<u>Neutral citation number: [2015] EWHC 12 (Ch)</u>

<u>IN THE HIGH COURT OF JUSTICE</u> <u>Claim No: HC-2013-000097</u>

<u>CHANCERY DIVISION</u>

Royal Courts of Justice, Rolls Building,
Fetter Lane, London, EC4 1NL

Date: 7 January 2015

Before:

<u>His Honour Judge Keyser QC</u>
<u>sitting as a Judge of the High Court</u>

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Between:

ALTUS GROUP (UK) LIMITED

<u>Claimant</u>

- and –

(1) BAKER TILLY TAX AND ADVISORY SERVICES LLP

(2) BAKER TILLY TAX AND ACCOUNTING LIMITED

<u>Defendants</u>

- -

David Yates & David Ewart QC (instructed by **Bird & Bird LLP**) for the **Claimant**

David Turner QC & Aparna Nathan (instructed by **Taylor Wessing**) for the **Defendants**

Hearing dates: 11, 12, 13, 14 & 17 November 2014

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Judgment

H.H. Judge Keyser Q.C.:

Introduction

1. The claimant claims damages for professional negligence on the part of the defendants, who carry on the business of accountants with expertise in the field of taxation, in failing to give advice that would have enabled the claimant to implement a restructuring proposal with a view to mitigating its tax liabilities.

2. The defendants admit that they were in breach of duty, although they raise an issue concerning the time at which the breach occurred. However, they deny that the claimant would have implemented the proposal for which it contends. And they contend that, even if the restructuring proposal had been implemented, it would have been ineffective as a matter of law for purposes of tax mitigation and would have been successfully challenged by HMRC.

3. In addition to relatively limited factual evidence, the parties adduced written and oral expert evidence in respect of the efficacy of the restructuring scheme and the likely attitude of HMRC towards it. The claimant called Ms Toni Dyson, a tax specialist at FTI Consulting LLP, and Mr Bas Kundu, a tax specialist at AuHg Consulting Limited (previously at FTI Consulting LLP). The defendants called Mr David Sayers, a tax specialist at Mazars LLP. I shall address their evidence when considering the specific issues in the case.

4. I shall summarise the principal facts before identifying and explaining the issues in more detail and setting out my conclusions with respect to them. There is a short summary of my decision and the conclusions on which it is based at paragraph 181 below.

5. I am grateful to Mr Yates, Mr Ewart QC (who attended on the final day of the trial to make submissions on behalf of the claimant in relation to one specific point of law), Mr Turner QC and Ms Nathan for their most helpful and, in the circumstances, remarkably succinct written and oral submissions.

The Facts

6. The claimant is part of the Altus corporate group ("the Altus Group"), which has its headquarters in Canada. It is a UK subsidiary of Altus Group Limited ("AGL"), a Canadian company.

7. The claimant is also a member of Altus UK LLP ("the Existing LLP"). The Existing LLP was incorporated on 24 September 2007 as the corporate structure whereby AGL acquired the property consultancy business of a firm called Edwin Hill. The other members of the Existing LLP are Altus Group (UK2) Limited ("AGUK"), the Altus UK LLP Employee Benefit Trust, and various individual members, who were formerly partners in Edwin Hill. Through the claimant and AGUK, AGL exercises corporate control over the Existing LLP.

8. The profit-sharing arrangements are set out in section 10 of the LLP Agreement dated 1 October 2007. For the purposes of this judgment it will suffice to summarise the main effect of that provision. The individual members are first paid out a profit share in priority ("priority profit share"). Any remaining profits are then distributed to the claimant and AGUK in proportion to their respective interests: 99.99% to the claimant and 0.01% to AGUK.

9. The acquisition of the business of Edwin Hill gave rise to an asset in the Existing LLP's accounts in respect of the goodwill of that business; the total cost of the goodwill was approximately £26.5 million. In late 2007 it was decided that the goodwill would be amortised over a five-year period concluding at the end of the third quarter of 2012. This resulted in amortisation of goodwill at the rate of approximately £5 million per annum.

10. For an understanding of the decision to amortise the goodwill and of the significance of the events that followed, it is necessary to say something about aspects of the tax position as it applied to the Existing LLP and its members in 2007.

11. For the purposes of UK tax law, an LLP that carries on a trade is treated in the same way as a partnership and is not itself liable to tax. Rather its profits and losses arise to the members. Individual members are subject to the income tax regime. Corporate members are subject to the corporation tax regime.

12. One material difference between the two regimes is that for the purposes of corporation tax amortisation of goodwill is an allowable deduction against profits, whereas it is not an allowable deduction for the purposes of income tax. According to the HMRC Manual, amortisation of goodwill for the purposes of the tax liability of a corporate member is taken into account in computing the profits and losses of the LLP; it is not calculated by reference only to the profits and losses of the corporate member.

13. It is possible, but not certain, that until 2009 there was another material difference between the two regimes, with respect to the allocation of losses from an LLP.

14. As regards individual members, the basic rule was set out in section 850(1) of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"):

> "For any period of account a partner's share of a profit or loss of a trade carried on by a firm is determined for income tax purposes in accordance with the firm's profit-sharing arrangements during that period."

However, the remainder of section 850 provided a machinery whereby, if the effect of the profit-sharing arrangements would be to allocate profits to one partner and losses to another, those losses would be reduced to nil and the profits would be allocated to the members on a pro rata basis.

15. As regards corporate members, by contrast, there was no similar machinery in the relevant provisions, which until 2009 were those of section 114 of the Income and Corporation Taxes Act 1988 ("ICTA 1988"). Section 114(2) provided:

> "A company's share in the profits or loss of any accounting period of the partnership, or in any matter excluded from the computation by subsection (1)(b) above, shall be determined according to the interests of the partners during that period, and corporation tax shall be chargeable as if that share derived from a trade, profession or business carried on by the company alone in its corresponding accounting period or periods; and the company shall be assessed and charged to tax for its corresponding accounting period or periods accordingly."

16. On one view, the absence from the provisions relating to corporate members of any machinery corresponding to that in section 850 of ITTOIA indicated that corporate and individual members were treated differently. However, that was not HMRC's view. Paragraph 72245 of the HMRC Business Income Manual (BIM), headed "Partnerships—computation and assessment: allocation must not create or increase a loss", stated:

> "Although the allocation of profit follows the commercial profit sharing arrangement the use of this arrangement alone might produce a spurious result. For instance it would be possible to have an allocation in which one or more partners are allocated an aggregate (but notional) profit greater than the actual profit made by the partnership, and the remaining partners are allocated an aggregate (but notional) loss.
>
> For tax purposes the allocation of profit (or loss) between partners must result in a straight apportionment of the actual profit (or loss) made by the partnership. If the initial allocation using the commercial profit sharing arrangement for all the partners produces a mixture of notional profits and losses, you must reallocate the actual partnership profit (or loss) between the profit making (or loss making) partners alone. This re-allocation is made in proportion to the notional profit (or loss) initially allocated to those partners. …
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> In the case of *PDC Copyprint v George* … the Special Commissioners held that it was not open to partners to inflate loss claims by payment of a 'salary' to one or more of their number. …"

ITTOIA was a product of the Tax Law Rewrite Project, which was established in 1996 with the aim of rewriting the UK's primary tax legislation to make it clearer and easier to use, but without making significant changes to its effect. The rewrite of the corporation tax legislation did not occur until 2008/9. HMRC's view was that the machinery in section 850 of ITTOIA did no more than put the existing law and practice on a statutory footing.

17. By an Engagement Letter dated 7 January 2008 the first defendant was engaged to prepare the claimant's corporation tax returns. The second defendant replaced the first defendant in that regard pursuant to an Engagement Letter dated 23 March 2011. I shall say something about the terms of the Engagement Letters later in this judgment. For the purposes of these proceedings the distinction between the first defendant and the second defendant is generally unimportant.

18. In February 2008 Ms Dale Lawr, the Chief Financial Officer of AGL, and Mr Steve Corrin, a director of the first defendant, agreed that the claimant's corporation tax returns would be prepared on the basis that the two corporate members of the Existing LLP were allocated 100% of the deduction for the amortisation of goodwill. In practice, this inevitably resulted in the claimant incurring a loss, which it could then carry forward to set aside its liabilities for corporation tax in future years. Throughout the relevant period, the priority fixed shares of the individual members of the Existing LLP exceeded its actual profits once the deduction had been made for amortisation. The rationale for not engaging the machinery in section 850 of ITTOIA was that *on income tax principles* (as opposed to corporation tax principles) the corporate members were to be treated as making a profit, because amortisation of goodwill is not an allowable deduction against profits for the purposes of income tax. Mr Corrin advised that it was proper to deal with the profits and losses in this manner and to prepare the claimant's corporation tax returns on the basis that the amortisation of goodwill was attributed solely to the corporate members. However, he did express some uncertainty as to whether the statutory provisions were properly read to give such a result and whether HMRC would accept the method adopted.

19. Despite these doubts, the claimant's corporation tax returns were prepared in the agreed manner for the periods ending on 31 December in 2008, 2009 and 2010. No challenge was made to the returns.

20. On 4 December 2008 a Corporation Tax Bill was introduced in the House of Commons. It was produced by the Tax Law Rewrite Project and, being primarily designed to rewrite existing legislation rather than to make major changes, it was subject to a streamlined parliamentary procedure. Nonetheless the Explanatory Notes to the Bill identified 106 minor changes that were proposed. Change 86 was to introduce into the corporation tax regime machinery similar to that contained in section 850 of ITTOIA. The Bill received Royal Assent on 26 March 2009, and the Corporation Tax Act 2009 ("CTA 2009") came into force on 1 April 2009, though having effect for corporation tax purposes "for accounting periods ending on or after that day". Change 86 was effected by sections 1263 and 1264. Of particular relevance to this case are the following provisions, which I paraphrase:

- Section 1263(1) provides that, where the calculation of a profit or loss for the LLP under corporation tax principles produces a profit, but the profit-sharing arrangements among the members result in a loss for the corporate member, the corporate member is treated as having neither a profit nor a loss.

- Section 1264(2) provides that, where the calculation of a profit or loss for the LLP under corporation tax principles produces a loss, but the profit-sharing arrangements result in a loss for the corporate member but a profit for at least one other member, the corporate member's loss is restricted according to the formula set out in the legislation, which reallocates the individual members' profits to reduce the loss available to the corporate member.

It is common ground that the effect of sections 1263 and 1264 was that (subject only to the availability of an election for 2009, which I shall mention below) it was beyond question impermissible for the claimant to be allocated a loss from the Existing LLP for corporation tax periods with effect from the period ending 31 December 2009.

21. Meanwhile on 21 January 2009, shortly after the corporation tax return for 2008 had been completed, Mr Corrin sent to Ms Lawr an email with an attached note. The first three pages of the note consisted of explanation and discussion of other matters relevant to the completion of the return. The final substantive page was under the heading "Split of LLP's result":

> "The draft tax computation for Altus Group (UK) LLP shows that the individual members of the LLP earned taxable profits of £2.9m, while the corporate members have a loss of some £1.2m. In a UK partnership that consists wholly of individuals paying income tax, if the various profit allocations give rise to a result that gives some partners a taxable profit, and others a loss, for tax purposes the losses have to be re-allocated to the partners that have profits (because the partnership as a whole has not made a loss for tax purposes).
>
> We have been able to find no corresponding rule where some of the members of the partnership pay income tax and others pay corporation tax. We do not see how it is possible to reallocate losses attributed to corporate tax payers against profits earned by income tax payers. By contrast with the income tax rule above, it is possible to make a loss for corporation tax purposes, while making a profit under income tax rules. This is illustrated starkly in the case of Altus where the corporation tax rules give a very different result to the income tax rules, mainly because of the treatment of goodwill amortisation.
>
> If HMRC were to take this point, it would mean that the individual members of LLP would have overpaid income tax, but there will have been no corresponding underpayment of corporation tax by the corporate members. In those circumstances, it seems most unlikely that HMRC would choose to pursue the point. If there were to be complications arising from this point, it may become necessary for the members of the LLP to enter into arrangements to ensure that their overall after tax position is as expected. However, hopefully it will not be necessary to deal with such a situation."

22. It was not until October 2011 that the defendants adverted to section 1263 and its bearing on the claimant's tax affairs. The corporation tax returns for 2009, 2010 and 2011 were prepared on the previously agreed basis, namely that there was no provision for corporation tax corresponding to section 850 of ITTOIA.

23. The effect of the changes brought about by the CTA 2009 was brought to Mr Corrin's attention in an email dated 25 October 2011 from Claire Lovegrove, a Manager with the second defendant. After some further consideration of the point, Mr Corrin informed Mr Stephen Howell, Vice President (Corporate Tax) of Altus Group, of the problem in a telephone conversation on 14 November 2011. He followed this up with a letter dated 15 November 2011, sent by email, which succinctly explained the difficulty. On 16 November 2011 Mr Corrin (SC) and Mr Howell (SH) spoke again by telephone. Part of the defendants' record of that telephone conversation reads as follows:

> "SH asked how the problem had come to light. SC said that it had arisen in the course of finalising the 2010 LLP tax return, which was prepared by a new member of staff. SC explained that changes in the law are normally dealt with in Finance Acts which are carefully scrutinised. This change came in a consolidating act which, as mentioned in the letter, is not intended to make anything other than inconsequential changes to the law. Unfortunately, the Altus fact pattern is such that it makes a considerable difference to them."

24. Also on 16 November 2011 Mr Howell sent an email to Mark Kaplan, an international tax planner with Ernst & Young in Canada. It was Ernst & Young LLP in the UK ("EY") who had done the tax planning work in connection with the original acquisition of the business of Edwin Hill, and Mr Howell made an urgent request of Mr Kaplan to get in touch with those who had done the work and find out whether they agreed with the defendants' view of the matter. On 24 November 2011 James Randall, a Senior Manager with EY, responded by email. He expressed agreement with the defendants on "the technical point", namely the effect of section 1263 of the CTA 2009, and advised that the claimant's returns for 2009 and 2010 ought to be re-filed, though the impact of re-filing would be to "essentially extinguish the share of the partnership losses recognised by Altus UK Ltd for these purposes—in total, based on the supporting documents provided, the de-recognition of losses should amount to £3,299,000." The email concluded:

> "We also have a number of planning ideas which could avoid this same issue arising in future accounting periods. We recognise that these would need to be implemented quickly if they are to be relied on for 2011, so we would be happy to discuss these with you."

25. On 29 November 2011 Mr Randall and Mr Howell spoke by telephone. Mr Howell's evidence was that in the course of that conversation Mr Randall first mentioned, albeit in very general terms, the restructuring proposal that subsequently developed into what has been called the New LLP Proposal (explained below). That evidence, which I accept, gains some support from

the evidence of Mr Lawrence Hall, who was the partner at EY who worked with Mr Randall in developing the New LLP Proposal; he confirmed that they had begun to work on the outline of the proposal shortly before 29 November 2011. However, it is clear that any mention of a positive strategy to address the claimant's problem can only have been at a very high level of generality and in very tentative terms. On 8 December 2011 Mr Randall sent to Mr Howell an email setting out thoughts on matters that they had discussed. The email made no mention of any specific restructuring proposal; rather it suggested a meeting with the claimant's solicitors to explore the restructuring options. Mr Howell's response of the following day noted that the substantive matters dealt with in Mr Randall's email were just what they had already discussed, and continued: "What I need to know right now is what planning you have in mind as we have to get this done ASAP." As Mr Howell explained in evidence, the particular urgency arose from the fact that the amortisation of the goodwill in the Existing LLP would be completed at the end of the third quarter of 2012.

26. By an email on 14 December 2011, Mr Corrin informed Mr Howell that it might be possible for the claimant to make an election under paragraph 10 of Schedule 2 to the CTA 2009, with the effect that any change in the law effected by that Act would not apply for the period ended 31 December 2009. It was decided to make an election. Accordingly by a letter dated 21 December 2011 the second defendant wrote to HMRC making elections on behalf of the claimant and AGUK. The letter said:

> "Arguably, the enactment of Part 17 CTA 2009 did bring about a change in the law, albeit the point is not beyond doubt as the applicable rule for corporation tax had not previously been codified. If you were to accept that a change in the law did arise, then the provisions of Para 10 Schedule 2 CTA 2009 would be in point. In the circumstances, we enclose elections under that Paragraph for your consideration and we should be grateful for your confirmation that they can be accepted with the effect that there is no change to the tax losses carried forward by the companies at 31 December 2009."

27. The elections have not been challenged by HMRC. Accordingly the claimant has retained the benefit of the losses that were allocated to it for the period ended 31 December 2009.

28. On 20 December 2011 EY produced a PowerPoint presentation document setting out its first proposals for a method "to facilitate the tax efficient allocation of profit and losses arising to the corporate and individual members of Altus UK LLP"—that is, for the purpose of circumventing section 1263. This is the New LLP Proposal. The "overview" explained the proposal:

> "• A new UK LLP will be set up with the members being Altus Group (UK) Limited and Altus Group (UK 2) Limited (as the corporate members) and the current individual members of Altus UK LLP.

- The membership interests of the respective UK members will mirror those in Altus UK LLP.
- The New LLP will be formed with the intention of providing staff services to Altus UK LLP.
- A Service Agreement will subsequently be entered into between Altus UK LLP and New LLP, the New LLP providing staff services for an arm's length return from Altus UK LLP.
- Under the new operating structure, Altus UK LLP is expected to generate tax losses allocable to both the corporate and individual members (which should not be restricted by the rules detailed in s. 1259-65 CTA 2009) as the LLP should make an overall loss before allocations are made to the members.
- Profits of New LLP should be allocated to the respective members in accordance with the Profit Sharing Ratio ('PSR'). We would expect the profit allocation to be skewed in favour of the individual members as they will be responsible for the provision of the staff services. The corporate members should receive only a nominal profit share."

Although there were several subsequent revisions of the New LLP Proposal, the revisions related principally to the implementation programme. The essential features of the proposal, as mentioned in the overview, did not change.

29. The presentation document dated 20 December 2011 also set out the "Anticipated taxation consequences" of the proposal:

"• The service agreement terms should be arm's length in nature to comply with the UK transfer price regime (Part 4 Transfer Pricing TIOPA 2010).

- New LLP should be transparent for corporation tax purposes (s. 1273 CTA 2009) with any profits and losses arising allocated to the respective members in accordance with the PSR.
- There is not expected to be any adverse income tax or NIC consequences as a result of the proposal. Currently Altus UK LLP individual members should reflect the profits (or losses) arising in their personal tax returns and pay income tax and NIC thereon. On transition to the dual LLP structure, the results of both LLPs should be reflected in the personal tax returns and charged to income tax and NIC. The individual members should take their own tax advice to confirm their personal tax position.

> - Any Altus UK LLP tax losses allocable to Altus Group Limited should not be restricted by the tax loss "commercial provisions" (s. 44 CTA 2010) as the trade of the LLP should be considered as part of a larger profit making venture (s. 44(2) CTA 2009).
>
> - VAT registration of New LLP may be required."

30. An "Important Note" on the presentation document said:

> "The ideas presented in this pack would need to be further developed and specifically worked through for the group, shareholder and member's requirements. … The information included is based on preliminary research on the feasibility of the options. Further detailed research will be required prior to any implementation."

31. By an email on 20 December 2011, Mr Randall informed Mr Howell that he had met with lawyers at Bird & Bird, solicitors, who had not identified "any immediate show stoppers to the idea of a dual partnership structure being established". However, he identified some areas in respect of which the solicitors and EY would have to carry out further research; one of these was "confirmation that … the individuals should not be regarded as disposing of partnership interests". The email said:

> "In terms of implementation, we agreed that 1 February 2012 appears to be a reasonable target at this stage, subject to further research on the above points and completion of the necessary technical analysis. The new LLP structure should be expected to become effective from the date of its implementation."

Accordingly Mr Randall was proposing an implementation process, of about six weeks, including the Christmas and New Year periods. On 21 December 2011 Claire Webster, the Director of Finance at the Existing LLP, sent an email to Mr Howell in which she expressed the view that this timetable was unrealistic.

32. On 2 January 2012 Mr Howell sent an email to Angelo Bartolini, who had succeeded Ms Lawr as the Chief Financial Officer of AGL, Liana Turrin, General Counsel to the Altus Group, and Alex Probyn, President of the Existing LLP, to explain to them what was proposed. The email, which attached EY's presentation document of 20 December 2011, was in the following terms:

> "We are looking at possibly reorganising the UK operations into 2 LLPs to maximize tax deductions. The original tax planning that took place in 2007 no longer works as a result of a change in the manner in which the UK taxes partnerships. Under the new structure the existing employees and partners would provide their services through a new LLP to the existing LLP. This would ensure that the partner remuneration and goodwill would be tax

> deductible in computing the partnership income of the existing LLP. Please note that the existing LLP would continue to be the entity that deals with customers. …"

The email was the first notification that Mr Probyn had received of the tax and restructuring issues.

33. On 5 January 2012 Mr Randall produced, for discussion purposes, a draft implementation step plan for the New LLP Proposal.

34. On 6 January 2012 Mr Howell enquired of Mr Corrin and Ms Lovegrove by email whether they had any thoughts on the New LLP Proposal.

35. Also on 6 January 2012 Ms Webster sent an email to Mr Randall, in which she observed that it would be necessary to reassure the individual members of the Existing LLP that the New LLP Proposal would not have any adverse impact on their own positions.

36. On 9 January 2012 Mr Randall produced a revised version of the implementation step plan, which took account of the fact that the restructuring would involve the transfer of employees from the Existing LLP to the New LLP and would therefore engage the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE"). Point 3.1 in this revision of the implementation step plan read:

> "Draft services agreement for the transfer of employees to the New LLP and for the payment of staff services by Altus UK LLP to New LLP".

