Case No: A3/2011/2831

Neutral Citation Number: [2012] EWCA Civ 1558
IN THE HIGH COURT OF JUSTICE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM UPPER TRIBUNAL
MR JUSTICE ARNOLD
FTC/69/2010

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 28/11/2012

Before :

LORD JUSTICE RIX
LORD JUSTICE ETHERTON
and
LORD JUSTICE LEWISON

- -

Between :

MJP Media Services Limited	**Appellant**
- and -	
The Commissioners for her Majesty's Revenue and Customs	**Respondent**

- -

(Transcript of the Handed Down Judgment of
WordWave International Limited
A Merrill Communications Company
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Tel No: 020 7404 1400, Fax No: 020 7831 8838
Official Shorthand Writers to the Court)

- -

David Goldberg QC and Hui Ling McCarthy (instructed by **Berwin Leighton Paisner**) for the **Appellant**
David Ewart QC and James Rivett (instructed by **Treasury Solicitors**) for the **Respondent**

Hearing dates : 29th October 2012

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Judgment

LORD JUSTICE ETHERTON :

1. This is an appeal by the taxpayer, MJP Media Services Limited ("MJP"), from the decision dated 2 September 2011 of Mr Justice Arnold sitting as the Upper Tribunal ("the UT's decision") By that decision the UT dismissed the taxpayer's appeal from the decision dated 1 July 2010 of the First-Tier Tribunal (Sir Stephen Oliver QC and Ms Anne Redston) ("the FTT") dismissing MJP's appeal from the disallowance by the respondents, the Commissioners for Her Majesty's Revenue and Customs ("the Revenue"), of a deduction of £6,690,000 included in MJP's 2004 corporation tax computation. That deduction had been included by MJP as a loan relationship debit for the purposes of Chapter II of Part IV of the Finance Act 1996 ("FA 1996").

2. The Revenue contended, and the UT and the FTT held, that in respect of the £6,690,000 there was no loan relationship within section 81 of FA 1996 ("section 81"). Whether, in reaching those decisions, the FTT and the UT made an error or errors of law is what is in issue on this appeal.

The background

3. For the period in question MJP was a wholly owned subsidiary of Carat International ("Carat"), and Carat was a wholly owned subsidiary of Aegis plc ("Aegis"). Aegis was listed on the London Stock Exchange. It carried on an advertising business. The companies used the accruals basis of accounting.

4. Between 2001 and 2004 a series of inter-company transactions took place between MJP and Aegis. Four of those transactions are at the heart of these proceedings. By 1 January 2004 Aegis was indebted to MJP in the sum of £6,815,366.

5. At some date between 1 January 2004 and 26 March 2004 Aegis and MJP entered into a written agreement which bore the description "Inter Group Loan Agreement" ("the Loan Agreement") and was expressed to be effective from 1 January 2004. The Loan Agreement stated that the "Initial Amount of Loan/Advance" was £6,815,366. Immediately before 26 March 2004 Aegis owed MJP £6,893,977, being the £6,815,366 specified in the Loan Agreement and accrued interest of £78,611. On 26 March MJP executed a deed of waiver ("the Deed of Waiver") under which it waived its claim to £6,704,000 of that outstanding indebtedness. The amount owed by MJP to Aegis was, therefore, reduced to £189,977.

6. MJP claimed a deduction of £6,690,000 in its 2004 corporation tax computation, being the waived amount reduced by a foreign exchange difference of £14,000.

The legislation

7. The relevant provisions of FA 1996 are set out in the Appendix to this judgment.

8. At the heart of MJP's case is the submission that each of the four transactions, on which it relies, gave rise to a debt due from Aegis to MJP and was a "transaction for the lending of money" within section 81(1)(b).

The 4 transactions

9. The following is a very brief summary of the way the FTT described the 4 transactions, but without reference to all the arguments and evidence placed before the FTT. It is intended to be purely for the purposes of identifying the transactions and not for their legal characterisation or evaluation for tax purposes.

The first transaction: £686,500 ("Transaction 1")

10. As at 31 December 2000, according to the MJP ledger, MJP owed £293,244 to Aegis. On 30 July 2001 Aegis made a VAT payment of £101,500 on behalf of MJP, increasing the balance on the intercompany account to £394,744.

11. A sum of £686,500, described as "payment", is shown in an entry dated 3 September 2001 in MJP's inter-company ledger account with Aegis; there is a matching entry in MJP's ledger for its Lloyds bank account, labelled "Aegis Group plc."

12. It was MJP's case that this transfer was made in cash, and that the contra entry in the ledger account for Lloyds bank demonstrated that this was so. The Revenue's case was that this transaction was not a cash transfer to Aegis, but a payment to a third party.

13. As a result of this transaction Aegis owed MJP £291,756 (£686,500 - £394,744) at the beginning of 2002.

The second transaction: £830,500 ("Transaction 2")

14. On 5 June 2002 MJP's inter-company account with Aegis shows a further debit of £830,500, again described as "payment". This is matched by a credit of the same amount and on the same date in the ledger account for MJP's Lloyds Bank account, labelled "Aegis Group plc".

15. This transaction appears on a bank statement submitted as evidence. It shows a sum of £830,500 paid out on 13 June 2002 and gives reference number 000145. The presence of the reference number shows that the payment had been made by cheque.

