[2017] UKUT 0418 (TCC)
Appeal number: UT/2016/0126

INCOME TAX – tax avoidance scheme – Partnership purchasing rights to dividends and receiving dividends – whether the purchase of dividend rights and receipt of dividends were transactions in the course of that trade – held no – whether certain fees in respect of tax advice were a deductible trading expense – held no – appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

CLAVIS LIBERTY FUND 1 LP
(acting through Mr D J Cowen) **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: MR JUSTICE MANN

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 18th July 2017

Andrew Thornhill QC and Jonathan Bremner, instructed by M&S Solicitors Ltd for the Appellant

Michael Gibbon QC and Imran S Afzal, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondent

DECISION

Introduction

1. This is an appeal from a decision of the First-tier Tribunal ("FTT") [2016] UKFTT 253 (TC)) delivered on 18th April 2016 by the members Judge John Walters QC and Elizabeth Bridge. In it they dismissed an appeal which was technically by Mr D J Cowen, a former member of the limited partnership known as Clavis Liberty Fund LLP ("Clavis") against a closure notice dated 1st February 2013. In that closure notice HMRC ("the Revenue") reduced a claim to trading loss of £60,942,061 to nil.

2. The claimed loss arose out of an artificial scheme (even Mr Thornhill QC, who appeared for the taxpayer Clavis, admitted that it had artificial elements) intended to generate a tax loss for members of Clavis (a Jersey limited Partnership) which they could then deploy in their tax affairs elsewhere. The loss was said to have been generated by the application of section 730 of the Income and Corporation Taxes Act 1988 ("ICTA"). I shall deal with the scheme below, but in essence it worked as follows. The plan of the Partnership was to buy the right to the bulk of dividends to be declared by a company known (for short) as Helios for a purchase price of £59,958,000. The amount of the dividends to which it would become entitled, when declared, would be £60,000,000, generating a profit of £42,000. The provisions of section 730 had the effect, according to the Partnership, of deeming the dividends still to be the income of the seller and not of the Partnership. If that is how the provisions work then the Partnership would bring in the cost of buying the dividend as an expense but would not bring in the actual fruit of the dividend as income. That is what is said to have given rise to the loss available to the members of the Partnership.

3. The questions arising on this appeal are in outline as follows:

(a) Was the transaction in question, as outlined above, a trading transaction? HMRC contended it was not, so none of the expenditure relating to the transaction falls to be taken into account for tax purposes, thus eliminating the loss. On this appeal this was described as Issue 1 (it was Issue 2 in the FTT).

(b) If the answer to Issue 1 is that it was indeed a trading transaction, then an issue arose as to the operation of section 730, and in particular whether it prevented the dividend, when received, from being treated as the income of the Partnership. If it allowed the income to be so treated then the loss would not arise. This was Issue 2.

(c) A question arose as to whether a sum of £761,000 odd, paid by way of tax advisory fees to a concern known as Mercury, were deductible in the tax accounts of the Partnership. They were incurred in relation to the planning and implementation of the scheme which gave rise to the transaction in question. In this appeal this was known as Issue 3.

4. Before the FTT there was a further issue (taken as Issue 1 there), namely whether any of the activities of the Partnership were trading (as opposed to investment) activities. The FTT held that the other activities were trading, and there has been no cross-appeal by HMRC on that. It therefore falls out of the picture for the purposes of this appeal. So far as this appeal is concerned it was accepted that if the taxpayer lost on Issue 1 then Issue 2 did not arise; it only arose if it were determined that the transaction in question in this case was properly viewed as a trading transaction. It was also common ground that Issue 3 was in effect automatically determined by the fate of Issue 1. If the transaction was a trading transaction then the fees were deductible as an expense. If it was not then the fees were not deductible.

5. At the end of argument on Issue 1 I was not persuaded that the FTT was wrong in concluding that the transaction was not a proper trading transaction for tax purposes. In those circumstances Issue 2 did not arise and I decided not to hear argument on it at that point. For the reasons appearing above it was not necessary to hear separate argument on Issue 3 anyway.

The transaction in question

6. The details of the transaction and all the surrounding transactions appear in the FTT Decision at paragraph 11 and following. Since that detail is publicly available I will not set it all out again here. An outline will suffice for the purposes of this Decision.

7. The transaction originated as a scheme devised by tax advisors known as Mercury. It is quite plain that the whole thing was designed to produce a substantial loss for tax purposes. A Credit Application form of S G Hambros Private Banking (created at some date before 20th December 2005) described its purpose, and the overall structure of the proposed scheme, thus:

> "to enable UK resident individuals to participate in the "Liberty Plan" which is a structure designed to mitigate income tax liabilities.
>
> The funds will be immediately used to establish a 'trade' in buying and selling UK or French gilt strips, US Treasury Bills or short term paper issued by banks rated AAA to AA-. These investments would be maturing within the loan period …
>
> After a short time the LP will use its funds to buy the right to a distribution from an arm's length third party ("the Seller"). Under UK tax provisions the consideration paid by the LP to the Seller will be a deductible amount for tax purposes, but the receipt of the distribution will be tax free and hence will not need to be treated as taxable income of the partners …

Following the purchase and receipt of the dividend, the LP will continue to trade in various investments as described above … ”

Thus was the dividend transaction intended to be, and it ultimately was, the centrepiece and effective raison d'être of the Partnership. The memorandum goes on to outline the various steps of the scheme. In substance those steps were what was ultimately implemented. That description of the steps indicates that the description of the Seller as being "arm's length" is inaccurate. The subsequent steps included the incorporation of a company specifically for the purpose of receiving money and declaring the dividend, and the steps indicate the level of control over the whole procedure. There is and was nothing arm's length about that.