37. Also on 9 January 2012 Mr Corrin sent to Mr Howell an email setting out his thoughts on the New LLP Proposal.

> "1. The profit sharing arrangements in the 2 LLPs will look no doubt look (sic) somewhat artificial, and so may provoke HMRC interest. While it is not clear how HMRC would succeed in setting aside the proposed arrangement, there must be risk that they would try to do so.
>
> 2. The original LLP structure enjoys the benefit of substantial National Insurance (social security) savings. Whether or not HMRC try to challenge the corporation tax position, careful thought would have to be given in the proposed structure as to whether the so called 'IR35' rules might apply to negate this NI benefit.
>
> 3. If the new structure were successfully implemented, it will achieve the desired outcome when the partnership result, after deducting individual members' remuneration (to be replaced by a management charge), gives a loss for corporation tax purposes. After the amortisation of goodwill

ceases in 2012, the chances of this happening may be much reduced, so any benefit may be short-lived."

38. Mr Howell forwarded those comments to Mr Randall, who responded on 10 January 2012.

> "1. … Although it is a topical subject, there is currently not a general anti-avoidance rule in the UK. We furthermore note that there are no targeted anti-avoidance rules in connection with the partnership profit allocation rules that we have been discussing. The only tool at HMRC's immediate disposal would seem to be if it could construct an argument that any payment between the LLPs is not made wholly and exclusively for the purposes of the LLP's trade (an argument that we do not think would be successful).
>
> We also note that should HMRC be successful in contending that the reorganisation should be disregarded (for example, through the application of anti-avoidance case law), we do not consider that this should leave the company in any worse position than if the proposed planning was not undertaken.
>
> 2. We have further discussed the impact of the proposed reorganisation with our social security specialists. Although IR35 is targeted at personal service companies, the legislation is widely drafted. … [W]e will work with our NIC specialists to ensure that the profit sharing arrangements of the New LLP are prepared in such a way as to limit the potential application of these rules.
>
> 3. In the event that the existing LLP is profitable from 2013 onwards and (when the profits are calculated under corporation tax rules) the LLP remains profitable after the allocations have been made to the individual partners, then the proposed planning should not serve to improve the group's corporation tax position. However, the proposed planning should not only provide a corporation tax benefit for 2012, it should provide security that if the results of the LLP are not strong in future years, then the loss restriction rules should not apply to prevent the UK corporate members from obtaining a benefit from the tax losses of the LLP."

39. A further revision of the implementation scheme was circulated by Mr Randall on 13 January 2012.

40. On 17 January 2012 Ms Webster sent an email to Mr Randall raising several matters, two of which are significant. First, she said that she favoured compliance with the recommended processes of consultation under TUPE; this would preferably involve a one-month consultation period commencing on 1 February 2012 with a view to a "go live" date of 1 March 2012. Second: "if we transfer everyone over to the new LLP but then only charge services back to Altus UK LLP, then HMRC may see this as a tax avoidance scheme and as such will seek to unravel it. Is there any way we can look to increase the substance of the new structure?"

41. On 20 January 2012 Mr Randall replied to Ms Webster, addressing in particular her concerns regarding a challenge by HMRC. His opinion was that, provided the payment to New LLP were at arm's length and made wholly and exclusively for the purposes of Existing LLP's trade, it was difficult to see on what basis HMRC could challenge the structure. Further, even if a successful challenge were made, it should not result in any worse position than if no restructuring were undertaken.

42. The final revision of the implementation scheme was produced by Mr Randall on 24 January 2012 and circulated on 25 January. It contained the same wording as the original presentation document of 20 December 2011 in respect of the need for further development of the New LLP Proposal prior to implementation.

43. On 2 February 2012 Mr Probyn informed the other individual members of the Existing LLP of the proposed restructuring, in advance of a proposed meeting to take place on 7 February.

44. On 3 February 2012 Altus UK 2 LLP ("the New LLP") was incorporated under the Limited Liability Partnerships Act 2000.

45. On 7 February 2012 the members of the Existing LLP met to discuss the proposed restructuring. It was decided to seek independent advice on behalf of the individual members from Beavis Morgan LLP.

46. On 17 February 2012 Ms Webster sent an email to Mr Howell, giving expression to her concern that "we are creating something very complex". As against potential tax savings, she set a number of considerations, including administrative time, professional costs, disruption and complexity, and the short-term nature of the remaining problem (amortisation would be completed by the end of September 2012). She also remained concerned regarding the possibility of a review by HMRC: "I know I have been reassured on this, however, I still don't believe we would be able to convince HMRC of any logical reason for this restructure other than tax avoidance."

47. Mr Howell's reply was to the point: "The restructuring is going ahead as there is far too much money at stake. Please proceed with the restructuring." However, the tenor of Mr Howell's evidence in cross-examination was that by this stage he was alive to the possibility that the proposed restructuring would not be worthwhile and, while keeping up the pressure on people within the Altus Group, he had "slowed things down" as regards the professional advisers. I shall have to consider that evidence in due course.

48. By a letter of 27 February 2012 a partner in Beavis Morgan advised the individual members of the Existing LLP of his views concerning the proposed restructuring. He observed that the purpose of what was proposed was the benefit of the Altus Group, not that of the individual members. Although the taxation effect on the individual members was likely to be neutral, it was not certain that this would be the case. It was therefore appropriate for them to seek a comprehensive indemnity from AGL.

49. On 1 March 2012, in an email to Ms Webster, Mr Howell said that AGL would provide "a limited indemnity". What that meant is unclear. However, on 6 March 2012 Mr Howell confirmed to Beavis Morgan: "Altus will provide the partners with an indemnity to cover off the issues as Altus does not want anyone to be worse off because of the transaction."

50. On 6 March 2012 Mr Howell and Mr Randall discussed the proposed restructuring by telephone. On 7 March Mr Randall sent to Mr Howell a lengthy email, which acknowledged that the restructuring would involve a great deal of administrative work, particularly if, as was being mooted, it were to be reversed at the end of the period of amortisation. That same day Claire Webster expressed to Mr Howell the view that the new proposal to close the New LLP at the end of the year was "impractical", not only because of the amount of work involved but because of the uncertainty that it would cause for both partners and staff. Mr Probyn expressed support for Ms Webster's views. Ms Webster sent to Mr Howell calculations showing the tax benefits of the restructuring on alternative financial outcomes for 2012.

51. On the afternoon of 7 March 2012 Mr Howell circulated an email: "The UK reorganisation will not be proceeding as it has now become far too complicated." In his witness statement, Mr Howell stated that the New LLP Proposal would have proceeded, despite the complications, had not the projected revenues for the Existing LLP for 2012 indicated that it would result in minimal financial benefit.

Issues

52. The claimant's case is that the defendants ought to have advised it as to the effect of sections 1263 and 1264 CTA 2009 (in general I shall hereafter refer only to section 1263) in January 2009, when Mr Corrin sent to Ms Lawr the Note mentioned in paragraph 21 above. The claimant contends that, if it had been properly advised at that time, it would within about four months have implemented a restructuring materially similar to the New LLP Proposal, and that there would have been a substantial chance that the restructuring would have been successful in mitigating the claimant's tax liabilities. It claims damages for the loss of that chance.

53. The defendants admit that they ought to have advised the claimant as to the effect of section 1263 in about mid July 2009, when they prepared the claimant's corporation tax computation for the six-month period to 30 June 2009. They deny, however, that they were under any duty to give that advice in January 2009. As for matters of causation and damage, the defendants contend: that the claimant would not have implemented the restructuring proposal as a result of timely advice; that, if it had done so, the restructuring would have taken approximately eight or nine months rather than four months to implement; that as a matter of law the restructuring would not have been effective to mitigate the claimant's tax liabilities and that therefore damages for the loss of the opportunity to mitigate those liabilities are irrecoverable in principle; and that, if on the contrary damages for lost opportunity are

recoverable in principle, they are either small or illusory because of the strong likelihood that HMRC would successfully have challenged the restructuring.

54. In those circumstances, the following matters potentially fall for consideration:

1) Whether the defendants were in breach of duty in failing to advise as to the effect of section 1263 in January 2009.

2) Whether, if correctly advised in 2009, the claimant would have implemented a restructuring akin to the New LLP Proposal and, if it would, how long implementation would have taken. (There is also a small question concerning the costs of implementation.)

3) What the prospects were of the restructuring being effective for tax purposes. I put the matter rather vaguely for the present, because of an important disagreement between the parties as to the correct approach in respect of the claimant's "loss of a chance".

4) Quantum of damages. It is agreed that, for the present, I should not make detailed findings on this issue.

Before I consider issues 1, 2 and 3, I shall discuss the question of the proper method of analysing the claim.

Is this properly a "loss of a chance" claim?

55. Where it is alleged that the breach of duty consists of an omission but the benefit to the claimant, had the breach not occurred, would have depended on the actions of a third party, the court will usually analyse the case in two stages. First, the claimant must prove on the balance of probabilities what he would have done if the breach of duty had not occurred. (This may be called the primary causation issue.) Second, if the claimant discharges the burden on the primary causation issue, the damages will be assessed on the basis of the value of the chance that the third party would have acted in such a way as to confer the benefit.

56. The classic statement of this approach is in the judgment of Stuart-Smith LJ in *Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 W.L.R. 1602, at 1609-11:

> "[W]here the plaintiffs' loss depends upon the actions of an independent third party, it is necessary to consider as a matter of law what it is necessary to establish as a matter of causation, and where causation ends and quantification of damage begins.
>
> (1) What has to be proved to establish a causal link between the negligence of the defendants and the loss sustained by the plaintiffs depends in the first instance on whether the negligence consists of some positive act or misfeasance, or an omission or non-feasance. In the former case, the question of causation is one of historical

> fact. The court has to determine on the balance of probability whether the defendant's act, for example the careless driving, caused the plaintiff's loss consisting of his broken leg. Once established on balance of probability, that fact is taken as true and the plaintiff recovers his damage in full. …
>
> (2) If the defendant's negligence consists of an omission … causation depends, not upon a question of historical fact, but on the answer to the hypothetical question, what would the plaintiff have done if the equipment had been provided or the instruction or advice given? This can only be a matter of inference to be determined from all the circumstances. …
>
> Although the question is a hypothetical one, it is well established that the plaintiff must prove on balance of probability that he would have taken action to obtain the benefit or avoid the risk. But again, if he does establish that, there is no discount because the balance is only just tipped in his favour. …
>
> (3) In many cases the plaintiff's loss depends on the hypothetical action of a third party, either in addition to action by the plaintiff, as in this case, or independently of it. In such a case, does the plaintiff have to prove on balance of probability, as Mr. Jackson submits, that the third party would have acted so as to confer the benefit or avoid the risk to the plaintiff, or can the plaintiff succeed provided he shows that he had a substantial chance rather than a speculative one, the evaluation of the substantial chance being a question of quantification of damages?
>
> Although there is not a great deal of authority, and none in the Court of Appeal, relating to solicitors failing to give advice which is directly in point, I have no doubt that Mr. Jackson's submission is wrong and the second alternative is correct."

57. On the basis of the approach in the *Allied Maples* case, Mr Yates for the claimant submits that the correct approach in the present case is as follows: first, the court must decide on the balance of probabilities whether the claimant would have implemented the New LLP Proposal; second, if the court finds that the claimant would have implemented it, it must assess the chance that the restructuring would have been successful in mitigating the amount of tax paid by the claimant—in other words, the chance that HMRC would not have made a successful challenge to the restructuring.

58. For the defendant, Mr Turner QC agrees that the first question, that of primary causation ("What would the claimant have done?"), is to be answered on the balance of probabilities. But he submits that, if that question is answered in favour of the claimant, the second question is whether the restructuring would have had the desired tax effect as a matter of law; that is, it is incorrect to assess the chances that HMRC might have chosen not to challenge it or that the Upper Tribunal might have rejected the legal challenges to it. This court must itself rule on the legal question of the efficacy of the New LLP Proposal.

If the proposal is held to be ineffective as a matter of law, no damages are recoverable, even if there might have been a significant chance of it succeeding in practical terms. In support of this submission Mr Turner relies on a number of arguments; the significant ones may be summarised as follows.

1) Unless the New LLP Proposal would have been technically effective in law, the failure to implement it can result in no loss recognisable in law. The assessment of the loss of a chance only arises once it has been established that there is a legally recognised loss; it is a method of quantifying that loss. If the New LLP Proposal would have been contrary to tax law, there is no loss to quantify.

2) A claimant seeking substantial damages must prove that its losses were within the scope of the duty that was breached: *South Australia Asset Management Corporation v York Montague Ltd ("SAAMCO")* [1997] A.C. 191, *per* Lord Hoffmann at 211. The taxpayer is under a duty to pay the tax that is lawfully due from it. The tax adviser can therefore be under no duty to facilitate the non-payment of tax that is lawfully due.

3) "[A]rtificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who not adopt such measures": *Pitt v Holt* [2013] 2 A.C. 108, *per* Lord Walker of Gestingthorpe at [135]. This and the taxpayer's duty to pay tax mean that it is contrary to public policy to permit a taxpayer to recover damages for loss of the opportunity to pay less tax than would have been properly payable.

4) Damages must be reasonable as between the claimant and the defendant: *Voaden v Champion (The "Baltic Surveyor" and "Timbuktu")* [2002] EWCA Civ 89, *per* Rix LJ at [88]. It would be unreasonable to make the defendants pay to the claimant damages to compensate it for paying tax that it was lawfully obliged to pay.

5) The same conclusion properly follows even if the matter is notionally dealt with under the "loss of a chance" principles. HMRC is under a statutory duty to collect tax that is due and payable and has no power to agree to accept less than is due: section 13, Inland Revenue Regulation Act 1890; section 5, Commissioners for Revenue and Customs Act 2005; *IRC v Nuttall* [1990] 1 W.L.R. 632, *per* Ralph Gibson LJ at 641. It is to be supposed that HMRC would have complied with its duties. And the court should be "far more ready to determine that the claimant would have failed or succeeded on a point of law than to determine that the claimant would have failed or succeeded on a point of fact": *Harrison v Bloom Camillin* [2001] PNLR 195, *per* Neuberger J at 230.

59. Powerfully though these arguments were made, I do not accept them. In my judgment, the correct approach at the second stage (that is, assuming the first question of primary causation has been answered in the claimant's favour) is, in the present case, to make a practical assessment of the chances that the New

LLP Proposal would in fact have resulted in a tax saving for the claimant. Only if a particular issue of fact or law is so clear that there was no substantial prospect of it being resolved other than in a particular way should the court depart from the "loss of a chance" approach.

60. Prima facie this case falls squarely within the scope of Stuart-Smith LJ's analysis in the *Allied Maples* case. If the claimant can prove that, but for the defendants' breach of duty, it would have implemented the New LLP Proposal, the benefit it would have gained from that scheme will depend on the prospects of it being successfully challenged. If the scheme had not been successfully challenged, the claimant would as a matter of fact have paid less tax. The resulting financial loss is no less real than, for example, the loss resulting from the loss of the opportunity to negotiate a more advantageous settlement of a dispute. In the latter case, the loss is not illusory merely because it might be said that the settlement actually achieved accurately reflected the strict legal merits of the dispute. I shall consider below whether there is something special about tax cases.

61. The fact that one of the contingencies on which the outcome was dependent was a judicial decision by the First-tier Tribunal or Upper Tribunal would not by itself preclude the "loss of a chance" approach. The usual principle is that, where the chance in question relates to the outcome of curial proceedings, it is inappropriate to try those proceedings as a trial within a trial: *Dixon v Clement Jones Solicitors* [2004] EWCA Civ 1005, [2005] PNLR 6, *per* Rix LJ at [27]. Of course, if the law on a point is clear, it will be inappropriate to proceed on the assumption that the court or tribunal would have got it wrong. But that does not mean that the court trying the professional negligence claim is bound to resolve disputed points of tax law.

62. The fact that the efficacy of the claimant's hypothetical conduct in achieving a benefit or avoiding a risk would have turned on a point of law does not by itself make the "loss of a chance" approach inappropriate, although in a suitable case the appropriate course might be to resolve the point of law. This appears from Neuberger J's discussion in *Harrison v Bloom Camillin* at 230-1, which may conveniently be set out at length:

> "… I should like to discuss how the court should deal with a pure question of law which might have arisen in the action. For instance, in a case such as the present, assuming that the claimants establish that, on the balance of probabilities, they would have maintained the action against Touche Ross, and that there was a real chance of recovering substantial damages from Touche Ross in the action, the question whether a certain head of damage would have been recoverable from Touche Ross may well turn on whether, as a matter of law (if all the relevant facts are clear) a certain head of damage would have been recoverable. Should the court assessing the damages for the loss of the chance resolve that issue of law or, provided that it is satisfied that there is a real argument both ways on the issue, should the court award something for loss of this particular head of damage, but, because

> there was a prospect of the head of damage failing in law, should a further discount be applied to that head of damage?
>
> In my judgment, the proper approach to the court to an issue of law which would have arisen in the action, which the claimant has been deprived of the opportunity to bring, is the same as in relation to an issue of fact or opinion which the claimant would have established in the action. However, at least in general, the court should in my judgment be far more ready to determine that the claimant would have failed or succeeded on a point of law than to determine that the claimant would have failed or succeeded on a point of fact or, even, opinion. That conclusion appears to me fair and practical, as well as consistent with the approach of the Court of Appeal in the three cases to which I have referred (albeit that they are not, as I have mentioned, determinative of this issue).
>
> …
>
> Because the issue did not arise, there is little assistance on this point in any of the cases to which I have referred. It is true that in *Mount*, the claim failed because the court formed the view that the claimant would have failed in his action as a matter of law, but, as I read the judgments, the court would have reached that conclusion on either approach (bearing in mind that, even if the court was considering the issue on the 'loss of a chance' basis, it was of the view that the claimant's prospects of success were so poor that, in the event, he did not lose anything of value).
>
> However, it is, I think, arguably implicit in the third and fourth numbered principles in the judgment of Simon Brown LJ in *Mount* that, at least in an appropriate case, it is right to assess damages on the 'loss of a chance' basis even where the issue in the action would be one of law. …"

This suggests that the correct approach will generally be to assess the chance of the scheme succeeding or failing upon a challenge, although there may be cases where it is appropriate to determine the legal point.

63. There are, I think, good reasons for eschewing Mr Turner's approach. First, in departing from normal principles, it would change the nature of the proceedings by importing into them the need for a "trial within a trial", namely the litigation of an HMRC challenge that was never brought. Second, it would result in that challenge being litigated, and disputed points of tax law being determined, without the involvement of HMRC. Third, it would involve the court making legal rulings on tax matters on a hypothetical basis; this is contrary to the way in which such rulings are generally made. It might be objected that the hypothetical facts are sufficiently clear for that to present no real problem. I would make three comments. First, although the objection may in the present case be correct, it is by no means certain that it is. One of the problems with proceeding on a hypothetical basis is that one is liable to be less than fully aware of the problems into which lack of firm grounding in

reality can lead. Second, in the present case, the legal agreements that would have been completed, such as the agreement for the transfer of staff and the provision of services, were never finalised. Assumptions as to what they would have said are a poor substitute for the agreements themselves. Third, whatever may be the case in the present claim, the obvious potential for difficulty more widely in making rulings on tax law on the basis of hypothetical facts tends to indicate that the entire approach urged by the defendants is flawed.

64. In considering the arguments for making a special case of claims involving tax, it is helpful to view the matter in context. First, there is no suggestion that the New LLP Proposal was a "try on", in the sense of a scheme believed to lack merit but proposed in the hope that it might fortuitously slip by the attention or challenge of lazy, incompetent or under-resourced commissioners of revenue. It was proposed in good faith and in the belief that its merits were sound or, at the least, properly arguable. Second, evidence was given by Ms Dyson, Mr Sayers and Mr Hall concerning the duties of an accountant or tax specialist who is engaged to prepare tax returns. The gist of that evidence is that such a professional would be expected to adopt any filing position that was properly arguable and was in the client's best interests, while at the same time making full disclosure of any matter that would be necessary for HMRC to understand and appraise the filing position. That seems to me to be a fair summary of the duties of such a professional for present purposes. An example of the performance of this duty is Mr Corrin's approach in early 2008, when he adopted a filing position that was known to be contrary to HMRC's stance but was believed to be properly arguable though uncertain of success; see paragraphs 18 and 19 above.

65. Mr Turner suggested in the course of argument that, although a professional might owe a duty to the client in respect of the filing position, no damages might be recoverable for breach of the duty on account of public policy. For my part, I have difficulty in seeing why public policy should countenance a duty to take a properly arguable filing position in the client's interests, with full disclosure to HMRC, while refusing to countenance damages for breach of that duty. No authority was cited in support of the public policy argument, and it was not clearly explained precisely what principle of public policy would deny substantive relief against a negligent professional adviser in circumstances where practical loss resulted from the negligence. Lord Walker's dictum in *Pitt v Holt* was made in a completely different context and does not seem to me to advance the case. As for the principle of reasonableness in awards of damages, Rix LJ's remarks in *Voaden v Champion* concerned the basis of assessment of damages for the destruction of an old item, in that case a pontoon. They had nothing to do with the issues in the present case.

66. In my judgment, the correct approach in this case, subject to primary causation being established, is to assess the chance of the New LLP Proposal being successful, in the sense of not being subject to a successful challenge. This involves consideration of the prospects of HMRC bringing a challenge in the first place (the assumption being that HMRC will act competently and

diligently) and an assessment of the prospects of any such challenge succeeding. Of course, my assessment of the merits of the New LLP Proposal will have a bearing on my assessment of the likelihood that HMRC would have challenged it. The assessment of the merits of the proposal will necessarily involve some weighing of the competing arguments for and against it, but it does not for that reason necessarily involve any purported determination of the legal issues. If a ground of challenge to the proposal would plainly have been misguided, it can be ignored. If a ground of challenge would plainly have been sound, the court may determine accordingly and the prospects of a benefit from the implementation will be illusory.

Breach of duty

67. It is common ground that, in performing their retainers by the claimant, the defendants were under a duty to exercise reasonable skill and care, both by reason of section 13 of the Supply of Goods and Services Act 1982 and at common law. Subject to one matter that I shall mention presently, it is also common ground that, in order to establish a breach of duty on the part of the defendants, the claimant must prove that no reasonably competent tax adviser would have performed its retainer as the defendants did.