16. The Nominal Audit Trail record, which consisted of extracted entries from Aegis's ledger setting out transactions between MJP and Aegis, has an entry dated 25 June 2001, showing a receipt by Aegis of £850,500. This is described as "MJP re I/Co MJP", and under Journal Type is printed "2961 Cashb". MJP's case is that this is a record of the cash turning up in Aegis.

17. It was the Revenue's case that the £830,500 had been made to a third party, and not to Aegis.

The third transaction: £6,101,401 ("Transaction 3")

18. At the beginning of 2002 Aegis owed over £6m to Carat, MJP's parent company. This is shown in Carat's statutory accounts. MJP's internal records show that Carat in turn owed £6,101,401 to MJP.

19. MJP's case before the FTT was that in September 2002 a circular transfer of cash took place, by which Aegis repaid £6,101,401 it owed to Carat; Carat repaid the same sum to MJP, and MJP then paid this amount to Aegis. Accordingly, Aegis had exactly the same money as before, but it was now in debt to MJP rather than to Carat.

20. MJP contended that the evidence for the first step, the repayment by Aegis of £6.1m owed to Carat, can be seen in Carat's statutory accounts for the year ended December 31 2002, which show that the debt owed by Aegis to Carat had gone down by more than £6.1m. As regards the second step, MJP's inter-company balance with Carat shows a debt owed to MJP of £6,101,410 at 1 January 2002, but on 4 September 2002 the same ledger account shows a credit of the same amount, in effect eliminating Carat's debt to MJP.

21. MJP's ledger account with Aegis shows that MJP was no longer owed £6.1million by Carat; instead, it was owed the same amount by Aegis. MJP's 2002 statutory accounts also show Aegis's debt to MJP increased by £6.1m during 2002.

22. The Revenue's case was that no cash changed hands and that what had happened was that MJP took over Aegis's debt to Carat in exchange for cancelling Carat's own debt.

The fourth transaction: £883,418 ("Transaction 4")

23. MJP's inter-company account with Aegis shows a further transaction of £883,418. This is dated 11 September 2003 and is described as "payment". The effect of the entry was to increase the debt owed by Aegis to MJP.

24. The matching entry of the same date and amount is shown in MJP's ledger account setting out its balances with National Westminster Bank. It is labelled "Aegis Group plc". MJP's case is that this was a further advance of cash.

25. The Revenue's case was that this was not a cash payment to Aegis, but a payment to a third party on Aegis's behalf.

The FTT's decision

26. The FTT recorded (in [11] to [14]) the witness statements that were made and the oral evidence that was given. Witness statements were provided on behalf of MJP by seven individuals. They were Colin Richards, Head of Aegis Group Tax; Michael Parry, Aegis Group Transfer Pricing Manager and a director of MJP; John Ross, Aegis Group Company Secretary; Susan Walker, Aegis Tax Compliance Manager; Alicja Lesniak, Aegis Chief Financial Officer and a director of Aegis; Lynda Poor, Head Office Reporting Manager, and Susan Frogley, Chief Finance Office of Aegis Media and a director of Carat.

27. Mr Richards, Mr Parry, Mr Ross and Ms Frogley gave oral evidence and were cross-examined. Mr Richards and Mr Parry are qualified accountants. Mr Richards joined Aegis in March 2002. Mr Parry and Mr Ross were employed by Aegis throughout the period under consideration.

28. Ms Lesniak gave evidence as to the role of Mr Ross and his authority to act on behalf of Aegis. The rest of her evidence, and that of Ms Poor and Ms Frogley, concerned the extraction of documents for the purposes of MJP's appeal.

29. The FTT observed that only four bank statements were provided to the Tribunal, being a single page from MJP's NatWest account and three sequential statements from Lloyds TSB. Furthermore, none of the witnesses was personally involved in any of the Transactions and none of them had made the entries in the financial records relating to the Transactions. They were simply using their financial training to interpret the records. There was no witness from Aegis' treasury department, which had responsibility for managing the group's funds and would have been best placed to explain what had happened to the bank statements. The FTT described (at [39]) Mr David Goldberg QC, MJP's counsel, taking them "through a jigsaw of accounting entries, mostly from MJP's ledger, with supporting roles played by the companies' statutory accounts and by Aegis's Nominal Audit Trail."

30. The FTT recorded (at [28]) that Mr Goldberg abandoned, at the inception of the hearing, the argument that by signing the Loan Agreement the parties had automatically brought themselves into a loan relationship by virtue of section 81(3).

31. The FTT said (at [73]) that, in claiming a tax relief, the burden of proof was on MJP, and the standard of proof was the balance of probabilities. They said that it would have been a simple matter for MJP to prove that the payments were in cash: it had only to produce the relevant bank statements. The companies had, however, apparently not retained copies of their bank statements. The FTT said (at [75]) that the Tribunal were instead faced with a patchwork of accounting entries and partial documentation.

