Neutral Citation Number: [2018] EWHC 130 (ADMIN)

Case No: CO/2057/2015

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 30/01/2018

Before :

THE HONOURABLE MRS JUSTICE WHIPPLE

- -

Between :

THE QUEEN (ON THE APPLICATION OF MARCUS CARLTON, ROGER HARTLEY AND OTHERS)	**Claimants**
- and -	
HER MAJESTY'S COMMISSIONERS FOR REVENUE AND CUSTOMS	**Defendant**

- -
- -

David Southern QC (instructed by **DWF**) for the **Claimants**
David Yates (instructed by **HMRC Solicitors' Office**) for the **Defendant**

Hearing dates: 5 and 6 December 2017

- -

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

....

Mrs Justice Whipple:

Introduction

1. This judicial review is brought by a number of Claimants represented for present purposes by Marcus Carlton and Roger Hartley. The Claimants are members of limited liability partnerships and one limited partnership (the "Partnerships") which invested in commercial property with a view to taking advantage of business premises renovation allowances ("BPRA") introduced by Finance Act 2005 (see below for the relevant parts of the statute). The Claimants claimed loss relief associated with their investment in the Partnerships in their personal tax returns. The Commissioners of HM Revenue and Customs ("HMRC") opened enquiries into the partnership tax returns of two of the Partnerships. HMRC then issued Partner Payment Notices ("PPNs") to the Claimants under the Accelerated Payments Notices ("APN") legislation contained in Finance Act 2014, requiring the Claimants to pay a given amount calculated as a percentage based on the losses claimed.

2. By this judicial review, the Claimants challenge those PPNs. The original challenge advanced a number of grounds which were common to those raised in *R (Rowe and Others) v HMRC* [2015] EWHC 2293 (Admin), a judicial review brought by a number of taxpayers to challenge the PPN legislation. Permission was granted in *Rowe* and on 31 July 2015 Simler J refused the application for judicial review in that case. Following Simler J's judgment, the Claimants amended their Grounds for seeking judicial review in this case. Some of the new grounds were said by the Claimants to be specific to their case and not touched by *Rowe.* On 13 April 2016 Jay J granted permission on two out of six grounds advanced by the Claimants in their Amended Grounds; he adjourned the remaining four grounds pending the appeal to the Court of Appeal in *Rowe.* The present hearing proceeds in relation to those two grounds only. Jay J granted permission on those two grounds because he accepted they raised issues which were distinct from those raised in *Rowe.* It follows that the four issues which are common to *Rowe* are stayed behind the appeal in that case.

3. The two grounds on which Jay J granted permission are as follows:

    i) The Partnerships were commercial in nature and did not constitute tax avoidance. In consequence, the application of the APN legislation to these arrangements is unreasonable and/or an abuse of power (known as "Ground 1");

    ii) HMRC's decision to issue the PPNs was ultra vires because the statutory conditions had not been met on the facts of this case (known as "Ground 3"). (Before me, there was a dispute about the proper ambit of this ground. I shall address that below.)

4. The grounds on which he adjourned permission were as follows (in summary): that the APN legislation amounts to a breach of natural justice ("Ground 2"), that HMRC had breached the Claimants' legitimate expectations of the tax treatment of the losses sustained by the Partnerships ("Ground 4"), that the decision to issue the PPNs was unreasonable because of a failure to exercise discretion in individual circumstances, alternatively fettering of discretion ("Ground 5") and that the APN legislation is a

breach of article 6, alternatively, article 1 protocol 1 of the European Convention on Human Rights ("Ground 6").

Court of Appeal's judgment in *Rowe* and *Vital Nut*

5. In the event, the Court of Appeal heard *Rowe* at the same time as an appeal from the judgment of Charles J in *R (Vital Nut) v HMRC* [2016] 4 WLR 144. That hearing took place on 18–20 July 2017 and the combined judgment in both cases was handed down on 12 December 2017, shortly after the hearing in this case had concluded and before I had delivered judgment. I invited the parties to make written submissions on *Rowe,* if they wished to. I received submissions from the Claimants dated 20 December 2017, and responding submissions from HMRC dated 22 December 2017. I will deal with the content of those submissions as appropriate later in this judgment.

Summary

6. In summary, it is my conclusion that judicial review on the grounds now before me must be refused. The various statutory conditions for the issue of a PPN are fulfilled (Ground 3). There is no other public law reason (such as mistake of precedent fact, abuse of powers, unreasonableness or irrationality) to impugn HMRC's exercise of those powers in this case (Ground 1). In consequence, I conclude that the issue of PPNs to the Claimants in this case was lawful.

Preliminary issue: Claimants' application to exclude certain evidence

7. Shortly in advance of the hearing, on 27 November 2017 the Claimants issued an application to exclude the Statement of Case in the appeal which is proceeding in the First Tier Tribunal in parallel with this judicial review (I will explain the background to and scope of the FTT appeal below). HMRC's witness, Ms Kate Nash, had appended HMRC's Statement of Case to her second witness statement as part of the evidence relied on by HMRC in support of their defence of this claim.

8. I heard the Claimants' application at the start of the hearing and dismissed it. I said I would give reasons in my decision. At the same time, I acceded to the Claimants' request that if I was to see HMRC's Statement of Case, I should see the Claimants' Reply to that document as well (and indeed the Further and Better Particulars of the Statement of Case provided by HMRC in response to that Reply).

9. I dismissed the Claimants' application because I wished to see the FTT pleadings. I thought they were likely to be relevant to the issues in this case. Specifically, I wished to understand the issues to be litigated in the FTT so that I could be sure that I was not trespassing on the FTT's jurisdiction, to ensure that the arguments advanced before me were consistent with the matters pleaded in the tribunal by each party, and to understand the context in which this judicial review fell to be determined. As it turned out, the FTT pleadings were indeed important documents. They were particularly material in the resolution of the Claimants' case on "circular financing", see below.

Substantive Challenge

10. It is logical to look at Ground 3 before considering Ground 1, which is in effect at "catch-all". Before turning to the parties' submissions, I set out the relevant legal provisions and the background facts.

Relevant Legislation

11. Three areas of legislation are relevant to this challenge: in chronological order, they are, the "DOTAS" legislation which relates to disclosure of tax avoidance schemes (first introduced in 2004 and substantially amended in 2006), the BPRA legislation (introduced in 2005), and the APN legislation (introduced in 2014). It is logical to start with the APN legislation because that legislation empowers HMRC to issue PPNs which are the subject of the present challenge.

APN Legislation

12. This legislation was introduced by the Finance Act 2014 ("FA 2014"). The reasons for the introduction of this legislation are well known. They were examined in *Rowe* and I gratefully adopt Simler J's description of the background (see [11]-[30]), and that of the Court of Appeal (see [6]-[7]), per Arden LJ). Chapter 2 of FA 2014 makes provision for "follower notices" which can be issued to a taxpayer where HMRC consider that a judicial ruling in another case is relevant to the particular arrangements of the notified taxpayer; in other words, and colloquially, that the taxpayer's particular arrangements "follow" a case which has already established the precedent against the taxpayer. The notified taxpayer is required to take corrective action, and is liable to a penalty of up to 50% of the tax at stake if he or she chooses to continue to dispute the tax in light of the follower notice. Chapter 3 of FA 2014 makes provision for APNs. The effect of an APN is to require the person notified to pay the tax in dispute immediately, so that it is held by HMRC pending the course of litigation to determine the tax liability of the underlying arrangements. Schedule 32 of FA 2014 makes special provision for APNs in the context of partnerships. These are known as partner payment notices, or PPNs. PPNs are a sub-category of APNs, directed specifically at partners who have participated in partnerships to which the legislation applies. A specific mechanism for notifying partners is required because those partners will be taxed as individuals, even though the transactions will have been undertaken by the partnership. The individual partners must file a self-assessment return which includes a self-assessment of the amount of income and capital gains payable after taking account of any relief (s 9(1) Taxes Management Act 1970, "TMA"). The partnerships must also file a return, including a partnership statement which sets out the income or loss sustained by the partnership and the income or loss attributable to each partner, for the relevant period (s 12AB(1) TMA).