68. The starting-point in considering breach of duty by a professional must be the terms of the professional's retainer. This was made clear, in the context of solicitors, by Oliver J in *Midland Bank Trust Co Ltd v Hett Stubbs & Kemp* [1979] Ch 384 at 402:

> "There is no such thing as a general retainer in that sense. The expression 'my solicitor' is as meaningless as the expression 'my tailor' or 'my bookmaker' in establishing any general duty apart from that arising out of the particular matter in which his services are retained. The extent of his duties depends upon the terms and limits of that retainer and any duty of care to be implied must be related to what he is instructed to do."

That dictum was approved as "wise words" by Lewison LJ in *Mehjoo v Harben Barker* [2014] EWCA Civ 358 at [69].

69. The undoubted general principle should, however, not be read in an unduly restrictive or artificial way. In *Credit Lyonnais v Russell Jones & Walker* [2002] EWHC 1310 (Ch), [2002] PNLR 2, Laddie J said at [28]:

> "A solicitor is not a general insurer against his client's legal problems. His duties are defined by the terms of the agreed retainer. This is the normal case although *White v. Jones* [1995] 2 AC 207 suggests that obligations may occasionally arise outside the terms of the retainer or where there is no retainer at all. Ignoring such exceptions, the solicitor only has to expend time and effort in what he has been engaged to do and for which the client has agreed to pay. He is under no general obligation to expend

> time and effort on issues outside the retainer. However if, in the course of doing that for which he is retained, he becomes aware of a risk or a potential risk to the client, it is his duty to inform the client. In doing that he is neither going beyond the scope of his instructions nor is he doing 'extra' work for which he is not to be paid. He is simply reporting back to the client on issues of concern which he learns of as a result of, and in the course of, carrying out his express instructions. In relation to this I was struck by the analogy drawn by Mr Seitler. If a dentist is asked to treat a patient's tooth and, on looking into the latter's mouth, he notices that an adjacent tooth is in need of treatment, it is his duty to warn the patient accordingly. So too, if in the course of carrying out instructions within his area of competence a lawyer notices or ought to notice a problem or risk for the client of which it is reasonable to assume the client may not be aware, the lawyer must warn him. …"

In my judgment, the same position should obtain in the case of other professionals, such as tax advisers.

70. It is necessary to consider only the position of the first defendant; the issue in respect of breach of duty relates to the period of the first defendant's retainer, and there is no material difference between the Letters of Engagement for the first and second defendants. By the terms of its Engagement Letter the first defendant purported to "set out the basis on which we have agreed to act as the company's tax agents and advisers". Under the heading "Corporation Tax Returns: our Responsibilities", the Engagement Letter stated:

> "We will prepare the company's corporation tax return, together with all supporting schedules and a computation of the company's tax liability. The first return which we will prepare following the signing of this letter will be the return for the chargeable accounting period ended 31 December 2007. We will also prepare any amended return that may be necessary for that period.
>
> ... We will advise you on the correct and complete disclosure to HMRC of the information supplied by you.
>
> ...
>
> We will prepare the company's corporation tax returns for succeeding chargeable accounting periods under the same conditions as are set out in this letter."

The section under the heading "General Tax Advice" read in part:

> "We will be glad to assist the company generally in tax matters, provided that you advise us in good time of any proposed transactions. Your attention is drawn to our Terms and Conditions of Business, in particular Clause 2 'Changes in Scope'. We would warn you that tax law changes frequently. If a transaction is

delayed or repeated, or an apparently similar transaction is undertaken, you should ask us to review any advice already given."

Clause 2 of the Terms and Conditions of Business provided, so far as material, as follows:

> "2.1 The scope of our work will be limited to the matters set out in the Engagement Letter. However, this does not preclude us from considering changes to the scope of our work as the assignment proceeds.
>
> 2.2 Should you require any additional services, we will be pleased to discuss any request with you. We would note, however, that we are under no obligation to provide such additional services."

71. In his report dated 18 July 2014, Mr Sayers accepted that the first defendant ought to have drawn the effect of section 1263 to the claimant's attention when it prepared the interim tax return for the six months ended 30 June 2009, because the interim return ought to have been completed under the new provisions of CTA 2009 and sufficient time had elapsed for the first defendant to have become aware of those provisions.

72. In her report dated 20 June 2014, Ms Dyson opined that advice on section 1263 ought to have been given when Mr Corrin sent his email of 21 January 2009 with its accompanying note ("the Note"): "This is not only because of the impact going forward, but also because these [prospective legislative changes and explanatory notes] may have been of relevance in assessing the risks associated with the tax positions taken prior to the rules changes, where those existing rules were unclear."

73. Ms Dyson found additional support for her opinion in two further matters. First, she considered that a large accountancy firm like the defendants should have been aware of the prospective changes promptly upon their publication. Second, the Note raised the possibility that the members of the Existing LLP might consider remedial planning if at a future date HMRC contested the loss allocation; attention should at the same time have been drawn to the possible need to consider such planning because of a prospective change in the law.

74. The Note, of which the most material part on the fourth page is set out at paragraph 21 above, needs to be considered in context. On 19 January 2009 the defendants sent by email draft tax computations for 2008 to Ms Webster and Ms Lawr among others. The covering email listed several points, to which the figures were said to be subject. Point number 3 was in respect of the risk that HMRC might seek an adjustment between the profitable and the loss-making members of the Existing LLP. On 20 January 2009 Ms Lawr raised some queries with the defendants, none of them relating directly to allocation of profits and losses. Mr Corrin's response promised a fuller note that same day. Ms Lawr responded: "Please discuss the period during which we can carry forward the losses. It is our expectation they should be available to shelter partnership income once the goodwill in Altus UK LLP is fully

amortized." Mr Corrin replied further on a specific and discrete point and said: "I will send a fuller note on the tax issues in advance of our call." What he produced on the following day was the Note.

75. It seems to me that, on a fair reading, the Note in general and the fourth page of the Note in particular were written with regard to the 2008 return, by way of explanation of the approach adopted and brief consideration of the potential implications of challenges to that approach. It did not purport to be in the nature of advice for 2009 and the years following but was by way of information to enable the claimant to assess the risks associated with its filing position.

76. In my judgment, if the defendants were or ought to have been aware of change 63 (the prospective section 1263), they were under a duty to bring it to the attention of the claimant, for two distinct but related reasons. First, it was material to the risks associated with the filing position for the 2008 return. Second, it undermined that filing position in respect of future returns.

77. As regards the 2008 return, Ms Dyson's evidence was to the effect that the risks associated with the filing position became "more apparent" by reason of the prospective changes to corporation tax in the Corporation Tax Bill. I have quoted from paragraph 2.7 of her report, which also reflected the tenor of her oral evidence. In the course of cross-examination, in response to questions both from Mr Yates and from me, Mr Sayers appeared to accept that the defendants should both have identified the forthcoming legislative changes and brought them to the claimant's attention.

> "JUDGE: So one way of looking at it is that the amendment in the 2008 Bill, enacted in 2009, was at least arguably just to put on a statutory footing the Revenue's position all along.
>
> A: Yes.
>
> JUDGE: So that it was material, because it actually weakened, or arguably weakened, the filing position that had been previously adopted. In other words, when you look at it, you say, 'Well we can't see any problem with this', and now you look at it you can at least say, 'Well, you know, there's an argument that sections 1263 and 1264 do actually bolster the Revenue's position. On the other hand, there's an argument that this is a straightforward change in the law. But it is relevant to the 2008 position.'
>
> A: I'd agree with that statement, yes.
>
> JUDGE: And if it is relevant, oughtn't it to have been identified?
>
> A: I think there's no doubt that Mr Corrin wishes that he had looked at the bill as it was going through Parliament.
>
> JUDGE: Yes, but that is not the question. If it was relevant to the 2008 filing position, ought it not to have been identified?

A: I would imagine it should have been identified yes, that's right. Ideally. Yes.

MR YATES: Just so I understand your position, let's assume … Steve Corrin had actually looked up the draft 2009 Act and identified the change in the law. … You're not saying, even there, that there was no obligation to tell the client, are you?

…

A: Assuming he knew, I think he would have put that point in this note that we have in front of us here, yes.

Q: Because he was obliged to?

A: Yes I think so. He would have been obliged to, because it would have been relevant. As we know, that particular provision put it on a more statutory footing, so the position was stronger—or sorry, weaker, going forward. But yes, the fact that it puts it on a statutory footing sort of gives some credence to what was previously in the Revenue manuals on the topic, I think."

78. For the defendants, Mr Turner submitted that the mere fact of relevance to the filing position was insufficient to give rise to a duty to advise the client, and that the presence of change 86 in the Bill was actually irrelevant to the risks of the filing position, because it did not purport to alter the law as it applied to 2008 and HMRC's position had previously been known from BIM 72245. In my judgment, that is to take too narrow a view. First, the allocation of profits and losses in the Existing LLP was known to all concerned to be a matter of considerable financial consequence to the claimant and to be a matter of some doubt; see paragraph 18 above. Second, although the Bill did not purport to change the law in respect of 2008, the presence of change 86 in a rewrite Bill (that is, one not intended to effect significant changes in the law at all) might reasonably be thought to lend weight to, or at least to indicate some support for, the view that HMRC had taken regarding the existing state of the law. Third, the tax treatment of the Existing LLP was still in its early days; this was the first full year for which a tax return had been made. It can hardly be right to suppose that experience showed that HMRC would not challenge the filing position. Fourth, both expert witnesses went beyond saying merely that the Bill was relevant; both expressed an opinion that change 86 ought to have been brought to the claimant's attention, and it is reasonable to understand that opinion as being that advice as to change 86 was to be expected of any competent tax adviser.

79. Accordingly, if in the course of dealing with the 2008 return the defendants became aware or ought to have become aware of change 86, it was in my judgment incumbent upon them to notify that change to the claimant, not only because of its relevance for 2008 but on account of its significance for future years: cf. *Credit Lyonnais v Russell Jones & Walker,* above.

80. The remaining question is whether, although the defendants had not become aware of the impending legislative changes, they ought to have become aware of them. In my judgment, they ought.

81. The Corporation Tax Bill did not come, so to speak, out of the blue. It was part of a rewrite project, in which income tax had been dealt with ahead of corporation tax. Mr Sayers accepted in cross-examination that it was logical to assume that the treatment of allocation of profits and losses in ITTOIA would be reflected in corresponding provisions in the rewrite of corporation tax legislation. Indeed, the matter goes further. What became sections 1263 and 1264 was already included as change 58 and clauses 251 and 252 in the draft Bill published in Consultation Paper CC/SC(06)07 in June 2006. The Explanatory Notes to change 58 stated: "This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with current practice." The same provisions and the same comment in the Explanatory Notes were carried forward into the draft Bill published in February 2008 or in the final Bill that became CTA 2009. It is not necessary to suppose the defendants to be under some strict or onerous duty to engage in what has been called horizon-scanning for future legislation. It suffices that, in considering the filing position for 2008, they ought, as Mr Sayers accepted, to have considered the relevance of the Corporation Tax Bill and brought change 86 to the attention of their client. Even if the defendants came to the view that nothing in the Bill affected the risks of the filing position regarding 2008, change 86 so manifestly affected the position regarding future years that it ought to have been brought to the claimant's attention.

82. In reaching this conclusion, it is not, I think, necessary to rely on the distinction between what may be termed an ordinary accountant and a large firm of tax and accountancy specialists such as the defendants. However, in agreement with Mr Yates and disagreement with Mr Turner, I consider that there is a distinction and that the case is a fortiori for firms that put themselves forward as providing a top-level specialist service. *Jackson & Powell on Professional Liability* (7th edition) states at paragraph 2-130 (footnotes omitted):

> "It is suggested that the correct approach (and that which is in practice adopted) is to judge the defendant by reference to the standard of skill and care appropriate to members of his profession, who have the same status or formal position as the defendant. Where the defendant holds himself out as a specialist in a particular field, he should be judged by the standards appropriate to a specialist in that field, even if there is no formal recognition of his specialisation."

In *Herrmann v Withers LLP* [2012] EWHC 1492 (Ch), [2012] PNLR 28, Newey J said at [67]:

> "It is common ground that, in considering whether Withers were negligent, I should have regard to the fact that they are a City of London firm and pride themselves on offering an excellent service

> to their clients. In *Hicks v Russell Jones & Walker* [2007] EWHC 940 (Ch), Henderson J said (at paragraph 138(3)) that it would be 'absurd' to judge the firm with which he was concerned, which had 'experience in the fields of commercial litigation and insolvency, including the conduct of complex appeals', by the same standard as a small country firm. Withers accepted that it would be similarly inappropriate to judge them by the same standard as a small country firm."

Although it is true that the point was not argued in *Herrmann v Withers LLP*, the approach taken in that case and in *Hicks v Russell Jones & Walker* seems to me to be eminently sensible. The defendants are and hold themselves out as being a top-end and very large firm of specialist advisers. It is that standing that brings clients to them and those with whom they are in competition. They are reasonably to be judged by the standards appropriate to that standing. The defendants are reasonably to be expected to have much greater technical resources than an "ordinary" firm of accountants and as a result to be aware of relevant impending changes to tax legislation.

<u>Primary causation: what would the claimant have done?</u>

83. The essence of the claimant's case on primary causation appears from paragraph 28 of the amended particulars of claim.

> "As a result of the defendants' breaches … the claimant lost the opportunity of restructuring its affairs to preserve its existing tax position. … Had the claimant had the opportunity of restructuring its affairs, it would have done so along the lines of the New LLP Proposal with effect from 1 January 2010 at the latest … This would have been possible to implement within 4 months of being notified of the change introduced by CTA 2009 s. 1263."

The claimant bears the burden of proving on the balance of probabilities that, if the defendants had performed their duty, it would have implemented the New LLP Proposal.

84. I have little difficulty in finding as a fact that, if the claimant had instructed EY in 2009, it would have implemented the New LLP Proposal. I reach this conclusion for a number of reasons.

1) The claimant would certainly have looked to preserve its existing tax position. The financial consequences of the effect of section 1263 were significant and the claimant would have sought to address them.

2) The two people, Lawrence Hall and James Randall, who devised and developed the New LLP Proposal in 2011-12 were at EY in 2009. Mr Hall's oral evidence was to the effect that EY's approach to the problem and its advice regarding the restructuring would have been the same in 2009 as it was in 2011. No real effort was made on the part of

the defendants to gainsay that evidence, which was inherently plausible.

3) The factors that led Mr Howell to decide not to proceed with the New LLP Proposal in 2012, namely the short period of benefit of no more than about six months and the effect of the claimant's financial projections for 2012, were not present in 2009. If the claimant had believed that the New LLP Proposal could be implemented and would have a good chance of success, it would have proceeded. It would have received positive advice in both of those regards from EY.

4) I find that the individual members of the Existing LLP would not have stood in the way of the restructuring. When the matter was raised with them in early February 2011, at least two members expressed a degree of disquiet and scepticism regarding the proposal. I see no reason to suppose that those members' scepticism concerning the motivation for the restructuring would not have been dispelled by explanation of the reasons that had led to it.

5) However, I accept Mr Turner's submission that the individual members would have required assurances that the restructuring would not be adverse to their own interests. This would have required in particular the provision by AGL of a satisfactory indemnity, in order to ensure that the individual members' personal taxation positions were no worse as a result of the restructuring. In 2012 Mr Howell recognised the need for an indemnity and was willing to provide one. It is inherently probable that the claimant would have been equally willing to provide an indemnity as the price of restructuring in 2009. Because the Existing LLP but not the New LLP would be "client-facing"—clients would not be aware of the restructured way in which services were being provided—it would also have been necessary for the New LLP Proposal to be implemented in a manner that would protect the New LLP's position as the exclusive supplier of services to the business of the Existing LLP. Because the relevant agreements were never completed in 2012 and drafts have not been disclosed, I do not know what provision was being made in this regard. However, I do not consider it in the least likely that difficulty would have been encountered in drafting satisfactory agreements.

6) I should note that both the claimant and the defendant approached the question of the stance of the individual partners as being part of the wider question of what the claimant would have done in 2009, to be decided on the balance of probabilities. I adopt that shared approach, although it might be arguable that the acceptance or otherwise of the restructuring proposal by the individual members falls to be considered in terms of the loss of a chance. At all events, I do not think that there would have been a serious risk that the individual members would scupper the restructuring proposal.

85. However, the significant question is whether the claimant would have instructed EY at all in 2009. If it cannot show that it would have done so, the

entire response to the introduction of section 1263 of CTA 2009 becomes speculative.

86. The Chief Financial Officer in 2009 was Dale Lawr. She held that post until May 2010, when she became an Executive Vice-President of the Altus Group. Mr Howell commenced employment at AGL on 1 June 2009. At some date prior to Mr Howell's arrival at AGL, Ms Lawr had made an arrangement with PricewaterhouseCoopers (PwC) to provide UK tax advice for the Altus Group as and when required. Her reason for choosing PwC, as expressed to Mr Howell, was that it was "a great firm".

87. Mr Howell, who had begun his career at Coopers & Lybrand, was happy to work with PwC. His evidence was that he used PwC to provide UK tax advice until about mid 2010, when a matter arose with respect to the tax return that Mr Corrin was preparing and the defendant carried out the necessary additional work. From then on, he stopped using PwC because he was very happy with the service he was getting from Mr Corrin at the defendants. In response to questions from Mr Turner, Mr Howell acknowledged that in 2009 he would probably have sought advice on any major UK tax matter from PwC, while keeping the defendants informed as to what was happening. However, when it was put to him that, if the issue regarding allocation of profits and losses had arisen in 2009, he would have sought advice from PwC, he replied that he would have gone directly to EY, because it had done the original tax planning in connection with the takeover of Edwin Hill. Mr Howell accepted that the existing tax planning was not particularly complicated and that the issue regarding section 1263 was one on which any major tax firm could have advised. However, he said that it would have been prudent to go to the people who were already familiar with the existing plan and the corporate structure: "We also had a relationship with Ernst & Young with respect to international tax planning, with respect to the Edwin Hill purchase, and it didn't make any sense whatsoever to go to any firm other than Ernst & Young with respect to the plan they'd already put in place." This was also the tenor of Mr Howell's evidence-in-chief.

88. I regret to say that I am far from persuaded, on the balance of probabilities, that the claimant would have consulted EY in 2009.

89. Mr Howell cannot speak directly regarding the decision that the claimant would have taken in 2009. He accepted that the relevant decision-maker would have been Ms Lawr. That is so both before and after 1 June, when Mr Howell began working at AGL. And of course Mr Howell did not start working for the claimant until several months after what I have found to be the date of the breach of duty, which is when the relevant decision would have been taken. Mr Howell's evidence as to what would have happened in 2009 represents an opinion as to what others would have done. Purely as opinion, that evidence seems to me to be inadmissible as well as speculative. I accept that under the form of opinion evidence there may lie the substance of fact, for example regarding the typical behaviour of a third person. The reasons for the opinion may also be material matters on which the court can rely. However, there is also the risk that evidence as to what would have happened in hypothetical circumstances is coloured, unconsciously, by the perceived

advantage of the party on whose behalf it is given. Although a largely satisfactory, and in my judgment honest, witness, Mr Howell did show clear signs of being a witness "with an agenda" (cf. *Lexi Holdings v Luqman* [2008] EWHC 1639 (Ch) at [141]). This was apparent in Mr Howell's reluctance to accept the characterisation of the New LLP Proposal as a means of getting around section 1263, although that is clearly what it was. More importantly, towards the end of his cross-examination, in connection with the issue of the length of time that it would have taken to implement the proposal, Mr Howell suggested for the first time that in the period leading up to his decision not to proceed with the proposal he had "slowed things down somewhat on the legal side", that is, with regard to the finalising of the necessary legal agreements by the professional advisers. The true position, in my judgment, was no more than that there was at that stage no active pressing of the professional advisers to produce documents because there was not perceived to be a need for such pressing. There was, as Mr Howell accepted in answer to further question, no instruction to the professionals to ease off. Indeed, such instruction or any action that tended to slow down the completion of the legal work would have been irrational. In the course of this entire passage of cross-examination Mr Howell appeared to me to be succumbing to the temptation to gloss the truth in a manner that appeared most advantageous to his company's interests.

90. As regards what Ms Lawr would have done in 2009, the probabilities seem to me to be against her instructing EY. If in 2009 the defendants had advised as they ought to have done, Ms Lawr would have sought an opinion from a different adviser, because she considered it inappropriate to take general taxation advice from the defendants when entities connected to them were the auditors of both UK and Canadian members of the Altus Group. Ms Lawr had a high regard for PwC. She either had recently appointed them or was shortly to appoint them as the Altus Group's advisers on matters of UK tax. The obvious and logical course was to instruct PwC to advise in respect of section 1263. The reasons proposed by Mr Howell and generally on behalf of the claimant for taking a different course are unpersuasive. The background to the matter was not complicated and did not require specialist knowledge. The issue itself concerned only the application of section 1263 to the LLP Agreement dated 1 October 2010 and the filing position for 2007-8 that had been agreed between Ms Lawr and the defendants. Although advice could have been sought from EY on this matter, the suggested reasons why it would have been sought from them are weak; it is more probable that Ms Lawr would have decided to consult PwC. No conclusion to the contrary can be reached from what happened in 2011-12: PwC were no longer advising the Altus Group on UK tax matters, having apparently been dropped by Mr Howell at around the time that Ms Lawr moved to her new position (Mr Howell agreed when it was put to him that PwC were by then "out of favour", though I do not think that he meant to indicate that there had been any positive falling out), and the Altus Group was usually taking general UK tax advice from the defendants.

91. I should remark that I do not consider it necessary to rely on any adverse inferences to be drawn from the lack of evidence from Ms Lawr pursuant to the principles set out by Brooke LJ in *Wisniewski v Central Manchester*

Health Authority [1998] PIQR P324 at P340. The principles do not require inferences to be drawn; what if any inferences are appropriate is a matter of fact in each case. This is not a case in which I feel driven to the conclusion that the failure to call Ms Lawr is due to the unhelpful nature of any evidence she might have given. It is at least equally likely that it was the result of the significance attached to the "dry-run" of the New LLP Proposal in 2011-12 and Mr Howell's part in it. It suffices to say that the evidence that was adduced at trial has not persuaded me that the claimant would have consulted EY in 2009.