32. The FTT concluded that MJP had not discharged the burden of proof for the following reasons. It said

> "76. We found that the burden of proof was clearly not met in the following respects:
>
> > (a) it was improbable that a cash payment would be made to a group company by way of cheque, and we agreed with Mr Ewart that the second transaction, for £830,500, was, on the balance of probabilities, not a cash payment to Aegis. Exactly what occurred, and why cash of the same amount turned up some three weeks later in the books of Aegis, we were unable to say, given the paucity of evidence provided, but that was not our task;
> >
> > (b) the intercompany transactions for £6.1m between Aegis and Carat, and Carat and MJP, had, on the evidence provided, been not been made in cash, but by intercompany transfer. As a result, there was an effective assignment by Carat to MJP of the debt owed to it by Aegis, in exchange for MJP writing off the debt it was owed by Carat. This automatically moved Aegis's debt between Carat and MJP: in other words, MJP stood in the

> shoes of Carat, without any funds changing hands. We thus agree with [the Revenue] that the book-keeping entries themselves complete the triangle. If further cash was paid by MJP to Aegis (or by Carat to Aegis on behalf of MJP), Aegis would owe £12.1m. If this were the case, the statutory accounts would show a movement of £12.2m and not £6.1. Again, we cannot explain the entries in the Nominal Ledger Audit Trail;
>
> (c) the accrued interest of £78,611 was by definition not paid in cash;
>
> (d) we have also excluded the £13,367 as its status was unclear even to MJP.
>
> 77. The amounts we have excluded total significantly more than the waiver. It is thus unnecessary for us to decide whether the other transfers were cash payments to Aegis.
>
> 78. However, the lack of bank statements, the absence of any witnesses with personal knowledge of the transactions, and the piecemeal documentation (however assembled) are all significant factors. It is for the Appellant to prove its case, and we find that, on the balance of probabilities, MJP also failed to discharge this burden in relation to the remaining transactions."

33. With regard to Transaction 3 the FTT said (at [94]) that, to bring itself within the loan relationship provisions, MJP would have to show that the loan assigned from Carat was itself a loan relationship, but no evidence to that effect was presented to the Tribunal.

34. The FTT said (at [95]) that the court was entitled to look behind the label which the parties had given the Loan Agreement in order to establish the reality as to whether the Transactions had been a lending of money within section 81.

35. That was sufficient to dispose of the appeal. The FTT went on to consider, however, the provisions of FA 1996 s.85(3)(c) and paragraphs 5 and 6, especially 6(3), of schedule 9 of FA 1996. The FTT agreed with the Revenue that, because Aegis and MJP were connected, the effect of those provisions was that, notwithstanding the Deed of Waiver, the statutory assumption was that every amount payable under the loan relationship would be paid in full, subject to authorised arrangements for bad debt. The FTT concluded (at [103]) that, in allocating the amount of the loan relationship to the 2004 accounting period, the waived amount of £6,704,000 was to be assumed to be still payable.

The UT's decision

36. The appeal to the UT was restricted to a point of law by virtue of section 11(1) of the Courts, Tribunals and Enforcement Act 2007. It is well established that an appeal may nevertheless be made on a finding of fact which was perverse in the sense that no person acting judicially could properly have reached the finding in question. The UT

quoted the following two well known passages from the speeches in *Edwards v Bairstow* [1956] AC 14. Viscount Simonds said at page 29:

> "… though it is a pure finding of fact, it may be set aside on grounds which have been stated in various ways but are, I think, fairly summarised by saying that the court should take that course if it appears that the commissioners have acted without any evidence or upon a view of the facts which could not reasonably be entertained."

37. Lord Radcliffe said at page 36:

> "If the case contains anything ex facie which is bad law and which bears upon the determination, it is obviously erroneous in point of law. But, without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene."

38. Mr Goldberg appeared on behalf of MJP before the UT. He accepted that he needed to succeed on all four Transactions in order to prevail on the appeal. The UT summarised as follows (in [19]) Mr Goldberg's six lines of attack on the FTT's decision. Firstly, the FTT had wrongly resorted to the burden of proof in order to determine the issue whether the Transactions had given rise to a loan relationship. Secondly, the Tribunal's criticism of MJP's failure to produce bank statements was unjustified. Thirdly, the Tribunal was wrong to attach little or no weight to the evidence of MJP's witnesses, and in particular the evidence of its principal witness Mr Colin Richards, Head of Aegis Group Tax, about the Transactions. Fourthly, the Tribunal was wrong to dismiss the documentary evidence as a "jigsaw" or "patchwork" of accounting entries. Fifthly, the Tribunal was wrong to say that it was not its task to explain certain things. Sixthly, the Tribunal was not entitled on the evidence to reach any conclusion other than that cash had passed from MJP to Aegis.

39. The UT considered each of those arguments in turn. It rejected all of them. It accepted (at [22]) the submission of Mr David Ewart QC, counsel for the Revenue, that, on analysis, the FTT had not resorted to the burden of proof with regard to Transactions 2 and 3, but on the contrary had positively decided on the balance of probabilities that there had not been a cash payment by MJP to Aegis; and, as for Transactions 1 and 2, the FTT had resorted to the burden of proof, but they were entitled to do so. On reviewing the evidence the UT held (at [33] and [37]) that the conclusion to which the FTT had come on Transactions 2 and 3 was a conclusion which the FTT were entitled to reach on the evidence before them.

40. The UT also rejected MJP's alternative case that, even if payments were made by MJP to third parties on behalf of Aegis, that was sufficient to amount to "transactions for the lending of money".

The appeal to the Court of Appeal

41. Mr Goldberg represented MJP again on the appeal to this court. MJP's contention is that the UT made errors of law relating to its appellate jurisdiction, to the evidence needed to exclude a loan relationship, and on statutory interpretation, and that it failed to address an argument concerning the application of the statutory assumption in FA 1996 s.85(3)(c) in relation to the drawing up of MJP's accounts.

42. At the end of the day, MJP can only succeed on the appeal to this court, as before the UT, if the FTT made an error or errors of law, including errors in law in the *Edwards v Bairstow* sense, vitiating their decision to dismiss MJP's appeal from the Revenue's disallowance of the deduction in MJP's 2004 accounts. The focus of the analysis must, therefore, be on the reasoning and conclusions of the FTT.

