the requirements of fairness and proper case management, such fresh arguments may be advanced by either side, or may be introduced by the commissioners on their own initiative.
>
> 116. That is not to say, however, that an appeal against a closure notice opens the door to a general roving inquiry into the relevant tax return. The scope and subject matter of the appeal will be defined by the conclusions stated in the closure notice and by the amendments (if any) made to the return."

39. In the Court of Appeal, Moses LJ (with whose judgment Scott Baker LJ agreed) explained at [35] that the scope of the appeal was defined by the subject matter of the enquiry and the subject matter of the conclusions which close the enquiry. But he cautioned against an attempt to identify some principle which defines the boundaries of that subject matter:

> "37. Parliament has not chosen to identify some legal principle defining the limitations on the scope and subject-matter of an enquiry and consequently an appeal. In those circumstances, I think it would be wrong for the court to attempt to do so. Any statement of principle is likely to condemn both taxpayer and the Revenue to too rigid a straitjacket. It might prevent a taxpayer from advancing a legitimate factual or legal argument which had hitherto escaped him or deprive, on the other hand, the public of the tax to which it is entitled."

40. Moses LJ later expressed his conclusion, and why it differed from that of Henderson J, in these terms:

> "50. … I agree with Henderson J that the fact that the taxpayers had pressed the Inspector to issue the closure notice had no relevance to the identification of the subject-matter of the appeal. It was, as he remarked, open to the Inspector to delay until he had considered, for example, the business plan. He chose not to do so. But the fact that the Inspector had indicated that there might have been other issues which arose, was relevant to the exercise of the Special Commissioner's case management powers. The taxpayer was not deprived of an opportunity fairly to marshal evidence as to the other grounds subsequently advanced by the Revenue on the appeal.

> 51. There is a second basis on which I differ from Henderson J. Apart from the importance of leaving it to the fact-finding tribunal to determine the subject-matter of the Closure Notice, in my view the Closure Notice itself does not allow of so restricted a view of the subject-matter of the appeal. Whilst it did refer to previous correspondence which clearly focussed on section 45(4), the closure notice itself was, in plain terms, a refusal of the claim for relief under section 45 [of the Capital Allowances Act 2001]. That was the conclusion stated pursuant to section 28B(1). There is neither statutory warrant nor any need to look further."

41. The Supreme Court agreed with the Court of Appeal on this issue. Lord Walker explained that there was little if any difference between the majority of the Court of Appeal and Henderson J as to the principles to be applied. The difference between the majority and the judge was to how those principles should be applied on the facts of the case. On that question, Lord Walker preferred the approach of Moses LJ. However, Lord Walker continued:

> "18. This should not be taken as an encouragement to officers of the revenue to draft every closure notice that they issue in wide and uninformative terms. In issuing a closure notice an officer is performing an important public function in which fairness to the taxpayer must be matched by a proper regard for the public interest in the recovery of the full amount of tax payable. In a case in which it is clear that only a single, specific point is in issue, that point should be identified in the closure notice. But if, as in the present case, the facts are complicated and have not been fully investigated, and if their analysis is controversial, the public interest may require the notice to be expressed in more general terms. As both Henderson J and the Court of Appeal observed, unfairness to the taxpayer can be avoided by proper case management during the course of the appeal. Similarly Dr Avery Jones observed in the *D'Arcy* case [2006] STC (SCD) 543, para 13:
>
> > "It seems to me inherent in the appeal system that the tribunal must form its own view on the law without being restricted to what the revenue state in their conclusion or the taxpayer states in the notice of appeal. It follows that either party can (and in practice frequently does) change their legal arguments. Clearly any such change of argument must not ambush the taxpayer and it is the job of the commissioners hearing the appeal to prevent this by case management."

