Appeal numbers: TC/2015/01817
TC/2015/01791

CORPORATION TAX - on a purposive construction of s 11, s 61, s 67, s 70A to 70E CAA 2001 were the appellants entitled to additional writing down capital allowances - no - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

CAPE INDUSTRIAL SERVICES LIMITED **ROBERT WISEMAN AND SONS LIMITED**	**Appellants**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE HARRIET MORGAN

Sitting in public at Taylor House, 88 Rosebery Avenue, London on 11, 12 and 13 June 2019

Mr Jonathan Peacock QC and Mr Edward Hellier, counsel, instructed by KPMG LLP, for the Appellants

Mr David Milne QC and Ms Barbara Belgrano, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents ("HMRC")

DECISION

1. Cape Industrial Services Limited ("**CIS**") and Robert Wiseman and Sons Limited ("**Wiseman**") appealed against HMRC's refusal of their claims for capital allowances made under the Capital Allowances Act 2001 (the "**CAA**") in respect of amounts they assert they incurred as capital expenditure on plant and machinery in use for their respective trades (the "**assets**") under a series of transactions undertaken in 2010 with a member of the Société Générale banking group, SG Leasing (June) Limited ("**SGLJ**") (the "**transactions**").

2. In outline, under the CAA a trader can claim annual writing down allowances ("**allowances**") on capital expenditure it incurs on the provision of certain plant or machinery wholly or partly for the purposes of its trade which it owns as a result of incurring that expenditure (under s 11 CAA (see [24])) ("**qualifying expenditure**"). Allowances are given in recognition that such plant or machinery depreciates over time. They can be used to reduce the profits which would otherwise be taxable in the trader's hands in the period for which they are given. I refer to plant or machinery which qualifies for allowances as "qualifying assets".

3. It was common ground that, when the transactions were undertaken, each appellant already had an on-going entitlement to allowances in respect of qualifying expenditure it had incurred when it acquired the assets for use in its trade. It is clear from the overall design and effect of the planning that the appellants' purpose in entering into the transactions was to generate further qualifying expenditure in respect of these assets without them suffering any actual financial cost and without disturbing their existing entitlement to allowances. In economic terms, therefore, if the transactions operate to produce the result the appellants argue for, each appellant would be able to claim capital allowances, in effect, twice over on a single amount of actual expenditure.

4. Throughout this decision, when illustrating how the transactions operate, I have adopted the simplified illustrative figures set out by the appellants at the hearing. Using those figures, the appellants sought to obtain the desired additional allowances under a structure whereby (a) they each sold their assets to SGLJ for net sales proceeds of £100, (b) SGLJ leased the relevant assets back to them for three or four weeks in return for weekly rentals of a total of £5, and (c) on the expiry of the leases, each appellant re-acquired the assets for £95 on SGLJ exercising a put option which each appellant had granted to it at the outset. The intention was that each appellant became entitled to capital allowances on £95 it paid to reacquire the assets, as funded, in effect, (as were the rents) by the sales proceeds received from SGLJ.

Part A - Overview

5. Unless specified otherwise all references in this decision to parts, chapters, and sections of legislation are references to those contained in the CAA as in force at the time the transactions were implemented.

Transactions

6. In summary, the structure operated as follows (again using the simplified figures for illustration only):

(1) The appellants each sold their assets to SGLJ for a price intended to equate to their market value at the time (giving rise to net sales proceeds of £100).

(2) Immediately on the sale of the assets:

(a) SGLJ granted each appellant a short-term finance lease of the relevant assets for a period of three or four weeks only for weekly rentals which totalled £5 (a "**Lease**").

(b) Each appellant granted SGLJ a put option to require the appellant to purchase the assets on the termination of the Lease (a "**Put Option**") for a sum equal to the predicted market value of the assets at that time (the "**Option Price**"). The Option Price due if the Put Option was exercised on the expiry of the term of the Lease was £95.

(c) SGLJ granted another company in CIS' or Wiseman's group (as applicable) a call option whereby that company could require SGLJ to sell the assets to it which was exercisable, broadly, at the same time as the Put Option and for the same Option Price (the "**Call Option**").

(d) The parent company of the respective groups of which CIS and Wiseman formed part entered into a contract with SGLJ (the "**Parent Guarantee**") under which the parent company committed to guarantee, amongst other things, the payment of all sums due from CIS or Wiseman to SGLJ under the Lease and Put Option and related documents.

(3) Throughout the Leases the appellants each made payments of rent to SGLJ and in return were allowed use of the assets.

(4) On the termination of the Leases through effluxion of time, SGLJ exercised the Put Options and the appellants purchased the relevant assets for the Option Price.

Operation of the structure on the appellant's analysis

7. As noted, it was common ground that, when they entered into the transactions, the appellants were entitled to allowances on an on-going basis on qualifying expenditure they had incurred on the acquisition of the assets for use in their trades under the general allowances rules in the CAA. In outline, these rules operate as follows under part 2 of chapter 5:

(1) A taxpayer is required to include all qualifying expenditure incurred in relation to a qualifying activity (such as a trade) in one or more pools for the purpose of determining its entitlement to allowances and liability to any balancing charges (s 53). The taxpayer is required to maintain different pools for certain different types of qualifying asset.

(2) In outline, a taxpayer can claim an annual allowance as computed at a specified rate of its qualifying expenditure in the relevant pool on a reducing balance basis. The allowance can be used to reduce the amount of its profits which would otherwise be subject to tax in the relevant annual period. For example, if the taxpayer has qualifying expenditure of £100 in its pool and the rate of writing down allowance is 20%:

(a) In the first relevant annual period, the taxpayer could claim an allowance of £20, computed as 20% of £100.

(b) In the second annual period, on the reducing balance basis, the taxpayer would (i) deduct the allowance of £20 obtained in the first period from its original expenditure of £100 to give remaining qualifying expenditure (referred to as available qualifying expenditure ("**AQE**")) of £80, and (ii) obtain an allowance of £16 computed as 20% of that AQE (and so on in future periods).

(3) A taxpayer is required to bring into account in his capital allowances computation a “disposal value” if the taxpayer “disposes” of a qualifying asset on which it has claimed allowances. This is provided for under s 61, which sets out when there is a disposal event and provides a table for the determination of the “disposal value” arising on that event. Under sub-s 61(1)(a), these events include where the taxpayer “ceases to own” a qualifying asset in respect of which it has claimed allowances (see the full rules at [26] and [27]).

(4) The taxpayer is required to deduct the disposal value(s) arising in respect of all disposals which take place in an annual period from the AQE for that period. If, on bringing the disposal value(s) into account in any relevant annual period:

(a) there is remaining AQE, the taxpayer can continue to claim allowances on that sum as described above or may be entitled to a final balancing allowance, broadly, when the trade ceases; or

(b) the disposal value(s) exceed the amount of the AQE, the taxpayer is subject to a balancing charge on the excess.

(5) These provisions are designed, therefore, to capture any excess allowances (or give any additional allowances) according to whether, in the relevant annual period when a disposal event occurs, the disposal value exceeds or is less than the AQE in the pool.

8. Again using the simplified figures produced by the appellants, it is assumed for the purposes of illustration only that (a) each appellant originally incurred qualifying expenditure on the acquisition of the assets of £200 which was accounted for in a main pool containing only that expenditure, and (b) by the time the transactions took place, having claimed allowances over a number of years, each appellant had AQE of £80 in that pool.

9. On their analysis, when the appellants sold the assets to SGLJ, they made a disposal of them for allowances purposes on ceasing to own them within the meaning of s 61(1)(a) (see [26]). Accordingly, they were required to bring an amount equal to the net sales proceeds (of £100) into account in their allowances computations as a disposal value (under s 61) which they had to deduct from the AQE in their respective main pools. On the basis that the AQE in each pool was then £80, there would be an excess of £20.

10. If the appellants had simply reacquired the assets immediately or very shortly after the sale (without entering into the Leases), for the purposes of s 11 they would have incurred additional qualifying expenditure equal to the price then paid. Assuming the repurchase price was roughly equal to the price received on the initial sale, the overall result would be that each appellant would continue to have AQE of £80 in their respective pools. The qualifying expenditure incurred on the reacquisition of the assets would simply restore the appellants’ allowances position substantially to that applicable before the sale and re-purchase took place.

11. It was essential to the plan, therefore, for the effect of the disposal of the assets on their sale to SGLJ to be neutralised for allowances purposes and that none of the other steps involved triggered any further substantial disposal value. On the appellants’ analysis this was achieved by structuring the sale and leaseback of the assets specifically to come within the special “funding lease” regime in chapter 6 CAA (see the full description of these rules at [30] to [36]).

12. Under the general rules, in the absence of the funding lease regime, the lessor under a lease of assets would be entitled to allowances on any qualifying expenditure on qualifying assets, as the legal owner of the assets. That was the position until the

funding lease regime was introduced in 2006. However, where that regime applies, the lessee is instead treated as the owner of the leased assets for allowances purposes. In outline, under this regime where the lease is a "long funding finance lease", as the Leases are accepted to be, the lessee is entitled to allowances on the present value of the "minimum lease payments", as determined for accounting purposes, under s 70C and s 70YE on the basis that:

(1) The minimum lease payments are (a) the minimum payments due under the lease over the term, and (b) "in the case of the lessee, *so much of any residual amount as is guaranteed by him or a person connected with him*" (emphasis added).

(2) The "residual amount" is "so much of the "fair value" of the plant and machinery subject to the lease [which usually means its market value] as cannot reasonably be expected to be recovered by the lessor from the payments under the lease".

I refer to the present value of the minimum lease payments as the PVMLP. The full provisions are set out at [30] to [34].

13. On the appellants' analysis, whilst, on the sale of the assets to SGLJ, the appellants made a disposal of them for allowances purposes for a disposal value equal to their net sales proceeds of £100, they were entitled to claim allowances under the funding lease regime on matching qualifying expenditure of £100:

(1) This was on the basis that, for the purposes of s 70C and 70YE, the PVMLP comprised the present value of the aggregate of (a) the rents and (b) the Option Price. (For the purposes of illustration, the present value of these sums is assumed to correspond to the actual rents and Option Price of £5 and £95 respectively). In the appellants' view, the Option Price was a residual amount which each appellant guaranteed to SGLJ in granting SGLJ the right under the Put Option to require it to repurchase the relevant assets on paying this sum. It did not appear to be disputed that, for this purpose, the Option Price represented the fair value of the assets which could not reasonably be expected to be recovered by SGLJ, as lessor, from the payments under the Leases (namely, the rentals).

(2) On that basis, in effect, it was as if nothing had happened at this point for allowances purposes. Whilst each appellant was required to bring £100 into account as disposal value by way of deducting that sum from its AQE in its pool of £80, thereby giving a negative figure of £20, it immediately received the benefit of further matching qualifying expenditure of £100, which was added back to the AQE in the pool to restore it to £80.

14. Under the funding lease regime, the lessee is required to bring into account a disposal value on certain disposal events, such as the termination of the lease (under s 70E (see [35] for the full provision)). On the expiry of the Leases, therefore, there was such an event but, on the appellants' analysis, it did not trigger any recapture of allowances:

(1) The disposal value is computed by reference to a formula QE - QA plus R (the "**disposal formula**") where:

(a) QE is the amount of the lessee's qualifying expenditure for allowances purposes as computed as the PVMLP under the provisions set out in [12] above.

(b) QA is defined as the aggregate of "the payments made to the lessor by the person under the lease" and "*the payments made to the lessor by the* *person under a guarantee of any residual amount*" (as the residual amount is defined in s 70YE as set out in [12] above) (emphasis added).

(c) R is a rebate of rentals under the Lease. There was no rebate in this case.

(2) On the appellants' analysis, the disposal value to be brought into account is nil because QE and QA each comprise £100. In their view, both the rents and the Option Price are to be brought into account under QA (as well as under QE) on the basis that the Option Price was a payment made by each appellant, as lessee, to SGLJ, as the lessor, under a guarantee of any residual amount.

15. On the appellants' view, therefore, looking at each step up to and including the expiry of the Leases, the appellants' allowances position in respect of the assets remained, in effect, precisely as it had been before the transactions were implemented. However, these steps put the appellants in the position whereby they could claim that, when they re-acquired the assets on SGLJ exercising the Put Options, for the purposes of s 11 they incurred new qualifying expenditure on the assets in the form of the Option Price. On their analysis, they incurred that sum on the assets for the purposes of their respective trades and owned the assets as a result of incurring it (having "ceased to own" the assets on the initial disposal of the assets to SGLJ).

16. The overall result, therefore, so the appellants assert, is that they added qualifying expenditure of £95 to the existing AQE relating to the assets (of £80). In their view, that was the case notwithstanding that (a) they had suffered no real cost of £95, given that the Option Price was funded by the sales proceeds received from SGLJ on the initial sale of the assets to it, and (b) they parted with ownership of the assets under a pre-set plan on a temporary basis only for the sole purpose of generating further allowances in this way.

Overview of HMRC's challenge

Ramsay argument

17. It was common ground that, following the seminal decision in *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300)("*Ramsay*"), it is well established that, in line with how other legislation is interpreted, the courts and tribunals must apply a purposive approach in interpreting tax legislation. The parties were agreed that the essence of the modern approach to statutory construction in a tax context is encapsulated in the comments of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 (2004) 6 ITLR 454, at [35], where he summarised the "driving principle" in the *Ramsay* line of cases as involving:

> "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."

18. The parties disagreed, however, on precisely how that approach is to be applied in this case and the result that it gives. In particular, they took different views on the relevance and application of the well-known comments made by Lord Wilberforce in *Ramsay* to the effect that, when interpreting a tax statute, the court may determine a composite transaction's tax effects by reference to its overall nature. In summary, Lord Wilberforce said that when construing a tax provision the court must determine the legal nature of the transaction for tax purposes but if that "emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded" and that, accordingly, the courts "are not bound to consider individually each separate step in a composite transaction intended to be carried through as a whole". By way of shorthand, I refer to this approach, as set out in further detail

in the case law section as the "composite approach" (see [101] to [114] below for the full details). In using this term, I do not suggest that Lord Wilberforce set out this approach as a distinct legal principle rather than as part of what may be required to construe a statute purposively.

19. HMRC's primary argument was that, applying a purposive approach, on the basis that on a realistic appraisal of the facts the transactions can be viewed as a composite whole, the transactions do not have the tax effects the appellants ascribed to them. In outline, in their view, when the appellants sold the assets to SGLJ, they did not "cease to own" the assets within the meaning of s 61(1)(a) so that there was no disposal event for the purposes of that section. They submitted that there can be no such event within the intended meaning of this provision where a taxpayer divests itself temporarily of the legal ownership of assets under a composite scheme entered into solely for the purpose of enabling it to obtain further allowances without incurring actual expenditure, whilst throughout retaining all of the practical benefits of ownership. It follows that the other steps involved in the scheme did not have the capital allowances consequences the appellants argued for. Using the illustrative figures, on HMRC's analysis, each appellant would remain entitled to allowances on the existing AQE of £80 but would not be entitled to further allowances on additional qualifying expenditure of £95.

20. Mr Peacock said that a purposive approach to the interpretation of the relevant provisions does not justify the tribunal in disregarding the entirety of the legal and commercial effects of the transactions which, in his view, is the effect of HMRC's stance. He submitted, in effect, that each step in the transactions should be analysed under the relevant provisions according to its individual legal and commercial effects to give the results set out at [9] to [16] above. He suggested that the composite approach is no longer good law but said that, in any event, such an approach is not justified in these circumstances. The parties' further submissions on this issue are set out in Section D.

Hire purchase argument and QA issue

21. HMRC argued in the alternative that, if their *Ramsay* argument is found not to be correct:

(1) On a purposive approach, taken together the Leases and Put Options fell within the "hire purchase" provisions of s 67; arrangements which fall within that provision are specifically excluded from falling within the funding lease regime:

(a) In outline, s 67 applies where a taxpayer incurs capital expenditure on the provision of assets for the purposes of its trade under a contract which provides that it shall or may become the owner of the relevant assets on the performance of the contract. Where s 67 applies, the taxpayer is treated as having incurred upfront all capital expenditure to be incurred under that contract, including any capital amount paid under an option to acquire ownership of the assets. (See [28] and [29] for full details of s 67.)

(b) It was common ground that if s 67 applies, the planning would fail on the basis that the appellants did not incur any qualifying expenditure (a) under the funding lease regime when they entered into the Leases or (b) when the Put Options were exercised. Rather they each incurred a single set of qualifying expenditure under s 67 which, in effect, simply neutralised the effect of the sale of the assets to SGLJ thereby leaving the appellants in substantially the same allowances position as they were in before the transactions were implemented.

(2) If the Leases are found to fall within the funding lease regime:

(a) Contrary to the appellants' analysis, each appellant had to bring a disposal value equal to the Option Price of £95 into account on the disposal occurring on the expiry of the Leases. For the purposes of the disposal formula:

(i) The appellants did not provide a "guarantee" of any residual amount for the purposes of either QE or QA as a result of granting the Put Options to SGLJ.

(ii) Rather, the parents of each group provided a "guarantee" of any residual amount in guaranteeing the relevant appellant's obligations to pay the Option Price under the Parent Guarantees.

(iii) On that basis, the Option Price is to be brought into account for the purposes of QE as a residual amount guaranteed by each parent, *as a person connected with* the relevant appellant as lessee (see [12] and [34]). However, it is not to be brought into account under QA as that only applies to a payment made under a relevant guarantee by the lessee itself (see [14] and [35]).

(b) On that analysis, QE would be £100 (as it would comprise the PVMLP of the rents of £5 and the Option Price of £95) but QA would be £5 (as it would include only the rents and not the Option Price). Under the disposal formula, (QE – QA) + R, the disposal value to be brought into account would be £95 (£100 - £5) (as there is no sum in R).

(c) The overall effect would be that the disposal value of £95 would off-set the benefit of the qualifying expenditure of £95 incurred under s 11 when the appellants re-acquired the assets on paying the Option Price pursuant to the Put Options.

(3) Finally, if the Option Price does fall within QA so that there is no disposal value to be brought into account on the expiry of the Leases, in any event, on a purposive approach, the appellants did not incur qualifying expenditure on paying the Option Price for the purposes of s11.

22. The appellants disputed all these points for the reasons set out in full in Parts E and F.

Conclusion

23. For all the reasons set out below, I have concluded that:

(1) On a purposive approach to the interpretation of the relevant provisions of the CAA, viewing the overall effects of the transactions as they were intended to operate as a composite whole, the appellants did not (a) dispose of the assets for the purposes of s 61 when they sold them to SGLJ, (b) incur any qualifying expenditure under the funding lease regime on entering into the Leases (or make a disposal of them on the expiry of the Leases), or (c) incur any further qualifying expenditure when they re-acquired the assets from SGLJ for the purposes of s 11. Accordingly, the appellants were not entitled to allowances on the Option Price.

(2) If it is found that the approach set out in (1) is not correct so that it is not permissible to apply the legislation by reference to the overall effects of the transaction, the relevant provisions of the CAA apply as set out by the appellants.

Part B Legislation

General capital allowances regime

Section 11- qualifying expenditure

24. Section 11 sets out the basis on which a taxpayer can claim capital allowances on plant or machinery as follows:

> "(1) Allowances are available under this Part if a person carries on a qualifying activity and incurs qualifying expenditure.
>
> (2) "Qualifying activity" has the meaning given by Chapter 2.
>
> (3) Allowances under this Part must be calculated separately for each qualifying activity which a person carries on.
>
> (4) The general rule is that expenditure is qualifying expenditure if -
>
> > (a) it is capital expenditure on the provision of plant or machinery wholly or partly for the purposes of the qualifying activity carried on by the person incurring the expenditure, and
> >
> > (b) the person incurring the expenditure owns the plant or machinery as a result of incurring it."

25. A "qualifying activity" includes a trade and there was no dispute that, at all material times, the appellants were carrying on a trade and used the assets for the purposes of that trade.

Section 61 – provisions relating to disposal

26. As noted, s 61 sets out when a taxpayer is required to bring a disposal value into account for allowances purposes and the amount of disposal value:

> "(1) A person who has incurred qualifying expenditure is required to bring the disposal value of the plant or machinery into account for the chargeable period in which -
>
> > (a) the person ceases to own the plant or machinery;
> >
> > (b) the person loses possession of the plant or machinery in circumstances where it is reasonable to assume that the loss is permanent;
> >
> > (c) the plant or machinery has been in use for mineral exploration and access and the person abandons it at the site where it was in use for that purpose;
> >
> > (d) the plant or machinery ceases to exist as such (as a result of destruction, dismantling or otherwise);
> >
> > (e) the plant or machinery begins to be used wholly or partly for purposes other than those of the qualifying activity;
> >
> > (ee) the plant or machinery begins to be leased under a long funding lease (see Chapter 6A);
> >
> > (f) the qualifying activity is permanently discontinued. …"

27. Where a person makes a disposal within sub-s (1)(a) on ceasing to own an asset on the sale of the asset, the general rule is that the disposal value is the net proceeds of the sale together with (a) any insurance money received in respect of the asset as a result of an event affecting the price obtainable on the sale and (b) any other compensation of any description so received, so far as it consists of capital sums.

Section 67 – hire purchase

28. Chapter 6, which is headed "Hire-purchase etc. and plant or machinery provided by lessee" contains the provisions setting out the special funding lease regime and s 67 relating to "Hire-purchase and similar contracts".

29. The relevant parts of s 67 are as follows:

> "Hire-purchase and similar contracts
>
> 67 Plant or machinery treated as owned by person entitled to benefit of contract, etc.

(1) This section applies if –

(a) a person carrying on a qualifying activity or corresponding overseas activity incurs capital expenditure on the provision of plant or machinery for the purposes of the qualifying activity or corresponding overseas activity, and

(b) the expenditure is incurred under a contract providing that the person shall or may become the owner of the plant or machinery on the performance of the contract. …

(2) The plant or machinery is to be treated for the purposes of this Part as owned by the person (and not by any other person) at any time when he is entitled to the benefit of the contract so far as it relates to the plant or machinery…

(3) At the time when the plant or machinery is brought into use for the purposes of the qualifying activity …., the person is to be treated for the purposes of this Part as having incurred all capital expenditure in respect of the plant or machinery to be incurred by him under the contract after that time…..

(6) If -

(a) a person enters into two or more agreements, and

(b) those agreements are such that, if they together constituted a single contract, the condition in subsection (1)(b) would be met in relation to that person and that contract, the agreements are to be treated for the purposes of this section as parts of a single contract."

Funding lease regime

30. As noted, HMRC argued that the relevant provisions in the funding lease regime do not apply on a *Ramsay* composite approach or, if that is not correct, that the funding lease regime is not in any event in point because s 67 applies to the transactions. However, leaving those arguments to one side, it was common ground that the Leases granted by SGLJ to the appellants were long funding leases for the purposes of the funding lease regime. In outline, a lease is a long funding lease where, amongst other conditions, it is not a short lease (s 70G). A lease is not a short lease where it constitutes a finance lease entered into under a sale and finance leaseback (within the meaning of s 228A). It was not disputed that the Leases were finance leases for this purpose.

Section 70A – entitlement to allowances under the funding lease regime

31. The relevant conditions for lessees under long funding leases to obtain allowances are set out in s 70A as follows:

"(1) This section applies if a person carrying on a qualifying activity incurs expenditure (whether or not of a capital nature) on the provision of plant or machinery for the purposes of the qualifying activity under a long funding lease.

(2) In the application of this Part in the case of that person, the plant or machinery is to be treated as owned by him at any time when he is the lessee under the long funding lease. That is so whether or not the lease also falls to be regarded as a long funding lease in the application of this Part in the case of the lessor."

32. The remainder of s70A sets out provisions for determining when and in what amount the lessee is to be treated as having incurred capital expenditure when the above conditions are satisfied as follows:

"(3) The person is to be treated for the purposes of this Part as having incurred capital expenditure on the provision of the plant or machinery as follows.

(4) The capital expenditure is to be treated as incurred at the commencement of the term of the long funding lease.

(5) The amount of the capital expenditure varies, according to whether the long funding lease is—

(a) a long funding operating lease (subsection (6)), or

(b) a long funding finance lease (subsection (7)). …

(7) *If the long funding lease is a long funding finance lease, the amount of the capital expenditure is to be found in accordance with section 70C.*

(8) See Chapter 6A for interpretation of this section." (emphasis added)

33. Again leaving aside HMRC's arguments in relation to the *Ramsay* issue and s 67, it was not disputed that (a) the Leases were long funding finance leases within the meaning of s 70A(7) and (b) the amount of any qualifying capital expenditure the appellants were entitled to as a result of entering into the Leases is to be computed as the "commencement PVMLP" under the following provisions of s 70C:

"(1) This section has effect by virtue of section 70A(7) for the purpose of determining the amount of the capital expenditure in the case of a long funding finance lease.

(2) If the lease is one which, under generally accepted accounting practice, falls (or would fall) to be treated as a loan, this section applies as if the lease were one which, under generally accepted accounting practice, fell to be treated as a finance lease.

(3) The amount of the capital expenditure is the total of—

(a) commencement PVMLP (see subsection (4)), and

(b) if subsection (6) applies, the unrelievable pre-commencement rentals ("UPR"), [subsection (6) does not apply in these appeals] but subject, in a case falling within subsection (7), to the restriction imposed by subsection (8).

(4) Commencement PVMLP is the amount that would fall to be recognised as the present value, at the appropriate date, of the minimum lease payments (see section 70YE) if appropriate accounts were prepared by the person.

(5) For the purposes of subsection (4)-

"appropriate accounts" are accounts prepared in accordance with generally accepted accounting practice on the date on which that amount is first recognised in the books or other financial records of the person;

"the appropriate date" is the later of—

(a) the commencement of the term of the lease;

(b) the date on which the plant or machinery is first brought into use for the purposes of the qualifying activity. …

(10) This section is to be construed as one with section 70A."

34. The "minimum lease payments" for the purposes of computing the qualifying expenditure under s 70C is defined in s 70YE (1) and (2) as follows:

"(1) *In the case of any lease, the minimum lease payments are the minimum payments under the lease over the term of the lease (including any initial payment) together with* -

(a) *in the case of the lessee, so much of any residual amount as is guaranteed by him or a person connected with him, or*

(b) in the case of the lessor, so much of any residual amount as is guaranteed by the lessee or a person who is not connected with the lessor.

(2) In determining the minimum payments, exclude so much of any payment as represents—

(a) charges for services, or

(b) qualifying UK or foreign tax to be paid by the lessor. "

(3) *In this section— … "residual amount" means so much of the fair value of the plant or machinery subject to the lease as cannot reasonably be expected to be recovered by the lessor from the payments under the lease.*

(4) In the definition of "residual amount" in subsection (3), "fair value" means—

(a) the market value of the leased plant or machinery, less

(b) any grants receivable towards the purchase or use of that plant or machinery." (emphasis added)

Section 70E – disposal for the purposes of the funding lease regime

35. Under s 70E, a lessee who is regarded as having incurred qualifying expenditure under the above provisions is treated as making a disposal for allowances purposes where certain specified events occur, such as on the termination of the relevant long funding lease, and is required to bring into account a disposal value as follows:

"(1) This section applies where—

(a) a person is the lessee of plant or machinery under a long funding lease,

(b) as a result of section 70A, the person falls to be regarded as having incurred qualifying expenditure on the provision of the plant or machinery, and

(c) a relevant event occurs.

(1A) A relevant event occurs if—

(a) the lease terminates,

(b) the plant or machinery begins to be used wholly or partly for purposes other than those of the qualifying activity, or

(c) the qualifying activity is permanently discontinued.

(2) In the case of that person—

(a) the relevant event is a disposal event, and

(b) the person is required to bring into account a disposal value for the chargeable period in which that disposal event occurs.

(2A) The amount of the disposal value is -

(QE-QA) + R

Where -

QE is the person's qualifying expenditure on the provision of the plant or machinery;

QA is the qualifying amount (see subsections (2B) to (2E));

[R is not applicable in this case] . …

……….

(2C) *In the case of a long funding finance lease, "the qualifying amount" means the aggregate of—*

(a) the payments made to the lessor by the person under the lease (including any initial payment), and

(b) the payments made to the lessor by the person under a guarantee of any residual amount (as defined in section 70YE), subject to subsection (2D).

(2D) The following are excluded from the "qualifying amount" under subsection (2C) -

(a) so much of any payment as, in accordance with generally accepted accounting practice, falls (or would fall) to be shown in the person's accounts as finance charges in respect of the lease, …

…..…

(9) If the relevant event gives rise to a disposal event in the case of the person apart from this section, that disposal event is to be ignored.