43. Mr Goldberg accepted before us, as he did before the UT, that MJP needs to succeed in respect of all four Transactions in order to succeed on this appeal. He further confirmed, as he did before the FTT and the UT, that MJP does not rely on section 81(3). He accepted that the Loan Agreement was not "issued" within the meaning of that sub-section. On the other hand, Mr Goldberg submitted that section 81(3) seems to suggest a rather wide approach to the meaning of "loan" in the context of section 81.

44. Mr Goldberg made detailed submissions on the evidence relating to Transactions 1 to 4. As appears below, for the purpose of disposing of this appeal it is sufficient to consider only his submissions on Transactions 2 and 3 and the Loan Agreement. It is not necessary to consider MJP's arguments on the statutory assumption in FA 1996 s.85(3)(c) in relation to the drawing up of MJP's accounts since that issue does not arise if, as I find, the FTT and the UT were entitled to reach the conclusions which they did in relation to Transactions 2 and 3.

Transaction 2

45. Mr Goldberg submitted that the evidence for this transaction is perfectly clear. MJP's running inter-company ledger account with Aegis has an entry dated 5 June 2007 showing an increase of £830,500 in the indebtedness of Aegis to MJP. There is a book entry showing the bank balance of MJP's Lloyds TSB Bank account No. 0250622. It has an entry for 5 June 2007 showing the payment of that amount to Aegis. There was in evidence a Lloyds TSB bank statement showing the payment of that amount out of MJP's account on 13 June 2002. All three documents show that the payment was made by cheque No. 000145. The same amount is shown as credited to Aegis in the Nominal Audit Trail record for Aegis. The date of the entry is 25 June 2002. It contains a description – "MJP Media Services Ltd i/c" and gives as details of the credit "MJP RE I/CO MJP".

46. Mr Goldberg submitted that the conclusion of the FTT that MJP made the payment to a third party rather than to Aegis was plainly wrong in the light of the evidence. He said that MJP's book entries would have been different if there had been a payment to a third party. They would have named the third party. He said it is complete speculation that the payment was to a third party since there was no evidence or suggestion as to who that third party might have been. He relied upon the fact that the payment is clearly shown by the evidence as leaving MJP's bank account and being received by Aegis. He said that the FTT wrongly ignored the evidence of Mr Richards in re-examination that book entries relating to the Lloyds TSB account

showed that the money went from MJP to Aegis. He said that the FTT had been wrong to place weight on the date of 25 June 2002 shown in Aegis' Nominal Audit Trail record since that was the date of the entry and not of the transaction.

Transaction 3

47. It is common ground that, before the Transaction, money was due from Aegis to Carat and money was also due from Carat to MJP and Carat had money which it was able to transfer. MJP's running inter-company ledger account with Aegis has an entry for 4 September 2002 showing an increase of £6,101,401.58 in the amount due from Aegis to MJP and the words "Carat International" alongside the entry. In MJP's running inter-company ledger account with Carat there is an entry for 4 September 2002 showing a reduction of the same amount and the words "Aegis Group plc" alongside. Mr Goldberg said that the proper explanation for these entries is that Carat paid that amount to Aegis in such a way that it established a debt between Aegis and MJP in the amount of £6,101,401.58 and at the same time reduced Carat's liability to MJP in the same amount. He relied upon an entry in the Nominal Audit Trail for Aegis dated 30 September 2002 referring to the cash book showing "INTERCO TRF MJP RE CARAT" in respect of that amount, again supporting, he said, the conclusion that there was a transfer of that amount from Carat to Aegis. The relevant page in Aegis' cash book does indeed show an entry dated 12 September 2002 to that effect. Mr Goldberg referred to the notes in MJP's statutory accounts for the year ended 31 December 2002 showing amounts owed by group companies of £6,312,000 and a figure of £6,392,000 for the previous year. He emphasised that the figure had not increased by the amount of the inter-company transfer. He also referred to the notes in Carat's accounts for the year ended 31 December 2002 showing a reduction of the amount owed by Aegis from £6,667,000 in 2001 to £159,000 in 2002.

48. Mr Goldberg relied upon the comment in the witness statement of Mr Richards that immediately before Transaction 3 Carat's accounts reflect a loan between Carat and Aegis. He pointed out that Mr Richards was not cross-examined on that statement. He also relied upon the passages in Mr Richards' witness statement stating that, before the Transaction, Carat was indebted to MJP by way of loan, but in September 2002 that loan was repaid, and the cash receipt by Aegis increased the loan from MJP to Aegis.

49. Mr Goldberg said that the FTT had decided that MJP had not proven on a balance of probabilities that the Transaction had given rise to a loan relationship between MJP and Aegis, but such an approach was unprincipled and the conclusion plainly wrong. He said it was unprincipled for the FTT to resort to a failure on the part of the taxpayer to discharge the burden of proof in a case where there was so much evidence that a payment had been made by Carat to Aegis which created a debt due from Aegis to MJP. In effect, he said, the evidential burden had passed to the Revenue, and the Revenue's mere speculation as to the nature and purpose of the Transaction was insufficient to discharge the burden. He referred, in this context, to *Wood v Holden* (2005) 78 TC 1 at [31] to [33] (Chadwick LJ).