42. Lord Hope gave the other reasoned judgment and emphasised (at [83]) that it is desirable that the statement of conclusions should be as informative as possible in light of the function the terms of the notice will serve in identifying the subject matter of any appeal. He then continued at [84]:

> "Notices of this kind, however, are seldom, if ever, sent without some previous indication during the inquiry of the points that have attracted the officer's attention. They must be read in their context. In this case Mr Frost drew attention to this when he prefaced his conclusion with the words "as previously indicated." He also sent a covering letter which cast further light on the approach which he had taken to the various issues that had been under examination. In these circumstances it does not seem unfair to the LLPs to hold that the issue as to their entitlement to the allowances claimed should be examined as widely as may be necessary in order to determine whether they are indeed entitled to what they have claimed. Furthermore, while the scope and subject matter of the appeal will be defined by the conclusions and the amendments made to the return, section 50 of the Taxes Management Act 1970 does not tie the hands of the commissioners (now the Tax Chamber) to the precise wording of the closure notice when hearing the appeal."

43. Mr Michael Flesch QC, who appeared on this appeal on behalf of Fidex, properly drew our attention to the use by Moses LJ in his judgment of the phrase "the subject matter of the enquiry" and submitted that this is taken from s.28ZA of the Taxes Management Act 1970. But, as he correctly pointed out, this is concerned with the particular situation where, during the course of an enquiry, a question arises in connection with the subject matter of the enquiry. Where that happens the question can be referred to the FTT for a determination. No such reference was made in the *Tower MCashback* case, however.

44. I do not for my part consider that Moses LJ intended by the use of this phrase in some way to expand the permissible scope and subject matter of an appeal against a conclusion stated or an amendment made by a closure notice beyond that contemplated by Henderson J. Nor do I understand the Supreme Court to have sanctioned any such expansion. Moses LJ was, I think, doing no more than explaining that the closure notice must be considered in context and in light of the enquiry that preceded it. Furthermore I would reject any suggestion that Moses LJ was in any doubt about the statutory provisions in issue.

45. In my judgment the principles to be applied are those set out by Henderson J as approved by and elaborated upon by the Supreme Court. So far as material to this appeal, they may be summarised in the following propositions:

    i) The scope and subject matter of an appeal are defined by the conclusions stated in the closure notice and by the amendments required to give effect to those conclusions.

    ii) What matters are the conclusions set out in the closure notice, not the process of reasoning by which HMRC reached those conclusions.

    iii) The closure notice must be read in context in order properly to understand its meaning.

iv) Subject always to the requirements of fairness and proper case management, HMRC can advance new arguments before the FTT to support the conclusions set out in the closure notice.

The closure notice issue

46. On 3 September 2007 HMRC gave notice in relation to Fidex's tax return for 2005. As I have mentioned, there followed three years of correspondence in the course of which HMRC maintained that there was no difference between the value of the four bonds in issue at the end of 2004 and their value at the beginning of 2005. Accordingly there was no paragraph 19A(3) difference and therefore no paragraph 19A(3) debit.

47. The closure notice was issued on 2 August 2010. It reads (with paragraph numbers helpfully added by the UT):

> "Company Tax Return – Year ended 31 December 2005
>
> [1] I have completed my enquiry into the company's Tax return for the period 1 January 2005 to 31 December 2005 and my conclusions are:
>
> [2] The derecognition of the listed bonds and preference shares should not have occurred on transition to IFRS. Therefore the sum of €83,849,399 representing the value of the derecognised listed bonds should not have been included in the change in basis adjustments following the adoption of IFRS.
>
> [3] The loss for corporation tax purposes is therefore as follows:
>
> | | |
> |---|---|
> | Loss for the period based on return as amended | €89,270,434 |
> | Reduction as noted above | €83,849,399 |
> | Revised loss | €5,421,035 |
> | €1= £0.68371393 Revised loss for the period | £3,706,437 |
>
> [4] Please note that the loss figure of €89,270,434 takes into account a Taxpayer Amendment made during the enquiry (letter from Michael Deriaz dated 12 November 2007) and deferred under paragraph 31(3) Schedule 18 FA 98.
>
> [5] Further analysis may reveal additional grounds supporting the conclusions I have reached.
>
> [6] This notice amends the return to give effect to my conclusions. If the company does not agree with the amendments I have made to the company's Tax Return it may appeal, by notice in writing within 30 days after the amendments were notified to it.