(10) This section is to be construed as one with section 70A." (emphasis added)

36. It was not disputed that if the funding lease regime is in point, on the assumption that the appellants incurred qualifying expenditure under the Leases, under s 70E they would be treated as making a disposal when the Leases terminated for a disposal value to be determined under the disposal formula set out in sub-s (2A). The dispute was essentially whether the Option Price fell within QA, as defined in sub-s (2C)(b).

Part C – Facts

Cape transactions

37. CIS is a subsidiary of Cape Plc ("**Cape**") which provides industrial services principally to the energy and natural resources sectors. The transactions under consideration in its appeal (the "**Cape transactions**") relate to assets such as scaffolding stock and ancillary equipment, pumps, cleaning equipment, heaters, tractors, trailers and testing and analytical equipment in each case used for the purposes of its trade.

38. On 21 June 2010, some months before the transactions were undertaken, KPMG LLP sent the Cape group a paper entitled "Short-term financing" which set out the steps involved in the transactions, a short tax analysis and a summary of the tax benefit, risks and costs. In summary, the description of the planning in this paper accords with the transactions as actually carried out and the analysis set out above.

39. The paper included the following main points:

(1) The suggestion was that (a) assets would be sold to a bank at market value (b) the bank would lease them back to the asset user for four weeks at weekly rentals, (c) "to eliminate asset risk" for the bank, the user would provide a guarantee as to the minimum value of the assets at the end of the lease term in the form of a Put Option, (d) the bank would provide a Call Option to a group company, and (e) it was expected that the bank would exercise its Put Option.

(2) It was stated that (a) the sale and finance leaseback should be tax neutral for the asset user being both an allowances disposal event and a re-acquisition for the same amount, (b) although the termination of the leaseback would be a disposal event, the terms of the Put Option should result in a nil value, and (c) the payment to acquire the assets under the Put Option should constitute new capital expenditure for the user and result in incremental capital allowances equivalent to the expected market value of the assets at the end of the lease term.

(3) It was stated that the user and the bank would account for the transaction as a finance lease or loan in their respective accounts and the assets would remain on the user's balance sheet throughout.

(4) It was stated that for a transaction size of £23 million the tax savings should be around £6.4 million part of which would be a reduction in current tax and part a credit through deferred tax which would be realised as tax relief in future periods.

40. KPMG LLP produced an accounting opinion on 14 July 2010 which included the following main points:

(1) In considering the accounting classification of the Lease under International Accounting Standard 17, KPMG LLP noted the following:

(a) Prima facie the Lease to be entered into under the transactions was likely to be classified as a finance lease on the basis that (i) the "Lease term is only 4 weeks which is significantly shorter than the expected remaining economic life of the vast majority of the Assets and the present value of the rentals is significantly less than the fair value of the Assets" but (ii) the transaction "involves a Put Option and a Call Option – the combined effect of which is that the exercise of the Put Option is reasonably certain – with the consequence that Cape will assume substantially all the risks and rewards incidental to ownership of the leased asset".

(b) However, under applicable guidance the transaction may be considered not to involve a lease for accounting purposes on the basis that (a) CIS was to retain all the rights and rewards incident to ownership and enjoy substantially the same rights to its use as before the transaction, (b) the transaction involved a Put Option for which exercise "is almost certain", and (c) it could be argued that "the primary reason for the Transaction is to achieve a particular tax result".

(2) KPMG LLP advised that CIS should not recognise a sale of the assets but should continue to keep the assets on its balance sheet and account for them as previously. It should recognise a financial liability/finance lease creditor for the sales proceeds and the rentals should be allocated between interest and a partial repayment of this liability such that, after four weeks, the liability would equal the Option Price.

41. By early December 2010 the Cape group had secured the consent needed for the transaction to take place from its existing lenders under the group's loan facility dated 3 September 2007:

(1) On 4 December 2010, a Barclays Bank Plc group company, acting as the agent for the "Majority Lenders" to Cape in respect of the existing loan facility confirmed that it was instructed by them to consent to the proposed transactions including to the placing of up to 50% of the sales proceeds into an account with Société Générale (London branch) and to the release of the assets from the existing security held over them at completion of the sale of the assets to SGLJ if requested to do so by SGLJ, subject to a number of conditions.

(2) The conditions included that:

> "…the consideration payable to the Vendor Account (as defined in each of the Sale Agreements) shall only be utilised, prior to the relevant Assets being reacquired by the relevant Company or [Cape], for the purpose of either (i) making a payment pursuant to the relevant Put Option or (ii) funding the obligations of [Cape] pursuant to the relevant Call Option"

42. On 7 December 2010, Cape provided SGLJ with a letter relating to its legal costs and in which it provided a tax indemnity in respect of the proposed sale and leaseback.

43. On 8 December 2010 (1) the directors of CIS resolved to enter into the proposed transactions and (2) the directors of Cape approved it acting as a guarantor for CIS as set out below.

44. On 9 December 2010:

(1) The parties entered into a Sale Agreement whereby CIS sold the assets to SGLJ for £14,902,538.68 (exclusive of VAT). The agreement included

provisions which might be expected to be included in such an agreement made on an arm's length basis including the following:

(a) A provision that CIS would sell the assets with "full title guarantee free from all liens, charges and encumbrances" (other than permitted encumbrances) and that subject to certain conditions "title and risk" in the assets would pass to the purchaser.

(b) The relevant conditions to SGLJ's obligation to acquire the assets and to pay the consideration included that the Lease, the Call Option, the Put Option, the Guarantee, the Deposit and Security Agreement, the Netting Letter and the Arrangement Letter were to be duly executed, that insurances were to be in place and that American Appraisal (UK) Limited ("**American Appraisal**") would provide SGLJ with a valuation of the assets dated not earlier than the completion date.

(c) It was provided that, subject to the provisions of the Netting Letter, CIS irrevocably directed SGLJ to pay £4 million of the consideration for the assets directly into its account with Société Générale (London branch) and the balance to its account with Barclays Bank Plc in discharge of the purchase price.

(d) CIS warranted that on completion it would have full legal ownership of the assets with full title guarantee free of any retention of title claims and that it had sole rights to possession of the assets, and legal capacity to sell them.

(2) Under a Deposit Agreement and Deed of Assignment, CIS agreed to deposit £4 million with Société Générale and to assign its interest in that account to SGLJ by way of security for its obligations under the Lease, Put Options and other documents.

(3) The parties entered into a Lease whereby SGLJ leased the assets back to CIS for a non-cancellable term of 21 days starting on that date and expiring on 30 December 2010:

(a) The total rentals payable under the Lease were £28,399 payable for the letting of the assets weekly in advance.

(b) The first rental of £4,407.77 was due when the parties entered into the Lease and was duly paid on that date.

(c) The Lease contained provisions which might usually be expected in such a document. For example, (a) SGJL warranted to the appellant that it had such title, right and interests in the assets as it acquired under the Sale Agreement free of Encumbrances created by, through or in respect of SGLJ and that there were no Encumbrances on the assets, created by, through or in respect of SGJL other than those created by or pursuant to the Lease Documents (and that at no time would it grant or create any Encumbrance on or over the assets other than those created by or pursuant to the Lease Documents), (b) there were provisions regarding responsibility for maintenance and repair of the assets, and (c) there were provisions setting out restrictions on the lessee which were designed to protect SGLJ's interests in the assets.

(4) Cape entered into an agreement with SGLJ under which:

(a) it guaranteed the due payment of all amounts payable by CIS under or in connection with the Lease Documents, being the Sale Agreement, the Lease and the Put Option and any agreement or document entered into between the parties pursuant to or in connection with any of these documents; and

(b) it undertook to pay to SGLJ, on its written demand, any such amount which was not paid by CIS pursuant to the Lease Documents when due and payable, to perform or procure the performance, on SGLJ's written demand, of all other obligations of CIS under the Lease Documents, and to indemnify SGLJ, on written demand, against any loss suffered by it if any obligation that CIS had in whatever capacity under or pursuant to the Lease Documents was or became unenforceable, invalid or illegal.

(5) CIS and SGLJ entered into a Put Option:

(a) In the recitals it was stated that the purpose of the option was to provide a guarantee to SGJL of the expected residual value of the assets at the end of the lease period.

(b) The Put Option gave SGLJ the right to require CIS to repurchase the assets (i) where the option was exercised prior to the expiry of the lease period through effluxion of time, for the Fair Value of the assets on the date of the actual transfer of the assets, and (ii) otherwise, for £14,889,315.35.

(c) The Fair Value was defined in the Lease as being "in relation to any item of the assets on any date (the "Relevant Date")" the "Initial Value" for the item less the "Total Depreciation" for that item multiplied by the number of days from the date on which the assets were delivered to the Lessor under the Sale Agreement to the Relevant Date and divided by 21. For this purpose, (a) the Initial Value was the amount paid for the item as set out in the Sale Agreement (b) Total Depreciation was the Initial Value less the Residual Value for the item, being the portion of the Option Price attributed to that item.

(d) SGLJ could exercise the option by serving an exercise notice on CIS, in outline, (i) if the Lease was terminated before it expired through effluxion of time not later than seven days after the termination date (and in any event not later than seven days before it would otherwise have expired through effluxion of time), and (ii) otherwise, not later than seven days before the end of the lease period. This was subject to the proviso that the Call Option took precedence if it was validly exercised:

(A) where notice to exercise the Put Option was served under (i), prior to 1:00pm on the date falling 2 business days after the service of that notice;

(B) where notice to exercise the Put Option was served under (ii), upon expiry of the lease period and provided that the Call Option was completed immediately after the end of the lease period.

(6) SGLJ granted Cape a Call Option:

(a) This gave Cape the right to require SGLJ sell the assets to it (i) where the option was exercised prior to the expiry of the lease period through effluxion of time, for the Fair Value of the assets on the date of the actual transfer of the assets and (ii) otherwise, for £14,889,315.35.

(b) The option was exercisable by the service of notice to be received not earlier than (a) if the lease period ended other than through effluxion of time, the date falling two business days after the termination date and (ii) otherwise, six days before the end of the lease period. The option was exercisable notwithstanding the Put Option had already been exercised but could not be exercised after the Put Option transfer time.

(7) Both the Call Option and the Put Option terminated and ceased to be exercisable if no notice to exercise the Put Option was served prior to 31 January 2011.

(8) SGLJ confirmed that it had appointed a number of individuals to act as its representative in accepting delivery of the assets, in delivering them to the appellant under the Lease and in accepting re-delivery on the expiry of the lease period (and to sign the relevant delivery/re-delivery and acceptance certificates). The appellant also confirmed it had appointed a number of individuals for corresponding purposes. The parties executed delivery and acceptance certificates in respect of the assets.

(9) CIS obtained a valuation report from American Appraisal in relation to the value of the assets as at 8 December 2010. In the report American Appraisal concluded that the market value of the assets lay in the range of £13.7 million to £18.9 million as at 8 December 2010 and that the internally determined market values were "a reasonable representation of the Market Value of the subject assets on an installed and in place basis" and that the group's valuation policy which had resulted in market values within the range of values determined by their independent analysis was reasonable.

45. On 9 December 2010, the parties also entered into a Fee Letter whereby Cape agreed to pay SGLJ the following arrangement fees:

(1) an initial fee of £200,000 on execution of the Sale Agreement, the Lease, the Put Option and the Call Option relating to the transaction with CIS and that with another group company; and

(2) a second fee of £50,000 payable if, and only if either (i) CIS or the other group company received a valid Put Option exercise notice "and completion under the Call Option does not take place under and in accordance with the Call Option following receipt by SGLJ, prior to completion of the sale contemplated by the Put Option, of a valid exercise notice under and as defined in the Call Option"; or (ii) if the lease period expired other than through effluxion of time and Cape issued an exercise notice under the Call Option.

46. The effect of this was, therefore, that SGLJ would receive the second arrangement fee (a) if the lease period expired by effluxion of time, only if it validly exercised the Put Option and (b) if the lease was terminated early, if Cape exercised the Call Option.

47. How the various payments due under the above documents were to be dealt with was set out in a Netting Letter also dated 9 December 2010.

(1) In this letter it was acknowledged that the following payments were required to be made on the date of the letter:

(a) Pursuant to and subject to the terms and conditions of the Sale Agreement, SGLJ was required to pay to CIS, the consideration for the assets of £17,510,482.95 (inclusive of VAT) which, in accordance with the Sale Agreement, CIS had directed SGLJ to make by paying (i) £4 million into CIS' account at Société Générale (London Branch) and (ii) £13,510,482.95 into CIS' account at Barclays Bank Plc.

(b) Pursuant to and subject to the terms and conditions of the Lease, CIS was required to pay to SGLJ (i) £4,407.77 being the first rent (exclusive of VAT) and (ii) £35,000 in respect of legal costs and expenses.

(c) Pursuant to and subject to the terms and conditions of the Lease and the Put Option, CIS was required to pay to SGLJ, £2,616,200.21 being the sum of the VAT payable on (i) the consideration for the Put Option, (ii) all rents due under the Lease, and (iii) all legal costs and expenses payable under the Lease.

(d) Pursuant to and subject to the terms and conditions of the Fee Letter, Cape was required to pay the initial arrangement fee of £235,000 (inclusive of applicable VAT).

(2) It was provided that the parties agreed that, without prejudice to SGLJ's right to make further claims for payment under the terms of the Sale Agreement and the Lease, the payment obligations set out in (1) above "shall be treated as being fully satisfied and discharged" by SGLJ paying (a) £4 million as set out above and (b) £10,619,874.97 into the account with Barclays calculated as £13,510,482.95 less the amounts specified in (b), (c) and (d).

48. Mr Milne submitted at the hearing that it is clear from the Netting Letter that CIS was required to pay the VAT due on the Option Price to SGLJ upfront; under the letter SGLJ only paid the price for the sale of the assets to it less sums due from CIS and Cape which included this VAT. Mr Peacock pointed out that the terms of the Netting Letter did not affect the substantive payment obligations of the parties under the documents implementing the transaction; as regards each sum it was noted that the terms of the letter were subject to the provisions of the relevant document. I note that, in any event, in practice the VAT on the Option Price was in effect paid at the outset by off-set against the amounts otherwise due from SGLJ.

49. On 16 and 23 December 2010, CIS paid its second and third rental payment as provided for under the Lease of £4,409.26 and £19,583.07 respectively.

50. On 22 December 2010:

(1) SGLJ's board resolved to exercise the Put Option and served the exercise notice on CIS on that day. It was noted in the minutes of the board meeting that under the Fee Letter a fee of £50,000 plus VAT became payable by Cape in the event that SGLJ exercised the Put Option and completion took place.

(2) SGLJ issued a letter "to whom it may concern" confirming that it had appointed a number of individuals to act as its representative in accepting delivery of the assets on expiry of the Lease and to effect delivery of them to CIS under the Put Option and to sign the relevant delivery/re-delivery and acceptance certificates.

51. On 29 December CIS issued a similar letter to that issued by SGLJ on 22 December 2010.

52. On 30 December 2010, the lease terminated by effluxion of time and CIS reacquired the assets pursuant to the Put Option. On that day, the parties executed delivery and acceptance certificates in respect of the re-delivery of the assets to SGLJ and subsequent immediate delivery to CIS.

53. The bundles contained a letter from PwC to Cape dated 5 November 2010 in which PwC set out their views on the accounting position. The comments they made indicate that there was an arrangement between Cape and CIS for CIS to regain access to the assets should Cape exercise the Call Option. PwC said that they understood that a group entity other than the selling entity was to enter into the Put and Call Options but "based on our understanding of an agreement in place between the other Cape entity and the selling entity, risks and rewards [of ownership of the assets] are not passed on" and that the Option Price was "fixed" such that "should the market value of the assets

decline then Cape will still be required to pay" the stated Option Price as at the expiry of the lease term.

Wiseman transactions

54. At the time of the transactions under consideration in the appeal made by Wiseman (the "**Wiseman transactions**"), Wiseman was a subsidiary of Robert Wiseman Dairies PLC ("**Wiseman Dairies**") which was a major supplier and distributor of milk. It was common ground that the assets which were the subject of the Wiseman transactions were in use in the Wiseman Dairies group's trade in the collection, processing, packing and distribution of milk and milk products.

55. On 7 January 2010 a Wiseman group entity produced a paper detailing the "tax efficient refinancing of plant or machinery" as discussed with KPMG LLP. The paper shows the impact of the transactions to be nil in cash terms and it was stated that there would be an increase in the capital allowances available to the group. It was noted in the paper that due to Put and Call Options the group would have "security that it can regain the assets and, were the assets to increase in value, the bank would be precluded from realising a profit on sale".

56. On 21 March 2010 Wiseman Dairies' company secretary (Gerrard Sweeney) explained the proposed transaction in an email to Mr George Donaldson as follows:

> "…We are undertaking a transaction where assets are to be sold to Societe Generale and then leased back for four weeks. After this they will be reacquired. Wiseman is a company incorporated in Scotland. and owned by the group. One benefit associated with this is the tax advantage that accrues…"

57. On 19 May 2010 Michael Everett of KPMG LLP emailed Mara Beveridge, a tax and financial accountant with the Wiseman group, with details of the calculations for the transactions:

> "…Per Gerry we are aiming to get to £82,400 or just below to ensure we don't breach the 25% test. So knocking off the £500,000 SG fees and the £50,000 interest [SG funding margin] gives £81,850,000. Half of that is £40,925,000. That is your target to stay just under. As discussed if that is the initial NBV, the total of the lease payments and the put price should equal the initial NBV plus the interest element of the lease rentals. Obviously the better result is if we can get confirmation from UKLA that one only needs to count the assets once."

58. On 21 May 2010:

(1) The directors of Wiseman Dairies, Wiseman and Robert Wiseman Leasing Limited ("**RWL**") approved the relevant company entering into the transactions.

(2) A number of companies within the Wiseman group who were obligors under a facility provided to the group by Clydesdale Bank Plc resolved to enter into a side letter with Clydesdale Bank Plc to amend the terms of the facility agreement for the duration of the scheme.

(3) SGLJ held a board meeting to approve the proposal to buy the assets from Wiseman. The minutes included references to the fact that Wiseman Dairies was to provide a guarantee in respect of Wiseman's obligations under the transactions and that Wiseman Dairies had agreed to pay arrangement fees comprising an initial payment of £170,000 and a second payment of £320,000 (in each case plus VAT) payable in agreed circumstances at the expiry of the lease term.

59. On 24 May 2010:

(1) Wiseman and SGLJ entered into a Sale Agreement whereby Wiseman sold the relevant assets to SGLJ for £45,292,364 (exclusive of VAT). This included

provisions which might be expected to be included in such an agreement from a commercial perspective including that Wiseman would sell the assets “with full title guarantee free from all liens, charges and encumbrances and property, title and risk in those [assets] shall transfer to [SGLJ] on the terms and subject to the conditions” of the agreement. The conditions and warranties were similar to those set out in relation to the Sale Agreement relating to the Cape transactions but there was no requirement for a valuation to be provided.

(2) The parties entered into a Lease under which SGLJ leased the assets back to Wiseman for a non-cancellable term of 28 days expiring on 21 June 2010. The total rentals payable under the Lease were £1,056,364 due and payable in weekly instalments the first of which (£249,965.25) was paid on the date the Lease was entered into. The Lease contained provisions which might usually be expected in such a document entered into on an arm’s length basis including similar provisions to those set out above in relation to the Cape transactions.

(3) Wiseman Dairies entered into a separate agreement with SGLJ under which it guaranteed Wiseman’s obligations in the same terms as applied under the guarantee entered into under the Cape transactions.

(4) Wiseman granted SGLJ a Put Option which gave SGLJ the option to require Wiseman to repurchase the assets in the same terms as applied under the Put Option entered into under the Cape transactions except that (a) the Option Price at the end of the lease term was £44,292,503 and the definition of Fair Value was amended to refer to a multiplier of 28 (reflecting the different lease term).

(5) SGLJ granted RWL a Call Option, which gave that company the right to require SGLJ to sell the assets to it on the same terms as applied under the Call Option entered into under the Cape transactions but with the same changes to reflect the commercial terms as set out in (4). Both the Put and the Call Option terminated and ceased to be exercisable if no exercise notice was served prior to 31 July 2010.

(6) As requested by Wiseman Dairies, American Appraisal produced a valuation report in which they made the following main points:

> (a) They noted that Wiseman held the assets at a net book value of £45,292,364 and that it was understood that the net book value at the option date of 21 June 2010 would be £44,292,503.
>
> (b) Based on the analysis set out in the report, they considered that, as at 24 May 2010, the Market Value of the subject assets, on an installed, in place basis, lay in the range of £43.1 million to £49.5 million.
>
> (c) “Based upon our analysis, therefore, we conclude that the current net book values are, in aggregate, a reasonable representation of the Market Value of the subject assets on an installed and in place basis and that Wiseman’s depreciation policy, which has resulted in net book values within the range of values determined by our independent analysis, is reasonable”.
>
> (d) “On this basis we therefore conclude that the option price, on 21 June 2010 is a reasonable representation of the Market Value of the subject assets on an installed and in place basis.” It was noted that the documents they looked at included the detailed accounting fixed asset record.

(7) Under a Deposit and Security Agreement, Wiseman agreed to deposit £15 million of the sale proceeds with Société Générale (London branch) and to assign

its interest in the account to SGLJ as security for its obligations under the Lease, the Put Option and related documents.

(8) Wiseman amended its existing facility with Clydesdale Bank Plc to reduce it by £45m for the duration of the scheme.

(9) SGLJ confirmed that it had appointed a number of individuals to act as its representative in accepting delivery of the assets, in delivering them to Wiseman under the Lease and in accepting re-delivery on the expiry of the lease period (and to sign the relevant delivery/re-delivery and acceptance certificates). Wiseman also confirmed it had appointed a number of individuals for corresponding purposes. The parties executed delivery and acceptance certificates in respect of the assets.

60. Under a Fee Letter also dated 24 May 2010 Wiseman Dairies agreed to pay the following arrangement fees to SGLJ:

(1) an initial fee of £170,000 payable upon execution of the Sale Agreement, the Lease, the Put Option and the Call Option; and

(2) a second fee of £320,000 payable only if Wiseman received a valid exercise notice under the Put Option and completion under the Call Option did not take place under the Call Option following receipt by SGLJ prior to the completion of the sale contemplated by the Put Option of a valid exercise notice under the Call Option.

61. How the various payments due under the above documents were to be dealt with was set out in a Netting Letter dated 24 May 2010 which contained the following main provisions:

(1) The letter set out that the parties acknowledged that the following payments were required to be made on the date of the letter:

(a) Pursuant to and subject to the terms of the Sale Agreement, SGLJ was required to pay the consideration for the assets to Wiseman of £53,218,527.70 (inclusive of applicable VAT) and Wiseman had directed SGLJ make the payment by paying (a) £15 million into an account held with Société Générale (London branch) and (b) the remainder of the consideration for the assets of some £38,218,527.70 into its account at Clydesdale Bank Plc.

(b) Pursuant to and subject to the terms and conditions of the Lease, the Fee Letter and the Put Option, (i) Wiseman was required to pay to SGLJ the first rent due under the Lease of £249,965.25 (exclusive of VAT) and £41,760 in respect of legal costs and expenses, (c) the Parent was required to pay to SGLJ £199,750 being the initial arrangement fee and £7,936,051.91 being the sum of the VAT payable in respect of both the Option Price and all rents due under the Lease (referred to as the "Day One VAT Payment").

(2) It was provided that the parties agreed that, subject to the remaining provisions of the letter (and without prejudice to SGLJ's right to make further claims for payment under clause 15.1 of the Lease), the payment obligations set out in (1) above "shall be treated as being fully satisfied and discharged" by SGLJ paying £15 million into the account with Société Générale (London) branch and £29,791,000.54 into Wiseman's account with Clydesdale Bank Plc calculated as £38,218,527.70 less the amounts specified in (1)(b).

(3) It was stated that the parties "agree and acknowledge" that the amount of the Day One VAT Payment "may be subject to adjustment and that the actual

amount of the Day One VAT Payment will be set out in a VAT invoice" to be provided by SGLJ to Wiseman on or about 24 May 2010 (the "VAT invoice"). It was provided that:

(a) If the amount set out in the VAT Invoice was greater than the amount specified in the letter, the appellant "will pay on 28 May 2010 to [SGLJ] an amount equal to the amount by which the amount set out in the VAT Invoice is greater than" that amount.

(b) If the amount specified in the letter was greater than that set out in the VAT Invoice, SGLJ "will pay on 28 May 2010 to [Wiseman] an amount equal to the excess" on the basis that SGLJ's obligation under that provision and Wiseman's obligations to pay the rent due under the Lease on 28 May 2010 was to be treated as being fully satisfied and discharged by Wiseman paying to SGLJ on that date an amount equal to the rent due under the Lease on 28 May 2010 less the amount payable by SGLJ under this provision.

62. The parties made the same points as regards this Netting Letter as they made in relation to the Netting Letter the parties entered into under the Cape transactions.

63. As a result of the Lease and option arrangements, the assets continued to be included within the group's tangible fixed assets at their previous net book value with an equivalent balance being owed to SGLJ.

64. On 28 May, 7 June and 14 June 2010 Wiseman paid the second, third and fourth rental payments due under the lease of £250,010.45, £250,123.45 and £306,265.93 respectively (in each case plus or minus interest adjustments).

65. On 14 June 2010 SGLJ gave notice exercising its Put Option to take effect on 21 June 2010.

66. On 18 June 2010 Wiseman held a board meeting approving the reacquisition of the assets under the Put Option. SGLJ confirmed that it had appointed a number of individuals to act as its representative in accepting delivery of the assets, in delivering them to the appellant under the Lease and in accepting re-delivery on the expiry of the lease period (and to sign the relevant delivery/re-delivery and acceptance certificates). Wiseman also confirmed it had appointed a number of individuals for corresponding purposes.

67. On 21 June 2010 Wiseman reacquired the assets. The parties executed delivery and acceptance certificates in respect of the assets.

68. On 4 March 2011 Wiseman elected that the assets were to be treated as short life assets.

69. The bundles contained two notes of meeting between KPMG LLP and HMRC in relation to this planning which took place on 25 October 2011 and 25 June 2012. These notes included a record that:

(1) HMRC queried why the full amount of the lease payments and Option Price was included in the VAT invoice at the start of the lease. The response was that the analysis was that this amounted to a supply of goods for VAT purposes on the basis that it was "anticipated that title will pass; this is the same VAT treatment as an HP contract". It was noted that it was a point of debate whether VAT should apply to the interest element but the view was "no" as this was separately identifiable.

(2) When asked if there was any commercial rationale for the transactions other than the tax benefit, KPMG LLP responded "no nothing else".

(3) When asked whether there was any case where there was "a material possibility of the Put Option not being exercised, possibly in cases where there was also a Call Option", KPMG LLP said that "realistically, there wasn't - the assets were required in the businesses of the scheme users and where there was a Call Option it was just an extra layer of protection for their business, to be sure they could get their equipment back, rather than something that anyone expected to be needed".

Commercial purpose

70. I note that under the arrangements described above, the appellants each realised part of the cash value of their assets. Mr Peacock said in his skeleton argument that this conferred a real commercial benefit on them. However, it is clear that obtaining short-term finance for use in their business was not the appellants' purpose in entering into these transactions and that they did not in fact receive any financial benefit other than the ability to fund the Option Price and at least some of the rents.

71. I note that, as set out above, there were restrictions on what the funds received on the sales of the assets to SGLJ could be used for and the Wiseman group's existing facility with Clydesdale Bank Plc was reduced for the duration of the scheme by around the same amount as Wiseman received from SGLJ. No evidence was provided that the appellants needed the funds for their business needs (whether by using the funds to replace a more expensive funding or otherwise) or that the funds were so used.

72. HMRC produced a simple model which showed that the effective cost of the "funding" provided by SGLJ to CIS and Wiseman equated to a very high estimated interest rate of around 15% and 30% respectively. HMRC worked this out as follows:

(1) In each case, HMRC calculated the "net cost of borrowing" the finance provided in the form of the sales proceeds by comparing that sum with the total relevant amounts paid by each appellant's group to SGLJ comprising the arrangement fees, the rents and the Option Price. On that basis:

(a) The Wiseman group received net sales proceeds of £45,292,503 and paid to SGLJ a total of £45,839,365 giving a net cost of borrowing of £546,922.55.