13. Paragraph 3 of Schedule 32 provides as follows:

> **"3 Circumstances in which partner payment notices may be given**
>
> (1) Where a partnership return has been made in respect of a partnership, HMRC may give a notice (a "partner payment notice") to each relevant partner of the partnership if Conditions A to C are met.
>
> (2) Condition A is that—

(a) a tax enquiry is in progress in relation to the partnership return, or

(b) an appeal has been made in relation to an amendment of the return or against a conclusion stated by a closure notice in relation to a tax enquiry into the return.

(3) Condition B is that the return or, as the case may be, appeal is made on the basis that a particular tax advantage ("the asserted advantage") results from particular arrangements ("the chosen arrangements").

(4) Paragraph 3(3) of Schedule 31 applies for the purposes of sub-paragraph (3) as it applies for the purposes of Condition B in section 204(3).

(5) Condition C is that one or more of the following requirements are met—

(a) HMRC has given (or, at the same time as giving the partner payment notice, gives) the representative partner, or a successor of that partner, a follower notice under Chapter 2—

(i) in relation to the same return or, as the case may be, appeal, and

(ii) by reason of the same tax advantage and the chosen arrangements;

(b) the chosen arrangements are DOTAS arrangements (within the meaning of section 219(5) and (6));

(c) the relevant partner in question has been given a GAAR counteraction notice …"

14. In this case, Condition A was met, on any view. HMRC had opened enquiries into the partnership returns.

15. At the hearing, a dispute arose as to the applicability of Condition B. Mr Southern QC, who represents the Claimants, submitted Condition B was not met on the facts. His submission was based on a proposed interpretation of paragraphs 3(3) and 3(4) of Schedule 32. Mr Yates, who represents HMRC, objected to the Claimants raising the issue because it was (he said) a new point taken too late. I shall deal with that objection shortly, but for present purposes, it is sufficient simply to identify the argument in outline. Mr Southern contended that the Claimants had not, on a proper analysis, obtained a "particular tax advantage" by reference to "chosen arrangements" as those terms appearing in paragraph 3(3) should be understood; the effect was that Condition B was not met; this, he said, was a ground for impugning the PPNs.

16. In so far as Condition C is concerned, HMRC had invoked paragraph 3(5)(b), on the basis that the arrangements were DOTAS arrangements. There is no suggestion that either of the other limbs of paragraph 3(5) could apply: no follower notice had been

issued to the Claimants (paragraph 3(5)(a)); nor had any partner been given a GAAR counteraction notice (this is a reference to the General Anti-Avoidance Rule introduced by the Finance Act 2013, which is the subject of detailed provisions contained in Schedules 43, 43A and 43B of that Act) (see paragraph 3(5)(c)).

17. Paragraph 3(5)(b) of Schedule 32 refers to section 219, subsections (5) and (6), of FA 2014, which define DOTAS arrangements for the purposes of the APN regime. They provide as follows:

> "(5) *"DOTAS arrangements"* means—
>
> > (a) notifiable arrangements to which HMRC has allocated a reference number under section 311 of FA 2004,
> >
> > (b) notifiable arrangements implementing a notifiable proposal where HMRC has allocated a reference number under that section to the proposed notifiable arrangements, or
> >
> > (c) arrangements in respect of which the promoter must provide prescribed information under section 312(2) of that Act by reason of the arrangements being substantially the same as notifiable arrangements within paragraph (a) or (b).
>
> (6) But the notifiable arrangements within subsection (5) do not include arrangements in relation to which HMRC has given notice under section 312(6) of FA 2004 (notice that promoters not under duty imposed to notify client of reference number)."

18. The Claimants contend that the arrangements were not as a matter of fact or law "notifiable arrangements" for the purposes of DOTAS, so that Condition C was not fulfilled. That issue is plainly before the Court (set out as Ground 3 in the Claimants' Amended Grounds).

19. For completeness' sake, I note that the legislation contains rules about the amount notified by way of PPN at paragraph 4(2) of Schedule 32 which provides as follows:

> "(2) The payment required to be made under paragraph 6 is an amount equal to the amount which a designated HMRC officer determines, to the best of the officer's information and belief, as the understated partner tax.
>
> (3) *"The understated partner tax"* means the additional amount that would become due and payable by the relevant partner in respect of tax if—
>
> …
>
> > (b) in the case of a notice given by virtue of paragraph 3(5)(b) (cases where the DOTAS arrangements are met), such adjustments were made as are required to counteract so much of what the designated HMRC officer so determines as the denied advantage as is reflected in a return or claim of the relevant partner;
> >
> > ...

> (4) *"The denied advantage"* —
>
> …
>
> (b) in the case of a notice given by virtue of paragraph 3(5)(b), means so much of the asserted advantage as is not a tax advantage which results from the chosen arrangements or otherwise, …"

20. The effect of these provisions is that a PPN can relate to a part only of the relevant tax advantage claimed. In this case, the PPNs were calculated on the basis of a percentage of the losses claimed by the Claimants by virtue of their investment in the Partnerships. HMRC accept that some of the losses were legitimately claimed and have allowed them.

DOTAS

21. DOTAS is a reference to a set of provisions contained in Finance Act 2004 ("FA 2004") establishing a scheme for disclosure to HMRC of arrangements which are or may amount to tax avoidance. Specifically, a person who is a "promoter" in relation to "notifiable arrangements" is required to provide certain information about them to HMRC (s 308). A promoter is defined at s 307. In this case, the promoter was Downing LLP ("Downing"). When a person notifies an arrangement in compliance or purported compliance with s 309, HMRC allocates a reference number to the arrangements, s 311. The promoter is then required to provide that number to the clients involved in the proposal or arrangements by s 312, and is required to provide client details to HMRC, s 313ZA. Thus, HMRC is on notice of the promoter's and the client's involvement in the arrangements, and can open enquiries or challenge the tax returns of the promoter or the clients, if they consider that to be appropriate.

22. The key concept for present purposes, touched on already in the context of the APN legislation, is 'notifiable arrangements'. Section 306 FA 2004 defines such arrangements as follows:

> "(1) In this Part *"notifiable arrangements"* means any arrangements which—
>
> (a) fall within any description prescribed by the Treasury by regulations,
>
> (b) enable, or might be expected to enable, any person to obtain an advantage in relation to any tax that is so prescribed in relation to arrangements of that description, and
>
> (c) are such that the main benefit, or one of the main benefits, that might be expected to arise from the arrangements is the obtaining of that advantage. …
>
> (2) In this Part *"notifiable proposal"* means a proposal for arrangements which, if entered into, would be notifiable arrangements (whether the proposal relates to a particular person or to any person who may seek to take advantage of it)."

23. The term "advantage" as it appears in s 306(1)(b) is defined at s 318 as follows:
"(1) In this Part—

"advantage", in relation to any tax, means—

(a) relief or increased relief from, or repayment or increased repayment of, that tax, or the avoidance or reduction of a charge to that tax or an assessment to that tax or the avoidance of a possible assessment to that tax,

(b) the deferral of any payment of tax or the advancement of any repayment of tax, or

(c) the avoidance of any obligation to deduct or account for any tax;

"arrangements" includes any scheme, transaction or series of transactions;
…"

24. Tax is defined to include income tax and capital gains tax (s 318).

25. At the relevant time, the Treasury had prescribed certain schemes (as presaged by s 306(1) FA 2004) by reference to "hallmarks" set out in the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543). Description 6 is relevant to this case. It prescribes loss schemes, as defined at regulation 12, as it was drafted at the relevant time:

"12. Description 6: Loss schemes
"Arrangements are prescribed if—
(a) the promoter expects more than one individual to implement the same, or substantially the same, arrangements; and
(b) the arrangements are such that an informed observer (having studied them) could reasonably conclude—
(i) that the main benefit of those arrangements which could be expected to accrue to some or all of the individuals participating in them is the provision of losses, and
(ii) that those individuals would be expected to use those losses to reduce their liability to income tax or capital gains tax."