50. Mr Goldberg submitted that the payment by Carat was an advance for the benefit of MJP. He emphasised that section 81(1)(b) speaks of a transaction "for" the lending of money, and not a transaction "of" lending. He further emphasised that the book entries showed a movement of cash, in the sense of an increase and decrease in the

cash sums owed, and not an assignment to MJP of the debt due from Aegis to Carat as the FTT found. He said that the book entries, or at any event some of them, would have been different if there had been an assignment as opposed to a movement of cash from Carat to Aegis. He submitted that, in reaching its conclusion about Transaction 3, the FTT had ignored the evidence of Mr Richards.

51. Mr Goldberg submitted that the evidence pointed to the proper characterisation of the transaction as being an agreement between MJP and Carat that, if Carat paid £1.6m to Aegis and Carat also treated Aegis as discharged from its indebtedness to Carat, MJP would treat Carat as discharged from its indebtedness to MJP.

52. At one point in his submissions Mr Goldberg also appeared to be putting forward the alternative possibility that there was a novation of MJP for Carat in respect of the indebtedness of Aegis to Carat in consideration of the discharge of Carat's indebtedness to MJP and that such a novation was to be characterised as bringing into being a new loan from MJP to Aegis or, at any event, a new loan relationship between MJP and Aegis for the purposes of section 81(1).

Further arguments and the Loan Agreement

53. Mr Goldberg made the general observation that Aegis is a publicly quoted company and there is no suggestion that any of the payments in the Transactions were made as part of some fraudulent or wrongful scheme or that the books and records were improperly maintained.

54. He observed that there was no challenge to MJP's witnesses as to what was shown by the entries in the Nominal Audit Trail record for Aegis and the cash book. He said that Aegis was a mere holding company and that there was no evidence that it was trading. He submitted that it is simply implausible that Aegis would have owed money to MJP for services rendered or goods sold by MJP to Aegis.

55. Mr Goldberg criticised the FTT for resorting to the burden of proof in holding that MJP had failed to prove on a balance of probabilities payments from MJP to Aegis.

56. Having examined the financial and accounting records relating to the Transactions Mr Goldberg next submitted that, even if the records did not show cash going directly from MJP to Aegis, the Transactions nevertheless gave rise to a loan relationship between MJP and Aegis not only because money paid to a third party at Aegis' direction or for Aegis' benefit could still be a loan to Aegis but also because the definition of "loan" in section 103 includes an advance. He pointed out that, where there is a running account between two parties, with credits on both sides, the book entries are to be treated as money. In connection with those various points he referred to *Parsons v Equitable Investment Company Limited* [1916] 2 Ch 527 at 530 (Lord Cozens-Hardy MR), *London Financial Association v Kelk* (1884) 26 Ch.D 107 at 136-137 (Bacon V.C.), and to the general approach of Mellish LJ in *Re Harmony and Montague Tin and Copper Mining Company, Spargo's Case* (1873) LR Ch. App. 407 at 414 to running accounts between two parties with sums due on each side.

57. Mr Goldberg further submitted that the Loan Agreement, which described the outstanding running balance of £6,815,366 as a "loan/advance" and contained various provisions characterising it as a loan, should have been taken into account as

colouring the proper characterisation of the Transactions. He said that, although MJP does not rely on section 81(3) directly, nevertheless that provision and the ease with which it could have been satisfied reinforce that there is no need for the court to be astute to go behind the parties' characterisation of the outstanding balance as a loan, particularly where a transaction may be interpreted in different ways. This is not, he emphasised, a case of artificial transactions with a view to tax avoidance, but it concerns real and genuine transactions. In that connection he drew attention to the description of the transactions in *Commissioners of Inland Revenue v HIT Finance Ltd* (2007) 10 HKFCAR 717 at [10] to [14] (Lord Hoffmann NPJ). He pointed out that paragraph 13 of schedule 9 to FA 1996 contains specific provisions dealing with transactions between related companies.

58. Mr Goldberg's final argument was that, if MJP failed on everything else, the Loan Agreement itself gave rise to a new loan relationship between MJP and Aegis within section 81. It clearly describes the £6,815,366 balance then outstanding from Aegis to MJP as a loan and contains provisions as to, among other things, its repayment and for interest.

Discussion

59. At the end of the day the issues that arise are short ones. The indebtedness of Aegis to MJP shown in the financial records and in the Loan Agreement is not in dispute. What is in dispute is the proper characterisation of the Transactions for the purposes of section 81(1)(b). Insofar as the findings of the FTT were findings of fact they could only be overturned on appeal to the UT if they were *Edwards v Bairstow* wrong. The issues, therefore, are as follows. Firstly, were the FTT entitled to conclude in respect of any one or more of the Transactions that the evidence did not show that something was paid to or for the benefit of Aegis? Secondly, was the FTT's conclusion undermined by the description and treatment of the accumulated indebtedness in the Loan Agreement? Thirdly, did the Loan Agreement itself give rise to a loan relationship between MJP and Aegis for the purposes of section 81?

60. The starting point for the first issue is that the FTT did not decide against MJP on Transactions 2 and 3 merely on the basis that MJP had failed to discharge the burden of proving on a balance of probabilities that there was a transaction for the lending of money by MJP to Aegis. It is quite clear from paragraph [76] of the FTT's decision that, in respect of those transactions, unlike Transactions 1 and 4, the FTT made a positive finding that on a balance of probabilities there was no cash payment by MJP to Aegis.