(b) The Cape group received net sales proceeds of £14,902,538.68 and paid to SGLJ a total of £15,167,715.45 giving a net cost of borrowing of £265,176.77.

(2) HMRC then worked out the interest rate by using the following formula: net cost of borrowing/total borrowed x length of the term = interest rate. For this purpose, the total borrowed is the relevant sales proceeds and the length of the term of the borrowing is the Lease period of 28 days as regards CIS and 21 days as regards Wiseman. Applying this formula:

(a) As regards CIS: £546,922.55/£45,292,503 x (365/28) = 15.74%

(b) As regards Wiseman: £265,176.77/£14,902,538.68 x (365/21) = 30.93%

(3) HMRC noted that they had assumed that all payments made to SGLJ were made at the end of the Lease periods but in fact part of the arrangement fees and the rents were paid before that time. They said that in fact, therefore, the cost of funding is higher than the above estimates.

73. The appellants did not comment on or challenge these figures. Whilst they are approximate only, I accept that they reinforce the view that obtaining the sales proceeds as a form of short-term finance for use in their business cannot realistically have been the appellants' purpose in entering into the transactions.

74. When Mr Peacock was asked at the hearing if the appellants were asserting that their purpose in entering into the transactions was to obtain these sums as finance for use in their businesses, he said, that "the primary, principal, main driver of these transactions was the perceived tax benefit" but "we reiterate and we do not think it is challenged that there was in any event a commercial funding benefit". When asked if the appellants were saying not only that the arrangements had a commercial effect as regards the provision funding but also that their *purpose* was to obtain that funding Mr Peacock said: "No, nor do we need to because there is no purpose test here. This is not a main purpose test".

75. In any event, my view is that it is plain from the design and economics of the scheme that the appellants' sole purpose in entering into the various transactions was to obtain allowances on the Option Price without suffering the economic burden of paying that amount. This appears to accord with the views of the appellants and their advisers as recorded in correspondence and meeting notes as set out above. It appears from Mr Peacock's responses to the question asked at the hearing that the appellants were not making any submission that the appellants had any other purpose in entering into the arrangements and, as noted, no evidence was produced which would support any contention that they had any such purpose.

Part D - Ramsay argument

Submissions

76. To re-cap, the first question is whether, on a purposive approach to the construction of the relevant provisions in the CAA:

(1) As the appellants argue, the appellants are entitled to the full amount of allowances claimed by reference to the Option Price, on the basis that each step involved in the transactions is to be analysed for tax purposes as a discrete transaction according to its individual effects.

(2) As HMRC argued, the appellants are not entitled to any allowances by reference to the Option Price on the basis that, on a composite approach, viewing the effect of the transactions as a whole:

(a) when the appellants sold the assets to SGLJ, they did not "cease to own" them for the purposes of s 61(1)(a); and

(b) correspondingly, the subsequent events did not have the tax consequences which the appellants ascribe to them.

77. HMRC's stance was based on the fact that Lord Wilberforce's comments in *Ramsay* on the composite approach (as read in the overall context of his judgement) remain good law and are very much in point. Mr Milne noted that the composite approach has been followed in many cases (including in *Carreras Group Ltd* v *Stamp Commissioner* [2004] STC 1377 *("Carreras"), IRC v Scottish Provident Institution* [2005] STC 15 ("*Scottish Provident*") and *Revenue & Customs v Tower MCashback LLP 1 & Anor* [2011] STC 1143 ("*Tower*")) and that it was endorsed most recently by the Supreme Court in *UBS AG & Anor v Revenue and Customs* [2016] STC 934 ("*UBS*"). In his view, it is clear from *UBS* that, in applying a purposive approach, facts that are of no relevance to the application of the statute, or transactions that are not the focus of the legislation, fall to be disregarded (see [65] and [68] of that decision). Further details of these cases and of the other cases the parties referred to in their submissions are set out in the caselaw section below.

78. Mr Milne noted also that, in the most recent cases, as is again consistent with *Ramsay*, the Supreme Court has emphasised that tax is generally imposed by reference to "real world transactions with real world economic effects" (see [62] to [64] of *UBS*

and [13] of *RFC 2012 Plc (formerly The Rangers Football Club Plc) v Advocate General for Scotland (Scotland)* [2017] STC 1556 ("*Rangers"*)). In his view, on a purposive construction, whether there is a "real world" cessation of ownership within the meaning of s 61(1)(a) must be assessed by reference to the overall effect of the steps involved in these transactions as a composite whole. That is on the basis that the parties intended from the outset that they would be implemented in their entirety with a single commercial goal, namely, for the appellants to obtain additional allowances on the Option Price (of £95) without suffering a cost of that amount.

79. Mr Milne emphasised that each step in the structure was implemented as planned and that it was known from the outset that assets would be reacquired by the appellants within three or four weeks given the grant of the Put and Call Options. He considered that it was obvious and inevitable from the outset that the Put Options would be exercised, in particular, on the basis that:

(1) SGLJ was only to receive its second arrangement fee if that occurred.

(2) The Netting Letter in effect provided for the upfront payment of VAT on the Option Price.

(3) It was essential for the tax planning to work in the way hoped for that the Put Option was exercised so that:

(a) the appellants could assert that they had "become the owner" of the assets for the purposes of their trades and had incurred capital expenditure to do so as required by s 11. The scheme was designed, planned, promoted and executed on this basis; and

(b) the appellants could assert that the Option Price was to be brought into account in the disposal formula under QA on the basis it was a residual value guarantee *from the lessee* (within the meaning of s70E(2C)(b) (see [35] above)). If SGLJ, as lessor, were instead to recover the fair value of the assets under the Call Option, even on the appellants' own analysis the price paid under that option would not fall within QA, as it would be due from a party other than the relevant appellant, as lessee.

80. He added that, in any event, it is not relevant that the Put Options might not be exercised and that to cover this eventuality Call Options were granted to the relevant group companies. The composite effect of the scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned (see *UBS* at [78] to [88] and *Rangers* at [65] in each case citing *Scottish Provident*). The Call Options thus fall to be ignored.

81. On that basis, in Mr Milne's view:

(1) On a realistic view of the facts having regard to the operation of the composite scheme as a whole, the appellants did not "cease to own" the assets when they sold them to SGLJ and, therefore, did not dispose of them for the purposes of s 61(1)(a). There is no cessation of ownership where a taxpayer divests itself temporarily of the legal ownership of assets as part of a composite scheme, comprising a set of wholly artificial steps, entered into solely for the purpose of enabling it to obtain further allowances without incurring further expenditure, whilst throughout retaining all of the practical benefits of ownership.

(2) It follows that the other steps involved in the scheme did not have the capital allowances consequences the appellants argued for:

(a) under the Leases, the appellants did not incur any qualifying expenditure on the "provision" of the assets for the purposes of their trades (within the meaning of s 70A(1));

(b) on the expiry of the Leases, the appellants did not make a disposal of the assets (within the meaning of s 70E(1)); and

(c) the appellants did not incur qualifying expenditure on the assets when they re-acquired them on the exercise of the Put Options (for the purposes of s 11). Amongst other matters, the appellants did not come to own the assets as a result of paying the Option Price. In fact, the monies each appellant used to fund that price were monies put into a loop for the purposes of a tax avoidance scheme, by analogy with, for example, *Ensign Tankers (Leasing) Ltd v Stokes* [1992] STC 226 ("*Ensign*") and *Tower*.

82. Mr Milne's "real world" analysis was, therefore, focused on the fact that the overall economic effect of the transactions is wholly out of kilter with the intended economic effects of the provisions.

83. He thought that HMRC's analysis is supported by the following factors:

(1) As reflects the substantive effect of the arrangements, the appellants accounted for the sale and leaseback of the assets as though they never sold the assets and instead received short term financing.

(2) The effect of s 61 is that when a disposal event occurs part of the expenditure that originally constituted "qualifying expenditure" ceases to be such, as that term is defined in s 11(4). However, in this case, the arrangements did not, on a realistic view, disturb the fact that the relevant conditions under s 11(4) continued to be met throughout the duration of the scheme.

(3) The appellants' construction of s 61 would lead to an anomalous outcome that Parliament could not rationally have intended (see the Court of Appeal decision in *Shop Direct Group v Revenue and Customs* [2014] STC 1383 at [16] and [29], as subsequently approved by the Supreme Court [2016] STC 747 at [26]).

84. Finally, Mr Milne referred to the fact that in *Sargaison (Inspector of Taxes) v Roberts* [1969] 1 WLR 951 ("*Sargaison v Roberts*") Megarry J held that for certain capital allowances purposes a person could not be regarded as transferring "the whole of his interest" in land to another person where he did so as part of a single transaction under which he immediately received back some lesser interest. In Mr Milne's view, the same analysis applies here given each appellant simply changed its status (a) from owner of the assets immediately to lessee and (b) within weeks, back to owner and throughout continued to use the assets for the purposes of its trade in exactly the same way. He noted that none of the usual commercial or financing reasons for entering into a sale and leaseback were present. The leasebacks were for extremely short periods, and there was no material, extra financing for the appellants' groups as a result of them.

85. Mr Peacock said that a purposive approach does not permit the tribunal to conclude simply that all the relevant transactions were as nothing for the purposes of the CAA as is the effect of Mr Milne's argument. He said that "the approach of the House of Lords in *Ramsay* was as if there was some substantive anti-avoidance rule of law that would allow transactions to be re-characterised". However, it is clear from the later cases that it is not correct to consider whether there is a composite scheme, as set out in *Ramsay*, or a pre-ordained series of transactions, as set out in *Furniss* v *Dawson* [1984] STC 153 ("*Furniss*"), as if those formulations provide a separate principle. In that context, as set out in further detail in the caselaw section, he referred, in particular,

to comments of Lord Templeman in *Ensign*, the House of Lords decision in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684 ("*BMBF*") and the decisions in *Arrowtown* and *Mayes v R&C Commrs* [2011] STC 1269 ("*Mayes*"). In his view, *Ramsay* "has been overtaken by better, later analysis" in these cases and the tribunal should take the approach set out in *Arrowtown* as "the fountain head".

86. He noted that, in the cases he referred to, the courts emphasised the need to avoid simply disregarding transactions on the basis of sweeping generalisations. Instead the court or tribunal must focus carefully upon the particular statutory provision to identify, on a close analysis, what, on a purposive construction the statute actually requires and whether, on a realistic view of the facts, those requirements are met. The mere fact that there is an element of circularity in a series of transactions or a tax avoidance purpose does not of itself mean that the beneficial tax implications are to be defeated. In that context, he referred, in particular, to *BMBF*.

87. I note that, whilst it is uncontroversial that the *Ramsay* composite approach does not constitute a substantive jurisprudential principle of its own, Mr Peacock seemed to suggest that it has no role at all in applying a purposive construction to tax legislation. He suggested, in effect, that the summary of the correct approach to the construction of tax statutes set out in *Arrowtown* (and the other cases he referred to) requires a different approach to that set out in *Ramsay*. I did not understand HMRC to dispute the relevance of the decisions in those cases (other than that in *Mayes*). However, HMRC's view is that there is no inconsistency between the approach advocated in those cases and that set out in *Ramsay*. Mr Milne submitted that it is recognised in those decisions that where, on a purposive approach, the terms of the legislation require it, the composite approach remains very much part of the close analysis and realistic appraisal of the facts required. He said that the required close analysis does not produce the step by step analysis Mr Peacock argued applies.

88. Mr Peacock said that the purpose of s 61(1)(a) is (a) to remove the benefit of capital allowances from a person when he ceases to hold the bundle of risks and rewards that constitute "ownership" of the relevant asset, in the ordinary sense of that word and (b) in those circumstances, ensure that a capital allowances adjustment is made by reference to the correct disposal value. He said that it is intended to operate, as is the capital allowances regime generally, as regards events in "the real world". Hence the use of a commonplace word such as "own" provides a test that, on its ordinary meaning, applies easily within that world.

89. I note, however, that Mr Peacock used the term "real world" in a different sense to Mr Milne. In his view, it suffices for there to be a "real world" cessation of ownership that, when the appellants sold the assets to SGJL, they lost both legal and beneficial ownership and thereby all the attendant consequences of ownership in legal terms; after the sale, the appellants could not dispose of the assets, they could not freely use the assets or hold themselves out as their owners. He emphasised that SGLJ could only lease the assets back to the appellant because it became the owner of the assets and it was only necessary for there to be Put and Call Options to enable the appellants to reacquire the assets because they lost ownership of them in the first place. He considered, therefore, that the focus of s 61(1)(a) (and the other relevant provisions under consideration) is very much on "ownership" in a legal sense.

90. Mr Peacock noted the following in support of this analysis:

(1) There is nothing in the terms of s 61(1)(a) to suggest that the word "own" is intended to have anything other than its ordinary, plain and natural meaning, namely, the ability to freely enjoy, control, and dispose of, the relevant asset.

(2) There is no requirement that the cessation of ownership must be permanent. Unlike in ss 61(1)(b) and (f), Parliament has not chosen to impose any temporal constraints in s 61(1)(a). The question is simply whether there comes a time at which the person, who owns the asset, stops owning it. The clear implication is that the cessation of ownership in s 61(1)(a) may be temporary.

(3) Section 61(1)(a) was not introduced as an anti-avoidance measure (unlike, for example, the provisions in issue in *UBS*). It operates as a simple trigger for determining a disposal event. There is no basis, therefore, to take into account tax motives in deciding whether it applies (see by contrast [75] and [85] of *UBS*).

(4) The fact that, in certain circumstances s 67 applies to deem a person who shall or may become the owner of an asset to be its actual owner for allowances purposes plainly indicates that "ownership" under s 11 (and correspondingly under s 61) does not encompass such limited rights. Otherwise, it would not be necessary for s 67 to apply with that effect.

(5) The guidance given by the House of Lords in *Melluish (Inspector of Taxes) v BMI (No 3) Ltd and related appeals* [1995] STC 964 on the meaning of the earlier corresponding provisions in s 41 of the Finance Act 1971 ("**s 41 FA 1971**") supports this meaning:

(a) Under those provisions and those in s 24 of the Capital Allowances Act 1990 which replaced them (s "**24 CAA 1990**"), a taxpayer had an entitlement to allowances on expenditure on assets where (amongst other conditions) they "belonged" to him and there was a disposal event where they "ceased to belong" to him.

(b) In *Melluish* it was held that assets, such as lifts and boilers, did not "belong" to the taxpayer for allowances purposes because on being leased to a local authority and affixed to its land they became part of the land as "fixtures". Essentially, Lord Browne Wilkinson equated belonging with ownership in the ordinary sense. At page 274, he said that: "what belongs to me is what I own" and endorsed the words of Fox LJ in *Stokes (Inspector of Taxes) v Costain Property Investments Ltd* [1984] STC 204 at page 209 that:

> "I agree that 'belong' and 'belonging' are not terms of art. They are ordinary English words. It seems to me that, in ordinary usage, they would not be satisfied by limited interests. For example, I do not think one would say that a chattel 'belongs to X' if he merely had the right to use it for five years."

(c) It is clear from the Explanatory Notes to the CAA that the main purpose of the legislature in introducing the CAA was to rewrite the legislation in CAA 1990 to make it clearer and easier to use, but it was not to change its meaning. There is no suggestion that the reason for the change in wording of the relevant provisions from "belong" to "own" was to import any different meaning, and indeed the note on s 61 states that it was "based on sections 24(6) and 26(1) of CAA 1990".

91. Mr Peacock asserted that, in any event, the transactions did not form a composite whole in the way HMRC contended for. Mr Peacock said that, at least as regards the transactions under consideration in the appeal by Cape, the payment of the second arrangement fee to SGLJ was not entirely dependent on the Put Option being exercised and that the Netting Letter did not have the effect which HMRC argued it had (see [48] and [79] above). He said that the arrangements included the grant of the Call Options due to the commercial uncertainty that SGLJ might not exercise its rights under the Put

Options; they were intended to enable the relevant groups to recover the assets at fair value. In his view, unlike the position in *Scottish Provident*, this arrangement did not create a commercially irrelevant contingency that can be ignored. He noted that the analysis is a legal one which does not depend on the accounting treatment.

92. He added that it cannot be the case that Parliament intended that there is no disposal under s 61 and no disposal value if a taxpayer sells an asset where he might buy it back under option arrangements. He asserted that to take that view runs the grave risk of undermining the very heart of the capital allowances code bringing many difficulties for taxpayers and for HMRC. In fact, the evident purpose of Parliament is exactly the opposite, namely, that a "real world" sale is a disposal event. In this case there is ample evidence there was such a "real world" event in that the monies moved, the assets were delivered, title to them passed, insurance was put in place, stock exchange announcements were made and provision had to be made in case SGLJ did not exercise the Put Options.

93. Mr Peacock said that moreover a *Ramsay* approach cannot sensibly be applied in this case. In *Ramsay* the House of Lords held that the taxpayer had not realised an allowable loss within the meaning of the capital gains tax rules under a set of self-cancelling transactions designed to ensure that the taxpayer did not make any economic loss. In that context, the court could conclude that the manufactured self-cancelling losses and gains could be ignored under the relevant provisions as, in the real world, the taxpayer suffered neither gain nor loss. If a person loses £10 but gains £10 three days later, the person's net gain/loss over the three days is zero. That is not the same as the case, where a person sells an asset for £10 and repurchases it for £10 three days later. Whilst it can be said that in real terms the person is back where he started, it cannot be said that on the second day he owned the asset. HMRC's analysis distorts the concept of "ownership".

94. He added that as held in *Mayes* if the result is that the taxpayer enjoys a particular advantage and HMRC/Parliament does not like that conclusion, then it is for Parliament to change the law as it sees fit. In this instance Parliament has subsequently changed the law in the Finance Act 2011 by amending ss 70C, 70D, and 70E such that the transactions would no longer produce the tax result which the appellants argue apply in this case.

95. On the *Sargaison v Roberts* argument, Mr Peacock said that, it is plain from the decision of the High Court in *Ensign Tankers* ([1989] STC 705) that the immediate grant of a leaseback of an asset following a sale does not prevent there being an effective sale in the first place. In that case, the purchaser acquired an asset and immediately granted a distribution licence to an entity related to the seller. Millett J (as he then was) rejected the argument that the relevant assets did not "belong" to the purchaser for allowances purposes (under s 41 FA 1971) due to the grant of the licence. He said, in effect, that there could only be the grant of a valid licence because there was a valid sale (at page 768). In this case, in the same way, SGLJ could only grant a lease back of the assets because they were sold to it in the first place.

96. Mr Peacock continued that, in that context, the length of the leaseback makes no difference to the analysis. He thought that was acutely true in a case where the long funding lease rules are in point. Those rules are specifically concerned with the length of a lease in that they distinguish between cases where there is a short lease (broadly, a lease of less than five years in duration) and a long lease. A taxpayer is not entitled to allowances in respect of expenditure incurred under a short lease unless it is a finance lease. Moreover, the special provisions in s 221 relating to sale and finance leaseback

transactions would have no application if the sale limb of the transaction is not respected as being such for capital allowances purposes.

97. He added that *Sargaison v Roberts* is not a good guide to the operation of s 61 given it was decided before the meaning of "belonging" for capital allowances purposes was considered in cases such as *Melluish*, *Ensign* and *Stokes v Costain* and before the introduction of provisions specially relating to sale and leaseback transactions (such as those in s 221). He noted that the particular provision it concerned was repealed by the CAA.

98. Mr Milne responded that HMRC were not arguing that "circularity" means that the scheme is not effective. Rather, the argument is that there was no cessation of ownership of the assets for the purposes of s 61(1)(a) as properly construed. Further, any change in the legislation is irrelevant. As the Supreme Court explained in *Rangers* (at [70]), subsequent provisions, which are designed to counter tax avoidance schemes, cannot affect the interpretation of prior tax legislation (and see also *Mayes*). In his view, the application of the *Ramsay* approach does not at all depend on the provisions in question being anti-avoidance provisions. The courts simply have to interpret the relevant legislation in the light of realistic view of the facts

99. He added that, contrary to the appellant's view "cease to own" does take a flavour of permanence from the other sub-paragraphs in section 61(1) but, in any event, taking this scheme as a whole, there was only a mere blip in the ownership, which was engineered by this scheme and does not amount to a cessation of ownership for the purposes of s 61(1). In his view, the decision in *Ensign* supports HMRC's view rather than the appellants' stance and in fact all the cases the appellants rely on are entirely consistent with HMRC's position.

Caselaw

Ramsay

100. I have set out details of the cases cited going right back to *Ramsay* given the parties' very different views on the relevance of the composite approach set out in that case. I have then set out my conclusions in the decision section.

101. In *Ramsay*, as noted, the House of Lords was concerned with a tax avoidance scheme under which the taxpayer sought to offset a capital gain by creating an allowable loss for capital gains purposes without incurring an economic loss. As Lord Wilberforce explained, at page 179, under the scheme "two assets appear, like particles in a gas chamber with opposite charges, one of which is used to create the loss, the other of which gives rise to an equivalent gain which prevents the taxpayer from supporting any real loss, and which gain is intended not to be taxable". The relevant assets were loans which he said "like the particles" had a very short life:

> "Having served their purpose they cancel each other out and disappear. At the end of the series of operations, the taxpayer's financial position was precisely as it was at the beginning, except that he paid a fee, and certain expenses, to the promoter of the scheme."

102. He also noted that it was the clear and stated intention that once started the scheme would proceed through the various steps to the end and that "the taxpayer does not have to put his hands in his pocket" given the monies required were provided by a finance house and were automatically repaid at the end of the operation.

103. Lord Wilberforce continued that their Lordships were invited to treat the transactions as a fiscal nullity not producing either a gain or a loss and that counsel described that approach as "revolutionary". Lord Wilberforce concluded, however, that far from being revolutionary, this approach resulted from the application of ordinary principles of statutory construction.

104. In my view, it is plain that, in explaining how those principles are to be applied in a tax context, Lord Wilberforce did not, as Mr Peacock asserted, intend his comments on the composite approach to be applied as a substantive principle. Rather he viewed it as part of the process of statutory construction (and that is how his comments have been viewed consistently in the later cases as illustrated below).

105. At pages 179 and 180, Lord Wilberforce set out what he considered to be well established principles:

(1) The courts are not confined to literal interpretation of statutory provisions but should consider "the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded…..".

(2) A person "is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. It must be considered according to its legal effect".

(3) It is for the fact-finding commissioners to find whether a document, or a transaction, is genuine or a sham in the sense that "while professing to be one thing, it is in fact something different. To say that a document or transaction is genuine, means that, in law, it is what it professes to be, and it does not mean anything more than that."

(4) "Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance. This is the well known principle of *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1, 19."

106. He continued, at page 180, that whilst the principle set out in the *Duke of Westminster* is "a cardinal principle" it "must not be overstated or overextended" to require a blinkered approach:

> "While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs."

107. In the same passage, he set out what I have termed as the composite approach:

> "If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded: to do so is not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded…."

108. He concluded that whether under the principle set out in *Westminster* or under any other authority:

> "the courts are not bound to consider individually each separate step in a composite transaction intended to be carried through as a whole."

109. Lord Wilberforce went on to state that the composite approach is particularly in point where "it is proved that there was an accepted obligation once a scheme is set in motion, to carry it through its successive steps" and where (as in *Ramsay* itself) "there is an expectation that it will be so carried through, and no likelihood in practice that it will not". In such cases "(which may vary in emphasis) the commissioners should find the facts and then decide as a matter (reviewable) of law whether what is in issue is a composite transaction, or a number of independent transactions".

110. He went on to state explicitly, at page 181, that the approach he set out did not introduce a new principle. Rather it involved applying to "new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation" in recognition that while "the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still". He said, at page 182, that:

> "To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process. In each case the facts must be established, and a legal analysis made: legislation cannot be required or even be desirable to enable the courts to arrive at a conclusion which corresponds with the parties' own intentions."

111. As Lord Reed later put it in *UBS*, it is plain that Lord Wilberforce was saying not only that the purposive approach to statutory construction, which was orthodox in other areas, extended to tax law but also "equally significantly….that the analysis of the facts depended on that purposive construction of the statute" (see [205] below).

112. Having noted, at page 182, that capital gains tax was "created to operate in the real world, not that of make-belief" Lord Wilberforce referred to his own comments in *Aberdeen Construction Group Ltd.* v. *I.R.C.* [1978] AC 885 that:

> "it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function."

113. He summarised the relevant facts, at page 183: (a) the scheme had no commercial justification as the taxpayer was bound to make a loss, (b) "every transaction would be genuinely carried through and in fact be exactly what it purported to be", (c) it was "reasonable to assume that all steps would, in practice, be carried out, but there was no binding arrangement that they should. The nature of the scheme was such that once set in motion it would proceed through all its stages to completion", (d) the transactions "regarded together, and as intended, were from the outset designed to produce neither gain nor loss…they were self-cancelling", (e) the scheme "was not designed as a whole to produce any result for Ramsay or anyone else, except the payment of certain fees for the scheme,…" and (f) the monies were advanced by a financier "on terms which ensured that it was used for the purposes of the scheme and would be returned on completion, having moved in a circle".

114. He concluded, at page 383, that:

> "it would be quite wrong, and a faulty analysis, to pick out, and stop at, the one step in the combination which produced the loss, that being entirely dependent upon, and merely a reflection of the gain. The true view, regarding the scheme as a whole, is to find that there was neither gain nor loss, and I so conclude."

Furniss

115. Notwithstanding the plain meaning of Lord Wilberforce's judgment, as Lord Nicholls recognised in *BMBF*, for some time there was a tendency for taxpayers and HMRC to view *Ramsay* as establishing "a new jurisprudence governed by special rules of its own" (see [148] to [150] below). That view was based, in particular, on comments made in the cases which followed in the wake of *Ramsay*, such as *Inland Revenue* v *Burmah Oil Co Ltd* 1982 SC (HL) 114 ("*Burmah Oil*"), *Carreras* and *Furniss*. Parties interpreted the decisions in these cases as meaning that, on a composite approach,

whatever the taxing statute, elements inserted into a pre-ordained composite scheme without any commercial or business purpose should be treated as having no significance to the tax analysis. In particular, the well-known comments of Lord Brightman in *Furniss* at page 527 (as based on the earlier formulation by Lord Diplock in *Burmah Oil*) suffered from this view.

116. In *Furniss* the taxpayers transferred shares which they wished to sell to a third party to a newly formed offshore company, IoM, in exchange for shares and that company then immediately sold the shares on to the third party for cash. The taxpayers' purpose in inserting this step prior to the sale was to avoid any immediate charge to tax on capital gains on the sale on the basis that IoM was outside the UK tax net. It was critical to the success of the scheme, therefore, that the initial transfer of the shares to IoM took place as a tax neutral reorganisation for capital gains tax purposes. The House of Lords took a composite approach in deciding that the taxpayers were to be treated as though they had disposed of the shares direct to the third party on the basis that, with their concurrence, the sale price was paid to IoM.

117. In the relevant passage Lord Brightman said that the correct expression of the limitations of the *Ramsay* principle is as follows, at page 527:

> "First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (ie business) end. The composite transaction does, in the instant case….It did not in *Ramsay*. Secondly, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax - not 'no business *effect*'. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied.
>
> In the instant case the inserted step was the introduction of [IoM] as a buyer from the [taxpayers] and as a seller to [the third party]. That inserted step had no business purpose apart from the deferment of tax, although it had a business effect…."

118. However, as set out in detail below, the House of Lords and the Supreme Court have been at pains to clarify that the view that the composite approach embodies a new jurisprudence governed by special rules of its own is a misconception. They have set out clearly that (a) *Ramsay* itself does not set out any such special principle, and (b) in *Furniss* and the other relevant cases, the courts were not laying down any such special principle or interpreting *Ramsay* as doing so (see, in particular, [119] to [124] and [148] to [150] below).

MacNiven

119. In *MacNiven* v *Westmoreland Investments Ltd* [2003] 1 AC 311 ("*MacNiven*"), the House of Lords held that a debtor made a payment of interest within the meaning of the relevant statute which entitled him to a deduction or repayment of tax notwithstanding that it was funded by monies borrowed for that purpose from the creditor himself and was made solely to reduce the debtor's liability to tax. The House of Lords said that the purpose of requiring interest to be "paid" is to produce symmetry; it gives a right to a deduction in respect of any payment which gives rise to a corresponding tax liability for the recipient (or which would do so if the recipient is a taxable entity.) As the payment was accepted to have had this effect, it answered the statutory description.