92. There is no evidence as to what advice PwC would have given if it had been consulted in 2009. It may have given advice along the lines of the New LLP Proposal, but it may not have done. On the balance of probabilities I find that it would not have done. My reasons for that conclusion are:

1) There is no evidence that anyone, whether at EY or PwC or elsewhere, had then or has since implemented such a proposal, that is, the use of a second LLP for the purpose of making a previously profitable LLP unprofitable. Mr Lawrence Hall, one of the devisers of the New LLP Proposal, gave evidence that he has not had experience of the use of such a scheme, although he had experience of the use of a dual LLP structure. The use of such a scheme (I use the word in a non-technical and non-pejorative sense) could not before 2009 have been directed towards circumvention of section 1263. However, it does not appear that it could not have been used as a means of addressing HMRC's existing stance as set out in BIM 72245. The lack of any known instance of its use is therefore not without some relevance.

2) The claimant's tax structuring expert, Mr Kundu, was a tax director at PwC from 2006 to 2008 and a Corporate Tax partner at PwC from 2008 to 2012, yet he had never encountered a scheme such as the New LLP Proposal or even, apparently, a dual LLP structure. (In fact, in acting as an expert in these proceedings, Mr Kundu came up with quite a different proposal for avoiding the effect of section 1263. The fact that he came up with that alternative proposal—which has not been pursued and is accepted not to be effective—does not necessarily mean that he or others at PwC would not have recommended the New LLP Proposal in 2009; it is however suggestive.)

3) Of course, lack of prior experience of such a scheme does not mean that one cannot devise it; Mr Hall is an example to the contrary. However, there is nothing obvious or axiomatic about advice such as the New LLP Proposal and no particular reason to suppose that it would be devised on this particular occasion in the face of section 1263 when it had not previously been devised.

93. I ought at this point to remark that the parties' approach throughout the case and until closing submissions was that the advice that would have been received from the tax specialist was relevant at the stage of primary causation; that is, it fell to be considered when making a finding on the balance of probabilities as to what the claimant would have done if properly advised by

the defendants. In answer to a (probably unhelpful) question by me in closing, Mr Yates submitted that the advice from the tax specialist fell to be considered in terms of loss of a chance. That would lead to a complicated analysis: on the balance of probabilities the claimant would have sought advice; there was such-and-such a chance of the advice being for the New LLP Proposal; on the balance of probabilities the claimant would have acted on such advice, if received; and there was such-and-such a chance of the proposal being efficacious. (Where multiple advisers in different disciplines would be involved, there would be further ramifications.) I accept Mr Turner's submission that such an analysis is inappropriate and that the parties' former common approach was correct. When Stuart-Smith LJ said in *Allied Maples Group Ltd v Simmons & Simmons* that the claimant must prove on the balance of probability "that he would have taken action to obtain the benefit or avoid the risk", he must be understood to have been referring to substantive rather than antecedent steps. In the context of this case, the "action to obtain the benefit" would be the implementation of the scheme, not the consulting of a tax adviser.

94. Accordingly the findings of fact that I have set out above must result in the failure of the claim.

95. Although they do not arise for decision in the circumstances, I shall state shortly my views on the two remaining issues at the stage of primary causation, namely (1) the time that it would have taken to implement the scheme and (2) a short question regarding the cost of implementation.

96. If the claimant had surmounted the initial hurdle of discharging the burden of proof on primary causation, the question of the timescale for the implementation of the New LLP Proposal would have been relevant to the further question whether the claimant would have had the advantage of the restructuring in time for the commencement of the new accounting period on 1 January 2010. My finding that the defendants were in breach of duty as early as January 2009 means that, even on the defendants' case, implementation would have taken place before the end of 2009. In the circumstances, I shall discuss this issue relatively shortly.

1) The claimant's case was that implementation would have taken no more than four or five months; even if the effect of section 1263 would not have been known until July 2009, implementation would have been complete before the end of the year. The defendants' case was that implementation would have taken eight or nine months.

2) A starting-point is the chronology set out in detail above. The effect of section 1263 was brought to the claimant's attention on 14 November 2011. The rudiments of the New LLP Proposal had been thought out by 29 November 2011. The Proposal itself was presented to the claimant on 20 December 2011, when 1 February 2012 was proposed as a target date for implementation. That date seems to me to have been unrealistic from the start; see, for example, the observations made by Ms Webster on 17 January 2012, when she envisaged a date of 1 March 2012. Mr Hall's oral evidence was that at the end of January he

and Mr Randall were of the view that a realistic implementation date was 1 April 2010, that is, two months ahead; little work remained to be done in respect of transfer pricing (there would not have been a benchmarking study), the work on IR35 had been substantially completed, no opinion from tax counsel was envisaged, and in view of EY's assessment of the merits of the New LLP Proposal formal advice could be deferred until implementation. The Proposal was abandoned on 7 March 2012, nearly four months after the defendants had notified the claimant of the problem. The drafting of the formal legal agreements had not been concluded by that date. More importantly, perhaps, the TUPE consultation necessary for the transfer of staff had not been commenced.

3) An assessment of the likely timescale involves both guesswork as to how future steps would have progressed and an element of speculation as to how far matters had already progressed, because the documentation relating to drafting of the legal agreements has not been disclosed. The most important matters left to be resolved were, first, the completion of the drafting, second, the approval of the drafting and of the Proposal by the individual members, who would have to take their own advice on the concluded documentation, and, third, the TUPE process in respect of staff. The evidence of what actually happened between November 2011 and March 2012 provides an illustration of the difficulties that can attend ambitious timetables. I must try to be realistic, rather than to identify the shortest possible period within which work could have been done. Keeping for convenience to the dates in the "dry run" in 2012, a period of six weeks from 7 March 2012 would seem reasonable for concluding the drafting and approval of the legal documents. Although the individual members would probably have been persuaded of the merits of the New LLP Proposal, they would certainly not merely have rubber-stamped them; at least a couple of them would have been likely to insist on careful consideration of the Proposal and of advice on it before they would have agreed to it. After the individual members had approved the restructuring, the TUPE procedure would have had to be followed for staff. A period of six weeks seems to be reasonable to allow for that procedure to be carried out and for implementation thereafter. This would take the date for implementation to 30 May 2012. That gives a total period of twenty-eight weeks for the implementation period. It is reasonable to reduce that to twenty-seven weeks, because the "dry-run" took place over Christmas and the New Year.

97. Finally, there is a single issue before me regarding the costs of implementation, namely whether an opinion would have been obtained from a tax silk. Mr Hall's evidence was that he had no plans to obtain such an opinion. There is no evidence that such an opinion would have been obtained in 2012 and I see no reason to suppose that it would have been obtained in 2009.

The chance of the New LLP Proposal being effective

98. The discussion of "loss of a chance" is relevant only if my rejection of the claimant's case on primary causation is wrong.

99. Logically, the question of the prospects of HMRC bringing any challenge at all is prior to the question of the prospects of any such challenging succeeding. However, in practical terms, in the absence of direct evidence from HMRC it is impossible to address the former question without having regard to the latter question. Accordingly I shall consider in turn each of the technical objections that the defendants make against the New LLP Proposal. Those objections may be considered under the following four headings:
    1) The *Ramsay* principle as applied to sections 1263 and 54, CTA 2009
    2) The *Heastie v Veitch & Co* argument
    3) Transfer pricing
    4) IR35.

(1) The Ramsay *principle*

100. The argument under this heading is simply that, if section 1263 and section 54 of CTA 2009 are construed purposively in accordance with ordinary principles of statutory construction, each of those sections has the effect that the New LLP Proposal is ineffective for the purpose of preserving the fiscal advantages of the claimant's previous filing position.

101. The *Ramsay* principle takes its name from the decision of the House of Lords in *W.T. Ramsay Ltd v Inland Revenue Commissioners* [1982] A.C. 300 and was authoritatively restated by the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson* ("*BMBF*") [2005] 1 A.C. 684. In *BMBF* Lord Nicholls of Birkenhead, giving the opinion of the judicial committee, pointed out that, so far from creating a new principle of tax law, the *Ramsay* case had simply applied to tax legislation the modern approach to statutory construction, namely "to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose." He referred to a number of cases in which the *Ramsay* principle had been applied with the effect that elements inserted into transactions without any commercial purpose had been treated as having no significance, and at [36] he continued:

> "Cases such as these gave rise to a view that, in the application of *any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far. It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, to decide whether the transaction in question does so. As Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, para 35:

> 'the driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.'"

102. I was also referred to the detailed and helpful statement of the ramifications of the *Ramsay* principle in the judgment of Lewison J in *Berry v The Commissioners for Her Majesty's Revenue and Customs* [2011] UKUT 81 (TCC), [2011] S.T.C. 1057, at [31]. (In the interests of at least some brevity, I omit the citations of authority from the quotation.)

> "(i) The *Ramsay* principle is a general principle of statutory construction.
>
> (ii) The principle is twofold; and it applies to the interpretation of any statutory provision: (a) To decide on a purposive construction exactly what transaction will answer to the statutory description; and (b) To decide whether the transaction in question does so.
>
> (iii) It does not matter in which order these two steps are taken; and it may be that the whole process is an iterative process.
>
> (iv) Although the interpreter should assume that a statutory provision has some purpose, the purpose must be found in the words of the statute itself. The court must not infer a purpose without a proper foundation for doing so.
>
> (v) In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole.
>
> (vi) However, the more comprehensively Parliament sets out the scope of a statutory provision or description, the less room there will be for an appeal to a purpose which is not the literal meaning of the words. As Lord Hoffmann put it in an article on *Tax Avoidance*: "It is one thing to give a statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there".
>
> (vii) In looking at particular words that Parliament uses what the interpreter is looking for is the relevant fiscal concept.
>
> (viii) Although one cannot classify all concepts a priori as 'commercial' or 'legal', it is not an unreasonable generalisation to say that if Parliament refers to some commercial concept such as a gain or loss it is likely to mean a real gain or a real loss rather than

one that is illusory in the sense of not changing the overall economic position of the parties to a transaction.

(ix) A provision granting relief from tax is generally (though not universally) to be taken to refer to transactions undertaken for a commercial purpose and not solely for the purpose of complying with the statutory requirements of tax relief. However, even if a transaction is carried out in order to avoid tax it may still be one that answers the statutory description. In other words, tax avoidance schemes sometimes work.

(x) In approaching the factual question whether the transaction in question answers the statutory description the facts must be viewed realistically.

(xi) A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually.

(xii) A series of transactions may be viewed as a composite transaction where the series of transactions is expected to be carried through as a whole, either because there is an obligation to do so, or because there is an expectation that they will be carried through as a whole and no likelihood in practice that they will not.

(xiii) In considering the facts the fact finding tribunal should not be distracted by any peripheral steps inserted by the actors that are in fact irrelevant to the way in which the scheme was intended to operate.

(xiv) In considering whether there is no practical likelihood that the whole series of transactions will be carried out, it is legitimate to ignore commercially irrelevant contingencies and to consider it without regard to the possibility that, contrary to the intention and expectation of the parties it might not work as planned. Even if the contingency is a real commercial possibility it may be disregarded if the parties proceeded on the basis that it should be disregarded."

(1)(a) Section 1263, CTA 2009

103. Having previously summarised the effect of sections 1263 and 1264, I shall set out section 1263(1) and section 1264(2) together with the relevant parts of sections 1259 and 1262, with which they must be read.

"1259 *Calculation of firm's profits and losses*

(1) This section applies if a firm carries on a trade and any partner in the firm ('the partner') is a company within the charge to corporation tax.

(2) For any accounting period of the firm, the amount of the profits of the trade ('the amount of the firm's profits') is taken to be the amount determined, in relation to the partner, in accordance with subsection (3) …

(3) If the partner is UK resident—
(a) determine what would be the amount of the profits of the trade chargeable to corporation tax for that period if a UK resident company carried on the trade, and
(b) take that to be the amount of the firm's profits.
…

(5) The amount of any losses of the trade for an accounting period of the firm is calculated, in relation to the partner, in the same way as the amount of any profits.

…"

"1262 *Allocation of firm's profits or losses between partners*

(1) For any accounting period of a firm a partner's share of a profit or loss of a trade carried on by the firm is determined for corporation tax purposes in accordance with the firm's profit-sharing arrangements during that period.

This is subject to sections 1263 and 1264."

"1263 *Profit-making period in which some partners have losses*

(1) For any accounting period of a firm, if—
(a) the calculation under section 1259 in relation to a partner ('company A') produces a profit, and
(b) company A's share determined under section 1262 is a loss,
company A's share of the profit of the trade is neither a profit nor a loss."

"1264 *Loss-making period in which some partners have profits*

(2) For any accounting period of a firm, if—
(a) the calculation under section 1259 in relation to company A produces a loss,
(b) company A's share determined under section 1262 is a loss, and
(c) the comparable amount for at least one other partner is a profit,
company A's share of the loss of the trade is the amount produced by the formula in subsection (3)."

104. It is convenient to focus on section 1263(1), which would have had potential application in 2010 and 2012. Section 1264(2) would have had potential application for 2011. The essential principles are the same for both provisions.

105. For the defendants Ms Nathan submitted that the New LLP Proposal would not successfully have circumvented section 1263 properly construed. Her argument may be summarised as follows.

1) The relevant fiscal concepts (point (vii) in *Berry*, above) are "profit" and "loss".

2) The purpose of section 1263 is to prevent manipulation of the profits of a profit-making partnership so as to allocate a loss to a corporate member. This is plain both from the text of the provision itself and from the commentary in the Explanatory Notes (including Annex 1) to CTA 2009. Section 1263 cannot be regarded as a mechanical provision that has no purpose distinct from its machinery.

3) The New LLP Proposal seeks to circumvent section 1263 by creating a loss in the Existing LLP, that is, by means of the payment of fees to the New LLP. However, this loss is not a real loss but is "illusory in the sense of not changing the overall economic position of the parties" to the transaction (point (viii) in *Berry*).

4) In particular, if the facts are viewed realistically and if the restructuring and the consequent payments from the Existing LLP to the New LLP are viewed together as part of one composite transaction, it is clear that the transaction has no commercial purpose but exists solely for the purpose of complying with the statutory requirements of tax relief (points (ix) to (xi) in *Berry*). The Existing LLP is being converted from a profit-making to a loss-making entity for no reason other than tax avoidance. The New LLP has no independent existence and serves no interests other than those of the members of the Existing LLP but is being created solely as a vehicle to achieve a loss for the Existing LLP. The New LLP would provide services only to the Existing LLP, and the latter would continue to be the only entity of which clients would be aware.

106. The contrary submission by Mr Yates for the claimant was, put shortly, that the defendants' objection was misconceived because the situation created by the implementation of the New LLP Proposal would not engage section 1263 at all. The argument in support of that submission may be summarised as follows.

1) The statutory provisions create a three-stage procedure. First, one calculates the profits and the losses under section 1259. Second, one allocates the profits and losses in accordance with the profit-sharing arrangements under section 1262. Third, if the result of the first two stages is to give the corporate member (here the claimant) a loss under

section 1262 although it would have had a profit under section 1259, there must be the adjustment required by section 1263(1).

2) However, the restructuring envisaged by the New LLP Proposal does not create the result to which section 1263(1) (or, for that matter, section 1264(2)) applies. Instead of artificially allocating profits and losses as envisaged by sections 1262-4, it achieves the desired result by creating deductible expenses so as to affect the profit and loss calculation at the first stage, namely under section 1259.

3) In principle, the New LLP Proposal might still be open to objection; in particular, the payments from the Existing LLP might be open to attack under section 54, CTA 2009, or on a challenge pursuant to *Heastie v Veitch & Co* principles (these grounds of objection are discussed below). But that is a different matter. "The legislation is predicated on the fact that the profit-sharing arrangements may give rise to an allocation which is 'artificial', and the legislation then seeks to correct this. However, section 1263 is concerned with a situation where the profit or loss of the LLP's trade has already been determined under section 1259. It follows that if the result produced by section 1259 (and then allocated [by] section 1262) means that one falls within sections 1263 or 1264, that is that. There is simply no basis to suggest that the trading profit of the LLP must be altered to ensure that one does fall within section 1263" (Mr Yates' closing written submissions).

4) Further, the argument has no application to 2011, where the Existing LLP was loss-making for the purposes of section 54, CTA 2009.

107. In the course of argument on this point I was referred to several authorities, among which were *Berry v HMRC* [2011] STC 1057, *Mayes v HMRC* [2011] STC 1269, *Astall v HMRC* [2010] STC 137, *Drummond v HMRC* [2009] STC 2206, and *Chappell v HMRC* [2014] UKUT 0344 (TCC). Having considered those cases, I do not feel it necessary to make further reference to them. As Ms Nathan observed, the relevant principles of statutory construction are well-known; and the application of those principles "must always depend on the text of the taxing statute in question": *Commissioners for Her Majesty's Revenue & Customs v Tower MCashback LLP1* [2011] UKSC 19, [2011] 2 A.C. 457, *per* Lord Walker at [43].

108. In my judgment, the defendants' argument from purposive construction of sections 1263 and 1264 is plainly misconceived, for essentially the reasons stated by Mr Yates.

109. The defendants' argument starts from the correct premiss that the New LLP Proposal was designed to avoid the effects of the introduction of sections 1263 and 1264. But that premiss only raises but does not answer the relevant question, which is whether "[those] provisions, construed purposively, were intended to apply to the transaction, viewed realistically" (*per* Ribeiro PJ, *supra*).

110. It is quite impossible, on any recognised canon of construction, to construe sections 1263 and 1264 in such a way that they are engaged by the New LLP Proposal. Consider section 1263(1). It applies if the calculation under section 1259 produces a profit for the claimant but the profit-sharing calculation under section 1262 produces a loss for the claimant. But that simply is not this case. The defendants' real complaint is that artificial losses have been manufactured in the Existing LLP. However, that complaint does not ground an argument based on the correct construction of section 1263. If the losses are not true losses, they must be attacked at the stage of performing the calculation under section 1259—most obviously, by disallowing the payments to the New LLP as a deductible expense. In that event, the adjustment under section 1263 will not arise; the specious loss will have been exposed at the earlier stage of section 1259. On the other hand, if the payments are deductible expenses for the purpose of the calculation in section 1259, that is an end of the matter. They do not cease to be deductible expenses because, if they had not been deductible, the claimant would either have been left with taxable profits or have been lumbered with the effect of section 1263.

111. It would accordingly be wrong to make any deduction or discount in respect of the chance that a challenge based on the true construction of section 1263 would have vitiated the New LLP Proposal.

(1)(b) Section 54, CTA 2009

112. The second limb of the defendants' *Ramsay* challenge seems to me to focus on the true gravamen of their case, namely that the creation of losses in the Existing LLP by the device of making payments to the New LLP for the performance of services integral to the Existing LLP's business is impermissible. Although in my view it falls within the scope of the issues already raised in the proceedings, this second *Ramsay* challenge was expressly formulated for the first time in the skeleton argument produced by Mr Turner and Ms Nathan shortly before trial.

113. Section 54, CTA 2009, provides as follows:

> "(1) In calculating the profits of a trade, no deduction is allowed for—
>
> (a) expenses not incurred wholly and exclusively for the purposes of the trade, or
> (b) losses not connected with or arising out of the trade.
>
> (2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade."

114. The defendants' argument may be summarised as follows.

1) The purpose of section 54 is clear on its face, namely to permit deductions only for expenditure that is incurred wholly and exclusively for the purposes of the trade, not for expenditure that is incurred for other purposes or for mixed purposes.

2) The guiding principles of the "wholly and exclusively" test are those set out by Millett LJ in *Vodafone Cellular Ltd v Shaw* [1997] STC 734, 742:

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

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

3) A realistic view of the facts (*Berry,* principle (x)) demands that the payments from the Existing LLP to the New LLP must not be viewed in isolation but rather as part and parcel of the restructuring as a whole, involving the setting up of the New LLP, the transfer of all staff to the New LLP, the execution of the Service Agreement whereby the New LLP would thereafter provide the necessary services for the Existing LLP to do business with its clients, and the payment of the fees under the Service Agreement (*Berry*, principles (xi) and (xii)).

4) The whole purpose of the New LLP Proposal, of which the payments were an integral part, is to create losses in the Existing LLP in order to provide a fiscal benefit to the claimant by circumventing the effects of section 1263. The New LLP would have no independent existence or

commercial purpose; it would exist only for the sake of the Existing LLP's business. But the Existing LLP would be converted from a profitable into a loss-making business. Therefore the only purpose of the transaction, viewed as a whole, is to serve the interests of the claimant. This purpose does not satisfy the "wholly and exclusively" test.

115. In response, Mr Ewart QC argued to the following effect.

1) The payments by the Existing LLP to the New LLP would have been an arm's length fee, which here means a fee that is within the range that would have been agreed between unconnected parties and is not artificially inflated for ulterior purposes. This assumption, which is necessary for the purposes of the second point made below, is also in accordance with the terms of the agreed statement of facts in the trial bundle. (Particular issues concerning arm's length provision arise in connection with the issue of transfer pricing, which is discussed below.)

2) That fee would have been paid solely for the staff and consulting services provided by the New LLP. That was for a genuine trading purpose. If as a matter of fact a payment is made as the commercial price of goods or services for use in trade, the personal motivation of the taxpayer in acquiring those goods and services is irrelevant. Therefore the payments by the Existing LLP to the New LLP would have been deductible under section 54.

3) There is no principle of law that a payment which would otherwise be deductible is rendered non-deductible because it is paid as part of arrangements designed for the purpose of minimising the tax payable.

4) It is important to note that there was no question of creating fictitious losses or failing to account for tax on receipts. Payments by the Existing LLP would be taken into account on the other side of the equation, when the profits or losses of the New LLP were calculated. And the claimant is specifically entitled under corporation tax law to claim relief in respect of amortisation of goodwill.

116. In the course of argument I was referred to several authorities on section 54 and its predecessors and similar provisions. The specific facts of those cases are important only to explain the reasoning, and for that reason I shall summarise them with a degree of oversimplification. I shall then make some comments in the light of the authorities.