8. The following paragraphs outline the steps in the scheme. In the description that follows the dramatis personae, and the abbreviations used in relation to the central characters, are as follows:

Schroders – Schroder Co Ltd – a bank.

Dickens – Dickens Ventures Ltd – a company incorporated in the BVI in 2004.

Helios – Helios Ltd – a Cayman Islands Company incorporated by Dickens on 6th January 2006

Mercury – Mercury Tax Strategies Ltd - tax advisors whose scheme this was.

Pirouet – Pirouet Investments Ltd – a BVI company which purchased the interests of the partners after the central transaction had played out.

Hambros – used generically to describe one or more members of the Hambros group, which lent some of the funds relevant for this transaction.

9. Clavis was registered in Jersey under the Jersey limited partnership legislation on 9th March 2006. Subsequently over 100 individuals were admitted to the Partnership. They subscribed over £62 million to its capital, mainly by borrowing. Most of that money was lent to the partners by Hambros; a relatively small amount was contributed by each of the partners personally (about £3.5m in aggregate). The loans were repaid as part of the cashflow arising from the scheme. An outline of the scheme is as follows.

(a) Previously, Helios had been incorporated by Dickens, and it was and remained at all times a subsidiary of Dickens. It seems to have been incorporated for the purposes of implementing the proposed scheme and for no other purpose. Its director was a Hambros appointee, demonstrating part of the control which the banks exercised (via security and other methods) over the moneys flowing around in this transaction.

(b) 104 individuals were admitted as limited partners subscribing over £62.6 million, principally funded out of loans made by Hambros (£59.7 million). About £3.5 million was paid as personally funded contributions.

(c) On 20th March 2006 Schroders lent £61 million to Dickens, so that Dickens could fund Helios and so that Helios could then pay the planned dividend.

(d) These moneys were paid to Helios on the footing that they were share premium moneys (and thus available for the declaration of dividends under Cayman law).

(e) On 30th March 2006 the sole director of Helios passed two resolutions resolving to pay two series of interim dividends totalling £61 million.

(f) On 31st March 2006 Dickens agreed to sell £60 million of the £61 million dividends declared to the Partnership for a price of £59,958,000.

(g) The dividend rights ought to have been purchased on 31st March (a Friday) but in fact the transaction did not complete until the following Monday when the Partnership paid the price and acquired the dividend rights. Neither the purchase price nor the amount of the dividend to be purchased was adjusted to take account of the delay.

(h) The relevant part of the dividends totalling £60 million was paid to the Partnership on 5th April 2006, thereby generating the £42,000 excess over the sums paid to Dickens for the right to have the dividend.

(i) Schroders were repaid by Dickens out of the moneys paid by the Partnership for the dividend rights, together with an addition of £1,000,000 from the dividends declared and fees of £710,000 payable under various arrangements (principally with Mercury) for having "facilitated" the transaction. Those fees had their origins in payments made by the partners (FTT decision paragraph 44).

(j) Hambros was repaid out of a sale of the Partnership interests a month or so later. On 19th May 2006 Pirouet purchased the limited partners' interests in the Partnership for a sum of just over £60 million and that was remitted to Hambros in repayment of the loans that Hambros had previously made (see above). In the intervening period Hambros was secured by a charge over the dividends received, which remained with the Partnership. Pirouet was connected with the transaction in that it was owned by a family trust whose ultimate beneficial owner was the managing director of Mercury. Pirouet was funded by Hambros in order to enable it to make its payment.

(k) At all times the banks which lent the money to facilitate the transaction (Schroders and Hambros) had security over various interests in order to ensure that money was only applied for relevant purposes and moneys would flow back to the banks so that they could be repaid. While I have mentioned the security that Hambros had over the dividend once paid, I have not set out details of the rest of that security; it is not necessary for the purposes of this appeal to do so. It is sufficient to note the tight security that the banks had at all times.

10. That is a sufficient outline of the transactions for the purposes of this appeal. The claim of the Partnership is that it is entitled to bring in the amount that it paid for the Helios dividends as an expenditure in its accounts, but is not obliged to bring in the amount of the dividends that it received because of the operation of section 730. For the reasons appearing above, I do not have to consider the effect of that section, but in order to understand the intentions of those propounding the scheme it will be useful to set it out here:

> "730. Transfers of rights to receive distributions in respect of shares.
>
> (1) Where in any chargeable period the owner of any shares ("the owner") sells or transfers the right to receive any distributions payable (whether before or after the sale or transfer) in respect of the shares without selling or transferring the shares, then, for all the purposes of the Tax Acts, that distribution, whether it would or would not be chargeable to tax apart from the provisions of this section –
>
> (a) shall be treated as the income of the owner … and
>
> (b) shall be treated as the income of the owner or beneficiary for that chargeable period."