120. In reviewing the *Ramsay* line of cases, Lord Nicholls emphasised that in *Ramsay* "the House did not enunciate any new legal principle" but rather highlighted that,

"confronted with new and sophisticated tax avoidance devices, the courts' duty is to determine the legal nature of the transactions in question and then relate them to the fiscal legislation…." (at [1]). He noted, at [2] to [5], that *Ramsay* brought out the following three points, in particular:

(1) When seeking to attach a tax consequence to a transaction, the court may have regard to the overall effect of a series or combination of transactions intended to operate as such and:

> "..Courts are entitled to look at a pre-arranged tax avoidance scheme as a whole. It matters not whether the parties' intention to proceed with a scheme through all its stages takes the form of a contractual obligation or is expressed only as an expectation without contractual force".

(2) That does not mean that transactions or relevant steps are to be treated as "shams" nor does it require going "behind a transaction for some supposed underlying substance". Rather it enables the court "to look at a document or transaction in the context to which it properly belongs".

(3) Having identified the legal nature of the transaction, the courts must then relate this to the language of the statute:

> "For instance, if the scheme has the apparently magical result of creating a loss without the taxpayer suffering any financial detriment, is this artificial loss a loss *within the meaning of the relevant statutory provision*?"

121. Lord Nicholls, therefore, specifically endorsed the composite approach. He then referred with approval, at [6], to the comments of Lord Steyn and Lord Cooke of Thorndon in *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991 ("*McGuckian*") at 1000 and 1005 respectively. He noted that they said that this approach (as Lord Nicholls had described it, including the composite approach) "is an exemplification of the established purposive approach to the interpretation of statutes" and "an application to taxing Acts of the general approach to statutory interpretation whereby, in determining the natural meaning of particular expressions in their context, weight is given to the purpose and spirit of the legislation".

122. At [7], he cautioned that the observations on the *Ramsay* approach in some later decisions should be read in the context of the particular statutory provisions and sets of facts under consideration and that they:

> "cannot be understood as laying down factual pre-requisites which must exist before the court may apply the purposive, *Ramsay* approach to the interpretation of a taxing statute. That would be to misunderstand the nature of the decision in *Ramsay*."

123. Whilst he "readily accepted", at [8], that the factual situation described by Lord Brightman in *Furniss* is one where, typically, the *Ramsay* approach will be "a valuable aid" which may well often have the effect he set out, it really is just an aid and:

> "This is not an area for absolutes. The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case. Further, as I have sought to explain, *Ramsay* did not introduce a new legal principle. It would be wrong, therefore, to set bounds to the circumstances in which the *Ramsay* approach may be appropriate and helpful. *The need to consider a document or transaction in its proper context, and the need to adopt a purposive approach when construing taxation legislation, are principles of general application. Where this leads depends upon the particular set of facts and the particular statute*….." (emphasis added)

124. It is clear, therefore, that Lord Nicholls did not consider that *Furniss* was wrongly decided or that the description Lord Brightman gave of how the composite approach

may apply was wrong, as applied in the context of the particular provision in issue in *Furniss* and the facts of that case. He considered that those comments provide useful guidance but are not to be viewed as providing a set of universally applicable conditions which must be satisfied for a *Ramsay* composite approach to apply; it is always a question of interpretation of the relevant provision and its application to the specific facts.

125. Lord Hoffman was also clear that, on a *Ramsay* approach, the ultimate question is one of statutory interpretation. However, he sought to provide guidance on precisely when a composite approach is appropriate. In summary, he drew a distinction between cases where a statutory concept is intended to be given (a) a commercial meaning, in which case steps with no commercial purpose artificially inserted into a composite transaction for tax purposes will not affect the answer to the statutory question, and (b) a legal meaning, in which case the juristic interpretation of the provision is to be respected.

126. At [28], Lord Hoffman said that "everyone agreed that *Ramsay* is a principle of statutory construction". However, in his view it involved an "innovation" in that its effect "was to give the statutory concepts of "disposal" and "loss" a commercial meaning" in recognition that "the statutory language was intended to refer to commercial concepts", so that "the court was required to take a view of the facts which transcended the juristic individuality of the various parts of a pre-planned series of transactions".

127. At [40], he considered what the court meant in *Ramsay* in referring to the "real" nature of the transaction and to what happens in "the real world". He said that: "The point to hold onto is that something may be real for one purpose but not for another". He said that accordingly:

(1) The acceptance that the transactions in *Ramsay* were not shams was an acceptance of "the juristic categorisation of the transactions as individual and discrete" and that "each of them involved no pretence. They were intended to do precisely what they purported to do. They had a legal reality".

(2) On the other hand, the view that the transactions did not give rise to a "real" disposal giving rise to a "real" loss was a rejection of "the juristic categorisation as not being necessarily determinative" for the purposes of those statutory concepts as properly interpreted. He thought that the "contrast here is with a commercial meaning of these concepts" and that reference to the income tax legislation as operating "in the real world", is a reference to "the commercial context which should influence the construction of the concepts used by Parliament".

128. He said, at [48], that in the famous passage in *Furniss* Lord Brightman provided "a careful and accurate summary of the effect which the *Ramsay* construction of a statutory concept has upon the way the courts will decide whether a transaction falls within that concept". He expanded on this as follows:

> "If the statutory language is construed as referring to a commercial concept, then it follows that steps which have no commercial purpose but which have been artificially inserted for tax purposes into a composite transaction will not affect the answer to the statutory question. When Lord Brightman said that the inserted steps are to be "disregarded for fiscal purposes", I think that he meant that they should be disregarded for the purpose of applying the relevant fiscal concept."

129. He emphasised at [49] that this formulation "is not a principle of construction" but is rather a "statement of the consequences of giving a *commercial construction* to a

fiscal concept" (emphasis added). He advised that before applying Lord Brightman's words:

> "it is first necessary to construe the statutory language and decide that it refers to a concept which Parliament intended to be given a commercial meaning capable of transcending the juristic individuality of its component parts. But there are many terms in tax legislation which cannot be construed in this way. They refer to purely legal concepts which have no broader commercial meaning. In such cases, the *Ramsay* principle can have no application. It is necessary to make this point because, in the first flush of victory after the *Ramsay*, *Burmah* and *Furniss* cases, there was a tendency on the part of the Inland Revenue to treat Lord Brightman's words as if they were a broad spectrum antibiotic which killed off all tax avoidance schemes, whatever the tax and whatever the relevant statutory provisions."

130. He noted, at [50], that the distinction between commercial and legal concepts has also been drawn in other areas of legislation and noted "by way of caution that although a word may have a "recognised legal meaning", the legislative context may show that it is in fact being used to refer to a broader commercial concept".

131. He also approved the comments in the *McGuckian* case which Lord Nicholls referred to and suggested, at [56], that particular attention should be paid to the way Lord Cooke of Thorndon dealt with the criteria stated by Lord Brightman in *Furniss.* He said that:

> "if the ultimate question is always the true bearing of a particular taxing provision on a particular set of facts, the limitations [in *Furniss*] cannot be universals. *Always one must go back to the discernible intent of the taxing Act*" and that he suspected that "the advisers of those bent on tax avoidance...do not always pay sufficient heed to the theme in the speeches in the *Furniss* case...to the effect that the journey's end may not yet have been found"., (emphasis added)

132. Lord Hoffman concluded, at [58] and [59], by again referring to the distinction between legal and commercial concepts:

> "The limitations of the *Ramsay* principle therefore arise out of the paramount necessity of giving effect to the statutory language. One cannot elide the first and fundamental step in the process of construction, namely, to identify the concept to which the statute refers. I readily accept that many expressions used in tax legislation (and not only in tax legislation) can be construed as referring to commercial concepts and that the courts are today readier to give them such a construction than they were before the *Ramsay* case. But that is not always the case. Taxing statutes often refer to purely legal concepts…If a transaction falls within the legal description, it makes no difference that it has no business purpose. Having a business purpose is not part of the relevant concept…
>
> Even if a statutory expression refers to a business or economic concept, one cannot disregard a transaction which comes within the statutory language, construed in the correct commercial sense, simply on the ground that it was entered into solely for tax reasons. Business concepts have their boundaries on this topic."

133. In the later cases, such as *BMBF* and *Tower*, the House of Lords clarified that Lord Hoffman's words are not to be interpreted as meaning that there is an a priori assumption that statutory concepts should be classified into legal or commercial ones before a *Ramsay* approach can be applied. As set out at [151] below, in *BMBF* Lord Nicholls referred to Ribeiro PJ's comments in *Arrowtown*, at [37] and [39]. In those passages, Ribeiro PJ said that he did not think that Lord Hoffman "actually intended to lay down a mechanistic test based on a "commercial"/"legal" dichotomy for pre-

determining whether a particular provision is or is not susceptible to a *Ramsay* approach" and that:

> "the "valuable insights" that Lord Hoffman was acknowledging [as regards Lord Brightman's comment in *Furniss*] were all centred on the proposition that the *Ramsay* doctrine has at its core the purposive interpretation of statutes applied to facts viewed realistically and untrammelled by "limitations" which might be thought to arise out of Lord Brightman's formulation. Such an approach strikes me as the antithesis of a mechanistic use of the "commercial"/"legal" dichotomy as a straitjacket limiting construction of the relevant statute…" [as Ribeiro PJ thought was reinforced by Lord Hoffman's comments at [50] (see [130] above).]

BMBF

134. If any further clarification were needed on the effect of the decision in *Ramsay* Lord Nicholls provided this in giving the unanimous judgment of the House of Lords *BMBF* in what is now regarded as the definitive word on this topic.

135. *BMBF* concerned whether a Barclays group company, BF, could claim capital allowances it asserted it was entitled to under a finance leasing transaction. The parties also referred to the earlier decision in *Ensign* and the later one in *Tower* which both relate to the availability of allowances in asset finance transactions. I have set out the facts of these cases in some detail as the parties each considered these decisions supported their very different analyses.

136. In summary, as set out in detail at [3] to [17] of the decision in *BMBF*:

(1) BF was a UK market leader in providing asset-based finance whereby typically it provided capital for the purchase of an asset for use by its customer in return for a series of periodic payments secured upon the asset. In *BMBF*:

(a) BF purchased a gas pipeline from an Irish entity, BGE, for £91 million and leased it back to BGE. BF borrowed the funds for the purchase price from Barclays Bank at a fixed commercial rate.

(b) BGE had constructed the pipeline largely with finance provided by a consortium of banks. The price of £91 million corresponded to that borrowing.

(c) BGE sub-leased the pipeline to, and made arrangements with, a newly formed UK subsidiary, BGE UK, for its operation.

(d) The lease to BGE was for a period of over 30 years for rents with an escalating profile and on terms typical of a finance lease, including that the rents were subject to adjustment if certain assumptions were to prove incorrect. The assumptions were based around the premise that BF would obtain allowances on the expected basis on £91 million and thereby achieve a particular level of tax saving. The sublease was on similar terms to the lease but the rents were not subject to this adjustment mechanism. BGE UK assumed direct liability to pay the rent to BF but with adjustments to the payment arrangements where the rental adjustment mechanism was triggered.

(2) There was no dispute that BF would ordinarily be entitled to allowances on the basis it incurred the purchase price on acquiring the asset for the purposes of its finance leasing trade. Nor was it disputed or perceived to be unacceptable tax

avoidance that the basic premise of a finance leasing transaction, as it was put by one of BF's witnesses is that "lessors pass on the value of the capital allowances available to them in respect of the asset being financed to the customer. The customer gets the use of the asset concerned and pays rent at a rate which reflects the margin required by the Bank and the reduced funding cost to the Bank of providing lease finance as a result of the tax deferral benefit available". The House of Lords stated that if the above steps were the only ones involved in the transaction, HMRC would accept that BF was entitled to the allowances (see [13]).

(3) The unusual feature, which caused both the Special Commissioners and Park J concern was that BGE did not have immediate access to the funds raised of £91 million. This was because:

(a) BF required BGE UK to procure a guarantee in respect of the rental obligations.

(b) This guarantee was provided by Barclays Bank itself, which required BGE UK to provide a charge over the £91 million as counter security for its potential liability under the guarantee.

(c) For this purpose, BGE provided the sales proceeds to Barclays Bank via a complicated set of arrangements whereby it deposited them with a Jersey company and they reached the bank via an Isle of Man Barclays company.

(d) The Jersey company undertook complicated obligations to make a range of periodical payments to BGE and BGE UK over the duration of the lease which totalled much more than £91 million. One set of payments was used to funds the rents and the rest, of some £8.1 million in net terms, were retained by BGE. The House of Lords noted (at [17]) that the benefit obtained by BGE was entirely attributable to BF being able to pass on the benefit of its capital allowances.

137. Lord Nicholls noted, at [18], that, in their decision (see [2002] STC 1068) the Commissioners found as facts that (a) the events were pre-ordained and designed to be a composite whole, (b) the circularity of the payments of the £91m was not an essential part of the scheme (as Park J also accepted), (c) BF bought and leased back the pipeline under commercial terms negotiated at arms' length (and the scheme originally contemplated that a company outside the Barclays group would be the purchaser and lessor), and (d) the terms upon which Barclays Bank provided the guarantee were ordinary commercial terms. I note that in the Court of Appeal's decision in *BMBF*, it was noted that a benefit to BF was that the deposit arrangements had the effect that "the finance provided by the Barclays group was weighted at 0% in [Barclays Bank's] capital adequacy return to the Bank of England (i.e. the transaction was treated as being of no risk and so did not affect the capital adequacy of the Barclays group)" (see [2003] STC 66 at [11(11)]).

138. At [19], Lord Nicholls remarked that Park J also acknowledged in his decision that the obligations to make periodic payments were not entirely circular given, for example, that BGE retained £8.1 million in net terms and BF needed more than the rents to repay its loan to Barclays Bank. He continued to note, at [20], that nevertheless Park J concluded in agreement with the Special Commissioners:

> "that the difference between what BF received from BGE (UK) and what it had to pay Barclays to service its borrowing was represented by the benefit of the capital allowances. It was these allowances which provided the only new money introduced into the circular system and which enabled BGE to receive

> the only money to leave the system [in the form of the sums released by the Jersey company]. All the rest was passed round between Barclays companies."

139. As Lord Nicholls recorded at [21], the Commissioners concluded that BGE, therefore, was to benefit to an extent of £8.1 million net under payments:

> "financed entirely by United Kingdom taxpayers by means of the hoped for capital allowances. Without the capital allowances BGE would receive nothing, for the amounts of the rents would increase to take account of the non-availability of capital allowances."

140. The Special Commissioners went on to say that looking at the matter in the round the payment of £91 million was not expenditure on the pipeline:

> "The payment by [BF] to BGE achieved no commercial purpose. Commercially driven finance leasing is designed to provide working capital to the lessee. But BGE could not get its hands on the money. It parted with a valuable asset allegedly for £[91 million] but received no immediate benefit from the transaction. [BF] provided no finance to BGE simply because the amounts had to be deposited as part of the arrangements with [the Jersey company] to be repaid only in accordance with the deposit agreement with [that company]…
>
> In our judgment the purpose of the expenditure by [BF]….was not the acquisition of the pipeline but the obtaining of capital allowances which would result in ultimately a profit to BGE and fees payable to [BF] and BZW. The transaction had no commercial reality."

141. In the High Court, Park J essentially agreed with this analysis (as set out by Lord Nicholls at [22] and [23]). He thought (at [49]) that finance leasing ordinarily involved the provision of "up-front finance" to the lessee: a capital sum used to buy the plant or refinance its previous acquisition but here there was no such up-front finance:

> "BGE already owned the pipeline and had paid for it with a loan from a syndicate of banks. After the transaction BGE was still able to use the pipeline as before, though by then it did so by virtue of the lease, sublease and Transportation Agreement, and it still owed to the banks the money which it had borrowed. Nor was the £91 million available to BGE for it to use in any other way to finance transactions or activities of its business."

142. Park J continued that in the light of the *Ramsay* authorities he had to interpret and apply the statute in a wider way to ask whether BF *really* incurred its expenditure of £91 million on the provision of the pipeline, or on something else and he held that:

> "the expenditure was really incurred on the creation or provision of a complex network of agreements under which, in an almost entirely secured way, money flows would take place annually over the next 32 or so years so as to recoup to BMBF its outlay of £91m plus a profit."

143. As Lord Nicholls noted, at [24], the Special Commissioners and Park J went so far as to say that the existence of the asset and the amount of the consideration were irrelevant to the operation of the scheme:

> "Because of the circularity of the payments, the scheme would have worked just as well whatever price had been named in the documents and whether there had actually been a pipeline or not."

144. The House of Lords disagreed with this. In short, in their view, on a purposive construction, what the lessee did with the sales proceeds it received from BF for the sale of the pipeline was irrelevant to the question of whether BF was entitled to capital allowances.

145. Lord Nicholls first re-capped on the applicable principles of statutory construction. At [28], he noted that, as Lord Steyn explained in *McGuckian* at 999 the modern approach to statutory construction is:

> "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".

146. He noted that until *Ramsay*, however, revenue statutes were "remarkably resistant to the new non-formalist methods of interpretation". The "particular vice" of formalism in this area was "the insistence of the courts on treating every transaction which had an individual legal identity ….as having its own separate tax consequences, whatever might be the terms of the statute". He continued that as Lord Steyn said, it was:

> "those two features - literal interpretation of tax statutes and the formalistic insistence on examining steps in a composite scheme separately - [which] allowed tax avoidance schemes to flourish."

147. He described *Ramsay*, at [29], as having "liberated the construction of revenue statutes from being both literal and blinkered". At [32] he summarised the essence of this liberated approach, noting specifically that it may include the composite approach:

> "to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction *(which might involve considering the overall effect of a number of elements intended to operate together)* answered to the statutory description…however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in [*MacNiven*], para 8:
>
> > "The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case."" (emphasis added)

148. He continued to emphasise, as he had done in *MacNiven*, that *Ramsay* did not introduce a new doctrine operating within the special field of revenue statutes. On the contrary, as Lord Steyn observed in *McGuckian* at 999 "it rescued law from being "some island of literal interpretation" and brought it within generally applicable principles". He said that the unfortunate tendency "to regard *Ramsay* as establishing a new jurisprudence governed by special rules of its own" was "encouraged by two features characteristic of tax law, although by no means exclusively so" (at [34]):

(1) The first is that:

> "tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said, "in the real world"."

(2) The second is that:

> "a good deal of intellectual effort is devoted to structuring transactions in a form which will have the same or nearly the same economic effect as a taxable transaction but which it is hoped will fall outside the terms of the taxing statute. It is characteristic of these composite transactions that they will include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge."

149. He continued to caution, at [35], as he had also done in *MacNiven*, that comments made in the cases such as *Burmah Oil*, *Furniss* and *Carreras* are not to be taken out of context, in effect, as justifying a broad-brush approach. In doing so, he did not suggest, however, that those cases were wrongly decided or that the wrong approach was taken. He said that in those cases, in looking at the overall effect of the composite transactions

in question, "*on the true construction of the relevant provisions of the statute,* the court treated the elements inserted into the transactions without any commercial purpose as having no significance" (emphasis added). However, the view based on these cases that, in the application of "*any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded" is "going too far" in that:

> "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 [*Arrowtown* at [35]]…" (as set out at [17] above).

150. He said, at [37] and [38], that the need to avoid sweeping generalisations about disregarding transactions undertaken for the purpose of tax avoidance was shown by *MacNiven* which, in his view, shows:

> "the need to focus carefully upon the particular statutory provision and to identify its requirements before one can decide whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute."

151. In the same passage, he commented on Lord Hoffman's approach in *MacNiven* as not "an unreasonable generalisation" but said:

> "we do not think that it was intended to provide a substitute for a close analysis of what the statute means. It certainly does not justify the assumption that an answer can be obtained by classifying all concepts *a priori* as either "commercial" or "legal". That would be the very negation of purposive construction: see Ribeiro PJ in *Arrowtown* at paras 37 and 39…." [see [133] above]

152. In turning to applying these principles to the facts of *BMBF,* Lord Nicholls said, at [39], that *BMBF,* like *MacNiven,* illustrates the need for a close analysis of what, on a purposive construction, the statute actually requires. In that context, he considered that the "object of granting the allowance is to provide a tax equivalent to the normal accounting deduction from profits for the depreciation of machinery and plant used for the purposes of the trade". He said that:

> "Consistently with this purpose, the relevant provision requires that a trader should have incurred capital expenditure on the provision of machinery or plant for the purposes of his trade. *When the trade is finance leasing, this means that the capital expenditure should have been incurred to acquire the machinery or plant for the purpose of leasing it in the course of the trade.* In such a case, it is the lessor as owner who suffers the depreciation in the value of the plant and is therefore entitled to an allowance against the profits of his trade." (emphasis added)

153. At [40] he held that the statutory requirements he had described are "*in the case of a finance lease concerned entirely with the acts and purposes of the lessor*". In his view the CAA:

> "says nothing about what the lessee should do with the purchase price, how he should find the money to pay the rent or how he should use the plant. As Carnwath LJ said in the Court of Appeal [2003] STC 66, 89, para 54:
>
> > "There is nothing in the statute to suggest that 'up-front finance' for the lessee is an essential feature of the right to allowances. The test is based on the purpose of the lessor's expenditure, not the benefit of the finance to the lessee.""

154. He said, at [41], that so far as the lessor was concerned, all the requirements to qualify for allowances were satisfied noting that a director of BF, "gave unchallenged

evidence that from its point of view the purchase and lease back was part of its ordinary trade of finance leasing" and that "if one examines the acts and purposes of [BF], it would be very difficult to come to any other conclusion". He thought that the finding of the Special Commissioners that the transaction "had no commercial reality" depended entirely upon an examination of what happened to the purchase price after BF paid it to BGE. However, in his view "these matters do not affect the reality of the expenditure by [BF] and its acquisition of the pipeline for the purposes of its finance leasing trade".

155. At [42] he concluded that, in light of the purpose of s 24 CAA 1990, on the facts of this case, the fact that there were pre-ordained arrangements and a circular movement of funds was simply not relevant to the analysis:

> "if the lessee chooses to make arrangements, even as a preordained part of the transaction for the sale and lease back, which result in the bulk of the purchase price being irrevocably committed to paying the rent, that is no concern of the lessor. From his point of view, the transaction is exactly the same. No one disputes that [BF] had acquired ownership of the pipeline or that it generated income for [BF] in the course of its trade in the form of rent chargeable to corporation tax. In return it paid £91m. The circularity of payments which so impressed Park J and the special commissioners arose because [BF], in the ordinary course its business, borrowed the money to buy the pipeline from Barclays Bank and Barclays happened to be the bank which provided the cash collateralised guarantee to [BF] for the payment of the rent. But these were happenstances. None of these transactions, whether circular or not, were necessary elements in creating the entitlement to the capital allowances."

156. The result in *BMBF* does not seem surprising given that it was accepted that a finance lessor under typical finance sale and leaseback finance arrangement, undertaken as part of a finance leasing trade, would be entitled to allowances on the price paid for the asset. The House of Lords appeared to accept (from their description of how such transactions work) that it is not objectionable for the lessee to benefit from the allowances under such transactions, in that, as is typically the case, their assumed availability to the lessor is factored into the level of rents due under the finance lease with the result that, assuming the allowances are in fact available, the structure provides the lessee with a cheaper form of financing than would usually apply under a commercial loan.

157. On that basis, the concerns of the Special Commissioners and Park J seem misplaced. Whilst the structure adopted in *BMBF* had some different features than those applicable under a typical finance lease transaction, they were commercially driven, and it appears that the overall economic effect for BGE was broadly the same as under a typical structure. The arrangements did not operate to enable BGE to replace its existing loan with a new financing with a lower repayment profile. However, BGE received funding of around £8.1 million in net terms which it is reasonable to suppose, given the allowances were factored into the payment profile, meant it achieved a significant contribution to its financing requirements.

158. Mr Peacock submitted that this decision embodies the correct approach to be taken in these cases noting that Lord Nicholls emphasised the need to avoid sweeping generalisations and to focus closely on the requirements of the statutory provision. In his view, the decision demonstrates that it is not sufficient to assess whether a provision applies by reference to "sound bites" such as that the transactions are "preordained" or that funds may be said to move in a circle. A much closer scrutiny is required. He noted that, on that approach, neither these features nor the fact that the transaction did not provide the lessee with upfront financing affected the conclusion that, on a

purposive approach, BF was entitled to allowances given it had plainly "really" incurred expenditure on the acquisition of ownership of the pipeline for the purpose of its finance leasing trade.

159. Mr Peacock said that, as in *BMBF,* in these cases there were very "real" events, in the form of the sale of ownership of the assets to SGLJ, the leaseback and the reacquisition of ownership of the assets pursuant to the Put Option. In his view the effects of these "real world" events should be respected for the purposes of applying ss 61 and s 11 just as the "real" acquisition of ownership of the pipeline for use in BF's trade was respected for the purposes of establishing BF's entitlement to allowances under s 24 CAA 1990.

160. It is certainly the case that *BMBF* sets out very clearly the effect of the decision in *Ramsay* (including as regards the composite approach) and the correct approach to be adopted in construing tax legislation. This has been recognised in many subsequent decisions including the latest decisions on this topic in *UBS* and *Rangers* (see [203] to [210] below). I do not understand HMRC to doubt the meaning or relevance of Lord Nicholls words. However, in their view, in these appeals, unlike in *BMBF*, the close analysis required of the relevant provisions does not, on a realistic appraisal of the very different facts, produce the result that the appellants are entitled to allowances on the Option Price. I have commented further on this in the decision section.

Ensign and Tower

161. In both *Ensign* and *Tower*, the question was whether the taxpayers could claim first year allowances and writing-down allowances respectively on all or any of the expenditure they claimed they had incurred on the provision of the relevant assets under asset financing structures (under s 41 FA 1971 and s 11 respectively). As in *BMBF*, one of the main issues was that a substantial part of the monies by reference to which the claims for the relevant allowances were made could be said to move in a circle; in these cases that was asserted to be the effect of the provision of finance by the seller in the form of non-recourse "loans". In both decisions, the courts adopted a composite approach in their construction of the relevant provisions.

162. In summary, in *Ensign*, as set out in detail at pages 229 to 231 of the decision:

(1) Four UK companies entered into a limited partnership (VP), as limited partners, with the subsidiary of an American film production company, as general partner, to produce and exploit the film "Escape to Victory". Under the Limited Partnerships Act 1907 and by the express terms of the partnership agreement the limited partners were not liable for the debts and obligation of the partnership beyond the capital they contributed.

(2) Under the agreement with the production company, LPI, (a) VP contributed $3.25 million towards the cost of the film, (b) VP became entitled to the master negative of the film and was granted the exclusive licence to make and exploit the film, (c) LPI agreed to complete the film and (d) LPI agreed to lend VP the cost of making the film in excess of the partnership contribution of $3.25 million.

(3) LPI "loaned" VP a total of $10.75 million. In summary, under the terms of the loan, until VP had received $3.25 million from 25% of the net receipts from the exploitation of the film an amount equal to 75% of the net receipts was to be applied towards repayment of the loan (and thereafter all receipts were to be applied in discharge of the loan). However, under a provision headed "Nonrecourse Loan", VP and the partners were freed and discharged from any liability to repay the loan and related costs or any other monies which became due to LPI under the terms of the agreement.

(4) VP granted two of LPI's subsidiaries the exclusive right to distribute and exploit the film in perpetuity. They agreed to (a) to pay 25% of the net proceeds from the film to VP and 75% to LPI until VP had received $3.25 million, (b) thereafter, to pay 100% of such proceeds to LPI until it had received essentially all monies due under the loan agreement, and (c) thereafter, to pay 25% to VP on the basis they were to retain the remaining 75%.

(5) The limited partners claimed they were entitled to first year capital allowances in respect of the whole of the cost of the film of $14 million on the basis that they had incurred that full sum on the provision of the master negative for the purposes of s 41 FA 1971.

(6) The parties were agreed that the documents were interdependent and constituted one single composite agreement or transaction, which was a tax avoidance scheme and must be read as a whole. HMRC argued in effect that the members of VP were not entitled to any first-year allowances on the basis that it was not carrying on a trade but was carrying out a device to avoid tax. In outline, it was held that:

> (a) The legal effect of the transaction, whatever its design, was as a trading transaction. Given that the master negative belonged to VP and it expended $3.25 million towards the production of a film in which VP had a 25% interest, the members were entitled to first-year allowances on that sum on the basis it was incurred for the purposes of its trade (see pages 231 and 243).
>
> (b) The remaining amount of $10.75 million was not incurred by VP on the master negative. The effect of the loan arrangements was that that sum was incurred by LPI and not VP.

