Neutral Citation Number: [2014] EWCA Civ 1062

Case No: A3/2013/3108

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
Mr Justice Newey and Judge Howard M. Nowlan
[2013] UKUT 0368 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 30/07/2014

Before :

LORD JUSTICE RIMER
LORD JUSTICE PATTEN
and
LORD JUSTICE KITCHIN

- -

Between :

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Appellants**
- and -	
LLOYDS TSB EQUIPMENT LEASING (NO 1) LIMITED	**Respondent**

- -
- -

Mr David Ewart QC, Mr Raymond Hill and **Ms Stephanie Barrett** (instructed by **HMRC's Solicitor's Office**) for the **Appellants**
Mr Jonathan Peacock QC and **Mr Michael Ripley** (instructed by **Norton Rose Fulbright LLP**) for the **Respondent**

Hearing dates: 24 and 25 June 2014

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Approved Judgment

Lord Justice Rimer :

Introduction

1. By a decision released on 12 January 2012, the First-tier Tribunal (Tax) (Judges Edward Sadler and Adrian Shipwright, 'the FTT') allowed an appeal by Lloyds Equipment Leasing (No 1) Limited ('LEL') against an amendment made on 24 April 2009 by The Commissioners for Her Majesty's Revenue and Customs ('HMRC') to LEL's corporation tax self-assessment return for the year ended 30 September 2006: see [2012] UKFTT 47 (TC). The subject of the amendment had been LEL's claim for writing-down capital allowances at the rate of 25% in respect of expenditure incurred by LEL on the purchase of two merchant vessels, the Arctic Voyager and the Arctic Discoverer, of which it is the owner and lessor. The vessels had been designed and built for the purpose of shipping liquefied natural gas ('LNG') from northern Norway to Spain and the USA as part of a project ('the Snøhvit project') for the exploitation of natural gas fields under the Barents Sea by a consortium of energy companies.

2. LEL is a wholly-owned subsidiary of Lloyds Banking Group. It is resident in the UK and carries on the trade of finance leasing. It claimed the disputed allowances in the computation for tax purposes of the profits of its trade. LEL contracted to purchase the vessels in September 2002 and they were delivered to it during its accounting period for the year ended 30 September 2006. LEL's total expenditure on the purchase of the vessels was £198,226,884, with the bulk of its expenditure incurred in the year ended 30 September 2006 (£33,351,994), but it had also made instalment payments in each of its four preceding accounting years. The effect of HMRC's amendment was (i) to deny LEL's claim for capital allowances in the return for the year ended 30 September 2006, and (ii) to recover in full the capital allowances LEL had claimed in the preceding four years. The further effect was to require LEL to pay additional corporation tax of £6,278,877, as well as certain penalties, for the year ended 30 September 2006; and to deny LEL the right to claim writing down allowances in respect of the balance of its expenditure on the vessels over subsequent accounting periods.

3. Four issues were argued before the FTT on LEL's appeal, of which the FTT decided issues 1, 2 and 4 in favour of LEL (which was sufficient for it to succeed), and issue 3 against LEL. Issue 3 was an argument by LEL that issue 4 did not arise for consideration at all.

4. By a decision released on 14 August 2013, the Upper Tribunal (Newey J and Mr Howard M. Nowlan, 'the UT') dismissed HMRC's appeal against the decision of the FTT: see [2013] UKUT 0368 (TCC). Of the same four issues argued before the FTT, the UT upheld the FTT on issues 1, 2 and 3. On issue 4, Newey J would also have upheld the FTT's decision, whereas Judge Nowlan would not. As, however, Newey J had a casting vote, the FTT's decision on issue 4 was also upheld.

5. HMRC, with the permission of the UT, now appeal to this court. Whilst they originally sought to appeal only on issues 1 and 4, they abandoned issue 1 shortly before the hearing and their appeal became confined to issue 4. By a respondent's notice, LEL appealed against the decision of the UT to uphold the FTT's rejection of its argument under issue 3.

6. I shall first summarise the facts and then deal successively with issues 3 and 4.

The facts

7. I take these from the meticulously full decision of the FTT, running to 432 paragraphs occupying 95 single-spaced pages. My account does not attempt to be similarly comprehensive: the interested reader is referred to the FTT's decision for the detail.

8. The Snøhvit project is a joint venture set up to extract, process and deliver to market LNG from the gas fields in the Barents Sea off the north-west coast of Norway. There were originally seven partners ('the Snøhvit Sellers') in the consortium, of which the lead member was Statoil SA, although since the relevant transactions were entered into the Snøhvit Sellers now consist only of Statoil. The Sellers required a fleet of dedicated, purpose-built vessels to ship the LNG to its long-term customers. Because of the location of the gas field in the high north, the vessels required were 'winterised' ones with design features capable of coping with the severe weather features they would encounter. The vessels were required to meet high standards.

9. Statoil led the tender process to select a counterparty for the provision of the vessels. That process commenced in January 2001. Some 55 companies were invited to participate in a pre-qualification process. Statoil also sought an owner and operator of the vessels which would hire them to the Snøhvit Sellers on a long-term time charter on commercial terms that they specified. Those terms were to reflect, over the time charter period, a return of the capital cost of the vessels and a finance charge on such cost, plus the expenses (or an estimate) of operating the vessels. It was a further requirement of the Snøhvit Sellers that, as the vessels would operate only within the Atlantic Basin, the commercial and technical management of the vessels in the course of their operation should be located in the European time zone.

10. The mandate to own and operate the vessels was, after a tender process, awarded to Kawasaki Kisen Kaisha Limited ('K-Line'). K-Line already had a subsidiary company incorporated in England and Wales, K-Line (Europe) Limited ('K-Euro'). K-Euro had an established shipping trade and K-Line intended that, however the vessels might be financed, K-Euro would be the company by which it met the requirements of the Snøhvit Sellers for the commercial and technical management of the vessels.

11. In the summer of 2001, Statoil recommended to the Snøhvit management committee the award of the contract for the vessels to K-Line, as was later approved by the Norwegian parliament. On 19 December 2001, there took place what the FTT called 'the preliminary stage', which included the following: (a) the entry by K-Line into a shipbuilding contract with Mitsui Engineering & Shipbuilding Co, Ltd in respect of the first vessel, the Arctic Discoverer; (b) a shipbuilding contract with Kawasaki Heavy Industries, Ltd in respect of the second vessel, the Arctic Voyager; (c) two time charterparties with Statoil, on behalf of the Snøhvit Sellers; and (d) a Memorandum of Understanding ('MOU') with Statoil. This preliminary stage did not include any financing in respect of the vessels: the MOU recorded the parties' intentions to seek such financing. K-Line reserved the right to introduce other parties as co-owners and to re-structure the ownership rights and arrangements.