11. Thus at the heart of the scheme was the operation of a section which seemed to move accounting for the receipt of the dividend away from the body that actually received it. It should be noted that all the steps of the scheme were all pre-planned, and the whole purpose of the transaction from its inception was to give rise to the loss which the Partnership now claims, though on the authorities there is a limit to the extent to which the planned fiscal consequences are relevant to the question that arose below and which arise here. The pre-planning and the various money circles that operated in relation to the Helios dividends distinguish this transaction from the other transactions which the Partnership entered into (as to which see below).

The other activities of the Partnership

12. The dividend transaction which is the subject of this appeal was not the only transaction entered into by the Partnership. As originally planned, and as described in the Hambros Credit Application, it was always intended that either side of the dividend transaction the Partnership would indulge in some trading. The memorandum reflects the fact that the funds provided by Hambros would be:

> "immediately used to establish a "trade" in buying and selling UK or French gilt strips, US Treasury Bills or short-term commercial paper issued by banks

rated AAA to AA-. These investments would be maturing within the loan period (indeed before the dividend is purchased)…"

And then later:

> "Following the purchases and receipt of the dividend, the [limited Partnership] will continue to trade in various investments as described above and subject to the same conditions as regards maturity, quality, hedging etc."

13. An Information Memorandum was published inviting subscriptions to the Partnership. It described the Partnership as having been established for the purpose of making a profit other than by means of investment, principally through the acquisition of short-dated fixed income receivables, dividends and the right to receive dividends. The minutes of a board meeting of the general partner for a meeting of 21st March 2006 described a trading strategy of improving "on the return then available to holding the funds on deposit with a bank (then around 4.1% per annum) with a similar level of risk by trading in short-dated highly-rated financial instruments including bonds and equity dividend rights".

14. Such acquisitions actually happened, though it is clear from the findings of the FTT that the Helios dividend transaction was the centrepiece of the Partnership business. The FTT recorded the other trades which were done in paragraphs 26, 30, 31 and 32 of its Decision. In brief, the pattern of this trading was as follows:

(a) In the period from 14th March to 5th April 2006 there were four trades. The fourth was the transaction which is the subject of this appeal. The other three were acquisitions of the nature described in paragraph 13 above and they rendered profits (rounded) of £17,700, £680 and £3,300 respectively.

(b) In the period from 6th April 2006 to 18th May 2006 there were 14 acquisitions of short-dated commercial paper all held to redemption. A profit of £257,000 resulted. The FTT found that the Partnership was conducting "a substantial business" in this period.

(c) Between 19th May 2006 and 29th September 2006 there were eight acquisitions of commercial short-dated paper which gave rise to a profit of £10,500.

(d) In its final period from 30th September 2006 to 30th April 2007 there were nine acquisitions resulting in a profit of £11,700 odd.

These other trades would seem to fit within the intended strategy of the Partnership as identified above.

The Decision of the FTT

15. In outline, the Decision of the FTT on the issues before it was as follows.

16. The FTT made clear and thorough findings of fact as to the various transactions conducted by the Partnership and in relation to the scheme, including the sale to Pirouet. I have summarised those facts above. Then it turned to the evidence of the witnesses. There was the evidence of Mr Derricott of Curzon Capital Limited, investment advisers to the Partnership. Mr Derricott also became a partner in the scheme. The FTT records (paragraph 64) that when pressed Mr Derricott said he hoped to receive a tax loss from the Partnership. At paragraph 69 it is recorded that Mr Derricott accepted that he understood the purchase of the Helios dividend rights was intended to produce a tax loss of £60 million and that in the context of the Partnership's trading strategy the acquisition of the dividend rights was "extraordinary", in the sense of not being "ordinary". The FTT also records the evidence of Mr Andrew Fitton, presented as an expert witness able to assist the FTT in determining whether the Partnership's business strategy could be considered to be a valid trading strategy. His evidence was that the Partnership had adopted a valid trading strategy. It was not investing.

17. The first issue which the FTT considered was whether or not the Partnership was carrying on a trade in the relevant accounting period. It found that it was, contrary to the contentions of HMRC (which had submitted that it was investing) and that ruling was not challenged by HMRC on this appeal (see above).

18. Having done that the FTT then turned to consider in turn the three further issues which I have identified above as being raised on this appeal. It decided in relation to the first of those issues that the transaction in question was not a trading transaction. On the section 730 point the FTT decided that the Revenue was correct and that that section did not have the effect for which the taxpayer contended. On the third of those issues (the Mercury fees) it decided that since the transaction in respect of which they were incurred was not a trading transaction then they were not deductible in computing the profit or loss from the trade. Then, as now, that third decision follows logically from the decision on the first of the three.