61. The next point is to emphasise again that no one gave evidence for MJP who had any direct knowledge of the Transactions. Nor did anyone give evidence who had actually drawn up the entries in the books and records of MJP and other group companies on which MJP relies. Nor did anyone give evidence about the way the group carried on business at the time of the Transactions, with particular reference to the commercial relations and dealings between the companies within the group.

Transaction 2

62. Mr Parry's evidence in cross-examination was that, if a large sum of money was to be transferred between group companies, it would have been transferred by online

banking transfer; it would not typically have been done by cheque. He said that £830,000 would be a large transaction. His evidence did not go so far as to say that an inter-group transfer could never or would never be done by cheque. He did acknowledge, however, that to make a payment between group companies by cheque would result in lost interest because it would take a number of days after coming out of one bank account to be credited to the payee's account. He agreed that in the circumstances "it would be rather stupid to [make a payment] within a group by way of a cheque". He was unable to say whether the cheque payment in Transaction 2 was an inter-group payment or to a third party.

63. No one gave evidence for MJP that the date in Aegis' Nominal Audit Trail record showing the receipt of the £830,500 was the date of the entry in the books rather than the date of receipt of the money. No bank statement of Aegis was produced showing the date of receipt by Aegis.

64. Further, as Mr Ewart observed, it appears from the statutory accounts of MJP for 2003 that the principal activity of MJP at that time was the purchase of media advertising space for subsidiaries of Aegis. In the absence of any further evidence about the inter-company commercial relationships within the group, it would be unrealistic to ignore the possibility that the payment may have been to a third party for trading between MJP and the third party or it may have been attributable to inter-group trading rather than, in either case, a payment by MJP to or for the benefit of Aegis. If it was made to a third party, there was simply no evidence that it was a payment on Aegis' behalf. The UT rightly observed as follows:

> "40. I can take the first and third arguments together. The problem with both arguments is that, as counsel for HMRC submitted, they lack a proper factual foundation. Counsel for MJP submitted that, if the transactions did not comprise cash payments from MJP to Aegis, then the only alternative possibility is that they were payments by MJP on behalf of Aegis. I do not accept this. First, it was not MJP's case before the Tribunal that MJP had made payments on behalf of Aegis. Secondly, MJP adduced no evidence to support such a case. Thirdly, this is not the only alternative possibility…. Even in the case of the second transaction, while I accept that it is possible that MJP made payments to a third party on behalf of Aegis, it is also possible, as counsel for HMRC submitted, that MJP contracted with and paid the third party to obtain services the benefit of which was passed on to Aegis, and Aegis agreed to re-pay MJP but the money was left outstanding as an inter-company debt."

65. Mr Ewart also drew our attention to the entries in the record of MJP's financial balances with Aegis in the financial reporting package for the year ended 31 December 2002. This showed a balance of £6,312,000 due to MJP, but it is not recorded in the "loan" column. This reinforces the likelihood that it represented a balance on a trading current account rather than the outstanding balance of a loan.

66. In the circumstances, it is simply impossible, in the light of the evidence as a whole, to say that the FTT made an error of principle or was perverse in concluding that on a

balance of probabilities the payment in Transaction 2 was not made to or for the benefit of Aegis but to a third party. The UT was entirely right to find that the conclusion of the FTT was one which they were entitled to reach on the evidence before them.

Transaction 3

67. MJP relies, as I have said, on the evidence of Mr Richards in his witness statement that there was a loan relationship between Aegis and Carat immediately before the Transaction. Mr Goldberg also submitted, by reference to the financial records and audited accounts of the companies involved, that it can be seen that the effect of the Transaction was that Carat's indebtedness to MJP went down "and the loan to Aegis" increased. On the other hand, Mr Richards' evidence in cross-examination was, that he was not aware of the actual mechanics of how the transfer was effected since he was not involved in the transactions and he did not do the book-keeping. It seems clear that he was not characterising the relationship between MJP and Aegis as a matter of law. He was merely interpreting the book entries. They nowhere stated, in relation to Transaction 3, that there was a loan from MJP to Aegis.

68. The FTT were faced with the difficulty of giving a legal analysis of Transaction 3 in the absence of any evidence from anyone who was involved with the Transaction or the making of the book entries in respect of it. The explanation put forward on behalf of MJP, namely an agreement between MJP and Carat that, if Carat paid £6.1m to Aegis and Carat also treated Aegis as discharged from its indebtedness to Carat, MJP would treat Carat as discharged from its indebtedness to MJP, is remarkably tortuous. It is all based on a supposition that there was a payment (by way of book entry) from Carat to Aegis even though it was Aegis that owed money to Carat. The explanation preferred by the FTT, namely an assignment to MJP of the indebtedness of Aegis to Carat in consideration of MJP's waiver of Carat's indebtedness to MJP, seems much more straightforward and plausible. It is impossible to say that it was plainly wrong.

69. The only other analysis that has been canvassed is that there was a novation of MJP for Carat in respect of the debt owed by Aegis to Carat, but that does not help MJP. It is of the essence of a novation that there is simply a substitution of one party for another in relation to an existing liability: there would have been no new money passing from MJP to Aegis, no new loan, no new transaction for the lending of money by MJP to Aegis and therefore no new loan relationship within section 81. On the other hand, MJP's support for a possible novation reinforces the conclusion that the assignment explanation preferred by the FTT is a plausible explanation, even if not the only possible explanation, since such a novation and the FTT's assignment analysis have much more in common with each other than the preferred analysis of MJP.