12. K-Line had, during the course of the tender process, sought indicative pricing for the vessels: it needed to do so in order for a time charter day rate to be calculated. K-Line met several institutions in order to discuss financing. The forms of financing it discussed with such institutions were debt financing, lease financing and securitisation of the project cash flows. One of the prospective lessor banks was Lloyds TSB Leasing Ltd ('Lloyds Leasing'). On 16 April 2002, heads of terms for the financing of the vessels were entered into with Lloyds Leasing by what the FTT called Northern LNG and the Snøhvit Sponsors. Each of Northern LNG Transport Co, I, Ltd and Northern LNG Transport Co, II, Ltd (severally or together, 'Northern LNG') became in due course the lessee of one of the two vessels from LEL. They are Cayman Island joint venture companies, whose shares were owned in different proportions (the difference is not material) by K-Line, Statoil, Mitsui and Iino Kaiun Kaisha ('the Snøhvit Sponsors').

13. The following key transactions were entered into on 19 September 2002:

    (1) Novation agreements between the shipbuilders, K-Line, LEL and Northern LNG under which certain of K-Line's obligations under the shipbuilding contracts were assumed by LEL and some by Northern LNG and K-Line; the substance was that LEL became the purchaser of the vessels;

    (2) Headleases in respect of each vessel granted by LEL to Northern LNG under which each vessel was leased on finance terms for a primary period of 30 years from delivery, with a right for the lessees to renew the leases for one-year secondary periods. The effect of these leases was to vest the equity reversionary value in the vessels in Northern LNG;

    (3) Bareboat charters in respect of each vessel granted by Northern LNG to K-Euro under which K-Euro was entitled to possession and use of the vessels over the 20-year bareboat charter period. That period could, under options exercisable by K-Euro, be extended for a term of five years. The hire payable by K-Euro was fixed for the first 12 years and was expressed to be a fair commercial rate;

    (4) Time charter novation agreements between K-Line, the Snøhvit Sellers and K-Euro, under which the time charters entered into in respect of the vessels on 19 December 2001 were novated by K-Line to K-Euro, which became the disponent owner;

    (5) Detailed and complex security arrangements were put in place in order to safeguard the interests of the different parties and the flow of payments under the lease and ancillary arrangements.

14. K-Euro's business was expanded from 2002 onwards, in particular by the establishment of a bulk and gas carrier division. K-Euro took on charter, or undertook the management of, a number of LNG and bulk carriers.

15. With effect from 1 January 2006, K-Euro's business was reorganised, in a way involving the following steps:

(1) The K-Euro LNG business, apart from the leases in respect of the two vessels, was transferred to K-Line LNG Shipping (UK) Ltd, a fellow subsidiary ('K LNG');

(2) The Bulk shipping business was transferred to K-Line Bulk Shipping (UK) Ltd;

(3) A new company, K-Line (Europe) Ltd, was incorporated;

(4) The agency business in respect of the car carrier and container vessels was transferred to the new K-Euro company.

16. The effect of this was that whilst K-Euro retained its interest in the vessels under the bareboat and time charters, it contracted out the management of the vessels to K LNG and also transferred all other parts of its business to other fellow subsidiaries. In addition, the hire payable by K-Euro under the bareboat charters was, for a specified period, reduced. As a further part of this re-organisation, but not until October 2006, K-Euro's share capital was re-organised so that its shareholders (and their respective interests) corresponded with those of Northern LNG, and its shareholders contributed further share capital. The reason for this re-organisation was because it was expected that, contrary to original expectations, K-Euro would make a substantial loss in operating the vessels and because certain of the security arrangements with respect to the lease structure through which K-Euro held its interest in the vessels were proving to be a commercial restraint upon the management and development of K-Euro's other business interests.

17. The Arctic Discoverer was delivered to LEL in February 2006; the Arctic Voyager in July 2006. The leasing arrangements in respect of each vessel took effect upon their respective delivery. K-Euro changed its name on 3 February 2006 to Polar LNG Shipping (UK) Ltd, but I shall stick to its original name.

18. I can now approach the issues but must first introduce the legislation.

The applicable capital allowances legislation

19. Section 123 of the Capital Allowances Act 2001 ('the 2001 Act'), upon which the appeal turns, is in Chapter 11, 'Overseas Leasing'. That chapter is driven by a policy directed at limiting the extent to which the benefit of 25% UK writing-down allowances on the acquisition of capital assets can flow through to non-UK residents. Such benefit will typically do so if the obtaining of the writing-down allowance enables the asset to be leased to a non-UK resident at a lower rate than would otherwise apply.

20. With this policy in mind, section 109 of the 2001 Act limits the extent of the available writing-down allowance to 10% in cases to which it applies. It applies to expenditure on the provision of plant or machinery 'used for overseas leasing which is not protected leasing, …'. 'Protected leasing' is defined in section 105 and means (a) short-term leasing, as defined in section 121 (not in point here), or:

> '(b) if the plant or machinery is a ship, aircraft or transport container, the use of the ship, aircraft or transport container for a qualifying purpose under section 123 or 124 …'.

Paragraph (b) reflects the further policy in Chapter 11, by way of a qualification of its main policy, to encourage and support, inter alia, the UK's shipping industry; and this case is concerned with ships. Put simply, capital expenditure on a ship used for a 'qualifying purpose' will not be restricted to the 10% section 109 capital allowance limit. There is no question of section 109 applying to this case. That is either because the plant in play is ships used for a 'qualifying purpose' within the meaning of section 123, in which case the 25% allowance is available; or the plant was not so used, in which case it cannot even qualify for a 10% allowance under section 109.

21. It is section 110 that explains the circumstances in which neither a 25% nor a 10% capital allowance is available in respect of expenditure on plant or machinery, but no allowance at all is available. This will be the case where the expenditure is incurred on plant or machinery for leasing, the plant or machinery is used for overseas leasing which is not 'protected leasing', it is used otherwise than for a 'qualifying purpose' and it is a lease within any of the items there listed. If LEL is not entitled to 25% capital allowances under section 123, the effect of section 110 is that it is not entitled to any allowances.

22. Section 123, headed 'Ships and aircraft', provides as follows:

> ''(1) A ship is used for a qualifying purpose at any time when it is let on charter in the course of a trade which consists of or includes operating ships by a person who is –
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> (a) resident in the United Kingdom or carries on the trade there, and
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> (b) responsible for navigating and managing the ship throughout the period of the charter and for defraying –
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> (i) all expenses in connection with the ship throughout that period, or
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> (ii) substantially all such expenses other than those directly incidental to a particular voyage or to the employment of the ship during that period.
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> (2) Subsection (1) applies, with the necessary modifications, in relation to aircraft as it applies in relation to ships.
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> (3) For the purposes of subsection (1)(b) a person is responsible for something if he –
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> (a) is responsible as principal, or
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> (b) appoints another person to be responsible in his place.
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> (4) Subsections (1) and (2) do not apply if the main object, or one of the main objects –

(a) of the letting of the ship … on charter,

(b) of a series of transactions of which the letting of the ship … on charter was one, or

(c) of any of the transactions in such series,

was to obtain a writing-down allowance determined without regard to section 109 (writing-down allowance at 10%) in respect of the expenditure incurred by any person on the provision of the ship or aircraft.'