26. So far as DOTAS is concerned, the mainstay of the Claimants' case is that the arrangements were not notifiable under DOTAS, and so, in turn, they were not caught by Condition C of the APN Legislation.

Business Property Renovation Allowances

27. BPRA were introduced by the Finance Act 2005 which inserted sections 360A-360ZA into the Capital Allowances Act 2001 ("CAA 2001"). The legislation applied to "qualifying expenditure" which was at the relevant time defined in this way at s 360B:

"(1) In this Part *"qualifying expenditure"* means capital expenditure incurred before the expiry date on, or in connection with—

> (a) the conversion of a qualifying building into qualifying business premises,
>
> (b) the renovation of a qualifying building if it is or will be qualifying business premises, or
>
> (c) repairs to a qualifying building or, where the qualifying building is part of a building, to the building of which the qualifying building forms part, to the extent that the repairs are incidental to expenditure within paragraph (a) or (b). …"

28. A qualifying building was defined at s 360C as business premises which were situated in a "disadvantaged area" (as designated by Treasury Order) and were unused at the time of the qualifying expenditure. The relevant Treasury Order was the Assisted Areas Order 2007 (SI 2007/107).

29. The legislation permitted a person who had incurred qualifying expenditure on a qualifying business premises to an allowance for that expenditure (s 360G). The allowance was 100% of the qualifying expenditure. If the building was held as an asset of a property business, the allowance was treated as an expense of that business. The effect was that qualifying expenditure was fully deductible when incurred. Because the Partnerships are transparent for tax purposes, the qualifying expenditure incurred by the relevant Partnership was treated as incurred by the partners in proportion to their respective partnership interests, thereby producing losses from the property business conducted by the Partnership which were deductible against that partner's general income for the loss-making year and the subsequent tax year (see s 120 Income Tax Act 2007). The allowances were liable to claw back if there was a sale or similar balancing event within 7 years (s 360M).

30. The Claimants relied on BPRA to claim losses in their self-assessment returns, by reference to their investment in the Partnerships. There is a dispute about the *amount* which each Claimant is entitled to deduct, and that dispute in turn relates to the proper meaning of the term "qualifying expenditure". HMRC argues that some of the elements claimed by Downing did not qualify under the legislation at all, and thus, that the losses have been overstated. This dispute will be resolved by the FTT in due course.

The Facts

31. The Claimants are all members of one or more of the 9 Partnerships under challenge. The representative partner of each of the Partnerships was Downing LLP (except for the Stellar Martineau Place LP, formerly Invicta Martineau Place LP, whose general partner is Martineau Place Ltd).

32. Enquiries were raised under section 12AC of the Taxes Management Act 1970 into the self-assessment tax returns filed by the Partnerships. One of the partnerships, London Luton Hotel BPRA Property Fund LLP ("London Luton"), was examined by HMRC in detail. The affairs of that partnership are the subject of the lead appeal proceeding in the FTT. An outline of London Luton will serve to illustrate the nature of the arrangements generally.

Example - London Luton

33. London Luton was incorporated on 26 November 2009. In February 2011, Downing produced marketing material to promote London Luton to individual investors (this is the "Information Memorandum"). Amongst other things, the London Luton Information Memorandum recorded that:

> "Under HMRC's disclosure regime, Downing will apply for a disclosure number for this scheme which will be notified to Members and should be included in Members' tax returns".

34. Accordingly, London Luton and the other Partnerships were all notified to HMRC and were given a DOTAS reference number. The partners investing in the Partnerships were aware that the arrangements were to be notified (and were indeed notified) under DOTAS.

35. The London Luton project involved the development of business premises with a view to converting them to a 124-bedroom hotel. An independent valuation of the completed hotel was obtained, which valued it at £11.9 million on day 1 of trading (post-development), and gave alternative future values based on different assumptions to provide a range of possible outcomes. On 25 March 2011 (i) a Members' Agreement was signed between Downing, Downing Management Services Ltd and 84 individual members who were intending to invest in London Luton; (ii) London Luton purchased the freehold property for the site for development; and (iii) London Luton entered into a Development Agreement with the proposed developer, OVL (Bankfield) LLP (the "Developer") by which London Luton was required to pay the Developer the "Development Sum" of £12,513,200 exclusive of VAT. Subsequently, the Developer entered into a design and build agreement with a contractor. The works price under the design and build contract was £5,721,914. By a separate agreement between the Developer and the same contractor, the contractor agreed to provide fixtures, fittings and equipment for £685,000 (subsequently increased to £735,541). Accordingly, there was a significant difference between the Development Sum on the one hand and the price paid to the contractor to complete the building and fit-out works.

36. The building and fit-out works were completed, and the hotel opened for business in July 2012.

37. In its return for 2011, London Luton claimed £12,478,201 as its qualifying expenditure for the purposes of BPRA. This figure was similar to the Development Sum under the Development Agreement (the modest difference is not explained but is not important).

38. In their self-assessment returns for the same tax year, each of the partners in London Luton claimed loss relief in proportion to their investment in that Partnership.

39. HMRC opened an inquiry into London Luton. In the event, and after PPNs had been issued to the partners in London Luton in relation to their personal tax returns, Downing requested a closure notice in relation to London Luton, in order to bring that enquiry to an end. The closure notice was issued on 5 February 2016 and it required an amendment to London Luton's 2011 return, by disallowing £6,784,015.34 of the

amount claimed. After some revision, the sum disallowed was £5,290,761. There is no dispute as to the remaining £7,187,640 which HMRC accepts was qualifying expenditure under BPRA (roughly 57% of the whole amount claimed).

40. London Luton filed a Notice of Appeal in the FTT to initiate its appeal (that document is not before me). HMRC lodged its Statement of Case dated 1 July 2016 and London Luton lodged a Response on 20 January 2017, in which further and better particulars of the Statement of Case were sought. Those further and better particulars were provided by HMRC on 17 March 2017. The latter three documents were put before this Court (and are referred to above in relation to the Claimants' application). The hearing of London Luton's tax appeal is listed in May 2018 with a time estimate of 3 weeks.

41. The appeal in the FTT is primarily concerned with the meaning of the expression "qualifying expenditure" as that expression appears in section 360B of the CAA 2001. HMRC's Statement of Case set out certain heads of expenditure claimed by London Luton as "qualifying expenditure" which HMRC disputes (see [56] – [73] of the Statement of Case). The core of HMRC's case in the FTT is that London Luton's claim for BPRA has been inflated (or "ramped up", as it is put in the Statement of Case) because some elements of the claimed sums are not qualifying expenditure at all. That is because, so HMRC argues, those elements were not incurred "in connection with" the conversion, renovation or repair of qualifying buildings, as envisaged by section 360B, regardless of whether those elements formed part of the Development Sum. London Luton joins issue with HMRC and contends that the entirety of the Development Sum, for which it was contractually liable, constitutes qualifying expenditure for the purposes of BPRA.