The FTT's reasoning on the "trade" point

19. This reasoning is set out in a section headed "Issue 2: discussion". The FTT appeared to approach its decision-making down two lines. The first appears in paragraph 101:

> "101. Although the thrust of Mr Goy's argument [for the Revenue] based on the '*Ramsay'* principle was directed at his case on Issue 3 (whether section 730 ICTA has the effect claimed by the Partnership) we consider it is relevant to this Issue (2), because a single composite transaction involving both the purchase of rights to dividends and the payments of those dividends pursuant to those rights cannot, in our judgment, be regarded as a trading transaction."

The second appears in the following two paragraphs:

> "102. To the same, or similar, effect, we have concluded that the principle in *Lupton* [ie *FA and AB Limited v Lupton* [1972] AC 634] does indeed cover this case…Lord Morris, giving the leading speech, was at pains to reject the proposition that the presence of a motive of securing tax recovery caused a trading transaction to cease to be such. However, he drew a distinction between trading transactions motivated by an intention to secure a tax advantage (as we consider the other transactions in short-dated securities in this case to have been) and transactions "so affected or inspired by fiscal considerations that [their shape and character] is no longer that of a trading transaction"…[further citations to the same effect].
>
> 103. In our judgment, these dicta apply to the transactions by which the Partnership acquired the rights to the Helios dividends from Dickens and subsequently received the dividends pursuant to those rights. These were not trading transactions carried out with a tax-avoidance motive – they were not trading transactions at all, but artificial arrangements entered into in order to enable the Partnership to claim a tax loss pursuant to its interpretation of section 730 ICTA. This is, in our view, cogently demonstrated by the fact that the delay in purchasing the dividend rights, from 31 March 2006 to 3 April 2006, had no effect at all on the purchase price (despite reducing from 6 days to 3 days the period before payment of the dividends). The fact that they sought for tax advantage originates in a particular interpretation of section 730 ICTA rather than from the intrinsic properties of the transactions themselves is, in our view, entirely beside the point. We consider that nothing in *Ensign Tankers* or *New Angel Court* precludes us from deciding (as we do) disposing of this Issue (2)) that the transactions concerned were not trading transactions at all."

The taxpayer's case on the appeal

20. Mr Andrew Thornhill QC for the taxpayer analysed that section of the Decision below as containing the two principal reasons just referred to. The first, contained in paragraph 101, was said to be wrong because it was based on the simple proposition that a single composite transaction of the kind described could not be regarded as a trading transaction. That was said by Mr Thornhill to be completely unfounded as a broad principle even if one was looking at it in a *Ramsay* context. He identified the second basis of the Decision as being one based on the considerations in *Lupton*, and while he accepted that that contained an intellectually justifiable approach, his essential point, when analysed, was that the FTT misapplied the test and came to the wrong result. He submitted that under that authority (to which I will come) trading transactions did not cease to be such merely because they were entered into in the hope of later taking tax advantage of the relevant law by making a claim for the recovery of tax. He said the approach in *Ensign Tankers (Leasing) Ltd v Stokes* (1992) 64 TC 617 (HL) 736 was to be preferred. The disputed transaction in

this case was a trade in the nature of the other transactions carried out by the Partnership and thus it fell on the *Ensign* side of the line. He claimed that the Tribunal had wrongly given some sort of primacy to the intended fiscal consequences of the transaction and ignored the effect of the dividend purchase transaction as a real trade. Since the disputed transaction was of the same nature, and was evaluated on the same commercial basis, as the other Partnership transactions, the principle in *Lupton* cannot operate. The point made by the FTT in relation to late payment was a red herring. Further, while he accepted that there were artificial elements in the transaction, the tax advantage which it was hoped that the transaction would give rise to was not the result of any particular artificial feature of the transaction itself; rather, it followed from the application of section 730.

The resolution of this appeal

21. I think that Mr Thornhill is right to view the FTT as having decided the case on two different bases. However, so far as the first of those is concerned I think that Mr Thornhill's analysis involves a misreading. The short paragraph 101 has to be read in its context. It refers back to Mr Goy's argument on the other main point in the appeal, and that is dealt with in the preceding (equally short) paragraph 100. There the FTT say:

> "100. Mr Goy also advanced an argument based on the '*Ramsay*' principle (*WTT Ramsay Limited v IRC* [1981] STC 174) to the effect that viewed realistically, the facts including the sale by Dickens to the Partnership of the rights to receive the Helios interim dividends and the payment of those dividends by Helios to the Partnership were a single composite transaction – and we have so found (see: above [56])."

Paragraph 56 points out that with one minor exception (the actual identity of the ultimate purchaser of the Partnership assets, Pirouet) all the arrangements had been pre-planned before the end of 2005. Funds were made available by Hambros and Schroders and were kept under the respective lenders' control (via security and the appointment of a Hambros nominee as director of Helios) at all times. The FTT then goes on to find that all the relevant steps were…

> "a single composite transaction or 'a series or combination of transactions, intended to operate as such' which may, in accordance with the report of the Appellate Committee of the House of Lords in *Barclays Mercantile Business Finance Limtied v Mawson* [2005] STC 1 at [30] be taken into account when the application of section 730 ICTA to the facts of this appeal is considered."