23. Sub-section (4) is an anti-avoidance provision. Subject to issue 4, there is no dispute that in principle LEL is entitled to the 25% writing-down allowances it claimed in respect of its purchase costs of the vessels. In particular, subject as aforesaid, there is no dispute that the vessels were used for a 'qualifying purpose' within the meaning of section 123(1), namely by being let on charter in the course of trade within such meaning. Putting it generally, the question raised by section 123(4), under issue 4, is whether 'the main object, or one of the main objects' of any of the transactions in question, 'was to obtain a writing-down allowance …'. If it was, the claim to the allowance fails because the ships will, *ex hypothesi*, not have been used for a 'qualifying purpose' and so will not satisfy section 123 at all. The FTT found in favour of LEL on this point, and the UT, albeit divided, upheld that decision.

24. Issue 3, however, raises a preliminary issue as to whether sub-section (4) applies to the present case at all. I turn to that issue.

Issue 3

25. LEL's point is that section 123(4) is, according to its express terms, directed only at a case in which the, or a, main object of any transaction or transactions falling within its sub-paragraphs (a), (b) and (c) is 'to obtain a writing-down allowance determined without regard to section 109 (writing-down allowances at 10%) …'. Thus the, or a, main object at which it is said to be directed is only one in which the aim is to achieve a 25% rather than a 10% allowance. There is no suggestion by HMRC that that was an object of any of the transactions in this case: it is agreed that, if obtaining a writing-down allowance was one of LEL's main objects (which LEL disputes), it was to obtain a 25% allowance rather than no allowance. As section 123(4) makes no comparable reference to section 110 (no allowances), it is said that the main object that HMRC attribute to LEL is not within the grasp of section 123(4) at all and so the subsection has no application.

26. LEL's proposition is beguilingly simple, if intuitively unattractive. It fell on stony ground with both tribunals below. Its consideration requires an explanation of the legislative antecedents to section 123(4).

27. The starting point is the Finance Act 1980, enacted when first-year allowances of 100% on expenditure on the provision of plant and machinery were available. Section 64(1), however, denied any such allowance unless the plant or machinery was to be used for a 'qualifying purpose' and section 64(2) defined when it would be so used. Section 64(5) provided that, without prejudice to subsection (2), a ship is used for a 'qualifying purpose' when let on charter in the course of a trade which consists of or

includes operating ships if the conditions in sub-paragraphs (a) and (b) are satisfied. Section 64(5) is, in its essentials, the forerunner of section 123(1) and (3) of the 2001 Act.

28. The Finance Act 1982 amended section 64(5) by providing that it was subject to the new subsection 6A. Section 64(6A) provided that section 64(5) did not apply if the main object, or one of the main objects, of one or more of various transactions, 'was to obtain a first-year allowance in respect of expenditure incurred on the provision of the ship …'. This was the forerunner of section 123(4) of the 2001 Act. It was, however, still only directed at, and concerned with, the obtaining of 100% first-year allowances.

29. I should refer also to section 70 of the Finance Act 1982, headed 'Allowances for assets leased outside the United Kingdom', and of which section 70(2) was the forerunner of section 109 of the 2001 Act. Section 70(2) provided that, in cases to which it applied, the relevant allowances legislation:

> '… shall have effect, subject to subsection (4) below, as if the reference in subsection (2) of section 44 to 25 per cent were a reference to 10 per cent'.

Section 70(4), there referred to, was the forerunner of section 110 of the 2001 Act and provided for the circumstances in which no first-year allowances, balancing allowances or writing-down allowances were available at all.

30. The Finance Act 1984 provided for the removal of first-year allowances with effect from 31 March 1986. The consequence was that, by the Finance Act 1986, section 64(1) of the Finance Act 1980 was repealed and section 64(6A) was amended so as to provide, materially:

> 'Subsection (5) above does not apply if the main object, or one of the main objects, of the letting of the ship … on charter, or of a series of transactions of which the letting on charter was one, or of any of the transactions in such a series was to obtain a writing-down allowance of an amount determined without regard to section 70(2) of the Finance Act 1982 in respect of expenditure incurred on the provision of the ship …'.

31. The Capital Allowances Act 1990 consolidated the earlier provisions. Section 39(6) is the forerunner of section 123(1) and (3) of the 2001 Act; and section 39(8) is the forerunner of section 123(4). Section 39(8) provides, materially:

> '(8) Subsection (6) above does not apply if the main object, or one of the main objects, of the letting of the ship … on charter, or of a series of transactions of which the letting on charter was one, or of any of the transactions in such a series was to obtain –
>
> > (a) …
> >
> > (b) if the expenditure in question is new expenditure, a writing-down allowance of an amount determined without regard to section 42(2),
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> in respect of expenditure incurred on the provision of the ship … '.

32. Section 42, 'Assets leased outside the United Kingdom', is the successor to section 70 of the Finance Act 1982. Section 41(1) provides, materially, that section 42 applies to expenditure on the provision of machinery or plant for leasing where the machinery or plant is used for the purpose of being leased to a person not resident in the United Kingdom and where the leasing is neither short-term leasing nor the leasing of a ship which is used for a qualifying purpose by virtue of section 39(6) to (9). Section 42(2) provides, materially:

> '(2) In their application to expenditure falling within subsection (1) above, sections 24, 25 and 26 as they have effect –
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> (a) in accordance with section 41, or
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> (b) in accordance with section 80, or
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> (c) in accordance with section 34, or
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> (d) with respect to any motor car to which section 35(1) applies, or
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> (e) with respect to machinery or plant to which section 35(1) applies,
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> shall have effect, subject to subsection (3) below, as if the reference in section 24(2) to 25 per cent were a reference to 10 per cent.'

33. There is no need to explain the various references in section 42(2), other than that to 'subsection (3) below'. Section 42(2) is the successor to section 70(2) of the Finance Act 1982 and the forerunner of section 109 of the 2001 Act, and provides for the circumstances in which only a 10% writing-down allowance is available; and section 42(3) is the successor to section 70(4) of the Finance Act 1982 and the forerunner of section 110 of the 2001 Act, and provides for circumstances in which no writing-down allowances at all are available.

34. The final legislative change was the enactment of the 2001 Act, described as 'An Act to restate, with minor changes, certain enactments relating to capital allowances'. In the 2001 Act, section 42(2) of the 1990 Act became section 109; and section 42(3) became section 110. There is, however, a difference in the drafting style of sections 109 and 110 as compared with that of their predecessors, in that section 109 is not expressed to be 'subject to section 110'.