Mr Carlton and Mr Hartley

42. Mr Carlton invested in Waterloo Street BPRA Property Fund LLP, and Mr Hartley invested in Cumberland House BPRA Property Fund LLP and Invicta Martineau Place LLP. HMRC issued a PPN to Mr Carlton on 23 February 2015 for £4,581.62. Two PPNs were issued to Mr Hartley dated 9 and 23 February 2015 claiming payment of £21,062.87 in total.

43. The figures notified in the PPNs represented approximately 30% of the losses claimed by each of Mr Carlton and Mr Hartley by virtue of their investment in those Partnerships. That percentage was adopted by HMRC following a meeting between representatives of HMRC and Downing on 2 February 2015. I shall return to that meeting later in this judgment. The letters sent to the Claimants were in standard form and were headed "About the tax avoidance scheme the partnership has used". The letter and its accompanying fact sheet referred in many places to "tax avoidance". Mr Southern returns to the language of these letters frequently, objecting to that language and to any suggestion that the Claimants were involved in tax avoidance.

44. On 8 May 2015, the Claimants issued their application for judicial review challenging the PPNs. As I have already noted, on 31 July 2015, Simler J handed down judgment in *Rowe,* on 21 October 2015, the Claimants filed their Amended Grounds and on 8 December 2015, HMRC filed Summary Grounds of Defence. On 21 April 2016, Jay J granted permission limited to Grounds 1 and 3 and stayed the rest of the case pending the outcome of the appeal in *Rowe.*

Issues

45. The Claimants listed a number of issues in their skeleton, but I do not consider that list to reflect the real issues in this case. I note that in any event, that list was markedly different from the issues identified in the Claimants' Amended Grounds and, indeed, different from Mr Southern's oral submissions when the matter came before me.

46. I conclude that the issues for determination in this judicial review are as follows:

    i) Whether HMRC's objection to the Condition B challenge should be sustained;

    ii) Depending on the first issue, what is the meaning of Condition B as a matter of law;

    iii) Depending on the first and second issues, whether Condition B was fulfilled on the facts of this case;

    iv) Whether these are "DOTAS arrangements" for the purposes of Condition C;

    v) Whether the Claimants are entitled to argue, in the context of issue 3, that these PPNs were not validly determined by a designated officer, as required by FA 2014;

    vi) Whether, in light of my conclusions on the first to fifth issues, the Claimants succeed on Ground 3, by which they assert that the PPNs were *ultra vires*;

    vii) Whether the PPNs were wrong in law for any other reason advanced under Ground 1.

Issue 1: whether HMRC's objection to the Condition B challenge should be sustained

47. Mr Southern suggested that his challenge to Condition B was simply a variant of the argument that the Partnerships are not tax avoidance (the mainstay of Ground 1 but a recurring theme in Mr Southern's written and oral submissions). Mr Yates did not accept this and submitted that the Condition B challenge was a new argument, of which HMRC had had no notice. He objected to the argument being raised so late in the day, but said (in the alternative) that if I was minded to allow it to form part of the case before me, he could deal with it because it raised an issue of statutory interpretation which could be countered without the need for any evidence, and was anyway wholly and obviously misguided.

48. I accept Mr Yates' submission that the Condition B challenge is a new argument. The Claimants did not suggest anywhere in their Original Grounds, their Amended Grounds or their skeleton argument that they were challenging Condition B of Schedule 32. Such an argument cannot be inferred from the Claimants' generalised challenges to the PPNs contained in those documents. Indeed, the argument was so novel that I required Mr Southern to reduce it to writing after the hearing, giving HMRC permission to answer in writing, in order to allow the written arguments to catch up with the oral argument which I had already, by that stage, heard. The position was very unsatisfactory. (I received the Claimants' Note on Condition B on 7 December 2017, running to 9 pages. It appeared to me to develop the arguments

rather further than they had been pressed at the hearing. I also received HMRC's answer on 10 December 2017.)

49. However, I am prepared to allow this argument to be advanced even at the late stage. That is, first, because Mr Yates was able to deal with the argument at the hearing and in the end HMRC were not prejudiced by its lateness. I am grateful to Mr Yates and his clients for marshalling their answers so quickly. Further, the Condition B challenge raises issues of statutory construction in relation to provisions which are in any event before me, and which are central to the outcome of this case and I too can deal with the point without going beyond the core materials in this case.

Issue 2: What is the meaning of Condition B as a matter of law?

50. The challenge turns on paragraph 3(4) of Schedule 32 (set out above) which cross references to paragraph 3(3) of Schedule 31, by providing that the latter provision applies for the purposes of Schedule 32 "as it applies for the purposes of Condition B in section 204(3)". What does that mean?

51. Schedule 31 is headed "Follower Notices and Partnerships". Paragraph 3(3) of Schedule 31 provides:

> "(3) For the purposes of Condition B in section 204 a partnership return, or appeal in respect of a partnership return, is made on the basis that a particular tax advantage results from particular tax arrangements if—
>
> > (a) it is made on the basis that an increase or reduction in one or more of the amounts mentioned in section 12AB(1) of TMA 1970 (amounts in the partnership statement in a partnership return) results from those tax arrangements, and
> >
> > (b) that increase or reduction results in that tax advantage for one or more of the relevant partners."

52. Mr Southern suggests that the reference to paragraph 3(3) of Schedule 31 must therefore be followed through to s 204, referred to in the first line of paragraph 3(3). Section 204 describes the circumstances in which a follower notice can be given, and includes s 204(3) which provides that:

> "(3) Condition B is that the return or claim or, as the case may be, appeal is made on the basis that a particular tax advantage ("the asserted advantage") results from particular tax arrangements ("the chosen arrangements")."

53. That, he says, in turn imports the definition of "tax arrangements" at section 201(3) which is in the following terms:

> "(3) Arrangements are "tax arrangements" if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements."

54. Thus, Mr Southern argues, fulfilment of Condition B in the context of PPNs depends on identifying the taxpayer's *purpose* in entering into the arrangements. That is because s 201(3) is imported into Schedule 32 via the various statutory provisions set out above. The language of s 201(3) – which refers to purpose - is to be contrasted with the language of the DOTAS legislation which refers to "benefit" (see s 306(1)(c) FA 2004, set out above). He submits that the concept of purpose involves a greater element of subjectivity than the concept of benefit which is more objective. He refers to various cases to make good his submission that the two terms mean different things: see *Crown Bedding Co v CIR* 34 TC 107, *Mallalieu v Drummond* [1983] STC 665 and *Fisher v RCC* [UKFTT] 804 (TC).

55. By reference to the facts, Mr Southern submits that there is no evidence to support the conclusion that the Claimants' purpose (the main purpose or one of the main purposes) in entering into these arrangements was the obtaining of a tax advantage, and thus, Condition B was not fulfilled and the PPNs must on that basis be set aside.

56. Mr Yates submits that Mr Southern has made a wrong turn at an early point in his argument. Mr Yates argues that the opening sentence of paragraph 3(4) of Schedule 32, which contains the cross reference to paragraph 3(3) of Schedule 31, merely imports the 'mechanics' contained in the latter paragraph, and no more. The mechanics are simple: first, you ask whether there has been an increase or reduction in one or more of the amounts in the partnership statement in a partnership return as a result of the tax arrangements in issue (paragraph 3(3)(a)); and if there has been, you ask whether that increase or reduction results in the particular tax advantage for the partners (paragraph 3(3)(b)). If both questions are answered positively, that means Condition B is fulfilled, whether you are in Schedule 31 (follower notices in the context of partnerships) or Schedule 32 (PPNs). That is as far as the cross-reference goes: it means that Condition B is approached by asking the same questions, in the two different contexts in which Condition B appears. But there is no need to consider section 204 or section 201 in the context of PPNs; no issue of "purpose" as opposed to "benefit" arises. Instead, so far as PPNs are concerned, the language of paragraph 3(3) of Schedule 32 remains objective, posing a test of whether a particular tax advantage 'results from' the particular arrangements, without regard to the taxpayer's purpose in entering into those arrangements. In any event, argues Mr Yates, even if that construction was not correct, and the definition of 'tax arrangements' at s 201(3) should be imported into Schedule 32, that definition is easily met on the facts here, because it would undoubtedly be reasonable to conclude, having regard to all the circumstances, that the obtaining of a tax advantage was at least *one of* the main purposes for the Claimants' entering into these arrangements (to adopt the language of s 201(3)). So, he says, the Claimants' argument comes to nothing, even if it is technically correct.