22. At paragraph 118, again in the context of considering the arguments about section 730, the FTT records Mr Goy's deployment of the *Ramsay* principle, inviting the conclusion:

> "…the transactions relied on by the Partnership in this case are not real transactions having commercial effect, but are both contrived and circular in

nature. He submitted that we should assume that Parliament only intended section 730 ICTA to apply to real transactions having commercial effect."

23. Those additional paragraphs have to be considered when one seeks to understand the rather condensed expressions in paragraph 101, although two of them are focused on the section 730 point. It is then clear enough what the FTT was saying. It was invoking the well-known *Ramsay* principle to say that this transaction was not a trade because, as a matter of construction, it was too artificial to be viewed as such. It is in that broader context that it invokes the "composite transaction" concept.

24. The criticism of this paragraph is accordingly misplaced. Mr Thornhill did not go on to criticise that deployment of the *Ramsay* principle, and the point did not figure much in the debate before me, but for my part there seems to me to be much to be said for the FTT's reasoning. However, it is unnecessary for me to develop this line of reasoning because it seems to me that at the heart of this point is a feature which it shares with the other way in which the FTT reached its decision, namely that it was not proper to treat the central transaction as being a trading transaction at all. Indeed, I find it hard to see the difference between the points. In any event, as a separate point it does not matter. If the Partnership fails in relation to the second way in which the FTT reached its decision, then it does not matter whether it wins on the *Ramsay* analysis. If it wins on this second way, then it seems to me to be inevitable that it would win on the *Ramsay* claim as well.

25. I therefore turn to the *Lupton* line relied on by the FTT. At this point I remind myself of the nature of the finding and the nature of this appeal. As Mr Gibbon QC, who appeared for HMRC, pointed out, the finding is essentially a finding of fact allied to a measure of judgment. Unless the appellant can identify an error of principle, or unless it can be established that the FTT's view was so unreasonable that no reasonable tribunal could take that view, then this appellate tribunal cannot and should not interfere. As will appear, in my view the appellant cannot establish either of those matters. In their Decision the FTT identified the right cases and the right principles. I do not consider that there is a case for saying that the results of their application of the principles to the facts is unreasonable in the sense just stated.

The principles applicable

26. *Lupton* was a dividend stripping case in which shares were acquired, a dividend paid and the then reduced value of the shares was then used to generate a loss which was used to offset tax. The House of Lords held that this was not a share dealing transaction but was one used to facilitate a tax benefit (to describe the findings in general terms). What the House of Lords had to consider was whether, and in what circumstances, something which might look like a trade, or even have the attributes of

a trade, was in fact disqualified from that appellation because of the circumstances, including the intended taxation consequences. Various of their Lordships reasoned differently but the thrust is the same, namely that while the presence of a tax benefit does not necessarily disqualify a transaction from being a trade for tax purposes, the transaction itself in its circumstances may have characteristics which prevent its being viewed as a trading transaction. Thus Lord Morris said:

> "Ought it [ie the transaction in question], when viewed fairly and rationally, to be classed as a trading transaction coming within the trade of a dealer in shares? Ultimately this becomes a matter of judgment." (p644E)

I note the description of its being "a matter of judgment". That emphasises the nature of the decision of the FTT and the circumspection which an appellate court ought to bring to bear when considering it.

27. Lord Morris acknowledged that a taxation motive by itself was not sufficient.

> "But, my Lords, once it is accepted, as it must be, that motive does not and cannot alter or transform the essential and factual nature of a transaction it must follow that it is the transaction itself and its form and content which are to be examined and considered. (p646G) …
>
> "It is manifest that some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction. The result will be not that a trading transaction with unusual features is revealed but that there is an arrangement or scheme which cannot fairly be regarded as being a transaction in the trade of dealing in shares. (647G)"

And he adopted some previously expressed views of Megarry J:

> "There are, therefore, cases where, as Megarry J. indicated, the fiscal element has so invaded the transaction itself that it is moulded and shaped by the fiscal elements. This was helpfully expressed by Megarry J. as follows ([1968] 1 WLR. 1401, 1419):
>
>> "If upon analysis it is found that the greater part of the transaction consists of elements for which there is some trading purpose or explanation (whether ordinary or extraordinary), then the presence of what I may call 'fiscal elements,' inserted solely or mainly for the purpose of producing a fiscal benefit, may not suffice to deprive the transaction of its trading status. The question is whether, viewed as a whole, the transaction is one which can fairly be regarded as a trading transaction. If it is, then it will not be denatured merely because it was entered into with motives of reaping a fiscal advantage. Neither fiscal elements nor fiscal motives will prevent what in substance is a trading transaction from ranking as such. On the other hand, if the greater part of the transaction is explicable only

> on fiscal grounds, the mere presence of elements of trading will not suffice to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an artificial structure, remote from trading and fashioned so as to secure a tax advantage, the mere presence in that structure of certain elements which by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure."" (p648B-E)