> [7] The amount available for the company to surrender as group relief has been reduced. I draw your attention to the company's obligation under paragraph 75 Schedule 18 FA 98 to withdraw, or amend, as many notices of consent as is necessary to bring the amount surrendered within the new amount available of £3,796,437. The company has 30 days to send a copy of any new notice of consent to each company affected and to HMRC."

48. The critical issue to which this aspect of the appeal gives rise is whether Sir Stephen Oliver QC in the FTT fell into error in the way he identified and characterised the conclusion in this letter as being that there was no loss in the sum of €84 million. As I have mentioned, he continued that the expressed ground for that conclusion was that there was no paragraph 19A(3) difference or debit. Sir Stephen's reasoning is admirably concise. He directed himself by reference to the decision of the Supreme Court in the *Tower MCashback* case and held that the HMRC enquiry was directed at whether a scheme designed to produce a loss through the operation of the loan relationship provisions in Schedule 9 was successful in achieving that result. He considered that the stated effect of the closure notice was that it did not, and that to confine the Tribunal to an analysis of one provision in the statutory code would be to impose an unacceptable restriction on its judicial function.

49. On further appeal to the UT, Fidex argued that the FTT failed to appreciate and recognise the clear distinction between the conclusion expressed in the closure notice and the amendment required to give effect to it. What the FTT described as the expressed ground for the conclusion (that there was no paragraph 19A debit) was in truth the conclusion; and what the FTT described as the ground for the conclusion (that there was no loss of €84 million) was in truth the amendment required to give effect to that conclusion.

50. The UT was clearly of the view that Fidex's approach to the interpretation of the closure notice was too rigid in the boundaries it sought to draw and would impose on HMRC precisely the kind of straightjacket that the decision of this court in *Tower MCashback* proscribed. The heart of the reasoning of the UT is contained in these two paragraphs of its decision:

> "[74] … we consider that the FTT was clearly entitled to find that the subject matter of the enquiry, of the closure notice and of the review related to the admissibility of the debit of €83,849,399 contained in the schedule which formed part of Fidex's tax return, and gave rise to the loss claimed by Fidex in box 122 of its company tax return form. At all times it was the admissibility of that debit that was the subject matter of HMRC's concern. True, their specific ground for challenging it, as set out in the correspondence during the enquiry, in the closure notice and thereafter until the appeal, focused on paragraph 19A and the accounting treatment said to give rise to the claimed difference. There was no mention of any other parts of Schedule 9 or the code. But in our view the FTT was also entitled to regard the paragraph 19A issue as constituting the legal ground or argument on which the challenge had been

> made up to the time of the appeal, and as not itself representing the entirety of the subject matter of the enquiry and its conclusions. By the same token it was entitled to find that the paragraph 13 issue constituted an additional ground on which HMRC could seek to uphold its essential conclusion that Fidex was not entitled to bring the claimed debit into account. Indeed, we consider that the learned Judge was correct in reaching the conclusion he did.
>
> [75] Paragraphs 2 and 3 of the closure notice (as we have numbered its paragraphs – see above) include conclusions of HMRC that Fidex's trading loss is wrongly stated in the return, and should be "revised" as set out. Although these conclusions are preceded by "therefore", which is clearly a reference back to the ground (i.e. paragraph 19A) on which the loss is challenged by HMRC as having been wrongly claimed in the return, that does not affect the essential conclusion in the notice that the specific debit which has been the subject of the enquiry should not be brought into account."

51. The UT went on to express the view, with which I agree, that it is not appropriate to construe a closure notice as if it is a statute or as though its conclusions, grounds and amendments are necessarily contained in watertight compartments, labelled accordingly. It also emphasised, again rightly in my judgment, that while there must be respect for the principle that the appeal does not provide an opportunity for a new roving enquiry into a company's tax return, the FTT is not deprived of jurisdiction where it reasonably concludes that a new issue raised on an appeal represents an alternative or an additional ground for supporting a conclusion in the closure notice.