57. So far as the issue is one of statutory construction, I prefer the arguments advanced by Mr Yates. The reference in paragraph 3(4) of Schedule 32 to paragraph 3(3) of Schedule 31 is limited to importing the mechanical elements of the latter paragraph only. It does not import the whole of the Condition B regime from Schedule 31. Specifically, it is not, and cannot sensibly be read as, a wider reference to (and importation of) the definition of "tax arrangements", including the concept of taxpayer's purpose, contained in s 201(3). I reach that conclusion for four reasons, which are connected. First, having regard to the structure of FA 2014 as a whole, it is

important to recall that Schedule 31 deals with follower notices. It is natural for paragraph 3(3) of Schedule 31 to refer to Condition B as it appears in s 204, because s 204 forms part of Chapter 2, which also deals with follower notices. The follower notice regime (Chapter 2 read with Schedule 31) is distinct from the APN regime, including PPNs, contained in Chapter 3 read with Schedule 32. Given that distinction, it would be very odd to read into a part of the APN regime (ie that part which relates to PPNs) an aspect of the follower notice regime, leaving APNs (other than PPNs) to be treated differently. I therefore conclude that Mr Southern's submission is inconsistent with the overall structure of the legislation. Secondly, if the draftsman had intended to import a test of "purpose" into Schedule 32 (PPNs), then he or she could have done so easily, for example by making a direct reference to s 201(3) in paragraph 3(3) or (4) of Schedule 32, or by referring in paragraph 3(3) to "tax arrangements" which would then link with the statutory definition of that term in s 201(3). But that has not been done. Instead, Schedule 32 refers to "particular arrangements". This difference in language cannot be explained on Mr Southern's proposed interpretation. Thirdly, Mr Yates' interpretation permits a plausible meaning to be given to the words "as it applies for the purposes of Condition B in s 204(3)" in paragraph 3(4) of Schedule 32. I understand those words to mean that paragraph 3(3) of Schedule 31 is relevant to a limited extent and only so far as is necessary to make Condition B in Schedule 32 work effectively, ie by importing its mechanics. By contrast, on Mr Southern's case, those words are unexplained and unnecessary. I prefer to construe the statute in a way which makes sense of its words, rather than rendering them otiose. Fourthly, on the basis that follower notices and APNs are aimed at different situations and operate on the basis of different conditions (contrast s 204 on the one hand with s 219(4) and paragraph 3(5) of Schedule 32 on the other), it is not a surprise, and certainly not a problem, if Condition B of each regime operates differently. Specifically, the APN regime comes into play only once the taxpayer has already passed through one of the three prescribed "gateways" which apply to that regime (namely, the partners have already been given a follower notice, the arrangements have already been registered under DOTAS, or a GAAR counteraction notice has already been given). But those gateways do not apply to follower notices. Given those differences, there is no reason to strain to arrive at a unified meaning for Condition B.

58. I therefore reject Mr Southern's argument on the construction of Condition B. I conclude that the mechanics of paragraph 3(3) of Schedule 31 are imported into Schedule 32, but that is all. Specifically, no issue relating to the taxpayer's purpose arises in the context of Schedule 32.

Issue 3: Whether Condition B was fulfilled on the facts of this case

59. So far as Condition B within Schedule 32 is concerned, and adopting the construction I have just outlined, the following two questions arise:

i) Has there been an increase or reduction in the partnership statement of the partnership return as a result of the arrangements entered into?

ii) If so, does that increase or reduction result in a tax advantage for one or more of the partners?

60. Answering those questions on the facts of this case leads to the answer "yes". The Partnerships' statements were substantially reduced by the qualifying expenditure. That reduction resulted in a tax advantage, namely loss relief, for the partners. Condition B is fulfilled.

61. I add that, even if my conclusion on the construction of paragraph 3(4) of Schedule 32 is wrong, I would not have reached a different answer on the ultimate question whether Condition B is fulfilled. On that hypothesis, I would have in mind that s 203(1) poses a test of whether "it would be reasonable to conclude that the obtaining of a tax advantage was … one of the main purposes of the arrangements". This is a test which contains at least some element of objectivity (… it would be reasonable to conclude….) and requires only that the tax advantage is <u>one of</u> the main purposes – that advantage does not have to be the sole purpose and the existence of a coincident commercial purpose would not be fatal. On the facts of this case, it would be reasonable to conclude that the Claimants were motivated by the prospect of obtaining tax advantages if they invested in the Partnerships; this was at least as one of their main purposes in making the investment. A passing glance at the Information Memoranda associated with each Partnership is sufficient to justify that conclusion: references to BPRA and the availability of losses are frequent, see for example the last paragraph of the executive summary of the London Luton memorandum:

> ".. approximately 81% of the Total Purchase Price will qualify for BPRA relief. It is estimated that £80,730 of each £100,000 investment will benefit from tax relief, providing tax relief of £40,365 to a 50% taxpayer. Net of the limited recourse bank loan, this equates to a net equity cost of approximately £6,087 for each £100,000 investment."

62. Condition B was fulfilled.

Issue 4: Whether these are "DOTAS arrangements" for the purposes of Condition C

63. The issue in relation to Condition C is whether the arrangements are "DOTAS arrangements" for the purposes of paragraph 3(5) of Schedule 32 FA 2014. This in turn depends on whether they are notifiable arrangements for the purposes of s 306(1) FA 2004.

64. As a matter of fact, Downing did notify HMRC about these arrangements, and was given a reference number in relation to each Fund. However, it is common ground that the fact of notification is not definitive of whether the arrangements were "notifiable" for the purposes of s 306(1) FA 2004. HMRC acknowledges that promoters sometimes opt to notify out of an abundance of caution.

65. Mr Southern argues that the schemes are not notifiable at all. He argues that the investment in each case was primarily for commercial purposes, so that any tax advantage generated by participation in the arrangements was not the (or, even, a) main benefit. On that footing, he says that Condition C is not fulfilled and the PPNs are defective. That line of argument of course encompasses far more than the Claimants' case on Condition C, it is the essence of the Claimants' case under Ground 1 too. The point made is that the Claimants were not involved in tax avoidance or anything close to it; they were simply investing in various funds with a view to renovating business premises in disadvantaged areas. The motivation was

commercial. The tax benefits were incidental. Further, BPRA was designed as an incentive to promote redevelopment in the public interest, and reliance on those provisions cannot now be characterised, in hindsight, as tax avoidance.

66. For HMRC, Mr Yates argues that these arrangements were loss schemes within Hallmark 6 as it is defined by Regulation 12 (see above). Accordingly, he argues that the requirements of s 306(1) are met and these schemes are indeed "notifiable" under DOTAS. On that footing, Condition C is fulfilled. (Mr Yates accepts that regulation 12 refers to "the main benefit" whereas s 306(1)(c) refers to "the main benefit, or one of the main benefits …". His submissions were predicated on the narrower formulation in regulation 12 which he says is met without difficulty on the facts of this case; in the circumstances, it was not necessary to have regard to the wider formulation in s 306(1).)