28. It is apparent for these purposes that one can look at the overall scheme. Having referred to those features in his case (going beyond the mere purchase of the shares in question) Lord Morris said:

> "It is apparent, therefore, that the transaction was not one in which any possible tax consequences resulting to a purchaser of shares would be his concern and would be no concern of the seller of the shares but it was one in which there was a carefully worked out scheme which (in the hope of mutual financial benefit) was shaped and moulded by the fiscal possibilities." (p649A-B)

And he ended by saying:

> "It would be a complete delusion to regard the transaction in this case as a share dealing transaction coming within the area of trade of a dealer in shares. It was something very different." (p650F)

Those were apparently the principles applied by, and reflected the approach of, the FTT although it did not set out all the dicta verbatim (see paragraph 102).

29. Lord Guest expressed his view as to the nature of the transaction, having expressed agreement with Lord Morris:

> "I have read the speech of my noble and learned friend, Lord Morris of Borth-y-Gest, where he analyses the features of the transactions in the present case. I do not repeat them but I think they show clearly that the transactions in which the appellants were engaged were not the transactions of a normal trade in share dealing. The shares were not bought as stock in trade of a dealer in shares but as pieces of machinery with which a dividend-stripping operation might be carried out." (p651D)

30. Viscount Dilhorne considered some of the circumstances surrounding the actual purchase and reflected on their relevance in trenchant terms:

> "On these facts the operation in which the appellants engaged cannot, in my opinion, be regarded as one which came within the scope of the trade of a dealer in stocks and shares. This is not a case where the appellants sought to make a profit by the exercise of their trade. The sale agreement shows that that was not contemplated. In my view, it would be wrong to hold that the shares were

> acquired for the purpose of and in the course of carrying on their trade unless it was established that the implementation of schemes for extracting money from the revenue forms part of the trade of a dealer in stocks and shares - and the appellants did not have the temerity to argue that that was the case." (p654A-D)

And he returned to the overall manner of implementation of a scheme thus:

> "My Lords, if a transaction viewed as a whole is one entered into and carried out for the purpose of establishing a claim against the revenue under section 341, I for my part would have no hesitation in holding that it does not form part of the trading activities of a dealer in stocks and shares.
>
> When I say "viewed as a whole," I mean that regard must be had not only to the inception of the transaction, to the arrangements made initially, but also to the manner of its implementation." (p657C-D)

31. Lord Donovan contrasted the case before their Lordships and "the case where the fiscal advantages are incidental".

32. Lord Simon set out some principles:

> "(1) the question in every case is whether the relevant loss has been incurred in the course of trade (of dealing in shares); (2) dividend-stripping (or any other transaction to secure a fiscal advantage) is not in itself part of the trade of dealing in shares (cf. also *Inland Revenue Commissioners v. Dowdall, O'Mahoney & Co. Ltd.*[1952] A.C. 401); (3) share-dealings and other business transactions vary almost infinitely; and to determine whether the transaction is, on the one hand, a share-dealing which is part of the trade of dealing in shares or, on the other, merely a device to secure a fiscal advantage, all the circumstances of the particular case must be considered; (4) a share-dealing which is palpably part of the trade of dealing in shares will not cease to be so merely because there is inherent in it an intention to obtain a fiscal advantage, or even if that intention conditions the form which such share-dealing takes; (5) what is in reality merely a device to secure a fiscal advantage will not become part of the trade of dealing in shares just because it is given the trappings normally associated with a share-dealing within the trade of dealing in shares; (6) if the appearance of the transaction leaves the matter in doubt, an examination of its paramount object will always be relevant and will generally be decisive (see also *Iswera v. Inland Revenue Commissioner* [1965] 1 WLR 663, especially at p. 668). The foregoing is merely an elaboration of what was said by Buckley J. in *Cooper v. Sandiford Investments Ltd.* [1967] 1 WLR 1351, 1361 and by Megarry J. at first instance in the case under appeal ([1968] 1 WLR 1401, 1417B, 1418F and 1419E-1420A)"

33. The FTT did not set out all those extracts but clearly had them in mind – see its references in paragraph 102. Applying them, the FTT came to the conclusions expressed in paragraph 103 – the transactions in the present case did not have the

character of trading transactions. They were artificial transaction intended to generate a tax loss.

34. The FTT did not consider that two further authorities cited by the taxpayer affected that conclusion. Mr Thornhill cited them to me too.

35. In *Ensign Tankers (Leasing) Ltd v Stokes* [1992] AC 655 the transaction in question involved a film which was financed in part by a partnership and in much greater part by a non-recourse loan (repaid out of the receipts from the film). A question arose as to whether first year allowances could be claimed based on the total cost of the film. Beyond that the detail does not matter for present purposes. Lord Templeman addressed the question of the relationship between a complex scheme and its fiscal consequences in terms relied on heavily by Mr Thornhill:

> "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… (p676H) …
>
> 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." (p676)

36. It must be remembered that the point in that case was different from that in *Lupton*. In that case the proper analysis of the transaction was that there was trading, and there was trading expenditure of $3.25m (not, be it noted, the balance of the expenditure which was made up of the non-recourse loan). The existence of a tax motivation did not prevent that transaction, to that extent, being held to be one which was capable of operating, for tax purposes, as the participants intended and in accordance with the tax scheme. That, however, does not mean that the analytical exercise required by *Lupton* should not be carried out. The principles in *Ensign* do not undermine the FTT's carrying out of that exercise.