163. I note that as Mr Peacock pointed out, in the High Court arguments were raised that the master negative did not "belong" to VP for the purposes of s 41 FA 1971 due to the immediate grant of the licence to exploit it to the distributors. This was rejected and did not appear to be raised in the House of Lords. They proceeded on the basis, therefore, that a party such as VP, which enters into a sale and leasing or licensing back financing transaction of this kind, may in principle qualify to claim capital allowances on the relevant asset. It was the way in which the members of VP were financed by the seller which was the cause for concern.

164. Lord Templeman gave the leading judgment. He concluded, in effect, that in substance the film was funded to the tune of $10.75 million by LPI borrowing from its own bank. In accordance with the scheme documents, a bank account (the scheme current account) was opened in the name of VP but it could not be operated without the approval of a representative of LPI. VP paid $3.25m into this account which was transferred to LPI's bank to reduce LPI's indebtedness. However, thereafter, as Lord Templeman set out at page 231, when LPI spent monies on making the film:

> "the amount involved was credited by LPI to the scheme current account (which was controlled by LPI) and returned to LPI on the same day for credit [LPI's bank account]. The scheme current account was thus never in credit or debit at the close of any day and [VP] was never in debt as a result of the scheme. The cost of the film, namely [$14 million] was borne as to [$3.25 million] by [VP] and as to [$10.75 million] by LPI which was indebted to [its bank].

165. Lord Templeman continued that the non-recourse nature of the loans meant that in fact VP was not liable for the cost of the film in excess of $3.25 million at page 234:

> "But the non-recourse nature of the borrowing ensured that LPI paid the whole cost of the film exceeding [$3.25 million] and conversely that [VP] would not be liable for the cost of the film in excess of [$3.25 million]. By the operation of the scheme current account in accordance with the provisions of the scheme, the money of LPI, at all times under the control of LPI, was electronically transferred from Hollywood to the City of London and back again without serving any useful purpose and leaving no trace except entries on computer prints."

166. Lord Templeman then set out a review of the authorities including *Ramsay*, *Burmah Oil* and *Furniss*. He said, at page 237, that *Ramsay* was a case where "the true legal effect of the two transactions treated as a whole was that the taxpayer made neither a gain nor a loss". In the present case, at page 238, the "true view, regarding the scheme as a whole is to find that [VP] expended" $3.25 million and that it had "the apparently magic result of creating for tax purposes expenditure" of $14 million "while incurring a real expenditure of only" $3.25 million". He added that it was crucial "to take the analysis far enough to determine where the expenditure on the film is *really* to be found" and concluded that the expenditure of £10.75 million was "*really* to be found to have been incurred by LPI" (emphasis added).

167. He continued to state explicitly that the scheme fell within the principles in *Ramsay* and later decisions in the House of Lords (at page 240). He then stated his conclusion on the financing at page 241:

> "….if LPI had been a British company, the fact that LPI borrowed $10¾m from Chemical Bank to enable LPI to make the film would not have denied to LPI a first year allowance equal to the sums borrowed and expended. *But [VP] neither borrowed nor spent $10¾m*." (emphasis added)"

168. In turning to consider HMRC's argument that the partners were not entitled to any capital allowances at all (even on the £3.25 million of expenditure they had funded themselves), he cautioned, however, at page 241, that the principles of *Ramsay* and subsequent cases:

> "*…..do not compel or authorise the court to disregard all the fiscal consequences of a single composite transaction read as a whole on the grounds that it appears that the transaction is a tax avoidance scheme*." (emphasis added)

169. In the same passage he said that the lower courts had applied the wrong approach in that the Special Commissioners "felt bound to ignore all the fiscal consequences which are beneficial to the taxpayer because [VP] had entered into the scheme with 'fiscal motives as the paramount object' and Sir Nicolas Browne-Wilkinson V-C in the Court of Appeal [1991] 1 WLR 341, at 357, determined whether VP was trading in respect of the relevant transactions by examining the taxpayer's fiscal purpose or object in entering into the transaction. In his view, the correct approach is simply to find the facts and apply the law:

> "My Lords, I do not consider that the commissioners or the courts are competent or obliged to decide whether there was a sole object or paramount intention nor to weigh fiscal intentions against non-fiscal elements. The task of the commissioners is to find the facts and to apply the law, subject to correction by the courts if they misapply the law…"

170. In the same passage he went on to state that the position was clear once the correct statutory question was examined. In his view, the lower courts had asked the wrong question in looking at the purpose of the transaction; the applicable provision (in s 41 FA 1971) is concerned with the purpose of the expenditure:

> "The facts are undisputed and the law is clear. [VP] expended capital of $[3.25m] for the purpose of producing and exploiting a commercial film. The production and exploitation of a film is a trading activity. The expenditure of capital for the purpose of producing and exploiting a commercial film is a trading purpose. By section 41 of the Act of 1971 capital expenditure for a trading purpose generates a first year allowance. The section is not concerned with the purpose of the transaction but with the purpose of the expenditure. It is true that [VP] only engaged in the film trade for the fiscal purpose of obtaining a first year allowance but that does not alter the purpose of the expenditure. The principles of *Ramsay* and subsequent authorities do not apply to the expenditure of $[3.25m] because that was real and not magical expenditure by [VP]…….."

171. Following his review of the cases on when a person is trading for tax purposes he concluded, at page 243, that:

> "In the present case the legal effect of the transaction, whatever its design was a trading transaction whereby [VP] expended $[3.25m] towards the production of a film in which [VP] had a 25 per cent interest.
>
> All these authorities were dealing with the identification of a trading transaction. In the present case a trading transaction can plainly be identified. [VP] expended capital in the making and exploitation of a film. That was a trading transaction which was not a sham and could have resulted in either a profit or a loss. The expenditure of $[3.25m] was a real expenditure. The receipts of $3m were real receipts. The expenditure was for the purpose of making and exploiting a film and entitled [VP] to a first year allowance equal to the expenditure. The receipts imposed on [VP] a corporation tax liability."

172. In taking a *Ramsay* composite approach, Lord Goff formed the same conclusion as Lord Templeman at pages 244 to 246. He accepted that money was paid by LPI to VP when the scheme account was credited (although it was deprived of any practical effect by the immediate repayment of the sum) but said, in effect, that he had to take a purposive approach to the construction of the relevant provision, which he evidently saw as including a composite approach:

> "*What I have to do, however, is to stand back from the composite transaction; to look at it as a whole; and to decide, first, what is the true nature and effect of the transaction* and, second, whether, on a true construction of section 41(1) of the Finance Act 1971, VP is entitled to an allowance in respect of the whole of the cost of the film, viz $14m." (emphasis added)

173. Lord Goff said that on that basis it was impossible to characterise the monies passing through the scheme account as "in any meaningful sense a loan" which was lent to VP to finance the production of the film; rather it was paid into the account "to enable VP to indulge in a tax avoidance scheme", and for no other purpose. At page 247 he said that the self-cancelling payments by LPI to VP and repayments by VP to LPI are "typical examples of artificial transactions, the sole purpose of which is the avoidance of tax" which can properly be disregarded for tax purposes. He also thought that the transfer of the title to the film negative could also be treated as irrelevant as it had no function other than "to give colour to the tax avoidance scheme since the net profits were to be shared in accordance with the parties respective contributions" and that the distribution of net profits to LPI could be treated "for what in truth it was, the arrangement being wholly inconsistent with the repayment of a commercial loan". He concluded that VP was:

> "trading, though only to the extent of its investment of [$3.25 million] and no more; and that that sum constituted, on a true construction of the statute, the only capital expenditure incurred by the partnership in the making of the film".

174. Mr Peacock made similar submissions in relation to *Ensign* as those he made in relation to *BMBF* (see [158] and [159]) as regards the significance to the capital allowances analysis adopted by the court of the acquisition of ownership rights in respect of the relevant asset as indicating the "reality" of the expenditure on those rights.

175. He also submitted that, in his comments set out at [168] to [171] above, in effect, Lord Templeman meant that the fact that transactions are pre-ordained or can be described as a single composite transaction and that the taxpayer had fiscal motives for entering into them "is neither here nor there" in applying the correct analysis. Mr Peacock emphasised that Lord Templeman stressed that s 41 FA 1971 "is not concerned with the purposes of the transaction but with the purposes of the expenditure". He said that s 11 is similarly concerned with the purposes of the expenditure and any wider purpose the appellants may have had in entering into the related transactions is simply irrelevant. In his view, on that basis, the requirements of s 11 were plainly met when the appellants re-acquired the assets on paying the Option Price; their plain purpose was to acquire the assets for use in their trades.

176. In my view, Lord Templeman's comments cannot be taken to mean that the composite approach has no role in a purposive construction of the relevant provisions or that fiscal purpose is never relevant to the required analysis. I note that Lord Templeman appeared to consider that he was applying a *Ramsay* composite approach to the construction of s 41. His concern was that that approach does not justify assessing the effects of a transaction for tax purposes by simply carrying out an exercise in weighing up fiscal and non-fiscal motives, on the basis that a sufficiently predominant fiscal intent necessarily negates *all* its beneficial fiscal effects. In his view, the lower courts had gone awry in simply not analysing the true effect of the composite transaction by reference to the particular statutory requirements in question; namely, by reference to the purpose of the expenditure under s 41 FA 1971 (as opposed to the purpose of the trade). Applying a composite approach in the context of that particular question, he considered that the answer was clear. The "true view, regarding the scheme as a whole" was that whilst it had "the apparently magic result" of creating for tax purposes expenditure of $14 million, only $3.25 million was "a real expenditure" for the purpose of making and exploiting a film with "real" receipts of $3 million. VP's entitlement to first-year allowances was confined to that "real and not magical" expenditure.

177. Certainly it can be taken from this that the construction of the relevant legislation is not to be approached on a broad brush basis and that simply labelling the relevant transactions as pre-ordained or as undertaken as a composite whole to achieve a tax benefit does not of itself assist the analysis. A much closer scrutiny is required of both the legislation and of the facts. In that respect Lord Templeman's cautionary words foreshadow the similar warning later given by Lord Nicholls in *BMBF* of the need to avoid sweeping generalisations about disregarding transactions undertaken for the purpose of tax avoidance. Moreover, that accords with Lord Wilberforce's own comments in *Ramsay* that "the fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. It must be considered according to its legal effect". It is all a question of assessing what the particular statute requires.

178. As noted, Mr Milne did not dispute the need for the tribunal to adopt a close analysis of the relevant provisions or that, when assessing whether the requirements of s 11 are met, it is the purpose of the expenditure which is relevant. In his view, however, on the required close analysis, the decision in *Ensign* in fact supports or, at any rate, is consistent with HMRC's stance in relation to these appeals. He noted that the intended

overall effect of the transactions under consideration in these appeals is akin to that produced under the non-recourse "loan" arrangements in *Ensign*; namely, to deliver additional allowances without the taxpayer suffering an economic cost as regards the supposed qualifying expenditure. He submitted that, viewed in that context, the appellants' plain purpose in paying the Option Price was to obtain the desired allowances. In his view, having regard to the taxpayer's purpose in incurring the supposed qualifying expenditure does not, therefore, assist the appellants' argument. I have commented further on this in the decision section.

179. Mr Milne also noted that Lord Goff very clearly followed a *Ramsay* approach and that in the later decision in *Tower* Lord Walker approved his comments and held that *Ensign* is still good law (see [185] and [196] below). In Mr Milne's view, all the relevant caselaw is consistent with what Lord Goff said in *Ensign*. He said that the tribunal should adopt a similar approach in these appeals.

180. In *Tower* the House of Lords adopted a similar composite approach to the construction of s 11 to that taken in *Ensign* in rejecting the taxpayers' claims to allowances on the seemingly inflated price which they paid for certain rights in relation to software to the extent the price was "funded" under non-recourse loans provided indirectly by the seller. In more detail the arrangements operated as follows:

(1) MCashback, approached the Tower group for additional funding to "roll-out" a complex software package (the system) to enable manufacturers to promote their products to retail customers by offering them free airtime on their mobile phones in return for a fixed fee per transaction.

(2) Tower proposed for MCasback to sell part of its software to four new LLPs in return for a right to receive a part of the fees it derived from the system. The members of the LLPs were to include both Tower personnel (as founder members) and outside investor members. The investors were to provide the finance for the purchase of the software through injecting capital into the LLPs using (a) their own funds, as to 25% of the purchase price and (b) funds obtained under non-recourse loans indirectly provided by MCashback, as to the remaining 75% of the price.

(3) If all had gone according to plan the LLPs would have "spent" in total around £156 million in relation to the software rights in return for a total of 13% of the fees derived from the system. However, the plan was never fully completed and much lower sums were involved. I also note that at the last minute it was decided to sell the software in different "bits". The price for the software was supported by a valuation but it was criticised by the Special Commissioner in his decision (see [2008] STC (SCD) 1).

(4) The non-recourse loans were for a ten year period and were funded by MCashback through arrangements with two banks: MCashback placed security deposits with bank A; bank A placed equivalent sums with bank B as security for a loan by bank B to a Tower special purpose finance vehicle; that vehicle made the non-recourse loans to the investors. The Special Commissioner concluded that the function of the banks was "window-dressing" only.

(5) In effect the loans were interest free. Capital repayments fell to be made out of 50% of the gross fees, and only to the extent that the LLPs had the available cash to enable them to repay loans on behalf of the investors. The balance of loans at the end of the 10-year period was effectively to be cancelled with MCashback losing its residual entitlement in respect of its deposits it made with bank A at the end of that period

(6) The court focused on the transaction entered into by LLP 2, whereby it paid £27.5 million for the relevant software rights (funded by the investors as set out above) in return for the right to 2.5% of the gross fees MCashback received from exploiting the system. Ninety per cent of the fees were paid directly to the investors, 50% of which was to be applied in repayment of the loans (subject to the non-recourse terms), and the rest was to cover the investors' higher rate tax liability on the fees. LLP2 retained the remaining funds for division between the investors and the founding partners (three employees of Tower) according to a formula.

(7) Lord Walker set out that the Special Commissioner made the following important findings on which he had concluded that the LLPs were entitled only to allowances on 25% of the amounts they asserted they had incurred on the provision of the software (at [66]):

> "(1) the scheme was not a sham, but it was pre-ordained and designed as a composite whole…; (2) the market value of the software rights disposed of was "very materially below" the price ostensibly paid for those rights…; (3) the last minute decision to sell the software 'in bits' added to the artificiality of the valuations….; (4) there was little chance that the members' loan would be repaid in full within ten years; as much as 60% of the loans might be unpaid, and waived, at the end of that period….; (5) there was no commercial justification for the insertion into the scheme of the two banks ….; and (6) the consideration paid by the LLPs was not paid partly for 'soft finance'…."

(8) In the High Court and the Court of Appeal, the decision was made in favour of the taxpayer as set out in further detail below. The Supreme Court found in favour of HMRC.

181. Lord Walker gave the leading judgment with which the other members of the panel agreed. He noted that HMRC's case was that "there was a single composite transaction….and that by that transaction, realistically assessed, much less than the full claimed amount of the expenditure was incurred on the acquisition of software rights". HMRC argued that "the highly uncommercial loan" reduced the cost to LLP2 of the software so that it did not incur expenditure of £27.5m" for allowances purposes. They accepted it incurred expenditure of at least £5m (being the 25% of the price the investors funded) but it was for LLP2 to prove how much more than this it incurred.

182. He noted, at [26], that (a) the LLPs relied strongly on the decision in *BMBF* and sought to distinguish the decision in *Ensign,* and (b) HMRC sought to distinguish *BMBF* but did not rely particularly strongly on *Ensign*, while repudiating any suggestion that *Ensign* had been impliedly overruled by *BMBF.*

183. On a review of the caselaw (including in particular *BMBF* and *MacNiven*), Lord Walker noted that there had been misconceptions regarding *Furniss* and said, at [43], that the need "to recognise *Ramsay* as a principle of statutory construction, the application of which must always depend on the text of the taxing statute in question", was clearly recognised in *Craven v White* [1989] AC 398 (at pp 502-503). He added that the "drawing back from the rigidity of *Furniss v Dawson*" was continued by the important decisions" in *McGuckian* and *MacNiven* and that "there are many helpful insights" in *Arrowtown*.

184. At [45] to [47], Lord Walker considered the decision in *Ensign* so far as it related to the financing arrangements and cited passages from it as set out above. He remarked, at [47], that Lord Goff emphasised that the *Ramsay* principle is indeed a principle of construction. He appeared to endorse the composite approach taken by Lord Goff as being entirely in line with the correct approach. He noted that Lord Goff focused on

the text of the relevant provisions, and answered the "ultimate question…whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically" (and he cited Ribeiro PJ in *Arrowtown* as quoted by Lord Nicholls in *BMBF* at [36]).

185. Lord Walker indicated that he considered *Ensign* remained good law following *BMBF* ([48]) as he confirmed at the end of his judgment. He thought that the only judge to mention *Ensign* in the House of Lords or the Court of Appeal (Gibson LJ [2003] STC 66 at [40] and [41]) impliedly distinguished it on the basis that: "*Ensign* was not a case in which the money went round in a circle; more simply, nothing happened to the money". He noted also, at [49], that the Court of Appeal "courteously expressed difficulty with the distinction between "legal" and "commercial" concepts drawn by Lord Hoffmann in *MacNiven* (at [44] and [69] to [73] respectively). He thought that [38] of Lord Nicholls' opinion in *BMBF:*

> "may perhaps be regarded as something of a strategic withdrawal by the House of Lords from a position which, if not untenable ("indeed perhaps something of a truism"), was likely to give rise to misunderstandings."

186. At [50] to [53] he cited passages from the Court of Appeal's decision in *BMBF* (as that was the decision in place when the arrangements in *Tower* were put in place) and noted that the House of Lords generally endorsed that decision and set out their conclusion (at [52]).

187. Lord Walker summarised, at [57] to [61], Henderson J's conclusion in the High Court (see [2008] STC 3366) that, in light of the principles in *BMBF* and *MacNiven*, the whole of the purchase price was expended on the software (and not on anything else):

(1) Henderson J formed this view (at [72]) principally because: (1) the purchase price was negotiated at arm's length between wholly unconnected parties; (2) title to the software rights passed on completion; (3) "what happened to the purchase price of £27.501m after it had been paid by LLP2 to MCashback is immaterial" because s 11 "requires one to look only at what the taxpayer did" (*BMBF* in the Court of Appeal, at 37)".

(2) He considered that the circularity of the movement of the £22.5m was irrelevant to the expenditure issue, as it had been in *BMBF* "in view of the fact that the legislation on its true construction focuses only on the position of the purchaser" (at [73]) and that so was the valuation of the assets, "once the contention that the purchase price was paid for something other than the software has been eliminated" (at [77]) (and that in any event the criticisms of the valuation report were unfounded). In his view, whilst the market value of the software may have been materially lower than the price paid and the LLPs might only have paid that price because of the non-recourse loans provided to the investors, "the LLPs have nevertheless paid the full price for the software and nothing can adjust that analysis for tax purposes".

(3) He said at [84] that the legislation relating to capital allowances, as expounded by the House of Lords in *BMBF*, is resistant to a *Ramsay* composite approach, "because it focuses attention solely on the position of the purchaser, and the wider financing arrangements are irrelevant so long as the purchaser actually incurs expenditure on acquiring the plant for the purposes of his trade".

(4) He rejected (at [85]) the argument that *BMBF* was distinguishable because in that case the circularity was "happenstance". He accepted there were factual distinctions between the two cases and that, in the absence of evidence from the banks, the Special Commissioner was entitled to be sceptical about the

commerciality of the relevant arrangements but that did not assist HMRC "because it does not impinge on the narrow question whether LLP2 incurred the relevant expenditure on the acquisition of the software".

(5) He concluded, at [86], that "in the absence of a finding of sham" the only conclusion was that the whole of the consideration for the software was expenditure incurred on its provision.

188. At [62] to [65], Lord Walker summarised the decision of Moses LJ in the Court of Appeal ([2010] STC 809 at [56] to [87]) who also decided that the LLPs were entitled to allowances on the full price paid for the software but on different reasoning to that adopted by Henderson J. Moses LJ thought that, on the basis of the decision in *Ensign*, it was relevant to consider the terms of the non-recourse loans. However, in his view, there were material distinctions in the facts of *Tower* and those in *Ensign* which justified him reaching a different conclusion to that in *Ensign*:

(1) Moses LJ considered (at [78] and [79]) that whilst the source of the money was irrelevant in *BMBF* because the borrowing was on regular, commercial terms, in this case, in the context of all the facts, the terms under the non-recourse loans should be considered "in relation to the fundamental question whether the taxpayer suffered the economic burden of paying the full amount" in order "to decide whether there was 'real' expenditure". He put aside (at [80] to [81]) the issue of whether 'incurring expenditure' was a legal or commercial concept.

(2) Moses LJ's then concentrated (at [82] to [87]) on the question whether there was real expenditure by the LLPs, as Lord Walker remarked, without any emphasis on the question *for what* the expenditure was incurred. He distinguished *Ensign* on two principal grounds.

(a) The first was that ([84]):

> "Whilst there was an expectation, on the basis of conservative predictions, that the whole of the loan agreement would not be paid off in full over the period of ten years, it cannot be shown that the *terms* were such that the loan was never likely to be repaid. It all depended on success in marketing the software. In *Ensign*, the loan never had to be repaid whatever success the film achieved."

(b) The second was that ([85]):

> "LLP and its members owned free of any liability software which could generate a substantial proportion of an annual income which the projections showed to be approximately £38m. In *Ensign Tankers*, the partnership never acquired a right to more than 25% of the returns."

(3) Lord Walker commented (at [64]) that this "is a seriously oversimplified version of the facts in each case":

> "The LLPs owned only rights in bits of the software which together (if the whole plan had gone through) would have brought them 13% of the clearing fees (one component in computing MCashback's trading profit). VP did own the whole of the master negative of the film, but that ownership did not entitle VP to the whole net profits from the film, because there were also heavy distribution and exploitation costs to be incurred by other companies connected with LPI before the film earned what it had cost to make."

(4) Moses LJ set out his conclusion at [86] (referring back to [85]):

> "It is this feature which to my mind is the most important ground for distinguishing *Ensign Tankers* and this appeal. The ownership of the

> software agreement was transferred to LLP 2. *The question of transfer of ownership casts a clear light on the reality of the expenditure, just as it did in Ensign Tankers*. It was unacceptable to contemplate that [VP] had incurred 100% of the expenditure on the film in acquiring a mere 25% of the rights. But the fact that LLP2 acquired the right to the full economic benefit of the agreement is a powerful, and, to my mind, a determinative feature of this appeal." (emphasis added)

189. Lord Walker did not agree with either Henderson J or Moses LJ. He did not accept that, as Henderson J said, the market value of the software was "completely irrelevant" in the context of "a complex pre-ordained transaction where the court is concerned to test the facts, realistically viewed against the statutory text, purposively construed" (see [67]). On that score, at [68] to [71], Lord Walker largely agreed with a number of criticisms the Special Commissioner had made of the valuation report and his comments plainly indicate that he thought the valuation of the software was unrealistic. His comments included that, in practice, even if all four of the LLPs had completed as planned, "they would together have received no more than 13% of the clearance fees in respect of their rights in the software" and that, on the LLPs' case, that was the consideration for which they would have paid £156m (had all the schemes gone through).

190. He said, at [72], that whilst market value was not determinative, Henderson J was "wrong to dismiss, as sweepingly as he did, the Special Commissioner's scepticism about the valuation of the software rights, and the commercial soundness of the transactions". He noted that Henderson J also downplayed the Special Commissioner's doubts about the prospects of the members' loans being repaid within ten years. He considered that Henderson J was wrong in law in holding that the outcome of *BMBF* was that the CAA is resistant to an approach on *Ramsay* lines; that overlooked the continuing validity of the decision in *Ensign.*

191. On the funding issue, he explained, at [73], that counsel for HMRC argued that only 25% of the funds which the investor paid as the price for the software "reached MCashback". The remaining 75% funded by the non-recourse loans "went into a loop from which MCashback received no immediate benefit at all. If in the future money were to flow back to MCashback out of the loop it would be because of its own commercial success in generating clearing fees" and "whatever this was spent on, it was not spent on acquiring software rights from MCashback, because it never reached MCashback".

192. At [75] he said that Henderson J was right to emphasise that the transaction was the subject of tough negotiation between MCashback and Tower because:

> "MCashback (unlike BGE in *BMBF*) really did need up-front finance in order to roll out its software and give effect to its business plan. It saw itself as parting with potentially very valuable rights indefinitely (the investor members dropped out after ten years, but the founder members did not) for only a modest part (just over 18% before fees and expenses, or just under 17% after fees and expenses) of the total capital apparently being raised. *That was because 75% of the capital raised, although not simply a sham, was really being used in an attempt to quadruple the investor members' capital allowances. That is what the tough bargain which Tower struck with MCashback enabled Tower to offer to its investor members*." (emphasis added)

193. In the same passage he referred back to the conclusions of Lord Goff in *Ensign* and said that the facts of that case were different, since in that case "there was not "in any meaningful sense" a loan at all" whereas here:

> "there was a loan but there was not, in any meaningful sense, an incurring of expenditure of the borrowed money in the acquisition of software rights. *It went into a loop in order to enable the LLPs to indulge in a tax avoidance scheme*……"

194. At [76] he said that Moses LJ was right in deriving assistance from *Ensign* as to the relevance of the terms of the borrowing (here that it was interest free and on a non-recourse basis) but that he was wrong to concentrate on those terms as an indication of whether there was "real expenditure". Whilst the issue in *Ensign* was "no real loan, no real expenditure", here "the issue was whether there was real expenditure *on the acquisition of software rights*":

> "*The transfer of ownership (or at least of rights) indicated the reality of some expenditure on acquiring those rights, but was not conclusive as to the whole of the expenditure having been for that purpose*. Moses LJ was also wrong…in saying that in *Ensign* the loan never had to be paid, whatever success the film achieved……" (emphasis added)

195. He continued, at [77], that one of the lessons of *BMBF* is that it is not enough for HMRC, in attacking a scheme of this sort, to point to the money going round in a circle. Closer analysis is required. He contrasted the position in *BMBF* with that in *Tower*:

(1) In *BMBF*, the whole £91m was borrowed by BF from Barclays Bank "on fully commercial terms (though they were companies in the same group) and [BF's] acquisition of the pipeline was on fully commercial terms". He also noted that BGE had that whole sum at its disposal, and:

> "though it was disposed of at once under further pre-arranged transactions, those transactions were entirely for the benefit of BGE. BGE had no pressing need for upfront finance (which is not, contrary to what Park J supposed, an essential feature of a leasing scheme capable of generating capital allowances)".

(2) In *Tower*, on the other hand:

> "the borrowed money did not go to MCashback, even temporarily; it passed, in accordance with a solicitor's undertaking, straight to [the bank] where it produced no economic activity (except a minimal spread for the two Guernsey banks) until clearing fees began to flow from MCashback to the LLPs (in an arrangement comparable, though not closely similar, to the arrangements between LPI and VP in *Ensign*)."

196. Having concluded that only 25% of the claimed allowances were available he noted, at [80], that it was to be expected that commentators would complain that the court had abandoned the clarity of *BMBF* and returned to the uncertainty of *Ensign* but he would disagree:

> "Both are decisions of the House of Lords and both are good law. The composite transactions in this case, like that in *Ensign* (and unlike that in *BMBF*) did not, on a realistic appraisal of the facts, meet the test laid down by the CAA, which requires real expenditure for the real purpose of acquiring plant for use in a trade…..."

197. Mr Peacock submitted that Lord Walker's comment at [76] ((as set out at [194] above), clearly means that the transfer of ownership of the relevant asset (or at least of rights in relation to it) is to be taken as the touchstone for indicating the reality of expenditure on a qualifying asset for allowances purposes. Mr Milne considered that this decision again supports HMRC's stance given that Lord Walker plainly adopted a composite approach in reaching his conclusion. I have commented on this in the decision section.

Scottish Provident

198. HMRC relied on the decision of the Supreme Court in *Scottish Provident* as authority that, in construing the relevant provisions, the transactions in this case should be viewed as they were intended to and did in fact take place. The decision in *Scottish Provident* was released on the same day as that in *BMBF* by the same panel as in *BMBF*. The case concerned a scheme designed to take advantage of a change in the law governing the taxation of gains and losses made by mutual life offices on the grant or disposal of options to buy or sell gilts. Under the scheme:

(1) The life office, SPI, granted Citibank the option to buy a quantity of gilts from it at a "strike price" of 70, well below their anticipated market value at the time the option was exercised, in return for a premium. Under the law then in force, the premium was exempt from tax.