52. The UT recognised there were certain differences between the *Tower MCashback* case and the present, but it considered there were striking similarities too. In *Tower MCashback* the legal ground of challenge changed but the subject matter of the enquiry and of the conclusion remained the same, namely whether the LLP was entitled to the capital allowance. So too in the present case, the legal ground of challenge changed but the essential subject matter of the enquiry and of the conclusion again remained the same, namely whether Fidex was entitled to claim the benefit of the debit. Indeed the UT thought it would have been extraordinary if, in light of *Tower MCashback*, the FTT had found it had no jurisdiction in the present case.

53. There followed this forthright conclusion:

> "81. Further, to decide that there is no jurisdiction would, in the circumstances of this case, allow form to triumph over substance. Nor would it represent an appropriate balance between the protection of the taxpayer, on the one hand, and the public interest in the collection of the correct amount of tax, on the other."

54. On this appeal Mr Flesch submitted that the fundamental error made by the UT was that it failed correctly to identify in the closure notice (i) HMRC's conclusions and (ii)

the amendment required to give effect to those conclusions. Mr Flesch developed that submission as follows. Paragraph [1] of the notice properly informed Fidex that HMRC had completed their enquiry and indicated that HMRC's conclusions followed. Paragraph [2] then stated those conclusions. Finally, paragraph [3] set out the amendments required to give effect to those conclusions.

55. Mr Flesch continued that it is clear from the terms of the closure notice that HMRC's conclusions were that because the bonds and preference shares should not have been derecognised on transition to IFRS, the sum of €83,849,399 should not have been included in the change in basis adjustments. In other words, no debit arose under paragraph 19A of Schedule 9 to the 1996 Act because there was never a paragraph 19A(3) difference. It follows that HMRC's conclusions did not in any way relate to or encompass their subsequent submission based upon paragraph 13 and both the FTT and the UT erred in law in finding that the FTT had jurisdiction to hear that argument.

56. Mr Flesch also advanced the following further arguments in support of his primary submissions. First, the UT erred in law in failing to recognise that the references by Moses LJ to "the subject matter of the enquiry" in his judgment in the Court of Appeal in *Tower MCashback* were entirely irrelevant to the present case. Further, by adopting this phrase repeatedly in the course of its judgment, the UT failed properly to focus upon the real issue, namely how properly to identify and characterise the conclusions in the closure notice.

57. Second, the UT fell into similar error in its judgment at [74]. Here it wrongly focused on the "the subject matter of the closure notice", wrongly characterised the subject matter of the notice as the "admissibility of the debit of €83,849,399" and invented a new and irrelevant expression namely, the "essential conclusion" in the closure notice. Had it focused as it should have done on the conclusions in the closure notice it would have appreciated that these related to the *existence* of the debit, that is to say the paragraph 19A issue.

58. Third, the UT erred at [75] in stating that paragraphs [2] and [3] of the closure notice include conclusions of HMRC. On a fair reading and as previously indicated, the conclusions are set out in paragraph [2] and the amendment necessary to give effect to those conclusions is set out in paragraph [3].

59. Fourth, the UT was wrong to suggest as it did that Fidex was seeking to construe the closure notice as if it were a statute. In this case the conclusions are indeed set out in separate watertight compartments for they appear in separate paragraphs, and there are no grey areas or overlaps.

60. Fifth and finally, the UT was quite wrong to suggest that there was no material difference between the facts of this case and those in *Tower MCashback*. The differences are, said Mr Flesch, fundamental. In *Tower MCashback* the conclusion in the closure notice was that the claim for relief under s.45 of the Capital Allowances Act 2001 was excessive. That being the conclusion, HMRC were entitled to advance new arguments in support of it. In the present case, by contrast, the conclusion was that there was no paragraph 19A(3) difference and therefore no paragraph 19A debit. The argument based upon paragraph 13 cannot conceivably be said to be an additional reason for supporting that conclusion.