117. Both parties relied heavily on *Ransom v Higgs* [1974] 1 W.L.R. 1594, a case that involved "two blatant tax avoidance schemes": *per* Lord Simon of Glaisdale at 1616. The second scheme involved the exploitation of development rights in an estate. Those rights were initially held by Company A, which was controlled by B. Company A sold the rights to an independent third party for £2250, which was their true value. After resale, the rights were bought by Company C, which sold them to Company D on terms that required

Company D to pay Company C £77,250—a gross overvaluation—when the plots on the estate were sold. The Revenue conceded that £2250 was a deductible expense for D. But it argued that the balance of the £77,250 was not deductible, because it was not a price paid by D from commercial motives as a free agent in its own interest but a price dictated by a tax avoidance scheme involving A, B and C as well as D. The House of Lords held that the payment was not deductible. Lord Reid said a 1604:

> "Neither party to the agreement was acting as a free agent in its own interest ... Both had been procured to play their part in the scheme. The price was dictated by the scheme, and plainly had nothing to do with the market value of the rights sold. … [I]t is quite obvious that neither [C nor D] acted in their own interests. They did just what [B and his companies] wanted. I would agree that if a trader is actuated by none but commercial motives the revenue cannot merely say that he has paid too much. He may have been foolish or he may have had what could fairly be regarded as a good commercial reason for paying too much. But if it is proved that some non-commercial reason caused the trader to pay more than he otherwise would have done, then it seems to me quite clear that the payment can no longer be held to have been wholly and exclusively expended for the purposes of the trade. No authority is needed for so obvious a proposition.
>
> But what happens if even without the non-trading purpose the trader would have spent part of the sum for the purposes of his trade? … [W]e do not have to decide that question because the revenue have agreed that in this case £2,500 of the £77,250 paid will be allowed as a deduction being the then market value of the rights."

Lord Cross of Chelsea said at 1623:

> "Suppose that a retailer is in the habit of buying certain articles from a wholesaler for £10 each which is a fair commercial price, that his son-in-law sets up in business as a wholesaler dealing in similar articles and that thenceforth the retailer deserts the other wholesaler and buys the articles from his son-in-law for £10 each. One of the purposes for which the retailer is entering into the transactions with his son-in-law is to help him in business but nevertheless the cost would be properly allowable because the transactions though entered into in a sense for a dual purpose are bona fide commercial transactions. … Suppose that, in the example which I have given, the retailer bought articles from his son-in-law for £15 each which he could have bought from other wholesalers for £10 each then the expense would not have been allowable at all events to the extent of the extra £5 — because the purchases were not genuine commercial transactions but purchases at a fancy price entered into to benefit the vendor. In this case … £77,000 was in truth a fancy price fixed by [B and his companies] for the purposes of the scheme. [I]t is true that the fact that a price

paid is extravagant does not necessarily show that the purchase is not a genuine commercial transaction. A purchaser dealing at arm's length with a vendor may say to himself, 'The price which he is asking is absurdly high but I cannot get him to take less and I believe that even at that price I can make a profit on the deal. So I will agree to pay what he is asking.' But [D] was not dealing at arm's length with [C]. It was controlled by [B] and it agreed to pay the £77,000 not because its directors other than [B] decided in the exercise of an independent judgment that it was worth [D's] while to agree to pay that price but because the scheme provided for that price being paid."

118. The parties sought to extract slightly different principles from the speeches in *Ransom v Higgs.* Mr Ewart submitted that the important point was that deduction was refused because the price was "fancy", that is, did not reflect the value of what was being acquired. If the price had reflected the true value of the rights, the full amount would have been deductible, regardless of the tax-avoidance motive. By contrast, Ms Nathan submitted that the payment was not deductible because it was not paid for the genuine commercial purposes of the payer but for the fiscal interests of its controlling party for reasons of tax-avoidance. Of course, on the facts of the case the fancy price was due to and in furtherance of the non-commercial purposes behind the payment.

119. In *Drummond v Revenue and Customs Commissioners* [2008] EWHC 1758 (Ch), [2009] EWCA Civ 608, [2009] STC 2206, the taxpayer claimed to set against his liability for capital gains tax a loss on the surrender of second-hand insurance policies. The loss in question was not a real economic loss; it was a capital loss resulting from the interaction of capital gains tax legislation and income tax legislation. Subject to a qualification that does not matter for present purposes, Norris J permitted the deduction. He explained his decision as follows (paragraph numbers are not consistent as between different versions of the judgment):

> "The unblinkered approach to the facts which is required by *BMBF* does not require me to don the blinkers of 'tax avoidance scheme' and with my vision so restricted then to view no part of the £1.962m as having been paid for the acquisition of an asset and the whole as paid for 'participation in a tax avoidance scheme'. No-one suggested that Mr Drummond would have paid £1.962 million for participation in a tax avoidance scheme if the AIG policies had only had a surrender value of £10,000. Of course the amount of the policies he purchased was influenced by the amount of the loss which he hoped the scheme would produce: but he still purchased policies and did not merely pay a fee for a service.
>
> It does not seem to me to be helpful to say (as Mr Brennan QC submits) that Mr Drummond 'did not incur the expenditure because he wanted to acquire the policies' but for some other reason. As I see it, Mr Drummond wanted to acquire the policies precisely because by so doing he thought he would obtain a tax

> advantage on their surrender: and he still gave consideration wholly and exclusively to acquire them."

That part of the judgment was not subject of appeal.

120. The defendants relied on *Interfish Ltd v The Commissioners for HM Revenue and Customs* [2014] EWCA Civ 876 as supporting the proposition that the existence of a clear fiscal purpose would be fatal to any claim for a deduction under section 54. The company had made large payments to a struggling rugby club. There were two purposes in making the payments: to improve the financial position of the rugby club, and to assist the profile of the company's business. The payments were disallowed as deductions for the purposes of a predecessor of section 54. The company accepted that it had to show that the sole purpose of the payments was the business purpose, the "wholly and exclusively" test. But it argued that the purpose of improving the rugby club's purpose was only an intermediate purpose in order to achieve the ultimate purpose of advancing the company's trade. The Court of Appeal rejected that argument. There were two purposes, and neither was intermediate or subordinate to the other. It was impossible to regard the purpose of improving the rugby club's position as merely incidental to the purposes of advancing the company's trade. Moses LJ, with whose judgment Lord Dyson MR and Patten LJ agreed, illustrated the point from two earlier cases. In *Mallalieu v Drummond* [1989] 2 A.C. 861, the barrister's expenditure on dark clothing for her job was not deductible, because one purpose of the expenditure was the provision of the clothing that she needed as a human being; that purpose could not be said to be subordinate or incidental to the purpose of dressing herself as was required by her profession. In *MacKinlay v Arthur Young McClelland Moores & Co* [1990] 2 A.C. 239 payments by a partnership to some of its members in order to meet their relocation costs were not allowed as a deduction; one reason for this was that the payments had the dual purpose of advancing the partnership business and of serving the personal interests of the partners who were relocating.

121. *Flanagan v Revenue and Customs Commissioners* [2014] UKFTT 175 (TC), [2014] SFTD 881, concerned participation in a tax avoidance scheme designed to create tax losses much greater than any genuine financial loss. The taxpayers entered the scheme only for the purpose of mitigating their tax liabilities; none suffered any real loss; none played any part in the purported trade of dealing in cars. The First-tier Tribunal (Tax Chamber) held that the taxpayers were not trading at all. Part of the scheme involved the payments of large fees for the cost of obtaining loans; deductions were claimed for these payments under section 58 of ITTOIA, which permitted deductions for expenses incurred "wholly and exclusively" for the purpose of obtaining the finance. Judge Bishopp said:

> "108. … I agree with Ms Nathan that the fee (assuming it to be a fee) does not satisfy the requirements of s 58(2). As I have just said, it would be absurd to pay a fee of £5 million to borrow £7,500, and it is perfectly clear that the appellants did not pay the huge 'fees', as s 58(2)(b) requires, 'wholly and exclusively for the purpose of obtaining the finance'; they paid them in order to gain a

tax advantage. It is, of course, true that the agreements provided for such fees, and that the loans would not have been forthcoming if the manufactured payments were not made; but the agreements themselves were an integral part of a structure whose admitted purpose was the creation of an artificial tax loss, and not the raising of finance. Treating them as if they were finance-raising arrangements elevates form over substance."

122. … If I may paraphrase Lord Donovan, 'the size of the manufactured payment was not decided upon by the present appellants as the result of any commercial appraisement. It was determined pursuant to a plan.' A realistic view of the facts shows that the aim was that the appellants, 'as though by magic', should appear to have incurred vast fees as a condition of borrowing modest amounts of money they did not need in order to invest it in a 'trade' they had no desire to pursue. The supposed fee for the loan bore no relation to the size of the loan, but was merely the amount of the artificial loss the user wished to generate. … [T]he 'trade' was no more than a device, necessary if the scheme was to work. … As Ribeiro PJ might have put it, the relevant statutory provisions, construed purposively, were not intended to apply to the transaction, viewed realistically."

122. In *Chappell v Revenue and Customs Commissioners* [2014] UKUT 0344 (TCC), the taxpayer claimed deductions for payments for the transfer of Loan Notes. The payments were made as part of a marketed tax avoidance scheme. "The scheme did not have any commercial or other purpose apart from the avoidance of tax." One issue was whether, viewed realistically in accordance with the *Ramsay* principle, the payments were for the transfer of the Loan Notes within the meaning of section 349(1) of the Income and Corporation Taxes Act 1988. The Upper Tribunal said this:

"41. [T]here were neither payments nor Loan Notes in a real or practical sense. Their purpose was not a commercial purpose, but exclusively a tax avoidance purpose. ... All the transactions were organised in advance, and consisted of movements of funds in a circle, with the payments being recorded in writing. … The transactions were self-cancelling; and no one was either better or worse off. The payments, the Loan Notes and the transfers were all, in that sense, artificial. They had no commercial purpose and no practical significance beyond enabling the taxpayer to claim that the requirements of the legislative provisions had been complied with.

42. In our judgment these features were sufficient to deprive them of their essential characteristics for the purposes of the statutory provisions.

43. Three further points from the cases may be noted.

44. First, it is clear from *BMBF* that not all circular self-cancelling transactions are to be disregarded; see Lord Nicholls in *BMBF* at [38] and Lord Walker in *Tower MCashback* at [77].

45. Secondly, a test of artificiality will not by itself provide the key. …

46. … However, it seems to us that having an eye to the artificiality of a scheme is inherent in viewing the transactions realistically. ... In the present case, artifice in the means led to unreality in the result.

47. Thirdly, … there was an important distinction between the facts of [*MacNiven v Westmoreland Investments Ltd* [2001] STC 237] and the facts of the present case. In *MacNiven* there was a genuine obligation to pay interest on a real loan which arose outside any scheme … In the present case the obligation to pay was created as part of the scheme and made for no other reason than that it could be used to make a claim for tax relief. The distinction was pointed out by Lord Millet (sitting as a Non-Permanent Judge of the Court of Appeal in Hong Kong) in *Arrowtown* …:

> ' ... as Lord Hutton's speech indicates, it is unlikely that the same conclusion would have followed if the scheme had included the creation of the company's liability in the first place'."

123. Finally, the defendants relied on the decision of the First-tier Tribunal (Tax Chamber) in *Scotts Atlantic Management Ltd v Revenue and Customs Commissioners* [2013] UKFTT 299 (TC), [2014] SFTD 210. That decision is being considered on appeal by the Upper Tribunal, which has reserved judgment. In brief, the taxpayer companies claimed corporation tax deductions for payments made to employee benefit trusts (EBTs). They claimed that the payments had been arranged under a scheme that did not bring into play the corporation tax disallowance for such contributions under paragraph 1 of Schedule 24 to the Finance Act 2003. The First-tier Tribunal refused the deductions on the ground that expenditure incurred for a dual purpose could not be incurred wholly and exclusively for the trading purposes of the company. The relevant part of the reasoning is as follows.

> "146. It is clear and cannot be disputed that an objective, on the part of a company, of seeking to eliminate its liability for corporation tax, cannot be a legitimate ground for claiming a trading deduction. In the case of ordinary payments of salary and bonus, we accept Mr Thornhill's contention that when a company ordinarily makes such payments the feature that it expects to secure a trading deduction for the payments does not occasion any 'duality of purpose' concern. In the ordinary way, salary and bonuses are obviously tax deductible, they are meant to be tax deductible, and the expectation that this will be so is not an objective of making the payments.

147. The provisions of para 1 Sch 24, however, undermine this ordinary expectation. The reality becomes that, if no steps are undertaken to oust the application of para 1 Sch 24, the corporation tax deductions will obviously be denied by that provision. If, however, a highly contrived scheme is implemented to oust the application of para 1 Sch 24, the reality then becomes that:

- the highly artificial steps of the scheme focus attention on the fact that those steps, which were central to the whole planning in the present case, were entirely designed to achieve a particular objective;

- that purpose was obviously to oust the application of para 1 Sch 24, which can be paraphrased realistically to be a purpose of achieving the precisely opposite corporation tax treatment for the EBT contributions than the result intended by Parliament; and that

- the deliberate and all-pervading objective of achieving a corporation tax deduction makes it impossible to treat the corporation tax result sought for the contributions as the 'ordinary, intended or realistically expected outcome' of making salary, bonus or equivalent payments.

These related factors appear to us wholly to undermine the general argument (in a case such as the present) that when salary or bonuses are paid, the expectation of securing a corporation tax deduction does not constitute any sort of 'duality of purpose'. [The companies'] intentions were plainly to secure a far from ordinary tax deduction, one that would not ordinarily be expected, and certainly one that was designed to achieve the very opposite of the result intended by Parliament. On this ground we consider that the resultant 'duality of purpose' in making the contributions, via the value-draining scheme, is the very factor that occasions the fatal duality of purpose that results in the denial of the entire deductions claimed by both companies.

148. The curious position thus becomes that if no attempt is made to circumvent para 1 Sch 24, the deduction is denied. If a contrived scheme is effected to achieve the opposite result, it fails simply because that objective becomes the fatal purpose that creates the duality of purpose that itself undermines the deduction.

149. We accept that HMRC did not advance the precise articulation that seems to us to be the overriding reason why the entire corporation tax deduction should be disallowed to both companies in respect of all the contributions. Since however in a general sense, HMRC had plainly contended that the objective of securing a tax deduction was a relevant motivation (indeed, as contended, even the dominant motive for making the contributions) we have no hesitation in reaching our decision on

the corporation tax point on the reasoning in this section of the decision."

124. In the light of these various authorities, I make the following remarks.

1) There does seem to me to be a real and substantial chance that, despite the decisions in *Drummond* and *Ransom v Higgs*, a challenge to the New LLP Scheme would have succeeded on the basis of section 54, CTA. I shall explain why, by reference to those and the other cases.

2) The starting-point is that expenditure does not fail the "wholly and exclusively" test simply because the taxpayer has arranged its business in a manner specifically and deliberately designed to involve deductible expenditure. This is clear from the decision of Norris J in *Drummond*. The payment (apart from a small part of it, which was disallowed as a deduction) was made for the purpose of acquiring the policies; the motive for acquiring the policies was to produce a loss for tax purposes—it was part of a tax-avoidance scheme; yet the payments were permitted as deductions, simply because they were in fact the price for the policies. As Mr Ewart pointed out, many companies structure their affairs in ways specifically designed to be tax-efficient; this is not usually taken to indicate duality of purpose as regards section 54, CTA 2009.

3) *Ransom v Higgs*, though clearly important, is not obviously determinative of the issue between the parties. The payment was not deductible because it was not truly for the purposes of trade but was disguised as a price. Mr Ewart submitted that, if the price had corresponded to the value of the rights acquired, the full amount of the payment would have been deductible, regardless of the tax-avoidance motive. However, although that may perhaps be true, it goes beyond the decision in the case (the small element of deductible expense having been subject of a concession by the Revenue). More importantly, a payment for full value would have been made for motives different from those that did in fact cause company D to make the payments. On the other hand, the price paid by company D was "fancy"; it "had nothing to do" with the value of what was acquired but was paid for the interests of the controlling party. The case does not seem to me directly to establish that, if the Existing LLP had paid to the New LLP the market value of the services provided under the Services Agreement, the payment would not be deductible.

4) It is neither necessary nor desirable that I comment on the correctness of the decision of the First-tier Tribunal in *Scotts Atlantic Management*. However, I do not think that the case can be taken as establishing a general proposition that a payment that would otherwise be deductible will fail the "wholly and exclusively" test simply because the taxpayer deliberately and for fiscal motives traded in a manner that would involve the making of deductible payments. Such a general proposition would be inconsistent with the decision and

reasoning in *Drummond* and, as Mr Ewart observed, would have alarmingly wide implications.

5) *Interfish* does not advance the matter. It was a straightforward case of duality of purpose, as was *Mallalieu*. Neither case resolves the question whether a fiscal motive in the structuring of the taxpayer's trade necessarily involves duality of purpose as regards payments made in the course of that trade. *Drummond* indicates that fiscal motivation in the structuring of a trade is not itself sufficient to prevent a deduction for a payment made exclusively for the purposes of that trade.

6) *Flanagan* is also of limited usefulness. Ms Nathan correctly observed that the payments were not viewed in isolation but were considered as part and parcel of the entire scheme; in that light they were not a deductible expense but merely a device to avoid tax. However, the primary finding was that the trade itself was a sham (at least, as regards the taxpayers) and the fees were not genuine payments for services but an inflated amount for no other purpose than attracting tax relief; as such the payments were similar to those in *Ransom v Higgs*. The case does not establish that the expenses of a genuine trade are not deductible merely because the trade has been set up in a way that is designed to bring fiscal advantages.

7) Much the same point can be made about *Chappell*. The case illustrates the willingness of the courts to view a scheme or series of transactions as a whole, rather than looking narrowly at each individual transaction or payment. But *Chappell* was an easy case, because of the artifice it involved: there was no commercial purpose at all, only a fiscal purpose, and the transactions were artificial paper transactions that did not correspond to what was happening in the real world. That would not have been so of the payments by the Existing LLP to the New LLP; those would have been real payments for real services, and they would have created a real loss. *Chappell* does not provide an answer to the essential question, which in broad terms is whether those losses can be used for tax purposes when the entire business structure has been arranged for the purpose of creating them. The strong answer made by the claimant is that, notwithstanding the fiscal motive behind the dual-LLP structure, the payments, viewed realistically, were truly within the scope of the application of section 54, construed purposively.

8) However, although there are general principles applicable to matters of tax law, the application of those principles is highly fact-specific. Further, as Lord Simon of Glaisdale said in *Ransom v Higgs*: "In some fiscal systems there is a general provision that any transaction the paramount object of which is the avoidance of tax shall be void for that purpose though valid for all other purposes. Our own fiscal system has no such provision, but rather attempts to deal with tax avoidance schemes specifically as they come to notice."

9) *Drummond* was a case where the taxpayer made payments solely for the purposes of trading in the policies; he qualified for the statutory tax advantage, even though his only motive for trading in the policies was his own fiscal advantage. Norris J's judgment involves a refusal to deny the existence of a genuine commercial motive for the payments. It also reflects the fact that the advantage sought by the taxpayer was not distinct from the trade but was an incident or consequence of it (cf. Millet LJ in *Vodafone Cellular Ltd v Shaw* (*supra*). It is well arguable that the present case is materially different, because the Existing LLP would not have been acting freely for any commercial motives of its own but on terms dictated by a tax-mitigation scheme devised by its controlling member. This goes a stage further than the facts of *Drummond*, and the reasoning in *Ransom v Higgs* does not show that this further stage is irrelevant.

10) It seems to me to be properly arguable that, if a realistic view is taken of the entire New LLP scheme, rather than isolating one part of it, it has no commercial purpose for the Existing LLP but is simply a method of creating fiscal advantage for a controlling member. Whereas in *Drummond* the trade was advantageous to the taxpayer because of the fiscal advantage that accrued to him, so that there was a genuine commercial motive, no such benefit existed for the Existing LLP. The New LLP proposal was specifically designed to be commercially (that is, in terms of trade) disadvantageous to the Existing LLP, in order to create fiscal advantages for its controlling member. Even if the payments accurately reflected the value of the services provided by the New LLP, so that they cannot be dismissed as merely artificial or unreal, it is properly arguable that the commercial and fiscal purposes were not single, as in *Drummond,* but dual.

11) In *Vodafone Cellular Ltd v Shaw* one of Millett LJ's propositions was: "A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment." The defendants' case is that the private benefit to the claimant was not a mere consequential and incidental effect of the payment but the very reason why the payment was made. This is highlighted by the disjunction between the trade purposes of the Existing LLP and the fiscal motives of the claimant. (I note that Millett LJ's remark that "for the purposes of trade" does not mean "for the purposes of the taxpayer" is not directly in point at this stage of the argument. He was not addressing the question whether the fiscal advantage of a third party was consistent with the section 54 test. Rather, he was making the point that it is not sufficient for the purposes of section 54 that the payment serve the purposes of the taxpayer.)

12) These points gain some force, I think, from the fact that the New LLP Scheme would not have involved any change in what actually happened regarding the conduct of the existing trade. In his first

report, Mr Kundu said that his opinion was given on the basis of the expectation that the New LLP would have its own allocated office space, dedicated telephone lines, letterhead, and accounting and administrative personnel to enable it to undertake its activities. "This is important to provide commercial substance to the New LLP to avoid the risk of any challenge by HMRC that the New LLP was not in fact providing services in the manner envisaged by the contract with the Existing LLP." In fact, however, the evidence suggests that there would have been negligible indicia of independent commercial substance.

125. On a broad analysis, I should take the view that the arguments on the section 54 issue are fairly evenly balanced. Accordingly, I would proceed on the basis that the prospects of a section 54 *Ramsay* challenge succeeding were 50%. If this has the appearance of fence-sitting, I would only say that the "loss of a chance" approach to legal issues seems to me to require a proper willingness on the part of the courts to impose upon themselves at times a certain kind of self-denying ordinance.