35. Mr Peacock's submission was simple. It is that the key words in section 123(4) – 'without regard to section 109 (writing-down allowances at 10%)' – are there for a purpose, they cannot be ignored, they must be given their ordinary meaning and that meaning is that the only type of 'main object' at which section 123(4) is directed is one aimed at obtaining a 25% allowance rather than a 10% allowance. If the 'main object' is to obtain a 25% allowance rather than no allowance, such object is not caught by section 123(4) and so section 123(4) cannot stand in the way of a claim to a 25% capital allowance in respect of a ship used for a 'qualifying purpose' satisfying section 123(1). It is common ground that if a 25% allowance was not available in this case, no 10% allowance could have been available: the only alternative was no allowance.

36. The FTT regarded the position for which LEL was contending as absurd. It noted that Mr Peacock was unable to identify any ground of logic or policy to limit the application of the 'main objects' anti-avoidance provision in section 123(4):

> '357 … to the circumstances where the taxpayer's claim (if he is unable to show a "qualifying purpose") is to 10 per cent allowances and to let the more "mischievous" taxpayer (who is denied all allowances if he is unable to show a "qualifying purpose") escape its clutches.'

37. The FTT considered that the archaeology of the legislation ultimately enshrined in section 123 provided the answer to LEL's submission. The FTT referred to sections 39 and 42 of the Capital Allowances Act 1990, which had consolidated the earlier provisions. I have summarised their essential provisions above, and there noted that a key provision of section 42(2) was that it was expressed to be '*subject to*' section 42(3) (those subsections being the forebears of sections 109 and 110 of the 2001 Act). The FTT's reasoning continued:

> '361. … The reference to "a writing-down allowance of an amount determined without regard to section 42(2)" in section 39(8) is not to be seen as limiting the operation of section 39(8) to the situation where the 10 per cent allowances are available, but, because of the inter-related subsections of section 42, to the situation where there is expenditure which falls within subsection (1) of section 42 (which is expenditure which may qualify for 10 per cent allowances or nil allowances as subsection (2) has effect, including where it has effect subject to subsection (3)).
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> 362. In the course of re-writing these provisions as they appear in [the 2001 Act], sections 109 and 110 … have been "disconnected" – effectively each is made to stand alone, which has had the apparent consequence (unintended, since there was no purpose to change the law) of giving the reference to section 109 … in section 123(4) … a limiting significance which is not found in the corresponding reference to section 42(2) [of the 1990 Act] in section 39(8) [of that Act].
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> 364. We consider that we should construe section 123(4) … having regard to the provisions of which it is a re-statement, so that the reference to section 109 … does not have the limiting or restricting effect which on its face it has. That gives a sensible result which accords with the scheme of the legislation.'

38. In other words, since the FTT did not regard the 2001 Act as intended to achieve a material change in the law, it considered that its legislative antecedents justified reading section 109 as if, like section 42(2) of the 1990 Act in relation to section 42(3), it was to be read as being 'subject to section 110'. On that interpretation, there was no justification for reading section 123(4) as focused exclusively on section 109. The more natural sense was that if section 109 was anyway incapable of being in play, the reference to it would include a reference to section 110.

39. The FTT's alternative, rather simpler, conclusion was that, taking the language of section 123(4) at face value, the words 'determined without regard to section 109' anyway provided no help to LEL. The words 'without regard to' mean 'without taking into account' or 'without heed to'. If no account is to be taken of the position under

section 109, it matters not whether section 109 could or could not apply: it is immaterial. As the FTT put it:

> '364. … If what the taxpayer sought to obtain was a 25 per cent writing-down allowance then that does not involve an allowance that is determined under section 109 … – section 109 … is not in point. If section 109 … is not in point either because it could not apply or because it could only apply if 25 per cent allowances were not available, then the exercise of determining whether or not the taxpayer sought to obtain a 25 per cent writing-down allowance can be carried out without regard to section 109 …'.

40. The UT agreed with the FTT's conclusion. The UT said:

> '69. We agree with the FTT's conclusion [and it then referred to the passage I have quoted from paragraph 357 of the FTT's judgment] … In our view, all that section 123(4) requires is that a main object of a relevant transaction was to obtain a writing-down allowance other than an allowance such as section 109 provides for. Section 123(4) does not say – as it could have – that the subsection applies where a main object was to prevent a writing-down allowance being reduced to the rate laid down in section 109. As it is, the focus is rather on whether there was an attempt to obtain an allowance determined otherwise than by reference to section 109. In the circumstances, the subsection will apply where a main object was to obtain a 25% writing-down allowance regardless of whether a 10% allowance (under section 109) could have been an alternative: either way, the parties will have been seeking a "writing-down allowance determined without regard to section 109" since section 109 would have played no part in the determination of the allowance.'

41. I respectfully agree with the conclusion of both tribunals below on this issue. I should say that I do not regard section 123(4) as a cleverly drafted piece of legislation. To make the availability of a capital allowance dependent on what is ultimately the subjective intention of a party to a transaction is a recipe for dispute and litigation, no better illustrated than by what has happened in this case, namely a seven-day hearing before the FTT, a four-day hearing before the UT and a day and half's hearing before this court. Neither LEL nor HMRC can be criticised for wanting to litigate the point, but that our tax legislation should be written like this appears to me to be unsatisfactory. So far as concerns the particular point on which issue 3 depends, Mr Peacock urged that we must give effect to the key words in section 123(4), and in principle I agree. That, however, requires the court to determine what the words mean. The essence of his submission was that they mean, and mean only, that the relevant intention is to obtain a 25% writing-down allowance rather than a 10% writing-down allowance.

42. If that is a fair interpretation of the words, LEL might have an arguable point. In my view, however, it is not. Their ordinary meaning is not one requiring a comparative determination of the relevant intention. The question posed by section 123(4) is whether the main object (or one of the main objects) 'was to obtain a writing-down allowance determined without regard to section 109 (writing-down allowances at 10%)'. It is, I consider, an odd piece of drafting but in my view the inquiry raised by the chosen words is most naturally to be divined as being whether the main object was to obtain a writing-down allowance determined without *reference* to section 109: in

other words, whether the intention was focused on obtaining a writing-down allowance in the determination of which section 109 played no part. That is this case. If (which is disputed) the main object (or one of its main objects) was to obtain a writing-down allowance, it did not intend the allowance to be determined by reference to or with 'regard to' section 109. That, in my view, is all there is to it.