70. In relation to all the analyses of Transaction 3 that have been canvassed, it is important to note the FTT's conclusion in paragraph [94] of their decision that there was no evidence that the indebtedness of Aegis to Carat itself arose from a loan relationship within section 81. That was not strictly correct because, as I have said, Mr Richards' witness statement did refer to that indebtedness as a loan relationship. On the other hand, as I have also said, Mr Richards was merely interpreting the book entries and financial records that are in evidence, but for which he was not personally responsible, and he was not personally involved in any of the Transactions. It is clear

that he was not intentionally applying a legal label to the relationship between Aegis and Carat.

Other arguments

71. I do not accept Mr Goldberg's general point that, in deciding the proper legal character of the Transactions, the court should accept the loan label applied by Aegis and MJP themselves in the Loan Agreement. It is not in dispute that, where there is an ambiguity, it may be appropriate and helpful to see the way the matter has been treated by the parties in contemporaneous documentation. The Loan Agreement, however, came into existence some time after the Transactions, particularly Transactions 1 to 3. As Mr Ewart observed, section 81(1)(b) directs attention to the transaction which created the debt. The FTT came to a legitimate conclusion on the basis of the contemporaneous material, that is to say the contemporaneous entries in the financial and accounting records, that on a balance of probabilities Transactions 2 and 3 did not involve any payment to or for the benefit of Aegis such as to give rise to a loan relationship. The parties could not retrospectively change the legal character of Transactions 2 and 3. In any event, the Loan Agreement does not purport to characterise retrospectively past transactions. On its face and clear language it purports to create a new loan, reflected in the expression "Initial amount of loan/advance". It does not anywhere refer to previous arrangements between the parties or explain how the £6,815,366 figure is made up or its derivation. It sets out terms as to the repayment of the loan, interest and default, which are entirely new.

72. I cannot see that any of the cases to which Mr Goldberg referred assist. In particular, *Spargo's Case* shows that the effect of netting off mutual liabilities between two parties can amount to actual payment, but that is irrelevant to the FTT's factual conclusions as to what took place in Transactions 2 and 3. The finding of the FTT was that there had been a payment to a third party, and not a payment to or for the benefit of Aegis, in Transaction 2. The FTT found that in Transaction 3 there was an assignment to MJP of Aegis' existing indebtedness to Carat. The issue of actual payment by virtue of netting off mutual liabilities between Aegis and MJP simply does not arise.

73. Mr Goldberg's ultimate alternative argument, namely that the Loan Agreement itself established a loan agreement within section 81, would seem to be more promising. I am satisfied, however, that this is an entirely new argument raised for the first time in this court. Despite Mr Goldberg's submissions to the contrary, I consider that it is clear that this was not a ground mentioned in MJP's Statement of Case. Paragraphs 11 and 12 of the Statement of Case allege an oral agreement between MJP and Aegis in 2002, by which MJP undertook to lend amounts from time to time to Aegis (described as "the Loan"). Paragraph 13 sets out the amounts from time to time advanced by MJP to Aegis pursuant to that oral agreement. Paragraph 14 alleges that in the Loan Agreement the parties confirmed "the Loan by MJP to Aegis which was at that date the amount of £6,815,365.64", recorded the Loan in writing and amended the Loan to provide for interest. Paragraph 17 states that "the Loan" was a transaction for the lending of money. It is nowhere alleged that the Loan Agreement created a new loan and a new loan relationship. Nor was that point run before either the FTT or the UT.

74. I accept Mr Ewart's submission that it would wrong and unjust to allow the point to be taken for the first time now because, had the point been in play before the FTT, the Revenue would certainly have wished to consider, and might well have wanted to explore in the evidence, including cross-examination, when the Loan Agreement was actually made, whether the amount mentioned was truly a loan or an advance or was part of some artificial arrangement tied to the partial waiver of the loan, and whether there was any scope for the application of the provisions of paragraph 13 of Schedule 9 to FA 1996 dealing with non-business loans and tax avoidance transactions. Even the date of the Loan Agreement is, for example, uncertain. The Loan Agreement is stated to be "effective from 1 January 2004", but the finding of the FTT (in paragraph [5] of its Decision) was that it was signed at some date between 1 January and 26 March 2004. Mr Ross, who signed on behalf of Aegis, could not remember when he signed it.

75. Accordingly, the FTT were entitled, and the UT was right, to reach the conclusions they did in respect of Transactions 2 and 3 and the Loan Agreement. It also follows that the appeal must fail, and it is not necessary to consider either the grounds of appeal or the respondent's notice on the application of the assumption in section 85(3)(c) to MJP's 2004 accounts.

Conclusion

76. For those reasons, I would dismiss this appeal.

THE APPENDIX

80 Taxation of loan relationships.

(1) For the purposes of corporation tax all profits and gains arising to a company from its loan relationships shall be chargeable to tax as income in accordance with this Chapter.

(2) To the extent that a company is a party to a loan relationship for the purposes of a trade carried on by the company, profits and gains arising from the relationship shall be brought into account in computing the profits of the trade.

…

(4) This Chapter shall also have effect for the purposes of corporation tax for determining how any deficit on a company's loan relationships is to be brought into account in any case …

(5) Subject to any express provision to the contrary, the amounts which in the case of any company are brought into account in accordance with this Chapter as respects any matter shall be the only amounts brought into account for the purposes of corporation tax as respects that matter.