(2) After the law had changed, Citibank exercised the option, requiring SPI to sell the gilts to it at a loss. Under the law then in force, the loss was allowable for tax purposes. In order to ensure that no real loss could be suffered by either party, the scheme also provided for Citibank to grant an option to SPI, entitling it to buy a matching quantity of gilts from the bank at a strike price of 90, calculated so that the overall movements of money between the parties were equivalent.

(3) It was anticipated that both options would be exercised, but there was a possibility that they might not be. In the event, both options were exercised, and neither gilts nor money changed hands.

199. Lord Nicholls set out, at [18], that whether SPI was entitled to treat the loss suffered on the exercise of the option granted to the bank as an income loss essentially depended on whether the option gave the bank an "entitlement" to gilts within the meaning of the relevant statute. At [19], he noted that if attention was confined to that option, it "certainly gave [the bank] an entitlement, by exercise of the option, to the delivery of gilts" but "if the option formed part of a larger scheme by which [the bank's] right to the gilts was bound to be cancelled by SPI's right to the same gilts, then it could be said that in a practical sense [the bank] had no entitlement to gilts". He then endorsed the view that a purposive approach to the construction of tax legislation allows and indeed may require a composite approach:

> "*Since the decision of this House in [Ramsay] it has been accepted that the language of a taxing statute will often have to be given a wide practical meaning of this sort which allows (and indeed requires) the Court to have regard to the whole of a series of transactions which were intended to have a commercial unity*. Indeed, it is conceded by SPI that the Court is not confined to looking at the Citibank option in isolation. If the scheme amounted in practice to a single transaction, the Court should look at the scheme as a whole. [Counsel] for SPI, accepted before the Special Commissioners that if there was "no genuine commercial possibility" of the two options not being exercised together, then the scheme must fail."

200. Lord Nicolls continued to note, at [20] and [21], that the taxpayer's counsel submitted that "even if the parties intended that both options should be exercised together….the Court could treat them as a single transaction only if there was "no practical likelihood" that this would not happen". In that context, the Special Commissioners, in adopting (at [24]) the analogy of horserace betting, had accepted this. They said that:

> "If the chance of the price movement occurring was similar to an outsider winning a horse race we consider that this, while it is small, is not so small that there is no reasonable or practical likelihood of its occurring; outsiders do sometimes win horse races."

201. Lord Nicholls explained, at [21], that the test of "no practical likelihood" derived from the speech of Lord Oliver of Aylmerton in *Craven* v *White* [1989] A C 398, at page 514. However, he thought there was a distinction between that case and *Scottish Provident*. In *Craven v White* "important parts of what was claimed by the Revenue to be a single composite scheme did not exist at the relevant date" (see Lord Oliver (at page 498)); there was an uncertainty about "whether the alleged composite transaction would proceed to completion which arose, not from the terms of the alleged composite transaction itself, but from the fact that, at the relevant date, no composite transaction had yet been put together" ([22]). On the other hand, in *Scottish Provident*:

> "…the uncertainty arises from the fact that the parties have carefully chosen to fix the strike price for the [option granted to SPI] at a level which gives rise to an outside chance that the option will not be exercised. There was no commercial reason for choosing a strike price of 90. From the point of view of the money passing (or rather, not passing), the scheme could just as well have fixed it at 80 and achieved the same tax saving by reducing the Citibank strike price to 60. It would all have come out in the wash. Thus the contingency upon which SPI rely for saying that there was no composite transaction was a part of that composite transaction; chosen not for any commercial reason but solely to enable SPI to claim that there was no composite transaction. It is true that it created a real commercial risk, but the odds were favourable enough to make it a risk which the parties were willing to accept in the interests of the scheme."

202. At [23] Lord Nicholls held that it would "destroy the value of the *Ramsay* principle of construing provisions" such as those in issue as referring to the effect of composite transactions:

> "if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be back in the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned."

At [24] he concluded, therefore, that the Special Commissioners erred in law in finding that "there was a realistic possibility of the options not being exercised simultaneously meant, without more, that the scheme could not be regarded as a single composite transaction".

UBS and Rangers

203. In the more recent cases of *UBS* and *Rangers*, the Supreme Court has endorsed fully the explanation of the modern approach to statutory construction in *BMBF* and the approach in *Scottish Provident*. I have not set out the facts of these cases given that they are far removed from those in these appeals. Mr Milne placed particular emphasis on the comments of Lord Reed on the basis that he endorsed the composite approach.

204. In *UBS* Lord Reed (with whom the other Lords agreed), at [61], referred to *BMBF* and noted that until *Ramsay* "the interpretation of fiscal legislation was based predominantly on a linguistic analysis" and that:

> "the courts treated every element of a composite transaction which had an individual legal identity (such as a payment of money, transfer of property, or creation of a debt) as having its own separate tax consequences, whatever might be the terms of the statute" (citing Lord Steyn in *McGuickan* at p 999)

205. He continued, at [62], that the significance of the *Ramsay* case was "to do away with both those features". In his explanation of *Ramsay*, he very plainly accepted that

it was established by that case that the composite approach is a feature of applying a purposive approach to the interpretation of tax legislation:

> "First, it extended to tax cases the purposive approach to statutory construction which was orthodox in other areas of the law. *Secondly, and equally significantly, it established that the analysis of the facts depended on that purposive construction of the statute.* Thus, in *Ramsay* itself, the terms "loss" and "gain", as used in capital gains tax legislation, were purposively construed as referring to losses and gains having a commercial reality. Since the facts concerned a composite transaction forming a commercial unity, with the consequence that the commercial significance of what had occurred could only be determined by considering the transaction as a whole, the statute was construed as referring to the effect of that composite transaction….." (emphasis added).

206. He continued at [63] to refer to *BMBF* (at [32] to [34] and [64]) and said that this approach has proved to be particularly important in relation to tax avoidance schemes as a result of two factors identified in *BMBF* at [34] (as set out at [148] above). In that context he also referred to the comments of Carnwath LJ in the Court of Appeal in *BMBF* [2003] STC 66, at [66] that, taxing statutes generally "draw their life-blood from real world transactions with real world economic effects". He said that:

> "Where an enactment is of that character, and a transaction, or an element of a composite transaction, has no purpose other than tax avoidance, it can usually be said, as Carnwath LJ stated, that "to allow tax treatment to be governed by transactions which have no real world purpose of any kind is inconsistent with that fundamental characteristic." Accordingly, as Ribeiro PJ said in [*Arrowtown* at [35]], where schemes involve intermediate transactions inserted for the sole purpose of tax avoidance, it is quite likely that a purposive interpretation will result in such steps being disregarded for fiscal purposes. But not always."

207. He then made a similar observation, at [65], as that made by Lord Nicholls in *BMBF* that in cases such as *Furniss*, *Carreras*, *Burmah Oil* and he added, in the later cases of *Scottish Provident* and *Tower*:

> "*the court considered the overall effect of the composite transaction, and concluded that, on the true construction of the relevant statute, the elements which had been inserted without any purpose other than tax avoidance were of no significance. But it all depends on the construction of the provision in question.* Some enactments, properly construed, confer relief from taxation even where the transaction in question forms part of a wider arrangement undertaken solely for the purpose of obtaining the relief. The point is illustrated by the decisions in [*MacNiven*] and [*BMBF*] itself." (emphasis added)

208. He said, at [66] that the position was summarised by Ribeiro PJ in *Arrowtown* at [35] (as set out at [17] above). He cautioned, at [67], that "references to "reality" should not, however, be misunderstood" and said, at [67] and [68]:

> "In the first place, the approach described in [*BMBF*] and the earlier cases in this line of authority has nothing to do with the concept of a sham, as explained in *Snook.* On the contrary, as Lord Steyn observed in *McGuckian* at p 1001, tax avoidance is the spur to executing genuine documents and entering into genuine arrangements.
>
> Secondly, it might be said that transactions must always be viewed realistically, if the alternative is to view them unrealistically. *The point is that the facts must be analysed in the light of the statutory provision being applied. If a fact is of no relevance to the application of the statute, then it can be disregarded for that purpose. If, as in Ramsay, the relevant fact is the overall economic outcome of a series of commercially linked transactions, then that is*

> *the fact upon which it is necessary to focus. If, on the other hand, the legislation requires the court to focus on a specific transaction, as in MacNiven and [BMBF], then other transactions, although related, are unlikely to have any bearing on its application*." (emphasis added)

209. At [69] and [70], he then referred at some length to the *Scottish Provident* case and proceeded to apply the approach set out in that case in concluding that a contingency which created a minor risk, but one which the parties were willing to accept in the interests of the scheme could in effect be ignored (see [88]).

210. In *Rangers,* Lord Hodge similarly described the speech which Lord Nicholls made in *BMBF* as explaining "the true principle established in *Ramsay*" and the cases which followed it. He referred, at [13], to Lord Nicholls' comments at [34] and [36] and to the same comments of Carnwarth LJ in the Court of Appeal as Lord Reed had referred to in *UBS*. At [14] he endorsed what he described as Lord Reed's helpful summary of the significance of the new approach, which *Ramsay*, as explained in *BMBF*, has brought about citing from [62] of his decision in *UBS*. At [65], he referred to *Scottish Provident* as authority that:

> "In applying a purposive interpretation of a taxing provision in the context of a tax avoidance scheme it is legitimate to look to the composite effect of the scheme as it was intended to operate" [and he cited Lord Nicholls at [23] of *Scottish Provident*].

Carreras

211. HMRC also cited the decision in *Carreras* as a further relevant example of a case where a *Ramsay* composite approach applied. Mr Peacock asserted that *Carreras* is no longer seen as good authority on the basis of comments made in the later cases such as, in particular, those of Lord Nicholls in *BMBF*. He noted that in *Scottish Provident, Tower MCashback* and *Rangers*, *Carreras* does not get a mention. In my view, however, Lord Nicholls did not in *BMBF* (or his earlier decision in *MacNiven*) cast any doubt on the decision in *Carreras* or indicate that the approach taken in that case or *Furniss* or *Burmah Oil* was wrong. Rather it was the case that for some time taxpayers and HMRC misinterpreted those cases (see [122] to [124] and [148] to [150] above). As Mr Milne pointed out, *Carreras* was referred to in the decision of the Court of Appeal in *Mayes* on which the appellants rely (see [224] below).

212. In *Carreras* the taxpayer transferred shares in one company to another company in return for an unsecured, non-transferable and non-interest bearing debenture which was redeemed only two weeks after the share transfer. It was held that, on a purposive construction of the relevant stamp tax provisions, the transaction was not an exchange of shares in one company for debentures of another company such that it did not attract stamp tax; rather it was the exchange of shares for money.

213. Lord Hoffman, who gave judgment for the Privy Council said, at [7], that if it was permissible to take a wider view and to treat the terms of the debenture and its redemption as part of the relevant transaction then the debenture was "only a formal step, having no apparent commercial purpose or significance", in a transaction by which the shares in the company were exchanged for money.

214. He continued, at [8], that whether the statute is concerned with a single step or a broader view of the acts of the parties depends upon the construction of the language in its context. He thought that sometimes the conclusion that the statute is concerned with the character of a particular act is inescapable (as in *MacNiven*). However, since *Ramsay*:

> "the courts have tended to assume that revenue statutes, in particular, are concerned with the characterisation of the entirety of transactions which have

> a commercial unity rather than the individual steps into which such transactions may be divided. This approach does not deny the existence or legality of the individual steps but may deprive them of significance for the purposes of the characterisation required by the statute…"

215. He considered that there were no reasons why Parliament should have contemplated a narrower definition of the transaction which has to be considered in this context.

216. He noted, at [15], that counsel for the taxpayer submitted that a factual inquiry into what constituted the relevant transaction for the purposes of the relevant provision would give rise to uncertainty. He seemed to accept that if the representative of Carreras had "handed the share certificates over the desk in exchange for the debenture and the representative of Caribbean had then handed it back in exchange for a cheque, it would be hard to say that the relevant transaction should not be characterised as an exchange of shares for money". But he asked "what if the debenture had been redeemed a year later? Why should a fortnight be insufficient to separate the exchange from the redemption?"

217. Lord Hoffman said that one answer was that it was plain from the debenture's terms and the timetable that:

> "the redemption was not merely contemplated (the redemption of any debenture may be said to be contemplated) but intended by the parties as an integral part of the transaction, separated from the exchange by as short a time as was thought to be decent in the circumstances. The absence of security and interest reinforces this inference. No other explanation has been offered."

218. He continued that in any case:

> "it is inherent in the process of construction that one will have to decide as a question of fact whether a given act was or was not a part of the transaction contemplated by the statute. In practice, any uncertainty is likely to be confined to transactions into which steps have been inserted without any commercial purpose. Such uncertainty is something which the architects of such schemes have to accept."

Mayes

219. The appellants placed much emphasis on the decision in *Mayes* which concerned a tax scheme designed to create a form of loss relief under provisions relating to the taxation of life assurance policies. In summary, the Court of Appeal found for the taxpayer notwithstanding that the scheme comprised a pre-determined set of steps some of which were self-cancelling, all of which were commercially pointless except "in the weird world of tax planning" and which were only undertaken to produce the relief that would be available for saving tax (see [27]).

220. In outline, the steps involved in the scheme included the payment of initial premiums for life assurance policies; the payment of additional "top-up" premiums by a non-resident company; followed, in less than a month, by a partial surrender of the policies by that same company, thereby creating a potential for relief without triggering a charge to tax; later followed by a full surrender of the policies by the individual investor who then claimed that he was entitled to make deductions for tax reduction purposes.

221. The taxpayer argued that the relevant provisions should be applied to each of the legally valid *individual steps*, in particular the payment of top-up premiums for the policies (step 3) and the partial surrender of the policies (step 4), thereby producing the tax relief the scheme was intended to achieve (see [24]) HMRC argued that on the

contrary a *Ramsay* composite approach should be applied with the end-result that no such relief was available.

222. Mummery LJ gave the judgment with which the other members of the panel agreed. At [9] Mummery LJ noted that an unusual feature which gave rise to difficulty in applying a purposive approach was that the series of pre-planned steps, which HMRC said "were artificial, unreal and uncommercial tax-avoidance insertions, are built on or structured around a set of provisions which themselves "operate on a basis and in a manner that can fairly be described as artificial, unreal and uncommercial".

223. At [19] he said in effect that the correct approach was that set out in *Arrowtown* and, at [20], that if the courts do not like the result, they have no means at their disposal to amend a law enacted by Parliament. The courts:

> "sole function is to decide the case on their best understanding of the relevant transactions and the applicable law, whatever that may be. Whether or not the courts approve of the outcome is beside the point. It is not for judges to shoulder the law-making responsibilities of Parliament."

224. He noted, at [22], that in *Carreras* (at [8]) Lord Hoffmann compressed the true significance of *Ramsay* into a single paragraph (citing the passage set out at [214] above) and, at [23], that the polarised positions of Mr Mayes and HMRC reflected the distinctions in that précis. At [38] he noted that Counsel emphasised the special nature of the regime in question in terms of:

> "its capability for producing results counter to commercial reality. The legislation could work in an arbitrary way unrelated to commercial gains and losses. Mr Furness describes it as a highly prescriptive way of exacting tax on the basis of a formulaic arithmetical approach to transactions…"

225. He explained, at [39], that the taxpayer's counsel submitted that in the context of the *Ramsay* principle as an aid to construction, the terms "premium" and "surrender" "bear the meaning and have the actual consequences that they ordinarily have" on the basis that the language of the legislation is "paramount" and "prevails over the purpose for which those particular steps were inserted in the scheme". On that basis, in counsel's view, steps 3 and 4 counted as a "real" partial surrender of "a real policy", even though the insertion of those steps was "for tax avoidance purposes as self-cancelling steps in a pre-planned scheme". Counsel contrasted this case with the context in *Ramsay* in which the key word to be construed in the legislation was "loss" which is capable of a real commercial connotation". I note that Mr Peacock made submissions in this case on similar lines to these.

226. At [53] he noted that Proudman J explained how the operation of the legislation made it difficult to give it a purposive commercial construction and, at [56], that she said that the legislation proceeded "on a formulaic approach without an overriding purpose that some types of transaction may not count" and "did not include terms (such as "loss" in *Ramsay*) capable of being construed as commercial concepts". She considered that the terms "premium" and "surrender", bore their ordinary meaning. On that approach, the relevant steps were:

> "respectively a payment of a premium and a partial surrender of the policies, not just for life insurance purposes but for *all* purposes, including fiscal purposes. The tax avoidance purpose and self-cancelling nature of the steps did not by themselves entitle the court to disregard the steps, when there was nothing in [the provisions] indicating or contemplating that, as a matter of construction, such steps were not to count."

227. At [57] he set out Proudman J's conclusion that a purposive construction of the relevant provisions did not enable her to disregard the relevant steps:

> "44 ….This is legislation which does not seek to tax real or commercial gains. Thus it makes no sense to say that the legislation must be construed to apply to transactions by reference to their commercial substance.
>
> 45. I sympathise with the instinctive reaction that such an obvious scheme ought not to succeed. However, I cannot extract from the legislation any underlying or overriding purpose enabling me to conclude that parts of the scheme may be ignored….
>
> 47. In summary it seems to me that [the relevant provision] adopts a formulaic and prescriptive approach. No overriding principle can be extracted from the legislation, or from the authorities, that some types of transaction should be ignored in the application of the Chapter. To say that there is no premium and no partial surrender, that those steps should be ignored, is in my judgment simply to sidestep the question of construction altogether. The pre-arranged and self-cancelling nature of the transaction was no different and no more extreme than that in *MacNiven."*

228. Mummery LJ concluded that, based on the key passages in *BMBF* he agreed with Proudman J and made the following main points:

(1) As recognised in all the decisions set out above, *Ramsay* did not "lay down a special doctrine of revenue law" but rather reflected "the general principle of purposive and contextual construction of all legislation…." Having referred to *BMBF* at some length, he noted that HMRC's arguments that the relief was not available were based on the application of *Ramsay* as a principle of statutory construction (at [75] and [76]).

(2) On the proper construction "the statutory requirements as to the transactions to which the provisions were intended to apply were far removed from the kind of case in which the focus is simply on an end result, such as a loss". In *Mayes*, the relief available:

> "was the product of real premiums paid at an earlier stage for real life policies and real surrenders made at an earlier stage. Although the corresponding deficiency was created solely to save tax, that alone does not entitle the court to disregard the fiscal consequences of payment of premium and the partial surrender which led to its creation" (at [77]).

(3) It would be an error to disregard the payment of a premium and the partial surrender "simply because they were self-cancelling steps inserted for tax advantage purposes". It was right to look at the overall effect of the composite steps to determine whether it answered to the legislative description of the transaction or fitted the requirements of the legislation for corresponding deficiency relief. So viewed:

> "[The relevant steps] answer the description of premium and partial surrender. On the true construction of [the provisions], which do not readily lend themselves to a purposive commercial construction, Step 3 was in its legal nature a premium paid to secure benefits under the Bonds and Step 4 was in its nature a withdrawal of funds in the form of a partial surrender within the meaning of those provisions. They were genuine legal events with real legal effects. The court cannot, as a matter of construction, deprive those events of their fiscal effects….because they were self-cancelling events that were commercially unreal and were inserted for a tax avoidance purpose in the pre-ordained programme….It follows that a corresponding deficiency relief is available to Mr Mayes."

229. Mr Peacock considered that the decision in *Mayes* very much embodies the approach which the tribunal should take in this case. Mr Milne said that the approach taken in *Mayes* is no different to that taken in the other cases. However, on a purposive

approach to the highly prescribed and formulaic legislation in issue, which was held to operate on a basis and in a manner described as "artificial, unreal and uncommercial", the court considered a composite approach was not permitted. In Mr Milne's view, that decision has no bearing on this case given the very different nature of the provisions of the CAA under consideration.

Decision

Appellants' stance

230. It was not disputed that each of the steps involved in the transactions (the sale of the assets, the leaseback and their reacquisition under the Put Options) if viewed as individual and discrete transactions, as Lord Hoffman put it in *MacNiven*, "involved no pretence. They were intended to do precisely what they purported to do. They had a legal reality". The question is whether, on a purposive approach to the construction of the relevant provisions:

(1) as Mr Peacock submitted, each of the steps should be analysed according to that legal reality or, as Lord Hoffman put it in *MacNiven*, on the basis that the juristic analysis of each step should be respected, with the result that the appellants are entitled to the claimed additional allowances; or

(2) as Mr Milne argued, the transaction should be analysed adopting a composite approach, having regard to the overall effects of the steps as elements designed to operate together, with the result that no additional allowances are due.

231. In support of the appellants' stance Mr Peacock seemed to go so far as to suggest that a composite approach has no place at all in a purposive approach to statutory construction. In his view, that approach (as applied in *Furniss* and *Carreras*) has been superseded by better analysis in *Arrowtown*, *BMBF* and *Mayes*; he seemed to suggest that the approach set out in those cases is somehow different to that set out in *Ramsay*. He said that, in any event, the transactions under consideration in these appeals did not form a composite whole.

232. Mr Peacock submitted that, on the sale of the assets to SGLJ, the appellants plainly ceased to own the assets within the meaning of s 61(1)(a) and were required to bring a disposal value into account as a result. As a result of the sale they were no longer the "real-world" owners of the assets; they had none of the rights or liabilities attached to ownership according to the ordinary meaning of that term. He said that, once that is accepted, it follows that the other steps are also to be accorded the analysis which applies viewing them, according to their individual "real world" legal and commercial effects, as the grant of a Lease and the re-acquisition of the assets when the Put Options were exercised.

233. He drew support for this view from the decisions in *Ensign, BMBF* and *Tower* on the basis that, in those cases, the courts recognised that the fact that the relevant taxpayers *acquired ownership* (or at least rights over) the relevant assets demonstrated the reality of all or some of the expenditure they claimed they incurred in relation to the assets for the purposes of s 11 (and the relevant corresponding earlier provisions). In his view, the concept of ownership must play the same role in the construction of both s 11 (as regards whether allowances are available in the first place) and s 61(1)(a) (as regards when the benefit of allowances is lost).

234. He submitted that, correspondingly, the fact that, in a legal sense, the appellants "really" transferred ownership of the assets to SGLJ and "really" re-acquired ownership of them must indicate the reality of (a) the disposal and related disposal value under s 61 (on the basis of *Ensign*, notwithstanding the immediate lease back and the existence

of the Put and Call Options) and (b) of the expenditure on the assets when ownership was reacquired by the appellants (as well as of the intermediate leases).

235. In summary, I have concluded, for all the reasons set out below and as accords with HMRC's stance:

(1) The cases set out above amply illustrate that, contrary to Mr Peacock's view, it continues to be the case that when interpreting tax legislation purposively a court or tribunal may apply a composite approach, where permitted or required by the terms of the relevant statute.

(2) This is precisely a case where a composite approach is required and, on that approach, the appellants made no disposal of the assets within the meaning of s 61 and none of the other relevant provisions of the CAA were engaged.

(3) The result is that the appellants are not entitled to allowances on the Option Price paid under the Put Options.

Approach to statutory interpretation

236. It is clear from the caselaw, that the composite approach is not to be applied as a freestanding principle of jurisprudence with its own special rules. In giving his judgement in *Ramsay*, Lord Wilberforce plainly did not intend the composite approach to be applied in that way and that is not how his words have been interpreted subsequently. As set out by the highest judicial authorities, the composite approach is simply part of what may be required under a purposive approach to construction of the relevant tax statute. I do not understand Mr Milne to be suggesting that a composite approach is to be applied in this case as anything other than as part of a purposive approach to the construction of s 61(1)(a) and the other relevant provisions of the CAA.

237. To recap, the decision in *Ramsay* was a key turning point in bringing the approach to interpreting tax legislation into line with the purposive approach adopted in other areas. In what is widely recognised as a succinct and accurate summary, in *Arrowtown* Ribeiro PJ said that the driving principle of the *Ramsay* line of cases is to apply in tax cases "a general rule of statutory construction and an unblinkered approach to the analysis of the facts"; in other words, the "ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically".

238. Most recently in *UBS* Lord Reed emphasised (as cited with approval by Lord Hodge in *Rangers*), that *Ramsay* established not only that a purposive approach must be taken to the construction of tax statutes but also and "equally significantly" that "the analysis of the facts depended on that purposive construction". In other words, "the facts must be analysed in the light of the statutory provision" and "if a fact is of no relevance to the application of the statute", it can be disregarded for that purpose. Lord Wilberforce's composite approach, therefore, provides an illustration of the effect of taking an "unblinkered" and "realistic" view of the facts where, in light of its purpose and context, the statutory provision in question is concerned with the characterisation of the entirety of a transaction which has a commercial unity rather than with the individual steps into which it may be divided (see *Carreras* at [8]).

239. The difficulty is that, whilst the principle is clearly stated, in practice, it may well be no easy task to identify when, on a purposive approach to a particular provision, a composite approach may or may not be allowed or required. Hence, on occasions the courts have sought to give guidance expressed in general terms as to when a composite approach may be used. Both taxpayers and HMRC have tended to elevate this guidance, such as the famous comments made by Lord Brightman in *Furniss*, into a set

of pre-conditions which must be satisfied for a transaction to be taxed according to its overall effects.

240. However, for many years now we have been told by the courts at the highest level repeatedly and consistently that Lord Brightman's comments and other guidance on the *Ramsay* approach (as set out by Lord Hoffman in *MacNiven*) are just that, *guidance* as to the factual circumstances in which a composite approach may be required and where it may generally give the effect Lord Brightman set out. Tax avoidance structures often contain steps inserted into a pre-ordained transaction with no commercial or business purpose other than to give or avoid a particular tax result. Whilst it may well be the case that such steps should be ignored in deciding on whether a particular statutory provision applies, that will not necessarily be so. The question is *always* one of what the particular statutory provision requires.

241. As Lord Nicholls put it in *MacNiven* the "paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case" in the light of "the need to consider a document or transaction in its proper context, and the need to adopt a purposive approach". As he later said in *BMBF*, the court or tribunal must "determine what transactions the relevant provision is intended to apply to and whether the actual transaction (*which might involve considering the overall effect of a number of elements intended to operate together*) answers to the statutory description" (emphasis added).

242. Lord Nicholls emphasised, therefore, the need to avoid sweeping generalisations about disregarding transactions undertaken for the purpose of tax avoidance. Rather it is essential "to focus carefully upon the particular statutory provision and to identify its requirements" before it can be decided "whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute". There is simply no substitute for a close analysis of what the particular provision requires. Lords Templeman and Walker commented to similar effect in the decisions in *Ensign* and *Tower* respectively.

243. As Lord Reed and Lord Hodge recognised in *UBS* and *Rangers* respectively citing the decision in *Scottish Provident*, in applying this purposive approach it is legitimate to look to the effect of the composite scheme as it was intended to operate without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned. In *Scottish Provident* Lord Nicholls said that it would destroy the value of the *Ramsay* principle if "the composite effect of transactions had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned".

244. Finally, I do not consider that in Mayes Mummery LJ was advocating any other approach to the construction of tax legislation other than that set out in *Ramsay*, as interpreted in *BMBF*. It was simply the case that the Court of Appeal did not consider that the relevant provisions required or allowed a composite approach to be applied to the construction of the particular provisions in issue in that case.

Purposive approach to the CAA

245. Turning to the provisions under consideration here, as Lord Nicholls set out in *BMBF*, the purpose of the capital allowances regime as it relates to writing down allowances "is to provide a tax equivalent to the normal accounting deduction from profits for the depreciation of machinery and plant" which is used for the purposes of a taxpayer's trade. It is central to a taxpayer's entitlement to claim allowances under s 11 that, as these requirements have been interpreted in cases such as *Ensign* and *Tower*, it "really" incurs capital expenditure for the "real" purpose of acquiring an asset for

use in its trade and that it "*owns*" the asset as a result of incurring the expenditure (although, in certain circumstances, a person is deemed to own an asset for allowances purposes). On its natural and plain meaning, as Mr Peacock submitted, the taxpayer "owns" an asset where he has the bundle of rights and liabilities which in legal terms are associated with that concept.