67. So far as the issue arises in the context of Condition C, it is important to recognise that the issue is, first and foremost, one of statutory construction as to the meaning of notifiable arrangements. It is not an issue which turns on the words used by HMRC in the letters sent to the Claimants informing them of the PPNs: the use of the words "tax avoidance" and "tax avoider" in those letters, or indeed at any other stage of the correspondence between HMRC and the Claimants, is not relevant to the meaning of "notifiable arrangements" under DOTAS. In this case, the legal issue depends on Regulation 12 because if these arrangements were loss schemes for the purposes of that regulation, then there is little, if anything, left to determine under s 306(1) (and the requirements of s 219(5) and (6) of FA 2014 and paragraph 3(5) of Schedule 32 will have been met also). And so Condition C will have been met.

68. Regulation 12 contains three important features:

   i) It poses an objective test, applied from the viewpoint of the informed observer who has studied these arrangements. It asks what such an observer could reasonably conclude.

   ii) It poses a test of "benefit", not purpose. This again tends towards an objective analysis.

   iii) The regulation does not refer to "tax avoidance". Instead, it applies a test based on two factors:

      i) first, whether the main benefit of the arrangements which could be expected to accrue to participating individuals is the provision of losses; and

      ii) secondly, whether those individuals would be expected to use those losses to reduce their liability to income tax or capital gains tax.

69. In light of that test, Mr Southern's submissions relating to tax avoidance, and his strenuous assertion that the Claimants were only ever involved in the Partnerships for good commercial reasons, are wide of the mark. The issue which arises under the statute is not whether the arrangements amount to tax avoidance; but whether the test, comprising those two factors, is met. There is, of course, a good reason why the statute makes no reference to tax avoidance: that concept is difficult to define and difficult to prove. The whole point of the APN regime is to shift the burden of the tax

onto the taxpayer, while litigation proceeds to determine the relevant tax issue (which in some cases will be tax avoidance; in other cases, as here, will be a technical issue relating to the tax analysis of the arrangements entered into). If a tax avoidance motive had to be proved before a notice could be issued, the purpose of the legislation would be defeated by the likely delay as that very issue was litigated.

70. Accordingly, I turn to the statutory test. I take the two factors outlined above at paragraph 68(iii) in reverse order. As to (b), it is clear that these arrangements were expected to generate losses which the Claimants would be able to use to reduce their own liability to tax; indeed, the availability of losses was the very incentive created by the BPRA legislation in order to encourage investment in business property in disadvantaged areas. That factor is present on the facts.

71. As to (a), there is more of an issue about whether the main benefit which could be expected to accrue to some or all of the individuals participating in these arrangements was the provision of losses. HMRC's answer is substantially contained in witness evidence which comes from Ms Nash. She has been employed by HMRC for 30 years and since 2012 has been the Technical and Litigation Lead dealing with BPRA arrangements, particularly those disclosed under DOTAS. Ms Nash has provided two witness statements dated 31 July 2017 and 13 November 2017. In her first statement, Ms Nash explains her approach. She considered the information memoranda prepared by Downing for the investors in each Partnership. In her statement, she takes the London Luton figures as illustrative, but she had available to her equivalent figures for each of the Partnerships. She analysed the earnings before interest, taxes, depreciation and amortisation ("EBITDA") by reference to Downing's own projected figures for that Partnership on two scenarios, the first being mid-range outcome, the second being the best-case scenario. Those figures are set out in Appendix A to this judgment. As she states, on either scenario, the tax advantage (ie losses generated by the arrangements) amounted to £6,256,000 whereas the return on investment was a lower postulated figure - on the mid-range scenario it was £2,710,000, on the best-case scenario it was £4,763,000. She recognised that if the time cost of money was taken into account the tax advantage would be even more valuable because it comes in the first year (when the qualifying expenditure is converted into losses for tax purposes) whereas commercial returns on exit from the scheme are only postulated for year 8 (see [20] of her first witness statement). Her conclusion was that the main benefit which could be expected to accrue to the Claimants was the availability of losses; and that she was satisfied that the LLPs were notifiable under DOTAS (see [19]).

72. Mr Southern suggests that Ms Nash is wrong in concluding that the main benefit could be thought to be the tax advantages. First, he suggests that she has overlooked the fact that each investor was responsible for a large initial investment (namely, the capital returned to investors in the amount of £7,200,000 in the case of London Luton) which should be combined with the return on investment to reflect the commerciality of the arrangements. But I cannot accept that argument. Ms Nash has considered the return on investment, compared with the value of the tax advantage as a product of that investment. This is what Regulation 12 requires. Regulation 12 refers to the "benefit" of the arrangements, and specifically to whether the losses expected to accrue represent the main benefit in the eyes of an informed observer. This is to require the tax advantage to be compared with the non-tax, or commercial return.

Theamount of the capital investment – which is ultimately returned to the investors - does not weigh as a factor in that exercise of comparison.

73. A similar approach was taken by the FTT in *Brain Disorders Research LP v HMRC* [2015] SFTD 1043, where in the context of s 787 of the Taxes Act 1988 which imposes a "sole or main benefit test" in the context of interest relief on borrowings, the tribunal referred to putting "onto the scales the tax benefit on one side of the scales and the other benefits on the other side, and seeing which were the greater benefits" (see [138]); the tribunal noted that the borrowings in that case "simply moved into and out of the Partnership which is neutral" (see [140]) and concluded that the tax benefits were the main benefit, and that relief on interest should be disallowed: see [141]-[143]. *Brain Disorders* supports my conclusion that the amount of capital invested does not fall to be taken into account in assessing the main benefit for the purposes of Regulation 12.

74. Secondly, he suggests that the tax advantage was specifically conferred by statute (namely, the BPRA scheme) and therefore should not be taken into account under regulation 12 which is aimed at tax avoidance, which this is not. Again, I am unable to accept that argument. Regulation 12 does not refer to tax avoidance schemes; nor does it exclude those schemes where the losses are generated by operation of statute. It simply refers to arrangements pursuant to which losses are accrued. It extends to any such arrangements, regardless of how the losses are generated, whether by operation of statute or not and without reference to "tax avoidance". There is obvious sense in that approach, for reasons I have already discussed.

75. Accordingly, Ms Nash's approach was correct. Her conclusion is one which a reasonable and well-informed observer, which I am prepared to accept that she was, could reach. Objectively assessed, the main benefit which could be expected to accrue to some or all of the individuals participating in these arrangements was the provision of losses. Factor (a) from the two-part test was met.

76. The Partnerships were therefore loss schemes within regulation 12. That meets the statutory requirement at s 306(1)(a) of the Finance Act 2004. Further, the Partnerships were arrangements which enabled, or might be expected to enable, an investor to obtain a tax advantage of a kind which was prescribed by the regulations (ie loss relief) so that s 306(1)(b) was met. The obtaining of that tax advantage was at least one of the main benefits which might be expected to arise from those arrangements, so that s 306(1)(c) was also met.

77. These arrangements were indeed notifiable under DOTAS. Condition C is fulfilled.

Issue 5: Whether the Claimants are entitled to argue, in the context of issue 3, that these PPNs were not validly determined by a designated officer, as required by FA 2014.

78. In his skeleton argument, Mr Southern argues that the figures in the PPNs were calculated in fact by Ms Nash and that "the designated officer calculated nothing. He was a mere cipher" [102]. This, he argued, renders the issue of the PPN ultra vires for that further and additional reason. (This was referred to in his skeleton, confusingly, as his "issue 5" but I shall refer to it as the "Designated Officer" issue.)

79. Mr Yates objected to the Claimants raising the Designated Officer issue in their skeleton. He noted, in his responding skeleton for the hearing, that the Claimants had originally complained only of a lack of evidence concerning the designation process and that that complaint had been answered by HMRC in its Detailed Grounds, supplemented by Ms Nash's witness evidence (see [9]-[12] of the Detailed Grounds). There had been no subsequent amendment of the Claimants' Grounds, and there was, in consequence, no issue pleaded in relation to any procedural shortcoming or failure by the designated officer. Mr Southern outlined his arguments on the Designated Officer issue at the hearing, and Mr Yates maintained his objection to it.