61. Attractively and forcefully though all of these submissions were presented, I find myself unable to accept them. The scope and subject matter of the appeal to the FTT were defined by the conclusions stated in the closure notice and the amendments required to give effect to them. HMRC were not, however, restricted on appeal to the process of reasoning by which they had reached those conclusions and they were free to deploy new arguments in support of them, subject to the exercise by the FTT of its case management powers to ensure that Fidex was not ambushed. There is no suggestion of any ambush here. Nor has it been suggested that Fidex was not able fully to present its case.

62. The FTT was therefore required to consider the closure notice, in context, and identify the conclusions it contained. That, so it seems to me, is precisely what Sir Stephen Oliver did. He properly directed himself by reference to the principles explained by the Supreme Court in *Tower MCashback* and he then proceeded to consider the closure notice in the context of the enquiry which it completed. In that regard, he noted that the enquiry was not some kind of roving investigation into Fidex's tax returns but a focused consideration of whether, having regard to the terms of the loan relationships' code in Schedule 9 to the 1996 Act, the implementation of the scheme served to increase for tax purposes the loss shown in Fidex's self-assessment tax return. He continued that the stated effect of the contribution notice, by which I understand Sir Stephen to have been referring to the stated conclusion, was that it did not. I believe, as did the UT, that this was a conclusion to which he was perfectly entitled to come.

63. I also share the view of the UT that this conclusion was correct. Focusing on the terms of the closure notice itself, in light of the enquiry, I believe the conclusion is contained in the second sentence of paragraph [2], that is to say that the sum of €83,849,399 representing the value of the derecognised listed bonds should not have been included in the change in basis adjustments. The reason for that conclusion is contained in the first sentence of paragraph [2], namely that the derecognition of the listed bonds and preference shares should not have occurred on transition to IFRS. There follows in paragraph [3] the amendment to the return that is required.

64. The conclusion I have identified is very different from that which Mr Flesch urged us to find and it is one which could be sustained by the paragraph 13 issue. Indeed the closure letter said in terms in paragraph [5] that further analysis might reveal additional grounds "supporting the conclusion I have reached". I therefore reject Mr Flesch's primary submission and the further submissions he advanced in which it finds an echo. In my judgment and just as Lord Hope observed in *Tower MCashback*, it was not unfair to Fidex to hold that the issue as to its entitlement to include the sum of €83,849,399 in the change in basis adjustments should be examined as widely as might be necessary to determine whether it was indeed entitled to what it had claimed.

65. Turning now to Mr Flesch's further criticisms of the reasoning of the UT, these can be dealt with quite shortly. I do not accept that the references by Moses LJ to the subject matter of the enquiry in his judgment in the Court of Appeal in *Tower MCashback* were entirely irrelevant to the present case. Nor do I consider that by referring to this phrase in its judgment in this case, the UT fell into error. The subject matter of the enquiry forms part of the context against which the closure notice must be considered.

66. I can take Mr Flesch's second, third and fourth criticisms together for they amount in large measure to a reiteration of his primary submissions concerning the proper interpretation of the closure notice. I reject the suggestion that the UT misled itself by focusing on "the subject matter of the closure notice" and by wrongly characterising the subject matter of the notice as the "admissibility of the debit of €83,849,399". Both were relevant to the proper interpretation of the notice. Nor am I persuaded that the UT fell into error by inventing a new and irrelevant expression, namely the "essential conclusion" in the closure notice. The use of this expression was perfectly justified in the context of the detailed and careful reasoning in which it appeared and I reject the suggestion that in using it the UT misdirected itself or otherwise fell into error. It was throughout properly focused on the essential task of identifying the conclusions and amendments contained in the closure letter.

67. As for the fifth and final criticism, I believe that the UT fairly characterised the similarities and differences between this case and *Tower MCashback.* I am doubtful that there is much to be gained by comparing the facts of one case with those of another, but I am entirely satisfied that nothing said by the UT in this regard undermines in any way its reasoning or the conclusion to which it came.

68. In summary, the FTT was in my judgment entitled and indeed correct to find that the stated conclusion in the closure notice was that there was no loss in the amount of €83,849,399, and that the loss, said by Fidex to amount to €89,270,434, should therefore be reduced by the amount of the disputed loss to €5.4 million. It follows that the FTT did have jurisdiction to hear HMRC's argument based upon paragraph 13.