43. If I am wrong in that approach, I would anyway also agree with the first way in which the FTT was disposed to rule against LEL on this issue: namely, (i) that section 123(4) was not intended to make any substantive change to the prior law, and (ii) that its antecedents justified an interpretation of section 109 as if were expressed to be 'subject to' section 110. On that basis, even if (which I doubt) the key words in section 123(4) justify the attribution to them of a more positive reference to section 109 than I consider they do, the reference is anyway to be read as if it were a reference to section 109 'subject to' section 110. In other words, in a case in which the only writing-down allowances potentially available are 25% and 0%, there is no warrant for an interpretation of section 123(4) that confines the main object to one directed at obtaining a 25% allowance rather than a 10% allowance,

44. For these reasons, I would dismiss LEL's appeal on issue 3.

Issue 4

45. The issue here is whether the UT was correct to uphold the decision of the FTT that, by reference to the critical language of section 123(4), it was not the main object, or one of the main objects, of the letting of the vessels on charter, or of any series of transactions which included such letting, to obtain the 25% writing-down allowance claimed by LEL.

46. Before coming to the FTT's reasoning, it is material to refer to two matters. The first is its findings of fact under the heading *'The lease financing of the Vessels'*. I need to set these out in full.

> '218. Once K-Line was engaged in the tender process arranged by Statoil in 2001 it sought advice from a number of financial institutions as to the ways in which it might finance the purchase of the Vessels. Apart from other considerations, K-Line needed to have a good sense of possible financing costs in order to include, in its bid in the tender, a Capital Element within the hire rental in the proposed time charter to the Snøvhit Sellers. Consideration was given to debt financing, securitising ship rentals, and a variety of lease financing structures based in different jurisdictions.
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> 219. In September 2001 K-Line mandated a leasing arranger, New Boston Partners (a subsidiary company of a major Japanese bank), to arrange the financing of the Vessels. The London firm of solicitors, Watson Farley Williams, was engaged to provide legal advice.
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> 220. K-Line was advised on the benefits of a UK finance lease where capital allowances are available to the lessor. There was also discussion of the availability of the tonnage tax rules. K-Line had no previous experience of UK finance leases and relied on its advisers as to the requirements which must be met

if a UK finance lease lessor is to claim allowances, and the basis on which those allowances are reflected in the finance lease provisions and financing terms.

221. Both New Boston Partners and Watson Farley Williams advised in the course of autumn 2001 that a "bona fide UK shipping company" was required to operate the Vessels if the "qualifying purpose" conditions were to be met. They advised that such a company should, if possible, be a company owned by K-Line or by the joint venture partners having the economic ownership of the Vessels (i.e. the shareholders of Northern LNG). They advised that it would be necessary for the ship operator to be in place as from the delivery of the Vessels, and that it should be a ship operator and not merely a manager of the Vessels. They also advised that it would be helpful if the ship operator had a trading history and could demonstrate that the operation of the Vessels was an extension of its existing trading activities. This advice was specifically given with reference to the terms of section 123 [of the 2001 Act], including section 123(4) ….

222. In the early stages of the tender process K-Line had indicated to the Snøhvit Sellers that K-Euro would have a role in the management of the Vessels (to meet the requirement of the Snøhvit Sellers that the Vessels should be managed from a base in a European time zone). In those early stages the exact way in which K-Euro would carry out the role was not decided upon. From the discussions between K-Line and its advisers K-Line was aware that for capital allowances to be available it was necessary that K-Euro should operate (and not merely manage) the Vessels in the UK finance lease structure.

223. In the course of email exchanges between K-Line and its UK advisers in relation to these matters and the role of K-Euro, K-Line sought advice as to the "proper profit level" of K-Euro if it were to act as ship operator, and whether there was any UK tax requirement in this respect – a concern which K-Line had was that, given the limited LNG carrier market, there was little by way of example to judge levels of profitability for a ship operator (as against a ship manager). Based on that advice, it was anticipated that K-Euro would make a profit margin of about 10 per cent of the Operating Cost Element of the hire received under the time charter.

224. K-Line also sought advice as to whether the establishment of a bulk and gas division by K-Euro would result in K-Euro being a ship operator for the purposes of the UK capital allowances legislation, and, in that context, whether there was a critical timescale in which that division had to be established.

225. K-Line was also advised as to the risks which K-Euro should bear for it to comprise a ship operator which would satisfy the requirements of the UK capital allowances provisions, and that the costs flowing from such risks should they materialise could ultimately and indirectly be borne by the shareholders of K-Euro (including the Snøhvit Sponsors should they become such shareholders) by reason of their respective shareholdings.

226. At this time K-Line also considered entering into a joint venture with a third party ship management company with experience in managing LNG carriers, in order to establish a ship operator in the UK, using the expertise and business of the joint venture party to establish rapidly a full service shipping company with

> LNG expertise. That idea was rejected by K-Line on the grounds that it did not fit with K-Line's strategy for growth of the Bulk and gas businesses at local level within the K-Line group and that it might not be acceptable to Statoil. K-Line recognised that it would be necessary to grow K-Euro's business organically so that it could function as a ship operator.
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> 227. As mentioned, the documentation entered into between K-Line and the Snøhvit Sellers on 19 December 2001 anticipates that K-Line might wish to arrange financing of the Vessels in the form of a UK finance lease, and the leasing structure which that would likely require, including K-Euro as the disponent owner of the Vessels.
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> 228. In January 2002 prospective UK lessor banks were approached, including the Lloyds TSB group. They were advised of the shipbuilding and time charter arrangements in place and of the leasing structure which was proposed should the financing of the Vessels be effected by a UK finance lease. Prospective lessors were informed that the Vessels would be used for a "qualifying purpose" by reason of K-Euro, as ship operator, satisfying the requirements of section 123 [of the 2001 Act].
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> 229. On 16 April 2002 Lloyds TSB Leasing Ltd entered into heads of terms with K-Line and the other Snøhvit Sponsors and with Northern LNG setting out the terms under which it was prepared to offer a UK lease facility in respect of the financing of the Vessels, subject to negotiation of satisfactory documentation.
>
> 230. Negotiations were completed in September 2002 (by which time parliamentary consent had been obtained in Norway for the Snøhvit project), and the lease documents, as set out above, were entered into on 19 September 2002.'

47. The second matter to refer to is the decision of Vinelott J in *Barclays Mercantile Industrial Finance Limited v. Melluish (Inspector of Taxes)* [1990] STC 314, to which Mr Peacock QC, for LEL, had referred the FTT and upon which the FTT plainly placed reliance. *Melluish* concerned paragraph 3(1)(c) to Schedule 8 to the Finance Act 1971, which denied a first-year capital allowance on the purchase of plant in circumstances in which:

> 'it appears with respect to the sale, or with respect to transactions of which the sale is one, that the sole or main benefit which, but for this sub-paragraph, might have been expected to accrue to the parties or one of them was the obtaining of an allowance under Chapter I of this Act …'.