81 Meaning of "loan relationship" etc.

(1) Subject to the following provisions of this section, a company has a loan relationship for the purposes of the Corporation Tax Acts wherever—

(a) the company stands (whether by reference to a security or otherwise) in the position of a creditor or debtor as respects any money debt; and

(b) that debt is one arising from a transaction for the lending of money;
and references to a loan relationship and to a company's being a party to a loan relationship shall be construed accordingly.

….

(3) … where an instrument is issued by any person for the purpose of representing security for, or the rights of a creditor in respect of, any money debt, then (whatever the circumstances of the issue of the instrument) that debt shall be taken for the purposes of this Chapter to be a debt arising from a transaction for the lending of money.

…

84 Debits and credits brought into account.

(1) The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, in accordance with an authorised accounting method and when taken together, fairly represent, for the accounting period in question—

(a) all profits, gains and losses of the company, including those of a capital nature, which (disregarding interest and any charges or expenses) arise to the company from its loan relationships and related transactions; and

(b) all interest under the company's loan relationship and all charges and expenses incurred by the company under or for the purposes of its loan relationships and related transactions.

…

(7) This section has effect subject to Schedule 9 to this Act (which contains provision disallowing certain debits and credits for the purposes of this Chapter and making assumptions about how an authorised accounting method is to be applied in certain cases).

85 Authorised accounting methods.

(1) Subject to the following provisions of this Chapter, the alternative accounting methods that are authorised for the purposes of this Chapter are—

(a) an accruals basis of accounting;…

…

(2) An accounting method applied in any case shall be treated as authorised for the purposes of this Chapter only if— …

(b) it contains proper provision for allocating payments under a loan relationship or arising as a result of a related transaction, to accounting periods;...

…

(3) In the case of an accruals basis of accounting, proper provision for allocating payments under a loan relationship to accounting periods is provision which—

(a) allocates payments to the period to which they relate, without regard to the periods in which they are made or received or in which they become due and payable;

…

(c) assumes, subject to authorised arrangements for bad debt, that, so far as any company in the position of a creditor is concerned, every amount payable under the relationship will be paid in full as it becomes due;

(d) secures the making of the adjustments required in the case of the relationship by authorised arrangements for bad debt; and

(e) provides, subject to authorised arrangements for bad debt and for writing off government investments, that, where there is a release of any liability under the relationship, the appropriate amount in respect of the release is credited to the debtor in the accounting period in which the release takes place.

…

(5) In this section—

(a) the references to authorised arrangements for bad debt are references to accounting arrangements under which debits and credits are brought into account in conformity with the provisions of paragraph 5 of Schedule 9 to this Act; …

87 Accounting method where parties have a connection.

(1) This section applies in the case of a loan relationship of a company where for any accounting period there is a connection between the company and—

(a) in the case of a debtor relationship of the company, a person standing in the position of a creditor as respects the debt in question; or

(b) in the case of a creditor relationship of the company, a person standing in the position of a debtor as respects that debt.

(2) The only accounting method authorised for the purposes of this Chapter for use by the company as respects the loan relationship shall be an authorised accruals basis of accounting.

103 Interpretation of Chapter.

(1) In this Chapter—

…

"loan" includes any advance of money, and cognate expressions shall be construed accordingly;

SCHEDULE 9

LOAN RELATIONSHIPS: SPECIAL COMPUTATIONAL PROVISIONS

Section 84

Bad debt etc.

5(1) In determining the credits and debits to be brought into account in accordance with an accruals basis of accounting, a departure from the assumption in the case of the creditor relationships of a company that every amount payable under those relationships will be paid in full as it becomes due shall be allowed (subject to paragraph 6 below) to the extent only that—
(a)a debt is a bad debt;
(b)a doubtful debt is estimated to be bad; or
(c)a liability to pay any amount is released.

…

Bad debt etc. where parties have a connection

6(1) This paragraph applies where for any accounting period section 87 of this Act requires an authorised accruals basis of accounting to be used as respects a creditor relationship of a company.

(2) The credits and debits which for that period are to be brought into account for the purposes of this Chapter in accordance with that accounting method shall be computed subject to sub-paragraphs (3) to (6) and paragraphs 6A and 6B below.

(3) The assumption that every amount payable under the relationship will be paid in full shall be applied as if no departure from that assumption were authorised by virtue of [paragraph 5(1)] above except where it is allowed by sub-paragraph (4) [or paragraph 6A or 6B] below.

….

LORD JUSTICE LEWISON

77. It is uncontroversial that where there is real difficulty in characterising a transaction, the label that parties attach to it can be of value in resolving the difficulty. In *Massey v Crown Life Insurance Co* [1978] 1 WLR 676 Lord Denning MR said:

> "…if the true relationship of the parties is that of master and servant under a contract of service, the parties cannot alter the truth of that relationship by putting a different label upon it. …On the other hand, if the parties' relationship is ambiguous and is capable of being one or the other, then the parties can remove that ambiguity, by the very agreement itself which they make with one another. The agreement itself then becomes the best material from which to gather the true legal relationship between them."

78. However, as Lord Justice Etherton has shown, the FTT made a positive finding of fact that transactions 2 and 3 were not transactions for the lending of money. Thus there was no difficulty in characterising those transactions. I also agree with him that the subsequent Loan Agreement cannot be allowed retrospectively to alter the nature of transactions that had already taken place.

79. When I refused permission to appeal on the papers I commented that this appeal would simply be a second appeal on a question of fact. So it has turned out to be. For the reasons given by Lord Justice Etherton I agree that the appeal should be dismissed.

LORD JUSTICE RIX

80. I also agree.