The paragraph 13 issue

69. For reasons which I summarised earlier in this judgment, we are only concerned with the finding of the UT that the paragraph 19A(3) debit could only be attributed to Fidex's unallowable tax avoidance purpose.

70. Paragraph 13(1) required the UT to assess how much of the debit as respects the loan relationship was, on a just and reasonable apportionment, attributable to the unallowable purpose. The essential reasoning supporting the UT's conclusion is contained in these two paragraphs of its judgment:

> "155. … The debit arises because the debt was held at the beginning of 2005. The company, in holding the debt at that time, had, as the FTT accepted in its *de bene esse* conclusion, a main unallowable purpose. The time for which the purpose is held may be relevant to what is just and reasonable to attribute to that purpose, but it is not the only consideration. In our view the FTT erred in its exclusive reliance on the time for which the purpose was held.
>
> 156. There were other main purposes for which the bonds were held during the lifetime of Fidex's 2005 unallowable purpose, but we do not see how the debit can be justly or reasonably attributable to those purposes. Those purposes related almost wholly to times after the debit had arisen and it

> was not attributable to them. The debit arose because of the Project Zephyr transaction, and the unallowable purpose to obtain the benefit of that transaction. In our view the debit can only be attributed to that purpose and the FTT erred in principle in its approach and its finding."

71. Mr Flesch submitted that, far from arriving at a just and reasonable apportionment, the UT made an apportionment without any justifiable reason at all. He developed that submission in the following way. He pointed out, correctly, that Fidex had three main purposes for holding the bonds (and so being party to the loan relationships they embodied) in its accounting period beginning on 1 January 2005, namely:

    i) the commercial purpose of having a right to the cash flows they generated;

    ii) the purpose of furthering its policy of conducting an orderly disposal of its whole bond portfolio; and

    iii) the tax avoidance purpose inherent in Project Zephyr.

72. Mr Flesch continued that if, in an accounting period, a company has one or more allowable (or 'good') main purposes for being a party to a loan relationship and one unallowable (or 'bad') main purpose, it is not just and reasonable to attribute the whole of the relevant debit to the bad purpose absent a very good reason. There could only be such a reason if and in so far as the debit was more than it would have been if there had been no bad purpose. Accordingly, the UT should have asked itself this question: How much greater was the debit in consequence of the bad purpose? This question admitted of only one answer, namely not at all, for it was always Fidex's intention to hold the bonds into 2005. If there had been no bad purpose, it would have held the bonds and the debit would have arisen in just the same way.

73. Moreover, said Mr Flesch, the UT was wrong to say as it did that the good purposes for which Fidex held the bonds related almost wholly to times after the debit had arisen. The good purposes were held from the beginning of 2005 and the fact that Fidex continued to hold them beyond the time for which it held the bad purpose was neither here nor there. Similarly, the UT lost sight of the fact that what mattered was Fidex's purpose in holding the bonds, not its purpose in issuing the preference shares. It was fair to say that the preference shares were issued for one purpose only and that was a bad purpose, but the same was not true of the bonds, for Fidex held these for two good purposes in addition to the bad purpose.

74. I believe that the answer to all of these submissions lies in the words of paragraph 13. The UT was required to assess how much of the *debit* was, on a just and reasonable apportionment, attributable to the unallowable purpose for which the bonds were held. I am content to assume that Fidex would have held the bonds from the start of 2005 irrespective of the unallowable purpose but that is nothing to the point. The question is whether and to what extent the *debit* was attributable to the unallowable purpose for which they were held. I agree with the UT that the answer to this question is quite clear. The debit arose from and was entirely attributable to Project Zephyr. But for this tax avoidance scheme there would have been no debit at all.

75. I therefore believe the UT came to the right conclusion. On a just and reasonable apportionment, the debit was wholly attributable to an unallowable purpose.

Conclusion

76. For all of the reasons I have given, I would dismiss this appeal.

Sir Stephen Richards:

77. I agree.

Lady Justice Arden:

78. I also agree.