48. The Special Commissioners ruled in favour of the finance lessor's claim for first-year allowance in respect of expenditure incurred in purchasing films pursuant to a sale and leaseback financing transaction, and their decision was upheld by Vinelott J on appeal, who said, at [1990] STC 314, 343:

> 'Paragraph (c) as I see it is aimed at artificial transaction [sic] designed wholly or primarily at creating a tax allowance.'

49. It was common ground before this court that the inquiry as to whether there were circumstances of the type to which paragraph 3(1)(c) were directed ('sole or main

benefit') were not comparable to the different inquiry ('the main object, or one of the, main objects') required by section 123(4). Nevertheless, the FTT, having referred to *Melluish* in its summary of Mr Peacock's submissions in relation to issue 4 said:

> '377. The [*Melluish*] case shows that if the taxpayer claiming capital allowances is engaged in a commercial transaction where the allowances are nevertheless a significant factor in rendering that transaction commercially viable, obtaining the allowances is not a main purpose of the transaction.'

50. It is central to HMRC's criticism of the FTT's decision on issue 4 that, whilst that statement may have been a correct summary of the decision in *Melluish* in relation to the provisions of paragraph 3(1)(c), it was an incorrect summary of the different inquiry required by section 123(4). Yet the FTT's statement can perhaps be read as if it was there accepting that, also for the purposes of section 123(4), *Melluish* showed that if the obtaining of the disputed allowances is a significant factor in rendering the relevant transaction 'commercially viable, obtaining the allowances is not a main purpose of the transaction'. Moreover, as I shall explain, the FTT returned to *Melluish* in the course of its discussion as to the answer to the section 123(4) inquiry with which it was faced. *Melluish* was, in my view, of no assistance in answering that inquiry; and a critical question is the extent to which, if at all, the FTT was influenced in its ultimate decision by its reference to the approach identified by Vinelott J in *Melluish.*

51. I make clear that there is no doubt that, at [370], the FTT had earlier correctly summarised the effect of section 123(4), and, therefore, the question they had to determine. At [386], however, which was the second paragraph of their discussion of the rival arguments, they expressly adopted the submission of Mr Peacock for LEL that section 123(4) 'cannot have been intended to emasculate the incentives available through the capital allowances legislation by reason of section 123(1) …'. I would respectfully question the soundness of that observation, which perhaps carries with it what I would regard as an unwarranted suggestion that the ordinary interpretation and application of the inquiry mandated by section 123(4) must in some manner be diluted, whereas it would appear to me that, difficult though its determination may be in any particular case, the inquiry required by section 123(4) is clear. The FTT continued:

> '387. An incentive, by its nature, is designed to influence behaviour – to encourage a person to choose a particular course of action he might otherwise not have chosen to take. To an extent (and that extent will vary according to the circumstances of the person concerned) the obtaining of that incentive will be the prime motive for the course of action chosen. In some situations the incentive will be the prime motive, as where a taxpayer would not have made a particular capital investment without the benefits provided by capital allowances. In other situations the incentive will shape a transaction, rather than bring it about, as where a taxpayer intends, entirely for commercial reasons, to make a capital investment, and chooses to structure it one way rather than another so that capital allowances are available to him or to another person who can take the immediate benefit of those allowances. In yet other situations a taxpayer will make a capital investment entirely for commercial reasons, and the capital allowances will be a welcome, but incidental, benefit, perhaps influencing marginally the timing of the investment, but nothing more. There is a wide spectrum here, and every

taxpayer's circumstances will place him at a particular point in that spectrum. Section 123(4) [of the 2001 Act] must be applied with these factors in mind.

388. We consider, therefore, that it is not fatal to a taxpayer's claim to capital allowances, where that claim is based on section 123(1) …, that the taxpayer has taken steps which seek to secure or bolster his likelihood of obtaining those allowances. The question which has to be answered is whether a main object of the relevant transactions was the obtaining of those allowances, and this envisages that there may be a range of objectives motivating the transactions, and that they must be assessed in some sort of priority or hierarchy and then some basis applied to separate those which are of sufficient significance to count as "main" from those which are not. The issue is then which side of the line falls any objective of obtaining the allowances.'

52. As it seems to me, the alternative situations that the FTT was describing in the third, fourth and fifth sentences of [387] covered respectively: (i) a case in which the obtaining of the allowance was a main object; (ii) a case in which it may, or may not, have been a main object; and (iii) a case in which it will not be a main object. In [388], the FTT then explained that in any particular case there may be a hierarchy of objectives motivating the transaction, including the obtaining of a capital allowance, and that the inquiry must then be as to which of them are 'main' and which are not. I would not disagree with that approach.

53. The FTT then expressed its view, in [390], that, in determining the objectives of the transactions, and ranking them, the key factor was their commercial basis or justification, or the commercial purposes which were served for the parties in entering into the transactions. Before, however, considering the commercial purpose of the transactions, the FTT reverted to *Melluish* and it did so since it regarded that decision as supporting its view that a 'key factor' was the commercial basis of, or purpose served by, the transactions. The FTT devoted [391] to a summary of the issue in *Melluish* and said that paragraph 3(1)(c) of the applicable schedule in that case showed that 'the taxpayer finance lessor had to satisfy a "main object" test similar to that faced by [LEL] in this case'. With respect, I consider that the FTT was wrong to regard the 'main object' test in paragraph 3(1)(c) as similar to the 'main object' inquiry in section 123(4). The former inquiry was whether '*the sole or main benefit* which … might have been expected to accrue to the parties or any of them was the obtaining of [a first-year allowance]', (my emphasis), whereas the section 123(4) inquiry is as to whether 'the …, or *one of the* main objects' of the chartering of the ship, or of a series of transactions including such chartering, was to obtain the writing-down allowance' (again, my emphasis). The FTT explained *Melluish* by saying:

'391. Both the Special Commissioners and Vinelott J accepted the taxpayer's submission that its main object was to make a profit by acquiring and leasing the film, and this was so even though it was probable that it would not have been in a position to offer a lease on acceptable terms had it not been able to obtain and utilise the first-year allowances. Vinelott went further, stating: "Paragraph (c) as I see it is aimed at artificial transactions designed wholly or primarily at creating a tax allowance".'

54. The FTT turned to consider the transactions in the present case, in respect of which it recorded LEL's acceptance that the letting of the vessels on charter was one of the

series of transactions that were carried out. The transactions were entered into in September 2002, but the FTT noted that they were in contemplation at the 'preliminary stage', that is on 19 December 2001. The MOU recorded not just that K-Line would seek a UK finance lease by which to finance the purchase of the vessels or some other form of financing, but that the vessels would be operated by a company carrying on business as a ship operator in the UK, for which purpose Northern LNG would grant a bareboat charter and the time charter would be novated.

55. This showed in the FTT's view that, contrary to the Commissioners' case, K-Euro was not inserted into the structure in September 2002 once K-Line understood what was needed in order for capital allowances to be available, but that the structure implemented in September 2002 gave effect to what the parties had intended at the preliminary stage; and this was so even though K-Euro was not a party to the MOU, nor was it there identified as the ship operating company.