246. The overall purpose of s 61 is to trigger an adjustment to the taxpayer's allowances position where any one of a number of specified disposal events occurs in relation to an asset in respect of which the taxpayer has claimed allowances. Given the entitlement to allowances is based on whether the taxpayer owns the relevant asset, not surprisingly one of the specified events is where a taxpayer "ceases to own" the asset under sub-s (1)(a). The other specified events fall into two broad categories (see [26] above):

> (1) Events where the asset ceases to be available to the taxpayer on a permanent basis or, at any rate, under a state of affairs which is expected to be on-going, such as (a) the loss of possession of the asset where it is reasonable to assume the loss is permanent, (b) where a person abandons an asset in certain circumstances or (c) where the asset ceases to exist.
>
> (2) Events where the asset may remain available to the taxpayer but a capital allowances adjustment is considered necessary under the general scheme of the allowances rules such as where (a) the asset begins to be used wholly or partly for purposes other than those of the qualifying activity or (b) the asset begins to be leased under a long funding lease, or (c) the qualifying activity is permanently discontinued.

247. In outline, when a disposal events occurs the taxpayer is required to bring into account a disposal value of a specified amount which, where sub-s(1)(a) is engaged by the sale of an asset, usually corresponds to the net sales proceeds received. For ease of illustration, assuming a corporate taxpayer has only a single asset and a pool of AQE of £60 at the time of the "disposal" of the asset on its sale:

> (1) If the taxpayer realises net sales proceeds of £70, it would be subject to a corporation tax charge on the excess of £10; in effect, the allowances previously given would be clawed back to that extent.
>
> (2) If the taxpayer realises proceeds of £50, the taxpayer would be entitled to an additional balancing allowance of £10 (although that cannot usually be claimed until the trade ceases).

248. It can readily be seen, therefore, that, viewed in the context of the overall scheme of the allowances code, s 61(1)(a) is intended to operate, by reference to the key concept of ownership, as a coherent whole with s 11. Ownership of the asset is an essential feature of a taxpayer's entitlement to allowances on capital expenditure incurred in respect of the asset (under s 11) and, correspondingly, the "*cessation*" of that ownership results in that entitlement ending and, in effect, a final reckoning of the allowances due during the period of ownership (under s 61(1)(a)).

249. The intended effect of s 61(1)(a) is that the taxpayer's entitlement to allowances, as established under s 11 by reference to "real world" events, gives rise to allowances (a) only for the period during which the taxpayer owns the relevant asset, and (b) in a total sum corresponding to the asset's actual depreciation during that period, as measured by the specified disposal value which, on the sale of assets, is a sum equal to the net sales proceeds received. Given the interrelationship between s 11 and s 61, it is a reasonable assumption that the disposal value, by reference to which an adjustment is to be made on a disposal occurring, must be no less "real" than the qualifying expenditure to which, in effect, the adjustment is made.

250. To some extent the funding lease regime operates as its own mini-code within the overall capital allowances regime. However, the provisions determining whether a taxpayer has an entitlement to allowances (under s 70A) and when there is a disposal event (under s 70E) operate by reference to the same concepts and, broadly, within the same framework, as those which apply under the general code (albeit that the entitlement to allowances and loss of entitlement depends on deemed ownership rather than actual ownership). On that basis, it is reasonable to suppose that the requirements of those provisions are also intended to operate by reference to "real" expenditure and "real" events with real economic consequences.

251. It is readily apparent, therefore, that the relevant provisions, in the words of Carnwath LJ in the Court of Appeal in *BMBF*, at [66], "draw their life-blood from real world transactions with real world economic effects". Allowances are intended to be due on amounts actually incurred for the specified purposes; adjustments are required to be made to a taxpayer's allowances position when specified events occur by reference to real sums received of the specified kind; the overall aim of s 61 is to limit the taxpayer's allowances to sums equating to the assets' actual depreciation during the relevant period.

252. In my view, accordingly this is precisely the sort of situation where to allow the tax treatment "to be governed by transactions which have no real-world purpose of any kind", as is plainly the case here, would be wholly inconsistent with the "real world" requirements of these provisions and their intended "real world" economic effects. To give effect to their true purpose requires them to be given, as Lord Nicholls put it in *Scottish Provident*, a "wide practical meaning" which requires the tribunal "to have regard to the whole of a series of transactions which were intended to have a commercial unity".

253. It is apparent from the very design of the arrangements that the parties intended that each step involved would be carried through in accordance with a pre-set plan with the single goal of generating (a) additional "qualifying expenditure" for the appellants in respect of the assets without the appellants suffering any actual material cost and (b) a fee for SGLJ for its role in facilitating this. There was no real suggestion that the transactions were undertaken for any other purpose.

254. The appellants' comment that the release of the cash value of the assets on their sale to SGLJ had a commercial effect has no impact on the analysis given the lack of any evidence that the appellants had any need of short-term financing for their business purposes or that the funds were so used. Moreover, as HMRC illustrated, the effective cost of the "finance" raised by the appellants over the 28 or 21 days of the relevant Lease period is out of kilter with what could be expected under a commercial loan. In reality, this was the cost which the appellants were prepared to pay for SGLJ playing its part in facilitating the plan, in particular, by providing the necessary monies to fund the desired "qualifying expenditure" (see [70] to [75] above).

255. From the outset, there was no real doubt that the appellants' respective groups would reacquire the assets at the end of the Lease periods given the Put and Call Option mechanism and the on-going need for the assets for use for the relevant group's trading purposes. For the reasons set out below, barring wholly unexpected events, the expectation was that the re-acquisition would take place on SGLJ exercising the Put Options on expiry of the Lease period. In CIS' case, under terms imposed by its existing lender, the funds released to CIS on the sale could only be utilised for the purpose of funding the Option Price under the Put Option or the Call Option. Both CIS and Wiseman were required to deposit a substantial part of the funds with Société Générale (London branch) and to assign the deposit in favour of SGLJ as security for their

obligations to it under the transactions. The terms of the Netting Letter indicate that the parties fully intended and expected the transactions to take place as planned.

256. Each step involved in the transactions was carefully constructed to achieve the desired result from an allowances and funding perspective as follows:

(1) It was intended that on the sale of the assets to SGLJ:

(a) For allowances purposes, the appellants would thereby cease to own the assets under s 61(1)(a) so that when, as planned, they reacquired the assets only three or four weeks later, they could claim that, for the purposes of s 11, in paying the Option Price they incurred fresh "qualifying expenditure" on the provision of the assets for the purposes of their trades. That was on the basis that, having previously *ceased to own* the assets, they then *owned* them again as a result of incurring that sum.

(b) For funding purposes, the appellants would receive sales proceeds which would be sufficient to fund the Option Price due when, as planned, the Put Options were exercised. It was integral to the operation of the plan, therefore, that the appellants would not have to put their hands in their pockets to fund the supposed "qualifying expenditure".

(2) As regards the grant of the Leases and the Put Options:

(a) From a commercial perspective, the need for the appellants to have the right to use the assets under the Leases was simply a function of the overall plan for the appellants to generate the desired allowances by temporarily giving up legal ownership of the assets. In practice, the appellants had to have a legal right to use the assets given they needed to continue to use them in their trades.

(b) From an allowances perspective, the Leases and Put Options were structured specifically with the intention that the funding lease regime would apply with the effect that:

(i) the appellants would be regarded as incurring qualifying capital expenditure of £100 on entering into the Leases (by reference to the rents and the Option Price), which would entirely negate the consequence of the appellants having to bring a disposal value of £100 into account for allowances purposes on the sale of the assets to SGLJ; and

(ii) whilst there would be a disposal event on the expiry of the Leases, there would be no disposal value for the appellants to bring into account on the basis that under the disposal formula the value was nil as QE matched QA. For this purpose, it was critical that the Option Price fell within both QE and QA as set out above.

It was essential to the success of the plan to ensure that the benefit of the "qualifying expenditure" which the appellants intended to generate was not, in effect, wiped out by a corresponding disposal value.

(c) The Put Option was also the mechanism put in place to enable the appellants to re-acquire the assets thereby generating the intended "qualifying expenditure" in the form of the Option Price. It was essential that the acquisition took place under this mechanism; it was only on that basis that the Option Price would be taken into account in QA in the disposal formula (so that there was no disposal value to be brought into account on the expiry of the Leases).

(3) All the steps set out above were put in place, therefore, so that when the appellants re-acquired the assets pursuant to the Put Options they could (a) fund the Option Price with the sales proceeds received on the initial sale to SGLJ, (b) claim that the Option Price constituted "qualifying expenditure" within the meaning of s 11, and (c) claim that there were no adverse allowances consequences which, in effect, would negate the benefit of that additional expenditure.

257. As noted, Mr Peacock submitted that the exercise of the Put Options was not inevitable; the Call Options were required to address a real commercial risk that SGLJ would not exercise the Put Options. However:

(1) Given the very plain purpose driving this planning and the nature of SGLJ's role within it, it seems highly unlikely that SGLJ would not have exercised the Put Options (as in fact it did) to recoup the temporary finance provided to the appellants and thereby to ensure that the purpose of the scheme was achieved. On the appellants' analysis, it was only by re-acquiring the assets that the appellants achieved the objective of generating additional allowances and, as noted, it was essential that this took place under the Put Options (rather than the Call Options).

(2) Moreover, there was an incentive for SGLJ to exercise the Put Options given that, under the Wiseman transactions, SGLJ was entitled to its second arrangement fee only if it exercised and duly completed the Put Option and that was also the case under the Cape transactions assuming that the Lease was not terminated early. It seems to me that the prospect that the Leases would be terminated early was highly unlikely given their very short-term nature.

(3) I note that Mr Milne also said that it was apparent that the parties fully expected the Put Options to be exercised from the fact that it appeared that the appellants paid VAT on the Option Price upfront. I note, however, that the correspondence in the bundles indicates that the view was that in fact the VAT was due at that stage notwithstanding the contingency of the payment of the Option Price. On that basis, my view is that this is not a material indicator of the parties' expectations but, in any event, it is clear what those expectations were.

(4) Viewed in the context of the overall scheme, it appears that the inclusion of the Call Options in the structure was simply a "belt and braces" approach to ensure that, should something go wrong with the intended plan, the appellants' groups could regain ownership of the assets. The assets are in each case plainly material to the operation of the appellants' trades such that the groups required certainty that, at the end of the three or four week period, they could reacquire them into the relevant group.

(5) In any event, on the basis of *Scottish Provident*, it is legitimate to look to the composite effect of this planning as it was intended to operate without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned. There is no doubt that it was intended to operate on the basis that SGLJ would exercise the Put Options.

258. Viewing the transaction as it was intended to operate as a composite whole, at the end of the three or four week period during which the Leases were in place, the appellants ended up in exactly the same position as they had started in, as the legal and beneficial owners of the assets having had the use of the assets in their trades throughout. The appellants gave up ownership of the assets (subject to the leaseback) with the attendant legal and commercial effects that entailed but they only did so to generate the desired allowances and, it appears, for the bare minimum of time

considered necessary to achieve that result. In economic terms they had incurred no material costs other than the fees due to SGLJ and other expenses associated with implementing the transactions.

259. In the words of Lord Templeman in *Ensign*, the intended overall effect of this set of transactions was to give the "apparently magic result" that the appellants were entitled to allowances on an additional £95 without actually suffering that cost through having divested themselves of ownership of the assets for three or four weeks only (and without any disruption to their use of the assets for the purposes of their trades). If successful, therefore, the appellants would obtain allowances on artificially created "expenditure" which would enable them, in effect, to claim allowances twice over on a single set of actual expenditure and would necessarily lead to them obtaining allowances vastly in excess of the assets' depreciation during their period of ownership. I use the term "artificial" in the sense that, whilst the sale of the assets had undoubted legal and commercial effects, it (and the other related steps) were undertaken for no commercial purpose other than to generate allowances in the desired way. As Mr Milne emphasised, if the appellants are right in this case, they could have, (a) reduced the length of the lease to an even shorter period and, (b) after that period, repeated the scheme any number of times until the law was changed.

260. In conclusion, in my view, on a realistic and unblinkered view of the facts, having regard to the effect of the composite transaction as a whole as described above, the provisions of s 61(1)(a), the relevant funding regime rules or s 11 were not engaged to give the effect the appellants said applied:

(1) On the sale of the assets to SGLJ, the appellants did not dispose of the assets for a disposal value for the purposes of s 61:

(a) Viewed in the light of the overall context in which that provision operates and in light of the other disposal events, it seems to me that the reference to a "*cessation*" of ownership in sub-s (1)(a) implies that, for that provision to operate, it is not sufficient for the taxpayer to give up or lose the bundle of rights and liabilities characteristic of ownership in legal terms if, as is the case here:

(i) it does so in the certain knowledge that, barring a wholly unforeseen event, it will re-acquire ownership within a matter of weeks, and

(ii) the temporary loss of ownership was effected as the first step in a composite scheme each element of which was carefully crafted to ensure that the scheme would operate to deliver additional "magical" qualifying expenditure for the taxpayer of £95 without it suffering an actual cost of that amount.

In other words, there is no such cessation of ownership on a sale of assets which was effected to generate a loss of ownership, which it was known from the outset would be for a very short period only, as an essential ingredient in an artificial construct to manufacture "qualifying expenditure".

(b) Accordingly, the sales proceeds received by the appellants on the sale cannot be viewed as comprising a "real" disposal value which is required to be brought into account in a capital allowances adjustment. These sums were merely monies put into a loop for the appellants to use to generate supposed "qualifying expenditure" by paying the Option Price when the Put Options were exercised.

(2) It follows that the grant of the Leases by SGLJ to the appellants and the re-acquisition of the assets on paying the Option Price had no consequences for allowances purposes. Viewed in the context of the overall plan:

(a) In entering into the Leases, the appellants did not incur any expenditure (whether or not of a capital nature) on the "provision" of the assets for the purposes of their trades within the meaning of s 70A (and, therefore, s 70C and the other relevant provisions of the funding lease regime are inapplicable).

(b) The appellants did not incur the Option Price as capital expenditure on the provision of the assets for the purposes of their respective trades and they did not own the assets as a result of incurring that sum within the meaning of s 11.

(c) In each case, the rents and the Option Price were paid to SGLJ, as in effect funded by it, simply for the purpose of generating allowances on an artificial basis. The sales proceeds provided by SGLJ to the appellants simply went into a loop purely designed to enable the appellants to claim capital allowances without suffering any economic cost.

261. In my view, the decisions in *BMBF*, *Ensign* or *Tower* do not assist the appellants' argument. On the required realistic appraisal of the facts, the circumstances in these appeals are far removed from those which were held to entitle the relevant taxpayers to the relevant capital allowances on some or all of the price paid for the acquisition of the relevant assets in those cases (under s 11 or the corresponding earlier provisions in s 41 FA 1971 or s 24 CAA 1990). Moreover, there is nothing in these cases to suggest that, as is the effect of Mr Peacock's argument, the tribunal is confined to applying a formalistic step by step analysis in assessing the tax effects of these transaction and is required to focus narrowly solely on the legal effects of the sale of ownership rights in respect of the assets and, correspondingly, the re-acquisition of those rights. In *Tower*, Lord Walker expressly rejected the view that s 11 is resistant to a composite approach.

262. As Lord Walker emphasised in *Tower*, it is clear from *BMBF* that the fact that monies move around in a circle or that the steps involved are "preordained" does not necessarily mean that all the desired tax effects of a structure are to be defeated. The court or tribunal is required to conduct a much closer scrutiny of the requirements of the particular statutory provision, and whether, on a realistic appraisal of the facts, those requirements are met. Lord Templeman took a similar view in *Ensign* (albeit expressed in different terms).

263. The decisions in *Ensign*, *Tower* and *BMBF* all have in common that, on the required close scrutiny, it was accepted that the relevant taxpayer did in fact acquire ownership of or rights in respect of the relevant asset for the purposes of using it to generate income on an on-going basis in the taxpayer's acknowledged trade of exploiting films or rights in software or of finance leasing:

(1) However, in *Ensign* and *Tower* these facts were not of themselves sufficient to establish that the taxpayers were entitled to allowances on the full sums paid for the acquisition. The courts looked beyond these factors to find the true effect of the "funding" of the price under the non-recourse "loan" arrangements made with the sellers (in *Tower,* also taking account of the fact that the price appeared greatly to exceed the asset's market value). It was held, broadly, that only the part of the price which the taxpayers funded themselves was "really" incurred as capital expenditure or "really" incurred as such expenditure on the provision of the asset for use in the taxpayer's trade. The "funding" of the rest of the price under circular or self-cancelling movements of funds under the "loan"

arrangements had the effect that (a), as it was held in *Ensign*, the relevant expense was really incurred by the seller, or (b) as it was held in *Tower,* the relevant monies were "put into a loop to fund" an inflated allowances claim (on what was considered to be an inflated price).

(2) In *BMBF* by contrast, BF was found to be entitled to allowances on the full price paid for the acquisition of the pipeline for use in its finance leasing trade under a transaction made on wholly commercial terms. There was nothing in the wider context to detract from the sufficiency of these factors in satisfying the statutory requirements:

(a) Unlike in *Ensign* and *Tower*, BF was funded in respect of the whole price by a loan on wholly commercial terms from Barclays Bank.

(b) The House of Lords dismissed the concern that BF did not incur the price on the provision of the pipeline because (i) BGE could not use the sales proceeds for its business purposes, as it was required to deposit the funds as cash collateralisation for the guarantee Barclays Bank provided to BF in respect of BGE's rental obligations under the finance lease, and (b) BGE received a net benefit of £8.1 million (as released to it over time) which was financed by the allowances BF claimed on the price. In their view, given the statutory provision is concerned with the taxpayer's own acts and purposes, the fact that under a pre-ordained set of steps, for its own benefit BGE used the price to support commercial security arrangements, which by happenstance were with the Barclays group, had no bearing on the analysis.

(3) As Lord Walker recognised in *Tower*, the decision in *BMBF* does not mean that the acquisition of the ownership of the relevant assets for the purposes of a trade for a commercially agreed price is necessarily determinative of a taxpayer's entitlement to allowances and that factors beyond that may not shed light on the analysis. Hence, in *Tower,* Lord Walker rejected Henderson J's conclusion to that effect and the view that *BMBF* prevented a *Ramsay* composite approach. In *BMBF* it just so happened that an examination of the broader picture did not, on the facts of that case, reveal any circumstances which had any bearing on the analysis. The security arrangements simply had nothing to do with the creation of BF's entitlement to allowances; the availability of allowances in no way depended on the circular movement of funds.

264. In these appeals, on the required close scrutiny, we are concerned throughout with the appellants' own acts and purposes in assessing whether (a) when the appellants sold their interest in the assets to SGLJ, they ceased to own them within the meaning of s 61(1)(a), (b) when immediately afterwards they entered into the Leases and granted the Put Options, they incurred qualifying expenditure under the long funding lease regime, and (c) when they re-acquired the assets on paying the Option Price, they incurred qualifying expenditure for the purposes of s 11.

265. Unlike in *BMBF, Ensign* and *Tower*, as set out in full above, the appellants had *no* commercial or business purpose at all in entering into any of these steps other than, through their combined operation as a carefully constructed commercial unity, to generate additional "qualifying expenditure" in respect of the assets without the appellants incurring any further actual financial cost. For the reasons set out above it is plain that, whilst the transactions had the commercial effect of releasing the value of the assets, the appellants' purpose was not to obtain finance for use in their businesses. They parted temporarily with legal ownership of assets which were already in use in their trades (and acquired the right to use them under an immediate lease back) only for

the purpose of achieving the desired allowances and only for the period considered necessary to do so.

266. In short, the transactions comprised a set of steps specifically designed to give the legal effects that would usually attract tax reliefs, in the form of allowances, but without any enduring commercial consequences. It is readily apparent, therefore, that, as Mr Milne submitted, the intended overall commercial and economic effect of the entirety of this closely integrated set of steps is akin, in broad terms, to that intended to be created by the non-recourse loans made in *Ensign* and *Tower*; the creation of allowances on sums which the taxpayer did not suffer as "real" economic costs on the provision of assets for use in its trade.

267. As in *Ensign* and *Tower* and unlike in *BMBF*, the pre-set nature of the composite transaction and the circularity of the movement of funds is highly material to the analysis. As explained, it was only through the operation of all the elements involved as an integrated whole that the appellants could, on their analysis, obtain the desired allowances. Moreover, it was an inherent part of the planning that the appellants could fund the "qualifying expenditure" through funds moving from SGLJ to the appellants, as sales proceeds received on the initial sale of the assets to SGLJ, and from them to SGLJ, as the Option Price due on the re-acquisition of the assets. The implementation of all the planned steps and the built-in circular movement of funds was integral to the success of the scheme to deliver the desired allowances.

268. It is clear from the caselaw that an acceptance that the steps involved in this structure had "real" legal and commercial effects does not preclude the tribunal taking the view that, on a purposive construction of the provisions, it is required to take a broad view of the overall effect of these transactions. As recognised in the cases, tax avoidance is the spur to executing genuine documents and entering into genuine arrangements in the sense that they are not a sham and have the legal effects they purport to have (see *UBS* at [67] and [68]).

269. In *Ramsay* itself there was no dispute that the transactions under which the taxpayer purported to make a gain and a loss were "real" in the sense that they had legal effects they purported to have. Viewed individually, the transactions generated a gain and a loss for the purposes of the relevant provisions. However, as Lord Reed put it in *UBS*, the relevant fact in *Ramsay* upon which it was necessary to focus was "the overall economic outcome of a series of commercially linked transactions".

270. Hence, Lord Wilberforce considered that a loss or gain which "appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage" under what was planned "as a single continuous operation" was ultimately not such a loss (or gain) as the capital gains legislation is intended to deal with. In his view, on the facts of that case it was not right to pick out, and stop at, the one step in the combination of events which produced a loss (which the taxpayer wished to use to offset an actual gain) when that was entirely dependent on, and merely a reflection of a gain which was intended to fund the loss but was itself structured to fall within an exemption from tax. On that basis "the true view, regarding the scheme as a whole, was that there was neither gain nor loss".

271. Similarly, for the reasons set out above, in assessing whether, on a purposive approach, the appellants made a disposal of the assets for a disposal value and re-acquired the assets on incurring qualifying expenditure, the relevant fact on which it is necessary to focus is the overall economic outcome of this closely integrated set of transactions. In economic terms, at the end of the transactions, nothing had happened except that the appellants had paid some fees and expenses in order to generate "qualifying expenditure" without suffering the financial burden of that "expenditure".

272. Having regard to the purpose of the legislation, for similar reasons as those given in *Ramsay*, it would be wrong to pick out and stop at the one step in the combination of the single continuous operation which produced the supposed tax benefit. The creation of the "qualifying expenditure" was entirely dependent on the prior taxable "disposal" of the assets which, like the gain in *Ramsay*, was intended to fund the creation of this benefit but not to lead to any adverse tax effect. The true view is that there was no disposal of the assets within the meaning of s 61, no incurring of expenditure under the Leases within the meaning of the funding lease regime and no incurring of qualifying expenditure within the meaning of s 11.

273. I note that, as in *Carreras*, the objection could be raised that this conclusion raises uncertainty. The question arises of whether the conclusion would be different if, for example, the assets were leased to the asset user for a much longer period of time before the asset user re-acquired them. However, as Lord Hoffman said in *Carreras*, "it is inherent in the process of construction that one will have to decide as a question of fact whether a given act was or was not a part of the transaction contemplated by the statute". As he said, in practice any uncertainty is "likely to be confined to transactions into which steps have been inserted without any commercial purpose" and that "uncertainty is something which the architects of such schemes have to accept".

274. Nor do I consider that the decision of the Court of Appeal in *Mayes* detracts from this conclusion. That case concerned a very different set of provisions from those in point here. Mummery LJ said they operated on a basis and in a manner he described as "artificial, unreal and uncommercial". As Proudman J put it, the provisions did not seek to tax "real or commercial gains" but adopted a "formulaic and prescriptive approach". It was simply not possible, therefore, to discern any overall purpose indicating whether or how the provisions were to operate as a coherent whole. For all the reasons set out above, that is not the case here.

275. Finally, I note that I have not placed any reliance on the decision in *Sargaison v Roberts* in forming this view. I accept Mr Peacock's submissions that that case has no material bearing on the correct analysis. I note, in particular, that that case concerns a differently worded statutory test for determining when an entitlement to allowances ceases to that in s 61.

276. In *Sargaison v Roberts* Megarry J held that the taxpayer had not lost his entitlement to capital allowances in respect of expenditure incurred on agricultural land he owned when he transferred the land into a settlement and received an immediate lease back. In his view, "the whole of his interest in the land" was not thereby "transferred to some other person" under the applicable statutory test. Megarry J thought that, given the provision was not couched in terms addressing the technicalities of land law but should be given a "broader and less technical construction", Parliament was referring to:

> "a process whereby the whole of the interest of A is transferred to B, and stays transferred for more than an imaginary moment of time, and not to a process whereby, in the twinkling of an eye, A's interest in the land is merely reduced from a fee simple to a term of years, and B acquires no more than the fee simple subject to the term.

277. He continued to note in the same passage that "where the technicalities of English conveyancing and land law are brought into juxtaposition with" a UK taxing statute, he was "encouraged to look at the realities at the expense of the technicalities" and:

> "The taxpayer's interest has, *uno ictu*, been merely reduced from ownership of the freehold to ownership of a lease: *the whole of his interest in the land has therefore not been transferred to another*; and that is the end of the case. I

> respectfully agree with the common-sense approach of the General Commissioners, and merely add that common sense is not a quality wholly to be abjured in the construction even of a taxing Statute." (emphasis added)

278. Bearing in mind the different context and statutory test, I do not consider that this provides a basis for a proposition that, as a matter of principle, there is necessarily no cessation of ownership when a taxpayer sells an asset and receives an immediate lease back. The courts in *BMBF, Ensign* and *Tower* all proceeded on the assumption that on a sale of an asset followed by an immediate lease or licence back, the entitlement to allowances in effect passes to the purchaser (and I note that point was specifically addressed in the High Court in *Ensign*).

Part E - Hire purchase issue

Submissions

279. I have considered HMRC's alternative arguments in case the analysis set out above is found not to be correct. HMRC's next argument was that, if the transactions are to be analysed on a step by step basis, the funding lease regime is not in point on the basis that s 67 applies to prevent the Leases from being "funding" leases (under s 70J(3)(a)). It was common ground that, if that is correct, the scheme does not achieve the intended tax advantage (see [21(1)] above).

280. To recap:

(1) section 67 applies if:

(a) A person carrying on a qualifying activity incurs capital expenditure on the provision of plant or machinery for the purposes of the qualifying activity (such as a trade) (s 67(1)(a)).

(b) The expenditure is incurred under a contract providing that the person shall or may become owner of the plant or machinery on the performance of the contract (s 67(1)(b)).

(2) Section 67(6) states that if a person enters into two or more agreements and those agreements are such that, if they together constituted a single contract, the condition in s 67(1)(b) would be met in relation to that person and that contract, then those contracts are to be treated as one for the purposes of s 67.

(3) Where these requirements are satisfied the lessee or hirer is treated as owning the assets for allowances purposes while it is entitled to the benefit of the relevant contract and as having incurred at the outset all capital expenditure which is to be incurred under the contract.

281. Mr Milne contended that, on a purposive approach to the interpretation of s 67 applying a realistic appraisal of the facts, each Leases and Put Option must be treated as forming a single contract under which (a) the appellants were to become the owners of the assets (for the purposes of s 67(1)(b)) and (b) they incurred the Option Price as capital expenditure on the provision of the assets for the purposes of their trades (for the purposes of s 67(1)(a)). He said that this follows from the fact that, on a realistic view, it was commercially certain that SGLJ would exercise the Put Options and, therefore, that the appellants would pay the Option Price. In that context, he made the same points as set out above in relation to the *Ramsay* issue (see [79] and [80]) in support of the view that the exercise of the Put Options was inevitable.

282. Mr Milne continued that the factors he referred to demonstrate that, at the very least, under the Leases and the Put Option the appellants *may* have become the owner of the assets for the purposes of s 67(1)(b). There is nothing in s 67(1)(b) which requires only the lessee to have the power to choose whether to become the owner of the assets;

it simply requires that the contract provides that the lessee/hirer "may" become the owner of the assets.

283. Mr Milne submitted, that if the tribunal accepts HMRC's argument as regards s 67(1)(b) but not as regards s 67(1)(a), nevertheless Wiseman can be taken to have incurred capital expenditure under the Lease on the basis that the rentals under the Lease themselves contained a capital amount. He noted that this reflects HMRC's view as set out in their manuals. In summary, their view is that, on the basis of the decision in *Darngavil Coal Co Ltd v Francis* (7 TC 1) ("*Darngavil*") payments made under a lease contract with an option to acquire the assets for less than their expected market value at the time the option is to be exercised are made up of (a) revenue payments for hire of the asset, which are deductible in calculating the lessee's taxable profits, and (b) capital payments for the purchase of the asset (or for the option to do so), which are not deductible but which may qualify for capital allowances under s 67.