80. As mentioned above, I invited the parties to make submissions, if they wished, in the light of the Court of Appeal's decision in *Rowe* and *Vital Nut.* Mr Southern's submissions dated 20 December 2017 suggested that the Court of Appeal's judgment supported his argument on the Designated Officer issue. He went on to develop his submissions on that issue further. He submitted that the Court of Appeal had determined that the officer had to be positively satisfied that the scheme was ineffective before he or she could issue a PPN, and that the test was not met on the facts of this case, so that there had been no valid determination within paragraph 4 of Schedule 32. Further, he submitted, this was a question of law "which can be raised at any time" (see [3(iii)]). Mr Yates took issue with all that Mr Southern said in HMRC's responding submissions dated 22 December 2017.

81. It is necessary to recap the pleadings. At [80] of the Claimants' Amended Grounds, the Claimants asserted that the amount specified in an APN had to be determined by a Designated Officer. Reference was made to paragraphs 4(2) and 4(3) of Schedule 32. At [83] of the Amended Grounds, the Claimants complained that there no evidence that the officer who issued the PPNs to the Claimants was properly designated and/or that that officer had properly determined the amount of the PPNs according to the requirements in paragraph 4 of Schedule 32, setting out six points on which information was requested (see [72] – [83] of the Claimants' Amended Grounds, under the heading "*ultra vires*").

82. HMRC's Detailed Grounds answered this complaint at [41], stating that the matters raised were addressed by Ms Nash in her witness statement and that in any event there was nothing in the Claimants' challenge on this point. It is important to record that Ms Nash's first witness statement dated 31 July 2017 set out the process for issuing the PPNs in some detail, and described the role of the designated officer in this case (see [30]). She answered the Claimants' six points in terms at [43].

83. The Claimants made no further amendment to their Grounds in light of HMRC's Detailed Grounds of Defence or Ms Nash's witness statement which dealt comprehensively with their queries on the process used to calculate the amount of the PPNs.

84. I therefore agree with Mr Yates and conclude that it is not open to the Claimants to raise the Designated Officer issue in this way at this stage of this part of the case. The Claimants originally asked for information about the designation process; HMRC provided that information; the evidence in which that information was contained has never been challenged; the Claimants have never suggested that the process described – by Ms Nash, in detail - was in some way deficient until they served their skeleton in advance of this hearing. The Designated Officer issue, as it is now outlined by Mr

Southern in his skeleton and follow up submissions, is simply not pleaded. It cannot therefore be the subject of any permission already granted, which could only extend to the pleaded case. I am not asked to grant permission to deal with the point. That, surely, is the end of the matter.

85. I would add two further points. First, no particulars of the suggested deficiencies in the process adopted by HMRC have ever been given by the Claimants. In consequence, HMRC has never had the opportunity to consider or answer those particulars, by further evidence and/or by way of submission. The Court is obviously not in a position to adjudicate the Designated Officer issue. Secondly, this is an entirely different situation from the Condition B argument, also raised late in the day, but which the Court could, in the circumstances, deal with (see above).

86. The Claimants are not entitled to argue the Designated Officer issue before me. Whether they should be entitled to argue that point at any subsequent stage is not for me to decide. They will have to follow the rules and seek permission to amend and to argue the point if they wish to pursue it.

Issue 6: Whether, in light of my conclusions on the foregoing, the Claimants have made out Ground 3, by which they assert that the PPNs were *ultra vires*

87. HMRC is empowered to issue a PPN to each relevant partner of the partnership *if* Conditions A, B and C are fulfilled (paragraph 3(1) of Schedule 32). There is no dispute about Condition A, which is fulfilled. I have resolved the disputes about Conditions B and C in favour of HMRC, and have concluded that they too were fulfilled. I have also decided that the Designated Officer issue does not arise as part of Ground 3, as pleaded.

88. Ground 3 fails.

Issue 7: Whether the PPNs were wrong in law for any other reason (Ground 1).

89. Mr Southern repeats his submissions to the effect that the Partnerships (and the Claimants who invested in them) have simply taken advantage of the BPRA legislation in the manner intended by Parliament, and that there is no tax avoidance. I have already addressed that argument in the context of Ground 3. As a general matter, it is difficult to see how that submission could assist Mr Southern in the context of Ground 1, once it is established (as it is by my dismissal of ground 3), that HMRC had power to issue the PPNs in this case because the statutory conditions were met on the facts.

90. Mr Southern points to a number of specific features of HMRC's conduct or analysis, which he says betray HMRC's fundamental misunderstanding of the arrangements, such that the PPNs should be quashed, either on the basis that there has been an error of precedent fact, or because those misunderstandings point to irrationality or unreasonableness or abuse of power in the decision to issue the PPNs.

91. The first allegation is that HMRC has misunderstood the arrangements by labelling the funding as "circular" when there was in fact no circularity. The second is that HMRC has acted irrationally, as can be shown by HMRC's shift in position from a disallowance of 55% to 30%. The third is that HMRC has recognised the essentially

commercial nature of the arrangements by its acceptance that the Claimants are entitled to 70% of the losses claimed in at least 7 of the 9 Partnerships and thereby accepted that the arrangements were commercial. I shall deal with each in turn.

92. **Circularity**: although this aspect of HMRC's challenge received only passing reference in the Claimants' Amended Grounds, it assumed centre stage in the Claimants' skeleton, being the first substantive issue this Court was invited to consider, and was pressed with vigour at the hearing in the form of an argument about the commercial validity of the "capital accounts" which were a feature of the structure adopted by some of the Partnerships. That feature involved the Developer putting a sum, £2 million in the case of London Luton, in an account held by the bank (the "capital account"), as a safeguard against the risk that the income from the developed property would prove insufficient to meet the bank loan repayments.

93. Mr Southern argued that the capital account was a normal commercial feature which was not circular in nature. It was not an indication of tax avoidance at all. When I pressed him, Mr Southern submitted that the money held on the capital account was not included within the amount claimed by way of qualifying expenditure for BPRA purposes.

94. Mr Yates answered that the money held on capital account certainly had been included in the qualifying expenditure claimed, and that the legitimacy of so doing was one of the several issues to be determined by the FTT in due course. Further and in any event, he maintained that this Court was not in a position to decide the status of the capital account (circular funding or not, hallmark of tax avoidance or not, qualifying expenditure or not) because this Court did not have the relevant documents before it; those documents had been disclosed in the course of the FTT appeal but that disclosure was not replicated in the judicial review.

95. In his oral reply, and in subsequent submissions in writing to me, Mr Southern has stepped back from the proposition that the money held on capital account was not part of the claimed qualifying expenditure. His adjusted submission is that the money in the capital account at no point returned to the Partnership(s) and was not, in that sense, "circular".

96. I agree with Mr Yates that there are problems with Mr Southern's submissions in relation to circular funding and the capital account. The first is that this matter is before the FTT for determination. HMRC's case in respect of it is set out at [71] – [72] of their Statement of Case, as follows:

> "71. Another element of the Development Sum paid by Luton LLP is what is referred to in the Co-Op Loan Agreement as the Capital Amount which OVL is obliged to deposit in the Capital Account so as to secure the obligations of Luton LLP under the Co-Op Loan Agreement and OVL under the Guarantee Agreement. As stated in the Schedule of Costs and in the IM the figure in question is £2 million. HMRC has disallowed this figure.
>
> 72. The reason HMRC has disallowed this figure is because such expenditure on the part of Luton LLP does not

> constitute expenditure incurred on or in connection with the conversion or renovation or incidental repair of the Property. The £2 million to be placed in a blocked account with the lending bank was required in order to support and/or ramp up substantial borrowing from Co-Op. As anticipated by the IM, such sum having been returned to Co-Op, it was then replaced by an unsecured, interest-free loan from OVL to Luton LLP to be repaid following a possible refinancing or sale of the Property. Accordingly, the sum in question would only ever ultimately be obtained by OVL in the event that the overall project was sufficiently successful. In the circumstances, it cannot be said that the £2 million constitutes "qualifying expenditure" within the meaning of 360B(1)."