56. The FTT directed itself, in [396], that the objects of the transactions with which they were concerned should be ascertained at the time the documents effecting them were entered into: the relevance of later events was only that they might shed light on the parties' purposes or aims at that earlier time. The FTT considered, in [397], that December 2001 was the key point at which to ascertain the objects of the relevant transactions.

57. At [401], and taking what it called 'the broader picture', the FTT said it was clear that K-Line's broad objective of letting the vessels on charter was to achieve its particular commercial aim, namely that of pursuing the group's strategy of expanding its gas and bulk carrier business into the Atlantic Basin. It found that the broad objective of letting the vessels on charter 'was entirely to achieve a particular commercial aim'. The K-Line group also identified K-Euro as the entity within the group that would comprise its regional centre and would so develop its Atlantic Basin business. As the FTT said:

> '403. … K-Euro had an established presence in the UK and European coastal shipping market (but not in respect of bulk and gas carriers operating in the Atlantic Basin) and it was the natural choice of entity through which the K-Line group could realise its plans generally and specifically in respect of its involvement in the Snøhvit project.'

58. The FTT, at [404], summarised how the K-Line group recognised that if K-Euro were to achieve its ambitions, it would have to increase its capability very significantly, and the FTT had earlier described how it did so. The FTT said this development was largely carried out after September 2002, but the decisions to pursue that course, and the initial steps, were taken before September 2002, no doubt in part to convince the Snøvhit Sellers before the intentions of December 2001 became 'legal certainty' in September 2002 that K-Euro would be in a position to operate the vessels when they were delivered.

59. At [405] the FTT recorded Mr Ewart QC's submission, for HMRC, that, once K-Line was advised of the need for K-Euro to be a 'bona fide commercial UK shipping company' if the lease financing were to secure capital allowances, it set about creating a business that would pass the test. The submission was, therefore, that its one real,

predominant motive was to do what was necessary to secure the allowances. The FTT rejected that submission, saying that it:

> '405. … disregards the wider business aims of the K-Line group evident in its strategy, and it also disregards the commercial reality and substance of what actually happened. In the period up to the 2006 reorganisation K-Euro expanded its business in a genuine, methodical and commercial way and to a substantial extent. By the time of that reorganisation it had (in addition to the Vessels) nine bulk or gas carriers which it was operating or managing or which it was committed to operate or manage on their eventual delivery. To argue that such an enterprise was undertaken principally to give credence to a claim for capital allowances in relation to the Vessels was not sustainable.
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> 406. Again, therefore, taking the broader view we conclude that K-Euro's participation in the chartering of the Vessels was undertaken in order to pursue commercial objectives by entering into commercial transactions which were the more commercially attractive in that they were indirectly funded by financings whose costs were reduced by the tax allowances taken elsewhere.'

60. The FTT considered HMRC's argument that the 2006 reorganisation of K-Euro raised a question as to whether in reality K-Euro had a genuine commercial role justifying its participation in the leasing structure. The end result of such reorganisation was to leave it with the status of a 'mere husk of a company with a single part-time employee whose role was limited to company and regulatory compliance matters.' The FTT rejected the argument. They repeated that the point at which the 'objects of transactions' were to be judged was when they were entered into. There was no evidence that at that time any of the parties expected that such a reorganisation would be required. The principal reason for the 2006 reorganisation was the unexpected increase in the manning costs of the vessels, which it became apparent would leave K-Euro with substantial losses once it took delivery of the vessels. The FTT said that '[t]here is nothing to suggest that the remedial action was in any way welcomed by K-Line or K-Euro: it was an act of expediency required to deal with a serious commercial threat.'

61. The FTT concluded its reasoning on the section 123(4) issue as follows:

> '420. We conclude therefore that a main object of the letting of the Vessels on charter, and of the grant of the bareboat charter to K-Euro and the novation of the timecharter to K-Euro, was to secure for K-Euro a commercial benefit, that commercial benefit accruing from operating the Vessels on charter with the intention of realising a profit for K-Euro. We also conclude that K-Euro entered into those transactions as part of, and in order to achieve, a wider commercial objective, namely the development of its business, in pursuant of the business strategy of the K-Line group, of operating and managing ships transporting bulk and gas products within, or to and from, the Atlantic Basin.
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> 421. The question then is whether it was also a main object of the transactions to obtain the writing-down allowances. In arguing that this was so, the Commissioners pointed to the extensive and detailed advice as to UK tax and capital allowances which K-Line obtained during the period in which it was planning the arrangements for the financing of the Vessels.

422. The nature, extent and timing of that advice is set out in paragraphs 218 to 227 above. K-Line had no prior knowledge of the UK tax regime as it related to capital allowances, and relied on expert advice to assist it in its consideration of the funding possibilities available to it for the purchase of the Vessels. By the time K-Line entered into the Preliminary Stage in December 2001 it had concluded that a UK tax lease offered the most favourable funding option, and from January 2002 its advisers began the process of seeking possible finance lessors on the expressed basis that capital allowances would be available for their expenditure on the Vessels by reason of section 123 [of the 2001 Act].

423. What is clear from the extensive and detailed emails between K-Line (its finance department in particular) and its advisers is that K-Line required the most precise and thorough advice as to the conditions which had to be met in relation to the chartering of the Vessels if the capital allowances were to be available. Much of that advice related to what was required in order that a company should be a "bona fide commercial UK shipping company" (shorthand for a person who lets a ship on charter in the course of trade within the scope of section 123(1) ….). K-Line even sought advice as to the profit margin which such a company would be expected to earn.

424. [LEL] says that once K-Line was aware that in principle capital allowances were available for the financing of the Vessels within the context of arrangements which accorded with the K-Line group's commercial intentions, it was merely prudent for K-Line to satisfy itself that it could and would meet the complex "qualifying purpose" conditions.

425. The Commissioners say that the purpose of seeking such detailed advice, which spilled over into matters such as the profitability of K-Euro which were commercial matters entirely within the competence and experience of K-Line, was to tailor the structure of the leasing of the Vessels so as to give the basis for a claim for the capital allowances.

426. It is clear that K-Line was intent on securing finance lease funding of the Vessels. Such funding offered certain non-tax commercial benefits (such as full funding without any initial deposit) and a UK finance lease prospectively offered the further commercial benefit of reduced cost of funding by reason of the capital allowances available to the finance lessor and shared by means of reduced rentals. The parties, in entering into the transactions for the letting of the Vessels on charter, had as an objective that the capital allowances should be obtained. K-Line sought advice so that it knew what the circumstances and conditions were that must obtain or be met in order that that objective could be achieved. We would characterise K-Line's attitude in seeking advice as being one of due diligence – the course of action was decided upon, but needed to be as certain as it could before approaching prospective lessors that the arrangements it intended should be implemented would indeed secure the benefits to be derived from the capital allowances.