(2) Heastie v Veitch & Co

126. The starting-point for this particular ground of challenge is the principle that was clearly stated by Lord Oliver of Aylmerton in *MacKinlay v Arthur Young McClelland Moores & Co* [1990] 2 A.C. 239 at 249:

> "A partner working in the business or undertaking of the partnership is in a very different position from an employee. He has no contract of employment for he is, with his partners, an owner of the undertaking in which he is engaged and he is entitled, with his partners, to an undivided share in all the assets of the undertaking. In receiving any money or property out of the partnership funds or assets, he is to an extent receiving not only his own property but also the property of his co-partners. Every such receipt must, therefore, he brought into account in computing his share of the profits or assets. Equally, of course, any expenditure which he incurs out of his own pocket on behalf of the partnership in the proper performance of his duties as a partner will be brought into account against his co-partners in such a computation. If, with the agreement of his partners, he pays himself a 'salary', this merely means that he receives an additional part of the profits before they fall to be divided between the partnes in the appropriate proportions. But the 'salary' remains part of the profits."

127. *Heastie v Veitch & Co* [1934] 1 K.B. 535 established that moneys paid by the firm to a partner other than in his capacity as a partner need not be brought into account. V and S carried on the business of chartered accountants in partnership together. The partnership business was carried on at premises which V owned, and the partnership paid V a market rent for the premises. It was not in dispute that, if the premises had belonged to an independent third

party, the payments of rent would have been deductible as an expense of the partnership when calculating its profits and losses. The Court of Appeal held that the payments were a deductible expense, even though they had been paid by the partnership to one of the partners. Lord Hanworth MR, with whom Slesser and Romer LJJ agreed, based his decision on the conclusion that the payments were properly characterised as rent rather than as a non-deductible payment in respect of capital brought into to the firm by V. Slesser LJ commented that there was an ordinary landlord and tenant agreement "in which one of the partners happened to be the landlord and the partnership the tenant". Romer LJ, whose judgment was much relied on by Mr Turner and Ms Nathan, said this:

> "I think that the answer to the argument advanced on behalf of the Crown, based on an analogy, or suggested analogy, between this case and that of services rendered by the partner to his firm, is that the services so rendered are rendered as a partner. Where two persons carry on a business in partnership, it is no more possible, in ascertaining the profits of that business or partnership for the purposes of Sch. D, to deduct the salary paid to one or both of them for the work they have done in carrying on the business than it would be for a man carrying on a business son his own account to deduct something which he thought was equivalent to the value of his services rendered to himself. But it is not true that in ascertaining the profits of a partnership no sum paid to one of the partners can ever be deducted. Suppose that two people are carrying on business in partnership as hotel proprietors, and it is necessary for the purpose of carrying on that business that they should be supplied form time to time with wine, and suppose that tone of the partners is carrying on a wholly independent business on his own account in the wine business and supplies wine to the partnership, it would, as it seems to me, be idle to suggest that for the purpose of ascertaining the profits of the hotel you could not deduct the sums paid to the partner who was the wine merchant. … In the present case it appears to me that the premises were supplied for the use of the partnership by the partner who owned them, not in his capacity of partner at all, but in his capacity of landlord of the premises."

128. In *MacKinlay*, Lord Oliver explained *Heastie v Veitch & Co* as follows at 253 and 254-5:

> "All that *Heastie's* case established was that sums received by a partner in a quite different capacity, for instance, as the landlord of premises let to the partnership or for goods supplied from an independent trade carried on by a partner, are not to be regarded as non-deductible expenses simply because they are received by a person who is also a partner in the firm."
>
> "What [a partner] receives out of the partnership funds falls to be brought into account in ascertaining his share of the profits of the firm except in so far [as] he can demonstrate that it represents a

> payment to him in reimbursement of sums expended by him on partnership purposes in the carrying on of the partnership business or practice … or a payment entirely collateral made to him otherwise than in his capacity as a partner (as in *Heastie v Veitch & Co*)."

129. The third building-block of the argument advanced by the defendants, after the principle stated in *MacKinlay* and the decision in *Heastie v Veitch & Co*, is what might be called the "transparency" of a limited liability partnership. In the context of corporation tax this is set out in section 1273, CTA 2009 (in the context of income tax there is a corresponding provision in section 863 of ITTOIA):

> "(1) For corporation tax purposes, if a limited liability partnership carries on a trade or business with a view to profit—
>
> > (a) all the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),
> >
> > (b) anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and
> >
> > (c) the property of the limited liability partnership is treated as held by the members as partnership property.
>
> References in this subsection to the activities of the limited liability partnership are to anything that it does, whether or not in the course of carrying on a trade or business with a view to profit."

130. The defendants' argument may be summarised as follows.

    1) For tax purposes, anything done by, to or in relation to the Existing LLP and the New LLP is treated as done by, to or in relation to the members as partners.

    2) Therefore the payments that would be made under the New LLP Proposal by the Existing LLP to the New LLP for the provision of services are treated as payments by and to the same persons as members of two general partnerships: the same members are making payments to themselves. The fact that the LLPs are corporate entities distinct from their members is not in point, because for tax purposes they are treated as the members in general partnership.

    3) The business of the Existing LLP is to provide property consultancy services to clients. The payments by the Existing LLP to the New LLP would be for the provision of the services to clients (or, in full, the provision of services to the Existing LLP to enable it to perform the services to the clients; but the services would be provided directly by

the New LLP to the clients pursuant to a service agreement with the Existing LLP). Accordingly the business of the members qua members of the New LLP is not "wholly independent" of their business qua members of the Existing LLP, and the payments by the Existing LLP cannot be regarded as "entirely collateral" or as received by the members of the New LLP otherwise than in the capacity of members of the Existing LLP.

4) The matter can be tested as follows. If a member of the Existing LLP made a services agreement with the Existing LLP whereby he would supply business consultancy services to clients on its behalf, the payments made to him under the services agreement would not be deductible expenses for the purposes of calculating the profits and losses of the Existing LLP. It makes no difference that the services are provided by several members rather than by one member. And it makes no difference that the services are provided not directly but through the New LLP, because the LLP is transparent to its members for tax purposes: section 1273, CTA 2009.

131. Mr Turner described this argument as a knockout blow. I do not agree. In fact, it seems to me to be a bad argument. The difficulty it faces is the interposition of the New LLP: under the New LLP Proposal the services are provided by, and the payments are made to, the New LLP not the members personally. Mr Turner says that this is immaterial, because the New LLP is transparent for tax purposes. But this is to take matters too fast and too far. Section 1273 applies to each LLP separately, for the purposes of determining that LLP's liability to corporation tax. In the case of the Existing LLP its effect is that the services provided by the New LLP under the services agreement are treated as services provided to the members of the Existing LLP in partnership, and the payments made by the Existing LLP for those services are treated as made by the members of the Existing LLP in partnership. In the case of the New LLP its effect is that the services provided by the New LLP are treated as being provided by the members of the New LLP in partnership, and the payments received for those services are treated as being received by the members of the New LLP in partnership. However, it does not follow, and section 1273 does not provide, that for the purposes of the Existing LLP the payments to the New LLP are to be treated *as payments to the members of the New LLP in partnership.* Moreover, as a matter of general law the payments are not made to the members of the New LLP but to the New LLP itself, which is a distinct and separate corporate entity. Section 1273 only makes each LLP transparent to itself; it does not purport to make LLP1 transparent to LLP2 or vice versa. This being so, the relevant question is simply, as Mr Ewart QC submitted, whether the payments by the Existing LLP satisfied the requirements of section 54, CTA 2009. Questions of commercial substance and artificiality are to be taken into account in respect of the challenge under that section. The *Heastie v Veitch & Co* challenge seems to me to add nothing.

132. On this particular issue, I am of the view that the objection based on *Heastie v Veitch & Co* is sufficiently weak that it would be wrong to discount any recoverable damages on account of it.

(3) Transfer Pricing

133. The expression "transfer pricing" is used to refer to tax provisions that are designed to adjust the fiscal distortions that can arise when dealings take place between associated entities other than at arm's length. Whereas dealings between independent entities will usually be determined by market forces, such forces are less likely to be determinative in dealings between associated entities, where the dealings may be so arranged as to manipulate profits and thereby the incidence of tax liability. The problem is likely to be of particular concern when the associated entities are located in different states with differing tax regimes, because the dealings may have the effect of removing tax revenue from the state that would otherwise receive it. Thus Article 9 of the OECD Model Tax Convention provides the following simple statement of the "arm's length principle" of transfer pricing:

> "[When] conditions are made or imposed between … two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

134. The transfer pricing regime in the UK is contained in Part 4 of the Taxation (International and Other Provisions) Act 2010 ("TIOPA 2010"), which came into force on 1 April 2010 and has effect for corporation tax purposes for accounting periods ending on or after that day. Section 147 provides in part as follows:

> "147 *Tax calculations to be based on arm's length, not actual, provision*
>
> (1) For the purposes of this section 'the basic pre-condition' is that—
>
> > (a) provision ('the actual provision') has been made or imposed as between any two persons ('the affected persons') by means of a transaction or series of transactions,
> >
> > (b) the participation condition is met (see section 148),
> >
> > (c) the actual provision is not within subsection (7) (oil transactions), and

(d) the actual provision differs from the provision ('the arm's length provision') which would have been made as between independent enterprises.

(2) Subsection (3) applies if—

(a) the basic pre-condition is met, and

(b) the actual provision confers a potential advantage in relation to United Kingdom taxation on one of the affected persons.

(3) The profits and losses of the potentially advantaged person are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision."

135. For the purposes of the basic pre-condition, "the affected persons" would have been the Existing LLP and the New LLP. It is common ground that the participation condition in section 148 would have been satisfied, essentially because the same persons would have controlled both the Existing LLP and the New LLP. The "actual provision", namely the payment of a fee by the Existing LLP to the New LLP for services, would not have fallen within the exception for oil transactions in section 147(7), and exceptions in respect of small and medium-sized enterprises would not have applied; cf. section 147(6)(b) and section 166. The actual provision would have conferred a potential advantage in relation to UK taxation on the Existing LLP through the generation of a loss. (That this would be "a potential advantage in relation to United Kingdom taxation" has been common ground in the argument before me.) The critical question is therefore, in the first place, whether the actual provision would have differed from the arm's length provision that would have been made as between independent enterprises: section 147(1)(d).

136. The defendants make, broadly, two points in respect of transfer pricing.

a) In an arm's length transaction, the party in the position of the Existing LLP ("P1") would never have contracted with a party in the position of the New LLP ("P2") on terms that generated a loss for P1. Either the fee would have been set at a level that would have enabled P1 to generate a profit, or the transaction would not have proceeded. The result, in either case, is that transfer pricing undermines the New LLP Proposal.

b) The New LLP Proposal involved the transfer of the Existing LLP's profit-making apparatus, both employees and (*qua* productive service-providers) members, to the New LLP. This transfer involved the surrender of a profit-making potential on the part of the Existing LLP and the creation of a corresponding potential in the New LLP. As such it was tantamount to the transfer of an ongoing activity and would properly be considered to involve the transfer of part of the goodwill of the Existing LLP, for which a payment would be made on an arm's

length basis. Such a payment would have been taxable and would have reduced the amount of goodwill available for amortisation.

I shall discuss these grounds of objection to the New LLP Proposal.

(3)(a) Transfer Pricing and the fee for services

137. The essence of the argument is that, if the parties were at arm's length, P1 would not have made an arrangement that involved it paying to P2 a fee that resulted in a loss for P1. Either the fee would have been set at a level sufficiently low to ensure that P1 retained its profitability, or the transaction would not have proceeded. If this is correct, the New LLP Proposal falls away.

138. The strong way of putting the argument maintains that the correct application of transfer pricing would result in the New LLP Scheme being disregarded entirely for the purposes of the Existing LLP's taxation position. (This has been referred to as "setting aside" the New LLP Scheme, but that is rather misleading, because all that would happen is that the scheme would be disregarded for specific purposes.)

139. Mr Sayers relied in this regard on section 147, TIOPA, in conjunction with section 164. The relevant parts of section 164 as originally enacted were these:

> "164 *Part to be interpreted in accordance with OECD principles*
>
> (1) This Part [viz. Part 4, comprising sections 146 to 217] is to be read in such manner as best secures consistency between—
>
> > (a) the effect given to sections 147(1)(a), (b) and (d) and (2) to (6), 148, 151(2), and
> >
> > (b) the effect which, in accordance with the transfer pricing guidelines, is to be given, in cases where double taxation arrangements incorporate the whole or any part of the OECD model, to so much of the arrangements as does so.
>
> …
>
> (4) In this section 'the transfer pricing guidelines' means—
>
> > (a) all the documents published by the Organisation for Economic Co-operation and Development, at any time before 1 May 1998, as part of their Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, and
> >
> > (b) such documents published by that Organisation on or after that date as may for the purposes of this Part be designated, by an order made by the Treasury, as comprised in the transfer pricing guidelines.

> (5) In this section 'double taxation arrangements' means arrangements that have effect under section 2(1) (double taxation relief by agreement with territories outside the United Kingdom)."

Section 58 of the Finance Act 2011 substituted a new section 164(4) with effect, for corporation tax purposes, for accounting periods beginning on or after 1 April 2011:

> "(4) In this section 'the transfer pricing guidelines' means—
>
> > (a) the version of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations approved by the Organisation for Economic Co-operation and Development (OECD) on 22 July 2010, or
> >
> > (b) such other documents approved and published by the OECD in place of that (or a later) version or in place of those Guidelines as is designated for the time being by order made by the Treasury,
>
> including, in either case, such material published by the OECD as part of (or by way of update or supplement to) the version or other document concerned as may be so designated."

140. In his report dated 4 April 2014, Mr Sayers contended that the entire transaction should be disregarded for taxation purposes. He referred to the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2009 edition); while accepting that it would normally be inappropriate to disregard the actual transaction entered into (paragraph 1.36), he referred to the second of two situations where, according to paragraph 1.37, it would be appropriate and legitimate for the tax authorities to disregard the structure adopted by the taxpayer: "where, while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price." His argument was that the arrangement lacked commercial rationality on any other basis than the interconnectedness of the two LLPs and that, because the transaction would not have occurred between parties at arm's length, it was extremely difficult to determine an appropriate transfer price.

141. In his oral evidence, Mr Sayers sought to rely also on the first situation mentioned in paragraph 1.37 of the 2009 *Guidelines*, namely "where the economic substance of a transaction differs from its form." It is one thing to plead diametrically opposed cases in the alternative. It is another to opine, as Mr Sayers tried to do, that two mutually exclusive situations exist at the same time. The first and second situations in paragraph 1.37 are strict alternatives. I do not see that Mr Sayers can advance them both as applying to the New LLP Proposal. Further, the first alternative (form and substance differing) is not pleaded. I shall disregard it.

142. I have considerable difficulty with this strong version of the argument.

1) By way of preliminary point, the 2009 *Guidelines*, on which Mr Sayers relied, do not apply under section 164 of TIOPA. In the original version of section 164(4)(a) the relevant *Guidelines* were the 1995 edition; this would have applied to the accounts for 2010 and 2011. In the substituted version of section 164(4)(a), the relevant *Guidelines* were the 2010 edition; this would have applied to the accounts for 2012. No documents have been designated by the Treasury under section 164(4)(b). In fact, the provisions of the various editions of the *Guidelines* are not materially different for present purposes.

2) The *Guidelines* seem to me to be an irrelevant distraction. They are specifically directed to "multinational enterprises and tax administrations". Section 164(1) applies only in cases of "double taxation arrangements", as defined by section 164(5) and section 2(1). The present case does not involve multinational enterprises, multinational tax administrations or double taxation arrangements. In my judgment section 164(1) simply does not apply, and the correct approach to transfer pricing is to apply section 147(3) of TIOPA. Mr Kundu is correct to say that this does not enable one to "set aside" transactions.

3) Even if the *Guidelines* did apply via section 164, I should not consider it at all plausible to say that the actual structure adopted by the two LLPs "practically impedes the tax administration from determining an appropriate transfer price". Paragraph 9.180 of the 2010 *Guidelines* contained guidance as follows:

   > "If an appropriate transfer price (i.e. an arm's length price that takes into account the comparability—including functional—analysis of both parties to the transaction or arrangement) can be arrived at in the circumstances of the case, irrespective of the fact that the transaction or arrangement may not be found between independent enterprises and that the tax administration might have doubts as to the commercial rationality of the taxpayer entering into the transaction or arrangement, the transaction would not be disregarded under the second circumstance …"

   That specific guidance is not found in the 1995 *Guidelines*, but the principle it states is sound and must be of general application. Mr Sayers' approach was, in my view, to move far too readily from the premiss that the transaction would not be found between independent enterprises to the conclusion that the tax administration would be impeded from determining an appropriate transfer price. In fact, he was ready to discuss such an appropriate transfer price separately, and the submissions eventually put to me on behalf of the defendants focussed on pricing rather than on set-aside.

4) I reject this strong version of the first argument. Even on a "loss of a chance" basis, I would consider it to have so little merit as to be

> capable of being disregarded; this is quite apart from consideration of what might have been HMRC's attitude to a potential challenge.

143. The second, weaker way of putting the argument relating to the fees for services is that transfer pricing requires a fee to be set at a level that would be sufficiently low to negate or reduce the tax benefits sought to be achieved by the New LLP Proposal. It is common ground that a challenge could have been brought on this ground and that it would have fallen for determination in accordance with section 147(3).

144. The experts were agreed that the New LLP would have been providing services on a "de-risked" basis, in that the risks of such things as client non-payment and creditworthiness and fee disputes would have fallen on the Existing LLP. In his first report, Mr Kundu said that the appropriate way of pricing for the provision of services by a de-risked service provider was the "cost plus" method, designed to provide a guaranteed return on the relevant cost base while reflecting the lack of risk undertaken by the service provider. He expressed the view that the appropriate range of mark-up would be of the order of 8-12% for the members of the New LLP and 4-6% for its staff. In the joint statement, he said that he would expect HMRC to have agreed a mark-up of 5% across the board. In fact, the evidence from Mr Hall in examination-in-chief was that EY had modelled on the basis of a 10% mark-up, which they considered to be within the typical range of 8-12% on the provision of such services.

145. In his report dated 18 July 2014, Mr Kundu was prepared to accept that there was "a certain logic" to Mr Sayers' contention that no mark-up should be applied to the provision of the individual members' services, because the individual members' remuneration comprised both a fixed, guaranteed amount (equivalent to the pay of a salaried partner) and a performance bonus (equivalent to a share of profits in the New LLP). The case actually advanced by the claimant at trial was based on the assumption that no mark-up would have been paid for the services of the New LLP. The claimant could take this approach, because anything other than a "negative mark-up" would be sufficient to preserve the desired tax advantages.

146. Mr Sayers' evidence was that a negative mark-up ought indeed to have been applied to the provision of services by the individual members of the New LLP, to reflect the fact that the individual members were not taking the same entrepreneurial risks that they had taken under the Existing LLP. His proposal was to adjust the payment for services to the extent required to strip out the bonus-related component of the individual members' remuneration, retaining it within the Existing LLP. When Mr Sayers was cross-examined, it was put to him that to talk of an entrepreneurial risk on the part of the individual members even prior to the proposed restructuring was to mischaracterise the position. His evidence in response was as follows:

> "[W]hat was suggested to me was that the risks and the client relationships would be retained within the existing LLP and the members of the new LLP would be operating on a de-risked basis, so they are not incurring the same risks and functions they would

> have had in the old LLP. In those circumstances, I think it is appropriate, or may be appropriate, for that [to] be characterised as a de-risked LLP, and therefore it is possible that a negative mark-up may apply, because … you've taken away one of their entrepreneurial risks, basically. …
>
> [A]s a matter of tax law, I think, by virtue of being members in an old LLP which owned the client relationships and ran those risks as well, they were exposed to that risk, in my view, for transfer pricing purposes much more so than when they transitioned across into the new LLP. …
>
> Q. [O]ne looks at commercial reality when one is looking at transfer pricing.
>
> A. No, you look at the transfer pricing principle. And clearly … these two entities are supposed to be separate. Who is bearing commercial risks? If we're saying that the entrepreneurial risks have effectively been left behind in old LLP, then I would characterise New LLP as a supplier of services without incurring a degree of those risks. So therefore, hypothetically, a negative mark-up could apply."

147. In his report dated 18 July 2014, Mr Kundu appeared to concede that the argument could not be resolved without a full transfer pricing study. No such transfer pricing study was undertaken in 2011/12 or by either of the experts. (In fairness to Mr Kundu, he maintained the position that, when the judgement of the professionals involved was that transfer pricing did not present a significant risk, the study could be deferred until after the proposal had been implemented.) He did, however, express disagreement with Mr Sayers' argument, principally on the basis that the structure put in place upon the acquisition of the business of Edwin Hill placed the primary entrepreneurial risk on the claimant as the corporate member of the Existing LLP. When he was cross-examined, Mr Kundu accepted that an argument could be made for a negative mark-up but held to the view that, as the individual members' position regarding remuneration was now solely dealt with in the New LLP it would be wrong to impose a negative mark-up for the sake of an illusory entrepreneurial risk in the Existing LLP.

148. My conclusions on the merits of this argument are as follows.

1) At this stage of the enquiry, the "actual provision" for the purposes of section 147(1)(d) is the price that would be paid by the Existing LLP for the services to be provided by the New LLP. The question is whether that differed from the arm's length provision (price) that would have been made (paid) between independent entities, P1 and P2.

2) It is, as Mr Kundu expressly noted, very difficult to address that question without a transfer-pricing study. That fact, coupled with his acceptance in cross-examination that an argument can be made for a negative mark-up, means that a technical challenge on this ground

cannot be ruled out as fanciful. On the other hand, I think that Mr Sayers was being deliberately cautious in cross-examination, when he said that it was "possible" that a negative mark-up might apply and that "hypothetically" it could apply. This suggests that the truth is simply that the appropriate mark-up may or may not be negative. The possibility that it would be negative clearly exists, but so does the contrary possibility.

3) It is accepted that P2 (the party in the position of the New LLP) would be de-risked. It would not be free of all risk, however; for example, it would face risks associated with the subsistence of P1's client-base and with the liquidity of P1. (There is, so far as I can see, no reason to suppose that it would be relieved of all risk relating to professional liability; such matters, though, are the province of insurance.) In particular, P2 would only be servicing the requirements of P1; therefore its own risks would be reflective of those of P1. I find Mr Sayers' arguments about entrepreneurial risk relatively unpersuasive, in circumstances where the individual members were always protected as to the guaranteed part of their remuneration (subject to the Existing LLP's continued viability) and where the risks associated with the remainder of their remuneration were, both before and after implementation of the New LLP Proposal, dependent on the health of the Existing LLP's client-facing business.