284. In *Darngavil* the taxpayer rented wagons from another party under an agreement for a set rent over the term of the lease on terms that the taxpayer was responsible for the repair of the wagons and that at the end of the lease it had the option of purchasing each wagon for a nominal payment of one shilling. The Court of Session held that whilst payments for the hire of the wagons were a revenue expense, a large proportion of the payments made by the company during the lease was really payment for the option to purchase the wagons at a sum far below their real value (see [11]).

285. Mr Milne said that there is a significant difference between the price at which Wiseman sold the assets to SGLJ of £45,292,364 and the Option Price, which it is asserted reflected the fair value of the assets when the assets were re-acquired, of £44,292,503. He submitted that the valuation provided to Wiseman in support of these sums, as reflecting the assets' market value at the relevant times, did not appear to be a serious valuation given the wide range of market values within which the sale price and the Option Price was stated to fall. He noted that the total rental payments of £1,056,364 amount to 2.3% of the sale price and 2.4% of the Option Price. He said that, on that basis, the pricing suggests that the rentals due over the lease period of 28 days were not just for the use of the assets but included a capital sum.

286. Mr Peacock submitted that:

(1) The plain words of s 67(1)(b) tie the application of s 67 to whether the contract itself (as read in the extended sense provided for under s 67(6)) provides that the person "shall" or "may" become owner of the assets. Therefore, the terms of the relevant contract are determinative as to whether this provision applies provided that the contract is not a sham or that the terms are not in some other respect misleading (as is plainly not the case here). On that basis, the provision is not to be construed having regard to the broader commercial setting as is the effect of HMRC's argument.

(2) The purpose of s 67 is to deem an asset user under certain hire-purchase and similar agreements to be the "owner" so that it is eligible for capital allowances *from the outset* even though it does not yet hold legal title to the asset where (a) the user has expended capital on the provision of the asset and (b) either *will, or has a choice or the power to,* become owner of the asset. That this is the correct interpretation is also supported by:

(a) The overall tenor and focus of s 67(1) which, as indicated by s 67(1)(a), is very much on the positive actions and choices of the asset user.

(b) The headings to both chapter 6 and s 67 which clearly identify that s 67 is intended to apply to hire-purchase contracts. Headings are part of the legislation and provide part of the contextual scene for construing the statute (see *R v Montilla* [2005] All ER 113 at [31] to [36]).

(c) The Explanatory Notes to the Finance Bill 2006 (which inserted s 67(6) into s 67) which state (at para 62 of schedule 9) that: “This new subsection ensures that *the hire purchase rules* will apply equally to alternative *hire purchase arrangements*, for example those developed to be Sharia compliant.” (emphasis added)

(d) HMRCs statement in BIM4535 that: “A hire purchase agreement provides for the asset being hired to become the property of the hire purchaser automatically at the end of the hire period or *gives the hirer an option* to buy the asset for a specified price.” (emphasis added) (See also HMRC’s Business Leasing Manual at 39010, which is an almost exact repeat of the Business Income Manual).

(3) In this case the terms of a single contract comprising each Lease and related Put Option can be taken to provide only that another party, SGLJ, can require the relevant appellant to purchase the assets if it chooses to exercise the option thereby granted. On the correct purposive interpretation, therefore, the terms of the single contract do not provide that the relevant appellant “shall” or “may” become the owners of the assets.

(4) The analysis is no different even if the tribunal were (incorrectly) to take into account a broad sweep of factual circumstances such as the existence of the Call Options. That does not affect either the “shall” or “may” test given that it was for the option holder, being a different entity to the appellants, to decide whether to exercise the Call Option or not.

287. As regards HMRC’s arguments, in Mr Peacock’s view:

(1) HMRC are wrong to assert that the exercise of the Put Options was inevitable. If that were the case, there would be no need for the Call Options to exist to ensure that the appellants’ groups could reacquire the assets if SGLJ did not exercise its Put Options. The fact that Wiseman was liable to pay SGLJ its second arrangement fee if it exercised the Put Option in fact demonstrates that it was contemplated as a possibility that SGLJ might not exercise the option.

(2) HMRC’s construction of “may” in s 67(1)(b) in effect as “might” is incorrect because it (a) is at odds with the purposive interpretation of s 67 as set out above; and (b) gives a vague and inapplicable meaning which cannot be properly applied. It should be borne in mind that this provision has to be applied in thousands of business transactions concerning large amounts of money. As Parliament recognised, a test of a probable or possible outcome is not sufficiently precise or certain for taxpayers to be able to organise their affairs and determine their tax liability. In contrast, by using a word that imports a requirement of choice on behalf of the asset user, Parliament has imposed a clear test for taxpayers, HMRC, and the courts and tribunals to apply.

288. Mr Milne responded that HMRC do not accept that their construction involves reading the word “may” as “might” but, in any event, the appellants’ assertion that a test of probable or possible outcome is not sufficiently precise or certain is irrelevant in the context of the present appeals, which do not (on any view) concern ordinary transactions. Artificial transactions of the type carried out by the appellants in the context of the scheme would simply not be carried out in the context of real-world business transactions.

289. Mr Peacock submitted that HMRC's alternative argument which only applies to Wiseman is also not correct. He noted that whether expenditure is of revenue or capital nature is a question of law for the tribunal to determine (see *Heather (Inspector of Taxes) v P-E Consulting Group Ltd* [1973] 1 All ER 8 at 19 per Lord Denning MR). HMRC's reliance on the accounting position (under SSAP 21 and IAS 17) necessarily cannot decide the issue. Here the near weekly payments of rent made by Wiseman under the relevant Lease were not made "with a view to bringing into existence an asset or advantage for the enduring benefit of a trade" (*British Insulated and Helsby Cables Ltd v Atherton* [[1925] All ER Rep 623 at 629 per Viscount Cave LC). They were paid for the short-term use of the assets under the Lease. Unlike the situation in *Darngavil*, the entire amount of the rents paid by Wiseman were for the hire of the assets as the Option Price represented the fair value of the relevant assets as valued by American Appraisal.

290. Mr Peacock noted that HMRC accepted at the earlier case management hearing held on 29 November 2016 that they were "not able to run…this argument in the Cape appeals" (as set out in the tribunal's decision given following that hearing). He submitted that as the valuation methodology of the Cape assets was the same as for the Wiseman assets and given that HMRC accept that this argument does not apply to Cape, HMRC's attempt to raise this argument in respect of Wiseman is wholly illogical.

291. Mr Peacock added that Mr Milne's assertion that the appraisal report was not properly done is not supported by the evidence which shows that it was provided following production of a number of drafts. Moreover:

(1) The valuation produced for Wiseman was, if anything, more tightly focused than that produced for CIS. In the Wiseman report it was stated that the net book value of the assets at the date of the report of £45,292,364 and the Option Price as at the expected exercise date was a "reasonable representation" of the market value of the assets at the relevant dates on the basis that the market value of the assets lay in a range spanning some £6 million (£43.1 million to £49.5 million). Proportionately the range of market values specified in the similar report prepared for CIS was much larger in that it spanned some £5 million as regards assets which were sold for nearly £15 million.

(2) The difference in the rate of the fall in value of the Cape assets and the Wiseman assets is simply a product of the fact that different assets depreciate at different rates and of the particular depreciation policies adopted In the case of Wiseman, the rate of just over 2.3% to 2.4% over 28 days equates to about a 25% rate of depreciation over a year. That suggests that, according to the expected economic life of the assets, when the transactions were entered into they would be depreciated over about four years as accords with Wiseman's depreciation policy which, as shown in its accounts, was to depreciate the assets over three to five years. In those circumstances, therefore, the 2.3 to 2.4% figure is precisely what is to be expected. He noted that in the report the documents that were examined by the valuer included the detailed spreadsheet that set out the assets and their depreciation.

Decision

292. I have concluded that, on a purposive construction, s 67 does not apply to these transactions on the basis that on entering into the Leases and related Put Options, neither appellant incurred capital expenditure on the provision of the assets for use in their trades under a contract providing that it "shall or may become the owner of the [qualifying assets] on the performance of the contract". In my view:

(1) It is plain, as Mr Peacock argued, that whether the "shall or may" test is satisfied is to be determined according to what the relevant contract provides, as that contract may be viewed in a broader sense as encompassing one or more agreements related to the lease or other hire contract under s 67(6).

(2) The term "shall" requires that it is certain that, on the performance of the contract, the lessee will become the owner of the relevant assets. Viewed in the context of the overall provisions of s 67, the term "may" requires, again as Mr Peacock argued, that the lessee or hirer itself has the choice whether to acquire ownership of the assets such as under an option which it can exercise at the end of the lease period. For the reasons Mr Peacock set out, Parliament cannot have intended to confer an upfront entitlement to capital allowances by reference to future capital expenditure on the basis of the inherently difficult exercise of assessing whether a person might become the owner depending on actions entirely beyond its control such as whether another party would exercise the right it has to require it to buy the assets.

(3) Mr Milne argued primarily that the "shall" test is in point; on a realistic view, it was commercially certain that SGLJ would exercise the Put Options and that the appellants would become the owners of the assets on paying the Option Price. However, in my view, a purposive approach to the construction of this particular provision does not justify ignoring entirely the fact that, viewing the Leases and the Put Options as a single contract, it was provided that whether the appellants would become owners of the assets depended on the actions taken by another party, SGLJ, albeit that, due to the nature of the overall planning, that was extremely likely to occur.

(4) If I am wrong as regards the application of the "shall or may" test, I cannot see that a purposive approach on a realistic appraisal of the facts justifies the conclusion that the appellants can be regarded as having incurred capital expenditure in the form of the Option Price when they entered into the Leases. Even if the payment of the Option Price is regarded as an inevitability, it is something of a leap, which is not justified on any view of the facts, to view the payment as having been made when the appellants started to use the assets under the Leases (as opposed to when it was really paid on the expiry of the Leases).

(5) Finally, as regards Wiseman there is insufficient evidence to conclude that the Option Price did not reflect the fair market value of the assets at the expected re-acquisition date such that the rents can be taken to include a capital element. There is no reason to doubt that the professional valuation which the appellants obtained was not properly prepared. HMRC's criticisms of it are unsubstantiated assertion. I accept Mr Peacock's points that HMRC made no valid distinction compared with the valuation provided to CIS with which they raised no issue.

Part F – QA issue

Submissions

293. As set out in further detail below, HMRC's further alternative argument was that, if a step by step analysis is the correct approach and, on that approach, on entering into the Leases, the appellants incurred qualifying capital expenditure for the purposes of the funding lease regime:

(1) Under s 70E, the appellants are required to bring a disposal value into account on the expiry of the Leases of an amount equal to the Option Price. On that analysis, the disposal value would, in effect, cancel out the corresponding

benefit for the appellants of incurring qualifying expenditure under s 11 in the sum of the Option Price as paid as consideration for the reacquisition of the assets.

(2) If that is not correct and, as the appellants' argued, the disposal value is nil, in any event, the appellants are not entitled to allowances on the Option Price under s 11. The Option Price cannot be brought into account both as qualifying expenditure under the funding lease regime (which is not clawed back on the disposal occurring on the expiry of the Leases due to its inclusion in QA in the disposal formula) and under s 11.

294. To recap, the appellants did not dispute that, on the expiry of the Leases, they were required to bring a "disposal value" into account under s 70E as computed under the disposal formula, (QE – QA) + R. However, as noted, in their view, the disposal value produced by the formula is nil on the basis that QA is the same as QE (and it was common ground that there was no R). For this purpose, under s 70E:

(1) "QE" means the relevant appellant's qualifying expenditure under the Lease being the PVMLP comprising the present value of (a) the "minimum payments under the lease over the term of the lease" and (b) "in the case of a lessee, *so much of any residual amount as is guaranteed by him or a person connected with him"* .

(2) "QA" means the aggregate of (a) the payments made to the lessor by the lessee under the lease and (b) the "*payments made to the lessor by that person under a guarantee of any residual amount*" (under s 70E(2C) (b)). (See [31] to [35] above for the full provisions.)

295. Mr Peacock submitted that the Option Price falls within QE as "so much of any residual amount as is guaranteed by" the appellant and QA as a "payment" which was "made to the lessor by that person [the appellant, as lessee] under a guarantee of any residual amount" for the following reasons:

(1) In granting the Put Options to SGLJ each appellant provided SGLJ with a "guarantee" of any residual amount in the ordinary sense of that term. Each appellant thereby gave SGLJ the right to require it to pay the Option Price (being a sum which, as did not appear to be disputed, equated to the fair value of the relevant assets on the expiry of the relevant Lease). The Put Options ensured, therefore, that SGLJ could demand that the appellants bought the assets for their fair value and so protected SGLJ from the risk of it not otherwise being able to sell the assets.

(2) Viewing the wording of s 70E(2C)(b) in context, it is plain that the reference to "payments made to the lessor *by that person*" is to payments made by the lessee itself. This is supported by the guidance set out by HMRC in a technical note dated 12 November 2008 which sets out the reasons for the introduction of the disposal formula as it applied when these transactions took place. This included a statement, at 3.14(a) and (c) of the note, that:

> "(a) New subsection (2A) provides a formula for calculating the disposal value to be brought into the capital allowances computations of a lessee when the lessee's deemed ownership of the leased asset ends, either because the lease terminates or because the plant or machinery ceases to be used wholly for the purpose of a qualifying activity. The formula deducts from the lessee's qualifying expenditure on the plant or machinery at the commencement of the lease an amount referred to as "the qualifying amount" and adds any relevant rebate received…….
>
> (c) New subsection (2C) provides the definition of "the qualifying amount" for the lessee under a long funding finance lease. "The

> qualifying amount" is the aggregate of the amounts *paid to the lessor by the lessee. This amount includes any initial payment and also includes any payment made under a guarantee.* It excludes the amounts mentioned in subsection (2D) [being the amounts of payments under the leases that represent finance charges, any service charges and qualifying UK or foreign tax to be paid by the lessor]" (emphasis added).

I have set out further details of the explanation given in the technical note for the introduction of the disposal formula in the decision section below.

296. HMRC submitted that, on the contrary, the Option Price is not to be brought into account for the purposes of QA for the following main reasons:

(1) As the term is applied as a legal concept, the only "guarantee" provided in respect of any residual amount was that given by Cape and Wiseman Dairies under the Parent Guarantees in agreeing to pay the Option Price should the relevant appellant fail to do so. The Option Price, therefore, constitutes a residual amount guaranteed by *a person connected with the lessee* for the purposes of QE. However, it is not a payment within QA; QA only applies to relevant payments made by the lessee itself (and not to such payments made by connected persons).

(2) Moreover, the appellants did not themselves provide a "guarantee" of any residual amount under the Put Options according to the commercial or natural and ordinary meaning of that term. It does not follow simply from the fact that the Option Price may be equal to the "residual amount" that it is paid "under a guarantee" of the residual amount. At this stage of the analysis, HMRC are proceeding on the assumption that their *Ramsay* argument is not accepted. On that basis, the better view is that, on paying the Option Price as consideration for the relevant assets, for the purposes of s 11 the appellants incurred qualifying expenditure of that sum. It cannot be said, therefore, that the appellants "guaranteed" that SGLJ would receive the Option Price. The purchaser of an asset under a sale contract does not "guarantee" the payment of the price to the seller; it simply pays the price pursuant to a contractual obligation to do so.

(3) On that basis, QE comprises £100 (including both the PVMLP of the rents (of £5) and of the Option Price (of £95)) but QA comprises £5 only in respect of the rents so that, under the disposal formula, there is a disposal value of £95 to be brought into account (£100 - £5).

297. Mr Milne accepted that, on ordinary principles of statutory construction, the person referred to in s 70E(2C)(b), as the provider of the guarantee, appears to be the lessee. However, he did not consider that this detracts from the conclusion that, on a purposive approach, viewed realistically, the Option Price cannot constitute both qualifying expenditure for the purposes of s 11 and a payment made under a guarantee of any residual amount for the purposes of QA:

(1) As noted, in HMRC's view, at this stage of the analysis, the better interpretation is that, given that it was always the intention for the assets to end up back in the hands of the appellants, the Option Price constituted *only* qualifying expenditure within the meaning of s 11 and not a payment falling within QA.

(2) However, if the Option Price is to be regarded as falling within QA, it cannot also constitute qualifying expenditure within the meaning of s 11. It cannot have been Parliament's intention to allow capital allowances twice on what is effectively the same expenditure on the basis that the Option Price is to be treated as:

(a) part of the appellants' qualifying expenditure which they incurred on entering into the Leases under the funding lease regime (under ss 70A and 70C) on the basis that sum is not clawed back on the expiry of the Lease due to the inclusion of the Option Price in QA in the disposal formula; and

(b) as qualifying expenditure incurred on reacquiring the assets under the Put Options under s 11.

298. In HMRC's view, such an anomaly is a strong indication that the appellants' construction of the legislation is incorrect. At this final stage of their analysis, HMRC reverted to raising the same points as they made in relation to their *Ramsay* argument as to why the requirements of s 11 are not satisfied in relation to the Option Price.

299. Mr Peacock responded that the guarantees given by Cape and Wiseman Dairies under the Parent Guarantees are not guarantees of any residual amount within the meaning of the legislation. The only guarantees of that nature for the purposes of both QE and QA are those provided for under the Put Options. In summary, he said that:

(1) For the reasons already set out, s 70E(2C)(b) is plainly not concerned with payments made by third parties under a legal guarantee under which the third party is answerable for the debt of another person. That is precisely the effect of the Parent Guarantees; essentially, Cape and Wiseman Dairies agreed with SGLJ to cover any liabilities that the appellants were unable or unwilling to meet. In doing so, they underwrote the risk for SGLJ in contracting with their subsidiaries. They did not provide an asset risk guarantee that SGLJ would be able to sell the assets for fair value.

(2) Accordingly, Cape and Wiseman Dairies could be called on to make payments under the Parent Guarantees only if the appellants failed to meet their obligations under the terms of the guarantee of the residual amount they provided under the Put Options. No matter what, the route by which SGLJ ensured it could recover the fair value of the assets was via the Put Options. The Parent Guarantees provided a second, separate, level of guarantee.

300. Mr Peacock saw no problem with the Put Options in effect performing a dual function. He said that:

(1) When the appellants paid the Option Price on re-acquiring the assets, the requirements for s 11 to be met were plainly met (for the reasons already given in relation to the *Ramsay* issue). The fact that under the Put Options the appellants also provided SGLJ with a guarantee of any residual amount for the purposes of QA in the disposal formula is simply not relevant to the application of s 11.

(2) Moreover, there is nothing in the language of s 70E(2C)(b) that suggests that a payment does not fall within its terms if it is made for a purpose other than merely satisfying a guarantee. That provision is not concerned with the purpose for which the payment is made, whether by reference to the purpose of the payment alone or the transaction as a whole. In any event, if purpose is relevant, the lessor's purpose is to be taken into account. SGLJ's purpose in entering into the Put Options was to ensure that it recovered the fair value of the assets which it would not otherwise recover from the rents paid under the Leases. That self-evidently satisfies the requirements of s 70E(2C)(b).

301. Mr Peacock noted that the overall purpose of the disposal provisions in s 70E is to provide a mechanism to recapture any excess allowances when the lessee's deemed ownership of the relevant qualifying assets ends. Hence, under the disposal formula, the disposal value is measured as the difference between (a) the lessee's qualifying expenditure, being the amounts which, when the lease was granted, the taxpayer

expected to pay under the lease and under any residual value guarantee, and (b) the payments of that nature which, by the time the lease expires, the taxpayer has in fact made or was then obliged to make (and taking account of the rebate, if any). It is entirely in accordance with how this provision is intended to work, therefore, that the disposal value produced by the formula in this case is nil; as the relevant amounts which each appellant expected to pay under the relevant Lease and Put Option were in fact paid in full, there is nothing to be recaptured under the disposal formula.

302. He said that by contrast HMRC's analysis would produce a very odd result for which there can be no policy justification. On their view, there would inevitably be a clawback of allowances because (a) each appellant, as lessee, would be entitled to allowances on an amount corresponding to the relevant rents and the Option Price on the basis that the parent companies provided a guarantee of the Option Price under the Parent Guarantees but (b) on the expiry of the Leases, there would be no amount other than the rents to bring into account as QA in the disposal formula.

Decision

303. It was not disputed that the Option Price is a sum which falls within QE albeit that the parties have different reasons for that view. I have concluded that the Option Price also falls within QA as a "payment" which was "made to the lessor by the person under a guarantee of any residual amount" within the meaning of s 70(2C)(b):

(1) I cannot see that the reference to a "guarantee" of any residual amount is to be interpreted otherwise than according to its natural meaning as an assurance that any residual amount will be received or recovered. There is nothing in the wording or context of the provision to suggest that this term is confined to meaning a guarantee in the legal sense (broadly, meaning an agreement to be responsible for another's debt or contractual performance if that person does not pay or perform).

(2) It is clear, reading the provision in the context of the immediately preceding sub-sections (see [35] above), that "the person" referred to as making the relevant payments to the lessor is the lessee. As Mr Peacock submitted, that this is the intended meaning is supported by the commentary on the QA definition he referred to in the technical note of November 2008 (and see also [306] below).

(3) On that basis, in granting SGLJ the Put Options, the appellants plainly guaranteed or ensured that SGLJ could recover any residual amount through requiring them to pay the Option Price on SGLJ exercising its rights under the Put Options.

304. Essentially, I agree with Mr Peacock's view that it is plain that the purpose of the disposal provisions in s 70E is to ensure that, when the relevant lease expires, any "excessive" allowances are recaptured by ensuring that the lessee obtains allowances only relevant sums it has actually expended. Accordingly, the lessee is required to account for a disposal value equal to the amount (if any) by which the sums the lessee expected to pay as rents and under any residual value guarantee (QE) exceed the sums of that nature which it was actually liable to pay (QA) plus any rental rebate.

305. I note that there are some oddities in the provisions for which there is no ready explanation. For example, it is not clear why QE encompasses a residual value guarantee provided by a person connected to the lessee whereas QA does not. Moreover, where the lessee provides the residual value guarantee by agreeing to purchase the asset it is difficult to see circumstances in which the sums in QE and QA would not entirely match so that, in practice, there would usually only be a recapture of allowances where there is a rental rebate. In any event, from the manner in which the disposal formula operates and the guidance given in the technical note of November

2008, s 70E is plainly intended to provide a mechanism to ensure that a relevant lessee, who is entitled to allowances under ss 70A and 70C, obtains those allowances only on sums which it actually expends.

306. In the technical note of November 2008, HMRC set out that, similarly to the treatment under the general rules, under the funding lease regime, a lessee who was entitled to claim capital allowances under that regime had to bring a disposal value into account when the lease ended (see 1.26 to 1.30). However, they noted at 1.27, that the concern was that the disposal rules in s 70E, as they applied prior to the changes then made, did "not work as intended when a long funding finance lease contains a residual value guarantee and the lease terminates as originally expected". The following example was given illustrating HMRC's concern:

(1) The lessee leased an asset worth £100 and paid rentals of £20 plus finance charges and guaranteed a residual value of £80.

(2) If the asset was sold for £80 at the end of the lease term the lessee would pay nothing under the guarantee but under the rules, as in place prior to the changes made in 2009, would not be required to bring a disposal value into account. The result would be that the lessee would be entitled to claim allowances on £100 although its cost was only £20 (plus finance charges).

(3) HMRC stated that the appropriate result would be a disposal value of £80, leaving the lessee with net capital allowances of £20.

307. HMRC stated, at 1.31 and 1.32 of the technical note, that:

> "The proposed legislation [being that applicable to these transactions] provides an improved formula for calculating the disposal proceeds to be brought into account by the lessee under a long funding lease.
>
> *The changes will mean that the relief given to a lessee under a long funding lease, by way of capital allowances and revenue deductions, does not exceed the net payments made by the lessee under or in connection with the lease*." (emphasis added)

308. It is plain from the note, therefore, that in amending the rules at that time, the Government was concerned to ensure that a lessee could not claim allowances in respect of a long funding finance lease on a sum in excess of the net payments actually made by the lessee under or in connection with the relevant lease. The issue was that, under the previous rules, a lessee could claim allowances in respect of any residual amount it had guaranteed even where ultimately it was not required to pay that amount.

309. I note that in the example given in the technical note it appears to be envisaged that the lessee would be called on to provide the guaranteed sum only if the asset was not otherwise sold to another party for that sum. It is not clear whether it was envisaged that, if the asset was not so sold and the guarantee was called upon, the lessee (a) would itself acquire the asset or (b) would simply pay the guaranteed sum to the lessor. However, even if the example is taken to contemplate the scenario in (b), in my view, that does not provide a sufficient basis to conclude that a payment made under a residual value guarantee provided by the lessee agreeing to acquire the asset is not intended to fall within QA. The example given was simply an illustration of the general concern, namely, that, under the previous rules, circumstances could arise where a lessee could obtain allowances on sums it had not actually spent.

310. As Mr Peacock argued, it appears, therefore, that the disposal formula works as intended in this case on the basis that the rents and the Option Price are to be included within both QE and QA. The resulting disposal value is correctly nil because, by the time the Leases expired, the appellants were in fact obliged to pay the rents and the Option Price which, on entering into the Leases, they had brought into account as their

qualifying expenditure; there was simply nothing to recapture under the disposal formula. Moreover, I take the appellants' point that HMRC's analysis would produce a result for which there is no discernible rationale.

311. HMRC's concern is that, if the appellants' view is correct, when exercised, the Put Options would operate to provide the Option Price both (a) as a payment under a residual value guarantee, which, therefore, would be taken into account in reducing the disposal value on the disposal occurring on expiry of the relevant Lease (in this case to nil) under s 70E and (b) as qualifying expenditure for the appellants on the re-acquisition of the assets (under s 11). That would result in the appellants obtaining allowances by reference to the Option Price in effect twice over.

312. However, I cannot see any viable basis for HMRC's view that (a) if the Option Price constitutes qualifying expenditure for the purposes of s 11, it cannot also be brought into account in QA for the purposes of s 70E or, (b) if it is to be brought into account in QA, it cannot constitute qualifying expenditure for the purposes of s 11:

(1) At this stage of the analysis, the assumption is that it is not correct to interpret the relevant provisions on a *Ramsay* composite approach in the way set out above. If, contrary to my view, whether and how the provisions apply is to be assessed, in effect, by reference solely to the juristic character of each particular step involved in the transactions, on the reacquisition of the assets on the expiry of the Leases, the individual requirements of s 70E(2C)(b) and s 11 are met for the Option Price to fall within QA and to constitute qualifying expenditure respectively.

(2) There is nothing to indicate that s70E(2C)(b) (whether in the wording of the provision or overall context of the special funding lease regime in which it operates) is not intended to apply to payments made under a guarantee of any residual amount which is provided by the lessee itself agreeing to acquire the assets. For the reasons set out above, for such a payment to be brought into the disposal value formula under both QE and QA produces a result which accords with the intended purpose of s 70E, namely, to confine the lessor to obtaining allowances under that regime only on sums actually spent by the lessee under or, in connection with, the lease.

(3) Similarly, I cannot see any justification for concluding that, where its requirements are otherwise satisfied, s 11 is not intended to operate where a lessee repurchases an asset under an agreement which also happens to operate as a guarantee of any residual amount for the purposes of the funding lease regime. I also cannot see that HMRC's argument that the requirements of s 11 are not satisfied viewing the bigger picture can operate otherwise than as part of the analysis applying a *Ramsay* composite approach as set out above.

313. It appears that the unfortunate result produced in this case, whereby the lessee in effect obtains allowances on the same sum twice over, is the result of a gap or glitch in the legislation due to the interaction of the general allowances regime and the complex funding lease regime. No doubt the legislature would not have wanted to produce this result had they considered the interaction of the two sets of rules in this particular scenario. However, if, contrary to my view, it is not permissible to analyse the transactions on a *Ramsay* composite approach on the basis set out above, my view is that, unpalatable as it may be, that is the result which the legislation produces. Such a gap in the legislation can be fixed only by the legislature amending the rules (as the legislature subsequently has done) and not by the tribunal unduly straining the plain meaning and effect of the relevant provisions.

Conclusion

314. For all the reasons set out above, the appeal is dismissed.

Rights of appeal

315. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

HARRIET MORGAN
TRIBUNAL JUDGE
RELEASE DATE: 23 MARCH 2020