427. The objective of obtaining capital allowances was not a main objective of the transactions for the letting of the Vessels on charter. In our judgment the commercial objective we have identified above was paramount. Each transaction in the series of transactions relating to the letting of the Vessels on charter had a

> commercial purpose: it created an economic interest, transferred or shared a commercial risk, or was in pursuance of a genuine business endeavour. Overall, it is the case that the main objective of the transactions whereby, in September 2002, K-Euro took on the rights and obligations which would, on delivery of the Vessels, make it the disponent owner of the Vessels, was to achieve a commercial benefit distinct from, and not dependent upon, obtaining capital allowances. The capital allowances were a route to reduced cost of funds for the financing of transactions already decided upon. The parties knew this to be the case if the capital allowances proved to be available, and they wanted to obtain the benefit of such allowances, by ensuring that, in carrying out their commercial objectives, they would comply with the necessary conditions upon which the capital allowances were dependent. In terms of priority or hierarchy, that was subservient to, or of lesser importance than, achieving the commercial purposes of the relevant transactions.
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> 428. We therefore conclude that the obtaining of writing-down allowances was not the main object, or one of the main objects, of the letting of the Vessels on charter or of any of the transactions in a series of transactions of which the letting of the Vessels on charter was one.'

62. As I have said, the UT (to whose decision neither counsel made any reference in the oral argument to this court) was divided on whether the FTT had misdirected itself in its approach to the inquiry of whether or not the, or a, main object of the relevant transactions was to obtain the writing-down allowance. Newey J was satisfied that the FTT had applied the correct legal test and that it could not be said that there was no evidence to support its conclusions. Whilst Judge Nowlan agreed that the FTT had directed itself correctly as to the legal test in [370], he was of the view that:

> '112 … in 'the crucial paragraph 427 of the Decision, where the FTT concluded that the tax objective was not a major object, no explanation was given for this other than the feature that the commercial object was paramount.'

Judge Nowlan's view was, in short, that the FTT's reference to and reliance upon *Melluish* had confused the FTT in the different inquiry that it was required to carry out under section 123(4) of the 2001 Act. He said that:

> '121 … The FTT were clearly laying a trail in their early references to context and *Melluish,* all the attention was then given to commercial claims (not of itself at all objectionable of course), but there was no evaluation of the object, admitted to be an object, of obtaining the allowances. When the advice in relation to capital allowances was described as due diligence advice, simply designed to ensure that allowances available on a structure for commercial reason would indeed be available, Judge Nowlan considers this description to have been untenable. When the decision that the obtaining of the allowances was an object, but not a main object of the identified transactions, is then explained by reference to the primacy of the commercial objects, Judge Nowlan considers that it is principally by furthering and following the wrong trail laid in relation to context and *Melluish* that led the FTT to apply the test wrongly, as an error of law. When the question posed by section 123(4) all relates to the significance, as a main object or not, of the admitted object of obtaining the allowances, there must have been an error of law when the Decision failed to evaluate the significance of the tax advice, other

than by describing it "in terms of priority or hierarchy, … as subservient to, or of lesser importance than, achieving the commercial purpose of the relevant transactions".'

63. The extended arguments before us involved a minute dissection of the FTT's decision. The thrust of Mr Peacock's submission was that there was no doubt that the FTT had correctly directed itself as to the required inquiry under section 123(4) and equally no doubt that it found as a fact, as it was entitled to, that the obtaining of the capital allowances was not a main object for the purposes of the subsection. Mr Ewart advanced a wide-ranging series of submissions as to why the FTT had fallen into error, although by the time of his reply he confined himself to three propositions, namely that the FTT's error lay in (i) being influenced by *Melluish* into considering that, provided all elements of the transactions had a genuine commercial purpose, any object of also obtaining the capital allowances could not be a main object for the purposes of section 123(4); (ii) being also influenced by their erroneous assessment that section 123(4) could not have been intended to 'emasculate' the obtaining of the incentives available through the capital allowances legislation; and (iii) their failure to consider the section 123(4) inquiry by reference to the intentions of all the parties to the transactions.

64. I have come to the conclusion that, putting it at its lowest, there is a very real concern that the FTT misdirected itself in its approach to the section 123(4) inquiry and that its decision is too unsafe to be allowed to stand. The most striking feature of the FTT's decision is that whilst it is, on its face, as painstakingly meticulous and comprehensive as they come, when the decision comes down to an assessment of whether or not the obtaining of the capital allowances was a section 123(4) 'main object', it is virtually unreasoned. The FTT opened its crucial [427] by asserting that the objective of obtaining capital allowances was not a main objective. It does not, however, then explain *why* it made that assessment save by explaining that the commercial objectives of the transactions were paramount, with each transaction in the relevant series having a commercial purpose. The thrust of [427] was that the achieving of each of those commercial purposes was the primary objective, and that obtaining the capital allowances was, in terms of priority, subservient to or of lesser importance than achieving such commercial purposes. The FTT also said in [427] that '[t]he capital allowances were a route to reduced cost of funds for the financing of transactions already decided upon.' If, however, that was intended to suggest (and it may be that it was not) that the leasing arrangements that would enable the obtaining of the capital allowances were decided upon before it was realised that such allowances would be obtainable, that is inconsistent with the course of events that the FTT had explained in [218] to [230], which I have earlier set out.

65. The apparent deficiency in [427] is, in my judgment, that although the FTT was no doubt entitled to find that each transaction in the relevant series served a genuine commercial purpose, it does not follow that the obtaining of the capital allowances was incapable of also being *a* main object of the transactions, even if it was not *the* main object of the transactions. The FTT does not explain why it was not such a main object. In my view, the likely explanation for this omission is, as Judge Nowlan concluded, that the FTT was wrongly influenced by *Melluish* into the assessment that, provided all the transactions were entered into for genuine commercial reasons, the obtaining of the capital allowances was necessarily an immaterial, subservient

consideration. In my view, however, that does not follow. Even if each of the transactions was entered into for a genuine commercial purpose, it may still be the case that a main object of structuring them in the way they were was to obtain the capital allowances; and the FTT's findings in [218] to [230] might be said to provide a factual basis for a finding that it was.

66. For these reasons, I have come to the conclusion that the FTT's decision on issue 4 cannot be allowed to stand. I would allow HMRC's appeal, set the decision of the FTT aside and remit LEL's appeal to the same FTT (that is to say, the same two judges) for a re-consideration of issue 4. If the parties consider that we should make any further directions for the purposes of such remission, they are at liberty to make any suggestions they consider appropriate.

Lord Justice Patten :

67. I agree.

Lord Justice Kitchin :

68. I also agree.