4) Further, it is not axiomatic that P2's de-risked status requires a negative mark-up. It might well be sufficiently reflected in a nil mark-up.

5) In my view it is implausible to contend that the arm's length provision would have stripped out the bonus-related component of the individual members' remuneration, retaining it within P1. The members' remuneration would in all likelihood have included a bonus element in any event. Having regard to the level of bonus received within the Existing LLP, I should be of the view that a negative mark-up, if applied at all, would be unlikely to remove more than 50% of the bonus-related component of the individual members' remuneration.

6) Having regard to the foregoing matters and to what I regard as the uncertain and rather speculative nature of the evidence, I conclude that, if a transfer pricing challenge had been brought it would have had a one-third chance of succeeding; and that success would in this context mean a reduction of the price paid by the Existing LLP to the extent of 50% of the bonus-related component of the individual members' remuneration.

(3) Transfer Pricing and a payment for goodwill

149. The purpose of the New LLP Proposal was to permit the claimant to take advantage of goodwill amortisation in the Existing LLP. This benefit would be lost if the New LLP Proposal had the effect of transferring goodwill to the

New LLP, because the transfer pricing regime would deem that an arm's length, taxable payment had been made by the New LLP to the Existing LLP. Accordingly, the critical question is whether, upon the setting up of the New LLP and the making of the Services Agreement between the Existing LLP and the New LLP, there was a disposal of goodwill by the Existing LLP to the New LLP. (I shall refer to goodwill, although the statutory provisions are not restricted to goodwill. The defendants' pleaded case is actually expressed in terms of a transfer of profit-earning capacity with a corresponding reduction of retained goodwill.)

150. Before summarising the arguments, I may conveniently set out the most relevant statutory provisions. Part 8 of CTA 2009 (sections 711 to 906) deals with "intangible fixed assets" (IFAs) in companies (which for present purposes includes LLPs). Section 713(1), CTA 2009, defines an IFA as "an intangible asset acquired or created by the company for use on a continuing basis in the course of the company's activities". Section 906 provides so far as material:

> "906 *Priority of this Part for corporation tax purposes*
>
> (1) The amounts to be brought into account in accordance with this Part in respect of any matter are the only amounts to be brought into account for corporation tax purposes in respect of that matter.
>
> (2) Subsection (1) is subject to any indication to the contrary."

151. Chapter 4 of Part 8 (sections 733 to 741) deals with the realisation of IFAs and "provides for credits or debits to be brought into account for tax purposes on the realisation by a company of an intangible fixed asset" (section 733(1)). I shall set out those sections and parts of sections that seem to me to be material.

> "734 *Meaning of 'realisation'*
>
> (1) References in this Part to the realisation of an intangible fixed asset are to a transaction resulting, in accordance with generally accepted accounting practice—
>
> > (a) in the asset ceasing to be recognised in the company's balance sheet, or
> >
> > (b) in a reduction in the accounting value of the asset.
>
> (2) In subsection (1) 'transaction' includes any event giving rise to a gain recognised for accounting purposes.
>
> (3) In relation to an intangible fixed asset that has no balance sheet value (or no longer has a balance sheet value), subsections (1) and (2) apply as if it did have a balance sheet value.
>
> (4) References in this Part to a 'part realisation' are to a realisation falling within subsection (1)(b)."

"735 *Asset written down for tax purposes*

(1) This section applies if there is a realisation of an intangible fixed asset in respect of which debits have been brought into account for tax purposes.

(2) If the proceeds of realisation exceed the tax written-down value of the asset, a credit equal to the excess must be brought into account for tax purposes.

(3) If the proceeds of realisation are less than the tax written-down value of the asset, a debit equal to the shortfall must be brought into account for tax purposes.

(4) If there are no proceeds of realisation, a debit equal to the tax written-down value must be brought into account for tax purposes.

(5) References in this section to the tax written-down value of an asset are to its tax written-down value immediately before the realisation."

"737 *Apportionment in case of part realisation*

(1) In the case of a part realisation—

(a) the references in section 735 to the tax written-down value of the asset …

must be read as references to the appropriate proportion of that amount."

"739 *Meaning of 'proceeds of realisation'*

(1) In this Part 'proceeds of realisation' of an asset means the amount recognised for accounting purposes as the proceeds of realisation, less the amount so recognised as incidental costs of realisation.

(2) The amounts referred to in subsection (1) are subject to any adjustments required by this Part or Part 4 of TIOPA 2010 (provision not at arm's length)."

152. On the question of what constitutes a "gain", I refer to relevant extracts from section 741:

"741 *Meaning of 'chargeable tangible asset' and 'chargeable realisation gain'*

> (1) For the purposes of this Part, an asset is a 'chargeable intangible asset' in relation to a company at any time if any gain on its realisation by the company at that time would be a chargeable realisation gain.
>
> (2) For the purposes of this Part, 'chargeable realisation gain', in relation to an asset, means a gain on the realisation of the asset that gives rise to a credit required to be brought into account under this Chapter.
>
> (3) For the purposes of subsections (1) and (2), there is a gain on the realisation of an asset in any case if section 735(2), 736(2) or 738(2) applies."

Section 735(2) is set out above. Section 736(2) is a corresponding provision where the asset is shown in the balance sheet but is not written down for tax purposes (that is, it is shown at cost). Section 738(2) provides that, where there is a realisation of an IFA that is not shown in the balance sheet, a credit equal to any proceeds of realisation must be brought into account for tax purposes.

153. In his report dated 24 January 2014 Mr Kundu noted that any disposal of goodwill would have been unintended; it is clear that in 2011/12 nobody thought there was to be such a disposal, and there was to be no sale and transfer agreement, only a Services Agreement. He also thought it unlikely that any such transfer or disposal would have been effected by an entity in the position of the Existing LLP (P1) in an arm's length transaction with a third party (P2); the purpose of such an agreement would have been to enable the third party to service the requirements of P1's trade—in other words, to enable P1 to continue to exploit its goodwill consisting of its customer relationships and the Edwin Hill brand. Mr Kundu did acknowledge the possibility that the entry into the Service Agreement with the New LLP might be regarded as having impaired the goodwill acquired by the Existing LLP on the acquisition of Edwin Hill's business. The only potential consequence of such impairment that he envisaged was the acceleration of the availability of losses to the corporate member, the claimant.

154. Mr Sayers, however, in his report of 4 April 2014, considered that such impairment of the goodwill "would have suggested that a disposal had occurred to the New LLP"; such a disposal, having been for no consideration, would be subject to the transfer pricing provisions in section 147 of TIOPA 2010. The New LLP Proposal would have involved the transfer of the fully trained and assembled workforce, including the individual members (so far as their involvement in the provision of professional services was concerned). "If immediate profit-making potential had been transferred along with the complete apparatus and the partners to generate those profits …, in my view there would inevitably have been a transfer of an intangible asset for transfer pricing purposes. … In my opinion it is not possible, applying the arm's length principle, for an entity to transfer profit-making potential at an overall cost to itself without either receiving a compensation payment for the loss of profit or a reduction in its intangible asset values."

155. Mr Sayers drew support for his opinion from the OECD's draft guidelines on business restructuring, contained in the document *Transfer Pricing Aspects of Business Restructurings: Discussion Draft for Public Comment[:] 19 September 2008 to 19 February 2009* ("the OECD Draft Guidelines"). Paragraph 66 of the OECD Draft Guidelines mentioned factors relevant to the question whether compensation should be given for the transfer of a profit- or loss-potential following on from a business restructuring; these included the expected return to each party after the restructuring, and the "[c]ompensation that might be required to appropriately remunerate the transferor's surrender of profit potential, in cases where the transferor has transferred or surrendered rights or other assets that carry that profit potential." Paragraph 93 said:

> "Business restructurings sometimes involve the transfer of an ongoing concern, i.e. of an activity. The transfer of an activity in this context means the transfer of a total bundle of assets (possibly including contractual rights, workforce in place, goodwill etc) and liabilities associated with performing particular functions, including the inherent risks. The determination of the arm's length valuation for a transfer of an ongoing concern does not necessarily amount to the sum of the valuations of isolated elements that are part of the transfer. In effect, transfers of ongoing concerns between independent parties often take account of any possible 'goodwill', i.e. of the profit/loss potential (if any) of the activity transferred, from the perspective of both the transferor and the transferee. Valuation methods that are used in acquisition deals between independent parties may prove useful to value a transfer of activity, including goodwill, between associated enterprises."

156. Although the OECD Draft Guidelines are helpful for giving insight into the OECD's thinking at the time and, perhaps, for understanding valuation methods, I do not agree with the defendants' submission that section 164 of TIOPA 2010 required engagement with the OECD Draft Guidelines. First, I do not consider that section 164(1) is engaged at all. Second, even if it is engaged, the OECD Draft Guidelines do not appear to be within the definition of "transfer pricing guidelines" for the purposes of that provision.

157. My reasoning and conclusions on the "transfer of goodwill" point are as follows.

1) The argument advanced on behalf of the defendants at trial was that (a) section 147, TIOPA 2010, requires a payment to be brought into account in respect of the transfer of goodwill from the Existing LLP to the New LLP and (b) that payment would be taxable under Part 8 of CTA 2009. See paragraphs 137 and 138 of the defendants' Closing Note.

2) The taxable amounts under Part 8 of CTA 2009 are amounts in respect of the realisation of IFAs. See the various provisions set out above.

3) The amounts to be taken into account for taxation purposes can be liable to adjustment on transfer-pricing grounds. See sections 739 and

906. Put shortly: if there has been a realisation within the meaning of section 734, transfer pricing can apply; but if there has not been such a realisation Part 8 is simply not engaged. Section 906 does not permit amounts to be brought into account for the purposes of Part 8 if there has not been a realisation within the terms of section 734, because the application of Part 8 is premised on such a realisation.

4) The first question, accordingly, is whether there has been (I shall assume implementation of the New LLP Proposal) a realisation of goodwill: section 734(1), CTA 2009. This depends on whether (a) there has been a transaction and (b) that transaction has resulted, in accordance with generally accepted accounting practice, in either (i) the goodwill ceasing to be recognised in the Existing LLP's balance sheet or (ii) a reduction in the accounting value of the goodwill (that is, a part realisation). It is to be noted that section 734(3) is clearly specifically designed to address the case of IFAs that would not be valued in accordance with generally accepted accountancy practice.

5) The whole of Mr Sayers' argument is premised on the notion that there has been a transfer that would not be reflected in the extinction or the reduction in value of goodwill in the Existing LLP's balance sheet in accordance with generally accepted accountancy practice. Given that premiss and the evidence of Mr Kundu to similar effect (albeit that he accepted that accountancy practice was outside his particular specialism), I proceed on that basis.

6) That being the case, Part 8 of the CTA 2009 has no application, unless section 734(3) applies. I shall come back to section 734(3) below.

7) Section 906 does not assist the defendants. First, they rely on amounts being taxable under Part 8. Section 906(2) does not affect what is brought into account under Part 8; it merely regulates what can be brought into account other than under Part 8. Second, there is no express indication that the transfer pricing rules have the effect that amounts can be brought into account outside Part 8. Third, as Part 8 itself recognises the transfer pricing rules (see section 739) there is no basis for recognising any implied indication for the purposes of section 906(2).

8) Although this does not appear to be the way that the defendants put their case, it is in principle open to them to contend that, as Part 8 does not apply to the transactions, section 906 does not itself apply; therefore the disposal/transfer that took place between the Existing LLP and the New LLP was not a matter in respect of which (cf. section 906(1)) Part 8 made provision; and therefore the transfer pricing rules can apply entirely outside Part 8. There would be at least three difficulties with such an argument. First, the defendants' case rests on saying that the amount of goodwill available for amortisation is reduced. That cannot, so far as I can see, be the case unless the transaction falls within section 734, CTA 2009. Second, a transaction that did not have the effect of extinguishing or reducing the value of

goodwill in the Existing LLP's balance sheet could hardly be a disposal or transfer of goodwill. Any suggestion that the value of the goodwill was preserved in the Existing LLP although some value in respect of essentially the same goodwill was created in the New LLP would have the appearance of arithmetical trickery; I should not accept it without cogent evidence in support. Third, the only IFA identified in the argument is goodwill. Goodwill is a classic example of an intangible asset that is valued in the balance sheet. A transfer or disposal of goodwill is accordingly a transaction that should be capable of being identified in the balance sheet. If such a transaction cannot be identified, it is strongly probable that it did not occur. If, on the other hand, the disposal or transfer related to a different IFA, it has not been identified.

9) More fundamentally, I agree with the submission of Mr Yates, supported by the opinion of Mr Kundu, that there was no transfer of any intangible fixed asset; there was simply the creation of the contractual rights and obligations between the two LLPs. The goodwill in the Existing LLP's business remained in the Existing LLP, which alone was client-facing. The New LLP took the cost of the staff—both employees and salaried partners—and benefitted to the extent of its remuneration under the Service Agreement, calculated on the basis that it was otherwise de-risked. That this objection to the objection is valid is, I think, illustrated by the reliance that was placed in the defendants' argument on section 734(3). Goodwill, however it may be analysed (and Mr Kundu analysed the Existing LLP's IFAs in his supplemental report dated 18 July 2014), is an asset with a balance sheet value, and no realisation of it could credibly be said to fall within section 734(3).

10) An additional, though in my view related, problem with the defendants' case on transfer pricing and goodwill is the difficulty in attributing any particular value to the objection in terms of the price that would be deemed to have been paid for the transfer. To recap: there is no express or intended transfer of goodwill; only the Existing LLP will be and remain client-facing; the Existing LLP will retain its clients; the New LLP has no existence vis-à-vis the clients; it is only a service-provider, for which it receives remuneration on a substantially de-risked basis. So far as I can see, unless the wholly implausible and unprincipled line be taken that a deemed payment sufficient to deprive the scheme of its intended tax benefit be deemed to have been made, no proper analysis has been undertaken of how the deemed transfer of goodwill would operate in monetary terms. Whether or not I am right in thinking that this omission is due to the inherent problems of the argument, it compounds the difficulties faced by the objection.

11) For these reasons I do not think that any award of damages (had one been made) ought to have been reduced to take account of the chance that the scheme would have been found to be subject to a valid objection relating to transfer pricing and goodwill. For completeness,

although it relates to a different aspect of the case, I should add that, in the light of all the evidence, including evidence regarding HMRC's historic attitude to transfer pricing and its available resources, and having regard to the need for commissioner approval of a transfer-pricing challenge, to the central focus of the statutory scheme on the effect of revenues within the jurisdiction, and to the relatively small amounts of money involved in this case, I should have thought it extremely unlikely that HMRC would have brought a challenge on this particular ground.

IR35

158. The final technical objection to the New LLP Proposal is of a rather different nature from the previous ones; it might be seen as a direct alternative to the *Heastie v Veitch & Co* argument. The objection is set out in paragraph 48(f)(A) of the re-re-amended defence:

> "IR35 would have applied to any service agreement between the [Existing] LLP and the New LLP with the result that the individual partners' profits from the New LLP would have been taxed as employment income. The defendants estimate that total additional employers' National Insurance Contribution ("NIC") liabilities of approximately £978,000 would have arisen in the New LLP as a result … together with additional personal NIC charges for the individual partners."

159. "IR35" is the shorthand given to various legislative provisions that are now contained in Chapter 8 of Part 2 of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA 2003'). The provisions are designed to prevent the avoidance of liability to make National Insurance payments by setting up arrangements whereby individuals provide services via the interposition of an intermediary, such as a partnership or company, in circumstances where the relationship between the provider and the recipient of the services would otherwise be one of employee and employer. It is necessary to refer only to select provisions of Chapter 8:

> "49. *Engagement to which this Chapter applies*
>
> (1) This Chapter applies where—
>
> (a) an individual ('the worker') personally performs, or is under an obligation personally to perform, services for another person ('the client'),
>
> (b) the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party ('the intermediary'), and
>
> (c) the circumstances are such that, if the services were provided under a contract directly between the client and the

worker, the worker would be regarded for income tax purposes as an employee of the client.

(3) The reference in subsection (1)(b) to a 'third party' includes a partnership or unincorporated body of which the worker is a member.

(4) The circumstances referred to in subsection (1)(c) include the terms on which the services are provided, having regard to the terms of the contracts forming part of the arrangements under which the services are provided."

"50. *Worker treated as receiving earnings from employment*

(1) If, in the case of an engagement to which this Chapter applies, in any tax year—

(a) the conditions specified in section … 52 are met in relation to the intermediary, and

(b) the worker …
(i) receives from the intermediary, directly or intermediary, a payment or benefit that is not employment income, or
(ii) has rights which entitle, or which in any circumstances would entitle, the worker … to receive from the intermediary, directly or indirectly, any such payment or benefit,

the intermediary is treated as making to the worker, and the worker is treated as receiving, in that year a payment which is to be treated as earnings from an employment ('the deemed employment payment')."

"52. *Conditions of liability where intermediary is a partnership*

(1) Where the intermediary is a partnership the conditions are as follows.

(2) In relation to any payment or benefit received or receivable by the worker as a member of the partnership the conditions are—

…

(b) that most of the profits of the partnership concerned derive from the provision of services under engagements to which this Chapter applies—
(i) to a single client …

(3) In relation to any payment or benefit received or receivable by the worker otherwise than as a member of the partnership, the conditions are that the payment or benefit—

(a) is received or receivable by the worker directly from the intermediary, and

(b) can reasonably be taken to represent remuneration for services provided by the worker to the client."

160. The argument on behalf of the defendants is accordingly to the following effect.

1) Members of the New LLP would be performing services for the Existing LLP but would be doing so under arrangements between themselves and the New LLP. Therefore section 49(1)(a) and (b) and section 49(3) are engaged.

2) If a member provided the services directly under a contract with the Existing LLP there would be a relationship of employment for income tax purposes, so section 49(1)(c) is satisfied.

3) The condition in section 50(1)(a) and section 52(2)(b)(i) is satisfied, because the New LLP's profits would be generated by its work for the Existing LLP.

4) Therefore any payment the member receives from the New LLP is a deemed employment payment, by reason of section 50(1)(b).

161. I regard this argument as plainly wrong, because its second step is incorrect. Section 49(1)(c) requires that the circumstances be such that, if the services were provided under a contract directly between the Existing LLP and the provider of the services (the member), the latter would be regarded for income tax purposes as an employee of the former. But the circumstances are not such. It has long been settled law in England and Wales that a member of a partnership cannot be an employee of the partnership: see *Ellis v Joseph Ellis & Co* [1905] 1 KB 324; *Cowell v Quilter Goodison Co Ltd* [1989] IRLR 392; *Tiffin v Lester Aldridge LLP* [2012] 1 WLR 1887. Section 4(4) of the Limited Liability Partnerships Act 2000 provides that "A member of a limited liability partnership shall not be regarded for any purpose as employed by the limited liability partnership unless, if he and the other members were partners in partnership, he would be regarded for that purpose as employed by the partnership." So a member of a limited liability partnership cannot be employed by the limited liability partnership. As Lady Hale explained in *Clyde & Co LLP v Bates van Winkelhof* [2014] 1 WLR 2047 at [20] – [21], the curious drafting of section 4(4) of the 2000 Act is probably to be explained by the fact that Scots law may permit a partner to be an employee of the firm of which he is a member.

162. Three arguments are raised against this conclusion. The first argument is that the factor that is said to prevent the condition in section 49(1)(c) from being

satisfied, namely the service providers' status as members in the Existing LLP, would not be imported into the hypothetical contract mentioned in that paragraph. I cannot see why it would not. Mr Sayers says that IR35 is an anti-avoidance provision and the New LLP Proposal seeks to exploit a loophole. In my view, that is not the point. The New LLP Proposal did not seek to get around a liability to pay National Insurance contributions for the members, because there was no such liability. Rather it sought to get around other statutory provisions. That is no excuse for twisting section 49 to thwart the purpose of what was proposed. It seems to me entirely arbitrary to say that what has to be supposed under section 49(1)(c) is a contract lacking in any features that would prevent it being a contract of employment. The words "the circumstances are such" point to the actual facts, not to hypothetical facts concocted so as to achieve a certain result. To put the point crudely: the purpose of the provisions is that, if you would have to pay N.I. contributions for a person's services, you cannot get round that by the use of an intermediary. The present case is not that case.

163. The second argument (in fairness, more alluded to than developed) is that the rule of English law that a partner may not be an employee of the partnership, though widely regarded as axiomatic and beyond question, has not been confirmed at the highest level. In *Clyde & Co LLP v Bates van Winkelhof* the rule was challenged but the Supreme Court did not have to address the point: see Lady Hale at [29]; also the judgment of Lord Carnwath at [50] – [59]. As Neuberger J recognised in *Harrison v Bloom Camillin, supra,* it might be appropriate to take account of the chance that a challenge to previously settled law would have been pursued with success to the highest level; cf. his remarks on mistake of law at 230. However, this possibility does not seem to me to merit any finding in the defendants' favour on this particular point. First, it would take a decision of the Supreme Court to alter what has long been understood to be the law. Second, it is not generally thought that any special problem of injustice or arbitrariness arises from the law as it has long been understood (cp. the former rules distinguishing between the effects of mistakes of law and mistakes of fact). Third, there is in my respectful view much to be said for Lord Carnwath's concise explanation of why an argument based on section 82(1) of the Law of Property Act 1925 does not justify a change in the law. Fourth, the furthest that an argument of that sort could go, as it seems to me, is to show that the current position in English law, namely that employment of a partner by the partnership is *impossible*, is too strong: that is, that it is not impossible for a partner to be employed by his firm. However, the mere possibility of an employment relationship is not remotely the same as establishing that such a relationship exists. I can see no basis at all for supposing that, were it not for the interposition of the New LLP, the members would be regarded as employees of the Existing LLP; they are not and have never been so regarded. To assume the fact of employment from the possibility of employment would be manifestly incorrect. I should regard it as equally untenable to suppose that the existence in any partnership agreement of terms obliging partners to provide services to the firm created a relationship of employer and employee; that would be to ignore the fundamental difference between the relations of partners *qua* partners and those of employers and employees. To get around this by positing, for the purposes of section

49(1)(c), an express contract of employment is to do more than the statute permits and would be a case of pulling oneself up by one's own bootlaces. Fifth, context is everything. *Clyde & Co LLP v Bates van Winkelhof* was concerned with the construction of provisions of the Employment Rights Act 1996. Section 49(1)(c) of ITEPA 2003 raises instead the question whether the member would be regarded "for income tax purposes" as an employee of the Existing LLP. Partners in firms and members of limited liability partnerships are regarded as self-employed for tax purposes; this is reflected in HMRC's BIM, paragraph 72115. This tends to confirm, sixth, that the defendants' whole case on this point is unreal. Despite Mr Sayers' valiant efforts to argue the contrary, I think it extremely unlikely that HMRC would have had the slightest interest in exploring this point, let alone pursuing it to a tribunal and perhaps the Supreme Court. To put it very shortly: the point of Chapter 8 of ITEPA 2003 is to stop people using intermediaries as a way of avoiding the payment of National Insurance contributions they would otherwise be obliged to pay. But the Existing LLP had not been paying or required to pay such contributions for its members.