97. That case is answered by London Luton at [46] of its Reply:

> "The Appellant submits that HMRC is wrong to have disallowed this amount. The sum of £2 million which was placed in the capital account by OVL was part of OVL's profit which OVL set aside and used to provide security to Co-op. At all times, the £2 million in the capital account was money which belonged to OVL and it was perfectly realistic that OVL would ultimately be able to secure its £2 million even at a distressed sale valuation of the Property. In those circumstances, there is no justification for removing the £2 million from the sums in respect of which BRPA are available"

The issue about the capital account, and the matter of circular funding to which it relates, are before the FTT. It is inappropriate for this Court to determine those matters.

98. Even if this Court was the appropriate forum, this Court is simply not in a position to determine the matter (of capital account, or, if different, of whether there is circular financing) without having before it all relevant evidence. These arguments involve matters of fact as well as law. The factual matters go to the nature of the funding arrangements generally and, specifically, to the terms of the capital account and whether it (or a sum equivalent to it) was part of the qualifying expenditure claimed. Although full disclosure has taken place in the FTT, there has been no such equivalent disclosure in this Court which is in consequence unsighted on the point.

99. Thirdly, I am not persuaded that there is any issue on the facts. I am unable to accept Mr Southern's assertion that the money held in the capital account(s) was not claimed by the Partnerships as part of the qualifying expenditure. Indeed, I understand Mr Southern to retreat from that assertion in his later submissions. The pleadings in the London Luton FTT appeal (see above) demonstrate that the amount held on capital account did form part of the amount claimed as qualifying expenditure and does form one of the issues for determination by the FTT. I was also shown a Note of Consultation with Leading Tax Counsel on 8 January 2015, disclosed by Downing to HMRC, in which London Luton's solicitors invite Leading Counsel to consider the way in which the element of Developer's profit which was held on capital account

was treated for tax purposes. They asked Counsel whether he agreed with their view that

> "7.2 … as this is the Developer's money and it is not returned to the LLP or the Investors if it is not drawn upon, but instead it is returned to the Developer, then this would qualify for BPRA as Developer's profit.
>
> 7.3 Likewise, if the money was drawn upon it created a loan from the Developer to the LLP but it remained the Developer's profit, which was lent to the LLP and which the Developer was able to reclaim from the LLP. On that basis Instructing Solicitors considered that it qualified for BPRA as Developer's profit."

The predicate seems to be that the money held on capital account was, indeed, properly claimed as part of the qualifying expenditure.

100. I am not persuaded that there has been any error of fact in relation to the capital account. It does not appear to me that HMRC has mischaracterised the capital account or misunderstood its commercial utility as part of the overall scheme. Nor does it appear to me that HMRC has challenged the Partnerships' claims to BPRA on the basis that the capital account in and of itself amounts to "circular funding" – this is not what their Statement of Case asserts.

101. Nor am I persuaded that there has been any unreasonableness or irrationality in relation to HMRC's analysis of the funding arrangements, including their analysis of the capital account. To the extent that there are differences of view, these will be resolved by the FTT (with the benefit of evidence and submissions specific to those points).

102. **Reduction in percentage:** on 2 February 2015, Ms Nash and another HMRC officer met with representatives of Downing. From an informal note of that meeting which Ms Nash exhibits, the parties analysed workings produced by Downing as to the types of expenditure included within the amounts claimed as qualifying expenditure. Rather than debating the minutiae, Ms Nash asked whether HMRC were being asked "to arrive at a broad brush percentage which would you want to apply …" to which Downing's representative answered "yes", and that all the schemes were similar. Later in the meeting Ms Nash is recorded as saying this:

> "To summarise – given this further information, we have agreed without prejudice that the AP notices for all the Downing Schemes except Baron House and Harrogate St will be based on 30% of the losses claimed and not 55%. We will review the documents you have provided to us…"

103. Mr Southern complains that the reduction in the amount of proposed disallowance from 55% to 30% in relation to 7 of the 9 Partnerships demonstrates a lack of proper governance and oversight by HMRC, because such a large reduction suggests a lack of proper analysis at the outset; and the acceptance of the larger part of the claims shows that they are, and are accepted to be, genuine and commercial arrangements.

104. Mr Yates counters that Ms Nash and her colleagues at HMRC acted entirely appropriately. HMRC gave an initial indication of the extent of the disallowance (55%), based on the information then available to them. HMRC met with Downing and discussed the case. Further information was provided. In light of that, HMRC agreed that a lower percentage of the overall claimed losses would be reflected in the PPNs to the partners. This does not suggest unreasonableness or irrationality. It suggests a pragmatic compromise.

105. I accept Mr Yates' arguments. HMRC's approach was reasonable and pragmatic. It is well within HMRC's powers to agree to reduce the figure to be notified by PPN, having listened to the taxpayers' arguments and representations, and having obtained further information in so doing. The reduction in amount does not suggest irrationality or unreasonableness.

106. **Accepted commerciality of the arrangements**: Mr Southern argues that HMRC was irrational or unreasonable or acted in abuse of power in issuing PPNs given that HMRC accepted that the arrangements were commercial (reflected by the fact that no challenge is made to the larger part of the qualifying expenditure claimed by the Partnerships). I have already dealt with the commerciality argument in the context of Ground 3. There is, at this stage of the analysis, little more to say. The fact that the Claimants derived (or hoped to derive) commercial benefit from the Partnerships is not sufficient to defeat the PPN legislation. Specifically, paragraph 4(2) of Schedule 32 permits a PPN to be issued which notifies an amount which relates to part only of the tax advantage obtained (see above). The amount notified is a matter for the designated officer.

107. I do not consider that it was unreasonable or irrational for HMRC to issue PPNs to these Claimants. There has been no misunderstanding or error of precedent fact on the part of HMRC. I am not persuaded that HMRC have abused their powers. Ground 1 fails.

Conclusion

108. The Claimants have failed to establish either ground on which they have permission to apply for judicial review. I dismiss those grounds.

109. The remainder of the case remains the subject of Jay J's order dated 13 April 2016. Now that *Rowe* has been determined in the Court of Appeal, the Claimants must formulate that remainder and put the papers before the Administrative Court for permission or further directions, as directed.

110. I am grateful to both Counsel for their assistance in this case.

APPENDIX A

London Luton BPRA Property Fund LLP

A. Mid Range Outcome

Estimated sale proceeds*	£14,372,000
less Repayment of outstanding borrowings	£4,462,000
less Capital returned to investors	£7,200,000
equals Return on investment	£2,710,000
versus Tax advantage	£6,256,600
(Figures derived from Financial Appraisal and Investor Acquisition Appraisal – pages 18 to 21 of IM)	
**Based on EBITDA Exit Multiple of 10.5 and net of costs*	

B. Best Case Scenario

Estimated sale proceeds*	£16,425,000
less Repayment of outstanding borrowings	£4,462,000
less Capital returned to investors	£7,200,000
equals Return on investment	£4,763,000
versus Tax advantage	£6,256,600
(Figures derived from Financial Appraisal and Investor	

Acquisition Appraisal – pages 18 of 21 of IM)	
**net of sale costs*	