164. The defendants' third argument for resisting the conclusion that I reach is that the IR35 point only arises if the claimant has "somehow resisted" the *Heastie v Veitch & Co* objection and that, in those circumstances, if it were also to resist the IR35 objection it would be eating its cake and having it. I reject this argument. First, the proper way of dealing with the grounds of objection is to treat each in turn on its merits, not to assume that one or other must succeed. Second, the reasons for rejecting the defendants' *Heastie v Veitch & Co* argument (paragraph 131 above) do not entail the acceptance of the defendants' IR35 argument.

165. In assessing the value of any lost chance I would accordingly disregard the defendants' IR35 objection, which I regard as manifestly wrong.

Would HMRC have brought a challenge to the New LLP Proposal?

166. I have identified two points on which, in my judgment, a technical objection to the New LLP Proposal would have been more than merely fanciful but would have had some substantial prospect of success: first, the *Ramsay* objection on section 54, CTA 2009 (paragraphs 124 and 125 above); second, the weaker transfer pricing objection in respect of the fee payable to the New LLP (paragraph 148 above). I have assessed the prospects of a challenge on these grounds being successful at, respectively, 50% and one-third. In the case of the second objection, success would mean a reduction of the price paid by the Existing LLP to the extent of 50% of the bonus-related component of the individual members' remuneration (paragraph 148(6) above).

167. The next question is whether HMRC would have brought a challenge on either of these grounds. A subsidiary question is whether HMRC would have taken the necessary prior step of enquiring into the restructuring that had taken place or, on the contrary, would have left it to pass unremarked and without enquiry.

168. To begin at a general level, relevant evidence was given by Mr Hall, Mr Kundu and Mr Sayers.

1) Mr Hall's evidence was that he would have advised the claimant and the Existing LLP to make full disclosure of all elements of the restructuring to HMRC. This would have included the agreements executed for the purposes of the restructuring. It would not necessarily involve the proactive disclosure of the motive for the restructuring (namely, circumvention of section 1263); whether the motive should be disclosed would have to be considered in the course of the preparation of the return, although any direct question by HMRC as to the reason for the restructuring would have to be answered truthfully, and it was generally in the taxpayer's interests to be more rather than less forthcoming with HMRC. The obvious differences that would exist between the former and the further tax returns meant that a challenge by HMRC was a possibility; Mr Hall was reluctant to say that it was "likely": "Likelihood is a difficult word to categorise in the context of an Inland Revenue enquiry. A number of factors come into play: the resources available to the Revenue; prevailing views within the Revenue. It is difficult for me to judge." He said that there were too many variables to permit assessment on a scale of probabilities and that he had never found it possible to predict HMRC's behaviour. In cross-examination he accepted that the fact that the restructuring was being undertaken to get round section 1263 "could have" increased the risk of a challenge by HMRC. In re-examination he said that, although he had used dual LLP structures for tax reasons (though never to turn a profitable LLP into a loss-making LLP), he had not known HMRC to enquire into the motivation behind such structures. He did not say whether this might be because the tax motivation had been obvious.

2) Mr Kundu's evidence as to the likelihood of an enquiry was closely similar to that of Mr Hall: an enquiry was likely and he would expect one, but he refused to say that an enquiry was "highly likely" and insisted that he "wouldn't be surprised" if there were no enquiry. I took this to indicate simply that it was impossible to predict such matters with a high level of confidence and that, as Mr Kundu put it, "we are often surprised by the lack of HMRC inquiry into matters where we might expect [an inquiry]". Mr Kundu did not consider that the full disclosure to be made to HMRC would include provision of the legal agreements, but he did envisage that it would include a statement of the purpose of the restructuring, to the effect that it would enable the claimant to preserve the entitlement to the goodwill deductions that it enjoyed before the enactment of section 1263. Mr Kundu did not think that this purpose would make HMRC more likely to bring a challenge, essentially for two reasons: first, section 1263 was not designed to undermine the entitlement to tax relief in respect of amortisation of profits; second, Mr Hall's experience did not suggest that dual LLP structures were subject to HMRC challenge.

3) Mr Sayers' view, as expressed in the experts' joint statement and not subjected to material challenge, was that an enquiry was "very likely" and "almost certain".

169. Although the prediction of the behaviour of third parties, including HMRC, is rarely certain, the position is in my view reasonably clear. Disclosure would have been made of the details of the restructuring. Whether or not the formal legal agreements were produced, that disclosure would have shown that there was a transfer of staff from the Existing LLP to the New LLP and a contract for the provision of services by the New LLP to the Existing LLP. The result, namely the conversion of a profitable entity into a loss-making entity, would have been entirely obvious. The reason for this state of affairs would probably have been disclosed in terms; Mr Hall did not say that it would not have been, and Mr Kundu's evidence tended positively to support the conclusion that an express statement of purpose would have been made. Whether or not the motivation were volunteered, I think it strongly probable that HMRC would either have inferred it or, if they could not infer it, enquired as to it; if they had done the latter, they would have received an honest answer.

170. The purpose of the restructuring, namely to circumvent section 1263, is not itself a free-standing ground of challenge to the restructuring. However, in the light of Mr Hall's evidence, albeit that it was expressed tentatively, and on the basis of inherent probability, I consider that the purpose would make HMRC more assiduous in considering whether grounds of challenge existed and would therefore make a challenge more probable. Mr Kundu's reasons to the contrary are unpersuasive. Although section 1263 is not intended as an attack on tax relief for amortisation of goodwill, it is clearly, to put the matter broadly, an attack on the ability of taxpayers to assert losses arising out of profitable businesses, and the New LLP Proposal was obviously an attempt to retain a tax advantage that section 1263 would otherwise rule out. The fact, advanced by the claimant and acknowledged by Mr Sayers, that the restructuring did not involve an attempt to claim deductions for expenses for unreal items—for example: real services were being provided for the money paid to the New LLP—does not seem to me to be entirely the point. The advantages obtained by the claimant in respect of amortisation of goodwill were precluded by section 1263, unless a way could be found around that provision; the fact that a profitable business was being turned into a loss-making business simply to hang on to those advantages is sufficient to excite scrutiny. (Cf. paragraph 2.18 of *Professional conduct in relation to taxation,* produced by the Institute of Chartered Accountants in England and Wales in 2006.) As for Mr Hall's experience, it did not include the use of dual LLP schemes to turn profitable businesses into loss-making businesses, which in the present case is the critical feature of what was proposed. In these respects I agree with the tenor of Mr Sayers' criticism of Mr Kundu's assessment of the likely approach of HMRC.

171. I did not obtain much enlightenment from the experts' comments on the approach of HMRC to challenges. When it descended from the very general, the evidence tended simply to reflect the different views as to the overall merits of the New LLP Proposal. The likelihood of HMRC proceeding from

an enquiry to a challenge must, in my view, depend primarily on the merits of the arguments they proposed to raise. As the actual views of HMRC are not known, I shall have to rely largely on my own assessment of those merits.

172. A *Ramsay* challenge on the basis of section 54 would (in my view) have had a 50% chance of success. This suggests a reasonable degree of likelihood that HMRC would have taken the point, if they pursued a properly diligent approach to their functions. It is clear from the case-law that challenges on the basis of section 54 were by no means unusual. Mr Ewart submitted that the lateness with which the section 54 argument had been formulated by the defendants was an indication that the point would probably not have been taken by HMRC. I do not agree with that submission, because it seems to me that section 54 lies at the heart of the potential objection to the scheme. In my judgment this is the most obvious ground of challenge, because it is where the confluence of the business motive for the actual payments and the fiscal motive for the overall structure is most clear. To assess the degree of likelihood of a challenge being made is subject to the difficulties identified by Mr Hall, but doing the best I can I think that it is more likely than not that HMRC would have pursued a challenge on this ground. I place the probability of it doing so at 60%.

173. A challenge on the transfer-pricing ground seems to me to be very much less likely, for several reasons. First, a determination of the amount to be brought into account for tax purposes under section 147(3), TIOPA, requires the sanction of the Commissioners for Revenue and Customs; it may not be made by an HMRC officer: section 208, TIOPA. Accordingly a high-level decision is required to set this ground of challenge in motion. Second, challenges on the ground of transfer pricing are significantly less frequent than challenges on section 54 grounds. Third, the experts accepted that HMRC is likely to have greater interest in a transfer-pricing argument that has implications for the prevention of removal of tax revenues to other jurisdictions. Although the argument here would have a potential use in increasing domestic tax revenues, it does not seem to be the kind of case that would most obviously attract transfer-pricing interest. Fourth, the potential ground of objection seems to be relatively weak. Fifth, the objection, if successful, would have only limited effect; it would not deprive the scheme of all its tax advantages. In the light of these matters, I am of the view that the only realistic likelihood of a transfer-pricing challenge being brought would have been in conjunction with a section 54 challenge. In the event of a section 54 challenge being brought, I should regard the chances of a transfer-pricing challenge being included as being 40%; that is, there is a 60% chance of a challenge on section 54 grounds, and there is a 40% chance that any such challenge that was brought would also include a transfer-pricing challenge.

Would HMRC have brought a challenge to the 2008 and 2009 returns?

174. The risk of a challenge to the restructuring is not the only risk to which implementation of the New LLP Proposal would have been subject. The re-re-amended defence and counterclaim avers that, if the New LLP Proposal had been implemented, HMRC's consideration of it and its sole and obvious

motivation (namely, to get around section 1263, CTA 2009) would have led HMRC to challenge not only the efficacy of the restructuring but also the filing position in the years prior to 2010. That is, HMRC would have taken the point that section 1263 did not change the law at all but merely made express what was its own understanding of the existing law as reflected in paragraph 72245 of the BIM (see paragraphs 16 to 20 above). The result would have been that the losses of £2,495,000 attributed to the Existing LLP for 2008 and 2009 would not have been available to the claimant.

175. It is fair to say that very little attention was paid to this contention at trial. However, it was never abandoned and I must deal with it.

176. The possibility of such a challenge arises clearly from HMRC's known stance that section 1263 did not change the law. The possibility of a challenge was expressly accepted by Mr Hall; he said that it was possible (see above for his views on likelihood and HMRC) but that he would have been confident of defeating it, on the basis that section 1263 was a change of the law and not a mere codification.

177. A number of factors militate against the likelihood of a challenge of this kind being brought. First, HMRC's position is not obviously correct, as is shown by the fact that both Mr Hall and Mr Corrin disagreed with it. It rests primarily on a disputed interpretation of the scope of the principle underlying the decision of the Special Commissioner in *PDC Copyprint (South) v George* [1997] STC (SCD) 326. Second, HMRC never challenged the claimant's original filing position as adopted by Mr Corrin (paragraphs 18 and 19 above). Third, HMRC did not challenge the elections made for 2009, even though those elections were premised on section 1263 having effected a change in the law (paragraphs 26 and 27 above). Fourth, the ground of challenge would be of limited importance; although it would have an effect on the particular case, any wider relevance would be overtaken by the operation of sections 1263 and 1264, CTA 2009.

178. Against those factors must be set, first, the fact that HMRC had a publicly expressed view that section 1263 was not a change of the law and, second, that a challenge to the New LLP Proposal would have been a very obvious occasion for challenging the earlier filing position, even if a challenge of the latter kind would not have been brought independently.

179. The merits of HMRC's position in paragraph 72245 of the BIM were not subject of argument before me from either party. The fact that the defendants did not attempt to demonstrate by argument that HMRC's position was correct would itself incline me to the view that it was not a strong position. That view gains confirmation from my own reading of *PDC Copyprint (South) v George*, which turned on the principle that the deduction as trading expenses of "salaries" payable to partners was prohibited by section 74 of the Income and Corporation Taxes Act 1988. Although it is arguable that the underlying reasoning would apply to the priority profit share payable to the individual members of the Existing LLP, I should think that the argument was relatively weak and that Mr Corrin and Mr Hall were right to be confident that it could be defeated.

180. Having regard to these matters, I conclude that, if HMRC had brought a *Ramsay* challenge on the basis of section 54, CTA 2009, to the restructuring (of which there was a 60% chance), there would have been a 40% chance that it would have brought with it a challenge to the claimant's original filing position; and a challenge to the original filing position would have had a 30% chance of success. By my reckoning, that means that the implementation of the New LLP Proposal would have entailed a 7.2% chance of the claimant's tax benefits from its original filing position being set aside.

Conclusion

181. For the reasons set out above I have arrived at the following conclusions:

181.1 The defendants were in breach of duty in January 2009. (See paragraphs 67 to 82 above.)

181.2 The consequences of that breach of duty are to be determined on the "loss of a chance" basis. This means that: (a) the claimant bears the burden of proving on the balance of probabilities that it would have taken the course of action on which it relies; (b) if the claimant discharges that burden, the court must then assess the chance that the course of action would have realised the benefits that it is alleged would have resulted from it. (See paragraphs 55 to 66 above.)

181.3 The claimant has not proved on the balance of probabilities that it would have taken the course of action on which it relies, namely the implementation of the New LLP Proposal. Therefore the claim fails. All further conclusions are accordingly immaterial to the final order that I shall make; they explain what would have been the outcome if the claimant had discharged the burden of proof on the primary causation issue. (See paragraphs 83 to 94 above.)

181.4 If the claimant had implemented the New LLP Proposal, it would have done so within a timescale of about twenty-seven weeks and would not have incurred the expense of an opinion from tax counsel. (See paragraphs 96 and 97 above.)

181.5 If the claimant had implemented the New LLP Proposal:

181.5.1 A *Ramsay* challenge based on section 1263, CTA 2009, would have had no substantial merit. (See paragraphs 100 to 111 above.)

181.5.2 A challenge based on *Heastie v Veitch & Co* would likewise have had no substantial merit. (See paragraphs 126 to 132 above.)

181.5.3 Having regard to the weakness of the argument, the difficulty of attaching any monetary value to the point, and the degree of likelihood of HMRC pursuing the point, no value can be

attributed to the chance that a transfer-pricing objection would have been brought on the basis of a deemed disposal of goodwill. (See paragraphs 149 to 157 above.)

181.5.4 A challenge on the ground of IR35 would have had no substantial merit. (See paragraphs 158 to 165 above.)

181.5.5 There was a 60% chance that HMRC would bring a *Ramsay* challenge based on section 54, CTA 2009. If such a challenge had been brought, it would have had a 50% chance of success. That means that there would have been a 30% chance of the New LLP Proposal failing as a result of such a challenge. (See paragraphs 112 to 125 and paragraph 172 above.)

181.5.6 In the event of a section 54 challenge being brought, there was a 40% chance that HMRC would include with it a transfer-pricing challenge in respect of the mark-up on the services of individual members. Such a transfer-pricing challenge would have had a one-third chance of succeeding; success would in this context mean a reduction of the price paid by the Existing LLP to the extent of 50% of the bonus-related component of the individual members' remuneration. (See paragraphs 137 to 148 and paragraph 173 above.)

181.5.7 If HMRC had brought a *Ramsay* challenge on the basis of section 54, CTA 2009, there would have been a 40% chance that it would have brought with it a challenge to the claimant's original filing position; and a challenge to the original filing position would have had a 30% chance of success. Accordingly, there was a 7.2% chance that the claimant would have lost the tax benefits of its original filing position. (See paragraphs 174 to 180 above.)

181.6 In the event, however, the claim fails for the reason set out in paragraph 181.3 above.

Postscript

182. The text of the foregoing part of this judgment is, subject to typographical corrections, substantially the same as that which I circulated in draft on 5 January 2015, when I indicated my intention to hand judgment down today.

183. On the evening of 6 January the claimant's representatives served submissions in respect of the draft judgment, requesting that I reconsider paragraphs 85 to 92, which deal with primary causation. Mr Turner managed to serve written submissions in response that same evening. I have considered both sets of submissions and the documents accompanying them, as well as a short response received late this morning from the claimant's solicitors.

184. The claimant's argument may be summarised shortly as follows. The judgment holds that the breach of duty occurred in January 2009, which is the date when the necessary advice ought to have been given and when the claimant would have begun to take action in response to that advice: see paragraphs 67 to 82, 89 and 181.1 above. The finding against the claimant on causation was based on the premiss that in January 2009 the claimant either had engaged or was about to engage PwC. However, there was no evidence at trial that the claimant had retained PwC as early as January 2009; the evidence went no further than that the retainer had been arranged before 1 June 2009. Further, the claimant has now, "[p]ursuant to [its] continuing duty of disclosure", re-examined its records, from which it can confirm that the engagement letter was dated 26 May 2009 and signed on 10 June 2009—both dates being several months after the relevant decision would have been made. Therefore "the Court has proceeded in error in assuming that as at January 2009 Dale Lawr had engaged or was about to engage PwC to conduct tax work." The proper inference is that the claimant would have engaged EY in 2009.

185. I shall not reconsider my decision.

186. For the claimant, Mr Yates referred me to the decisions of the Court of Appeal in *In re Barrell Enterprises* [1973] 1 WLR 19 and *Paulin v Paulin* [2009] EWCA Civ 221, [2010] 1 WLR 1057. For the defendant, Mr Turner referred me to the same Court's decision in *Robinson v Fernsby* [2003] EWCA Civ 1820. I have also found assistance in the discussion in paragraphs 16 to 27 of the judgment of Lady Hale in *Re L and B (children)* [2013] UKSC 8, [2013] 1 WLR 634; it seems to me that previous authorities must now be read in the light of that discussion.

187. The following considerations appear to me to be relevant for present purposes.

1) There is no doubt that the power to reconsider and alter the judgment exists. Further, the request for reconsideration has been made in respect of a judgment that has not yet been given; this is not merely a case where a judgment has been handed down and thereby become a public document but where the absence of a sealed order giving effect to the judgment means that the court retains a power to alter its reasoning or even its conclusions.

2) Each case is fact-sensitive, and in deciding whether to exercise its power to alter the substance of a draft judgment the court should apply the overriding objective.

3) Two relevant matters may come into some degree of tension. On the one hand, the court will not wish to hand down a judgment if it has come to the view that the judgment would do injustice as between the parties. On the other hand, the point has repeatedly been emphasised that the practice of providing draft judgments is intended to facilitate the avoidance of errors of typography and detail; it is not intended to provide an opportunity for the parties to reargue points on which they have lost or to seek to adduce new evidence to bolster cases that can

now be seen to have been inadequately supported at trial. (In this regard, cf. paragraphs 94 to 98 of *Robinson v Fernsby*.)

188. In the present case, however, I do not find any tension in the relevant factors. I do not see any reason to alter my conclusion regarding causation. And I do not consider that any proper justification has been shown for seeking to reopen that issue after circulation of the draft judgment.

189. First, I do not consider that the matters raised by the claimant affect the reasoning in the earlier parts of this judgment or require it to be amended. On the basis of the new evidence sought to be adduced by the claimant, which for the purposes of this paragraph only I shall treat as accepted, it now appears that in January 2009 Ms Lawr had not yet appointed PwC; she was to do so in a few months' time. I have not assumed that there had already been an appointment; see paragraph 90 above. For the purposes of that paragraph, the second alternative—Ms Lawr "was shortly to appoint [PwC] as the Altus Group's advisers on matters of UK tax—is the correct one. If the claimant's position is that there is determinative significance in the interval between January 2009 (when the advice would have been received) and 26 May 2009 (when the engagement letter was written), I disagree. There is nothing to suggest that the latter date marks some conversion experience on Ms Lawr's part, or that her professed admiration for PwC was a recent matter. Moreover, in the end, the matter comes back to this: it was for the claimant to prove its case on causation at trial, and neither the evidence adduced at trial nor the evidence sought now to be adduced is (in my judgment) sufficient for the purpose.

190. Second, I do not consider that there was any justification for the claimant to seek reconsideration of my findings on causation. If it is intended to suggest that my draft judgment was prepared on the basis of a mistake of fact (on the basis of the evidence given at trial), the suggestion is incorrect; I am aware of the evidence summarised in paragraph 4 of Mr Yates' submissions and have had regard to it. However, to the extent that reliance is placed on the new disclosure, the following observations may be made. First, the documents cannot bear the weight placed on them by the claimant. Second, the claimant's legal advisers were well aware both of the nature of their duty of disclosure and of the incidence of the burden of proof. They could have disclosed the documents in advance of trial, if they considered them relevant. (If, as is suggested, their relevance became apparent only in the course of or as a result of cross-examination, they could and should have been disclosed at that point.) Third, even if the new documents are said to be produced under a continuing duty of disclosure, the claimant cannot now rely on further documents without permission: r. 31.21. I should regard it as wholly wrong, as being inconsistent both with the well-known purpose for which draft judgments are circulated and with sound case-management and discipline in litigation, to permit the claimant now to re-open the issue of causation and adduce further evidence in that regard.

191. No terms of order have been agreed between the parties. The claimant has indicated that it seeks permission to appeal from this court. In accordance with the indication that I have when I circulated the draft judgment, I shall

adjourn consideration of that application and of other matters arising out of this judgment and shall extend the time for making an application to the Court of Appeal for permission to appeal.