37. The significance of a fiscal motive was made clearer in *New Angel Court Ltd v Adam* [2004] 1 WLR 1988. In that case an intra-group transfer of investment properties took place at market price from one company in the group to a group trading company in order to avoid incurring a loss in the first company. The question that arose was whether the second (trading) company had acquired it as trading stock so as to be able to benefit from a group loss on acquisition. There were clearly taxation motivations involved in the intra-group transaction, but that was held by the Court of Appeal not to prevent the assets being acquired "as trading stock" (which was the important statutory requirement for the purposes of that case). Jonathan Parker LJ cited *Ensign Tankers* and said:

"93. In my judgment, therefore, the mere fact that a group of companies sets out to avail itself of the opportunity of obtaining a fiscal advantage which Parliament has itself provided says nothing as to whether the requirement which Parliament has imposed as the condition of obtaining that fiscal advantage - that is to say that the asset in question must be acquired "as trading stock" - has been fulfilled. It would, as it seems to me, be strange if it were otherwise. Indeed, I find it hard to conceive of a situation in which an asset is acquired under an intra-group transfer "as trading stock", and an election made to convert the capital loss into a trading loss, where fiscal considerations have not played some part in the thinking of those concerned in planning or executing the transaction.

94. So in my judgment fiscal considerations, whether they be described in terms of motive, purpose, or object, must be put entirely on one side in considering whether an asset was acquired "as trading stock" for the purposes of section 173(1).

95. That is not to say, however, that an investigation into the *purpose* of the acquisition is not required. It is plain from *Coates v Arndale Properties Ltd* [1984] 1 WLR 1328 and *Reed v Nova Securities Ltd* [1985] 1 WLR 193 that such an investigation is required. As Lord Templeman made clear in the *Reed* case (in the passage from his speech quoted in para 32 above), not only must the asset which has been transferred be "of a kind which is sold in the ordinary course of the company's trade" but it must have been acquired by the taxpayer "for the purposes of that trade with a view to resale at a profit". It is therefore necessary to consider the purpose of the transfer. Was it for the purposes of the taxpayer's trade? Or, to put it another way, did acquisition of the asset have *a trading purpose* ?

……

98. In my judgment, therefore, section 173(1) does not require the absence of fiscal considerations as elements in the acquisition of the asset in question: rather, it requires the presence of a trading purpose. As *Coates v Arndale Properties Ltd* and *Reed v Nova Securities Ltd* demonstrate, a trading purpose is not negatived by the presence of fiscal considerations: to use Megarry J's word (in *Lupton's case* [1972] AC 634) the existence of fiscal considerations will not "denature" a trading purpose, just as the existence of fiscal considerations will not prevent what would otherwise be a trading transaction from being regarded as such for the purposes of section 173(1).

99 At the heart of the matter, as it seems to me, is the need to recognise that in the context and for the purposes of section 173(1) a trading transaction may be dictated entirely by fiscal considerations, without losing its character as a trading transaction (see, in particular, Lord Templeman's reference to "sound commercial reasons" in the passage from his speech in *Coates's* case quoted in para 90 above)."

38. Mr Thornhill did not go quite so far as to say that this authority meant that the FTT and the court had to be blind to all fiscal considerations. That, in my view, cannot be what Jonathan Parker LJ meant. While paragraph 94 might be thought to suggest blindness, paragraph 95 allows an inquiry into purpose. If tax considerations play a part in the purpose then the court does not necessarily totally ignore them, but they cannot denature a concurrent trading purpose. But if the fiscal purpose is, for example, the real purpose, and a suggested trading element, in terms of purpose, is no more than a fig leaf, then it can be concluded that there is no trading purpose. If one is investigating purpose then one cannot investigate all purposes except one; one investigates all possible purposes, and that could include a fiscal purpose. That is consistent with Jonathan Parker LJ's reliance on and citation of *Coates v Arndale* [1984] 1 WLR 1328 in his paragraph 98 (and elsewhere). In that case Lord Templeman said:

> "In my opinion Arndale never decided to acquire, and never did acquire, the lease as trading stock. The group's advisers procured the transfer of the lease from SPI to Arndale and from Arndale to APTL with the object of obtaining group relief of £2.2 million trading loss without in fact changing the lease from a capital asset to a trading asset. The group seeks the advantage of treating the lease as trading stock while ensuring that the group retains the lease as a capital asset at all times. Arndale followed instructions and lent to the transaction its name and its description as a property-dealing company. Arndale did not trade and never had any intention of trading with the lease. In order to give the whole transaction a faint air of commercial verisimilitude, the trading company Arndale was awarded the modest sum of £10,000 for entering into two assignments of property worth over £3 million. The award of £10,000 was ostensibly made at the expense of APTL which paid Arndale for the lease £10,000 more than the price paid by Arndale to SPI. In reality the award of £10,000 was made at the expense of SPI which sold for £10,000 less than the market value assessed by the group. The profit of £10,000 did not represent the difference between the price at which Arndale negotiated the purchase and the price at which Arndale negotiated the sale. The profit of £10,000 did not represent the difference between the value of the lease to SPI and the value of the lease to APTL. The profit of £10,000 was a timid veil designed to conceal the fact that the lease was not being traded. Moreover, all three companies being wholly owned subsidiaries of the same parent, the £10,000 was a book entry which had no material effect on the overall financial position of the group." (at p1333 C-G).

39. The second sentence of that passage indicates that some investigation of purpose can be made even if it turns out to be a tax purpose. What Jonathan Parker LJ is in my view saying is that a taxation purpose does not of itself determine the nature of the transaction if the question is whether the transaction is a true trade or not. His statements are not inconsistent with the proposition that a fiscal purpose, in the circumstances, can be determined to be the antithesis of a trading purpose to such an extent that the transaction does not have the qualities of a real trade – the *Lupton* inquiry.

40. At paragraph 106 of *New Angel* Jonathan Parker LJ approved a summary of the legal position set out by Lawrence Collins J in the decision appealed from, subject to 2 qualifications. That summary is set out in paragraph 68 of the Court of Appeal judgment:

> "To summarise: (1) Parliament has conferred on a group of companies power to convert an allowable loss into a trading loss which could then be shuffled to secure a tax advantage. The only requirement was that there must be an acquisition by a trading company 'as trading stock': *Reed v Nova Securities Ltd* [1985] 1 WLR 193, 202. The onus is on the taxpayer to show that the property was acquired as trading stock: at p 199. (2) Fiscal motive (even if it is the sole or paramount motive) will not denature what would otherwise be a commercial transaction: especially *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655 , 676–677; *Reed v Nova Securities Ltd* [1985] 1 WLR 193 , 197, 202. (3) But if the essence of the transaction is explicable only on fiscal grounds, then the mere presence of trading elements will not turn it into a trading transaction: *Lupton v F A and A B Ltd* [1972] AC 634. Some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction: *Lupton* , *Coates v Arndale Properties Ltd* [1984] 1 WLR 1328, 1333. (4) For this purpose, it is necessary to look at the transaction as a whole: *Coates v Arndale* at pp 1332–1333; *Overseas Containers (Finance) Ltd v Stoker* [1989] 1 WLR 606 , 614–615. (5) The transaction, to qualify, must have some commercial justification or conceivable reason: *Coates v Arndale* [1984] 1 WLR 1328, 1332–1333; *Reed v Nova Securities Ltd* [1985] 1 WLR 193 , 202; *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655, 679. (6) The asset must not only be of a kind which is sold in the ordinary course of the company's trade but must also be acquired for the purposes of that trade with a view to resale at a genuine profit: *Coates v Arndale* [1984] 1 WLR 1328 , 1332–1333; *Reed v Nova Securities* [1985] 1 WLR 193 , 200, 202; *Ensign Tankers* [1992] 1 AC 655 , 679. (7) Whether the circumstances of the transaction are normal is relevant, and in cases of doubt the taxpayer should be required to prove its case by evidence: *Reed v Nova Securities* at pp 195, 199. (8) Whether there is a profit in the transaction, or whether it has a commercial justification, are important elements in determining whether the transaction is a commercial one. If there is no profit or no commercial justification, then the acquisition will not normally be of trading stock. But the fact that there is a profit, or the fact that there may be some 'conceivable reason' for the transaction does not necessarily mean that it was acquired as trading stock. (9) What is trading, or what is trading stock, is a matter of fact for the general or special commissioners, and their conclusion is only subject to review in accordance with the principles in *Edwards v Bairstow* [1956] AC 14 (itself a case on whether a transaction was an adventure in the nature of trade)."

41. The second qualification does not matter for present purposes. The first qualification which Jonathan Parker LJ said should be applied to that summary is the effect of his own judgment at paragraphs 87 to 99, the material parts of which I have set out above. I confess it is not wholly clear to me which parts of the Lawrence Collins J's formulation fall to be qualified by those paragraphs, but the overall approach of that judge again does not require complete blindness as to fiscal motives.

The application of those principles to the facts found by the FTT and the appellant's criticism of the decision

42. The FTT clearly applied what was set out by the House of Lords in *Lupton* (see paragraph 102) in arriving at its conclusion in paragraph 103. It was entitled (and obliged) to do so. It equally plainly had *Ensign Tankers* and *New Angel Court* in mind – see the closing words of paragraph 103 and the recording of submissions on those cases in paragraphs 86 and 96. I do not consider that its decision contravened the principles in either case. Although paragraph 103 refers to the motivation (and was entirely correct, as a matter of fact, in that conclusion) it did not reason that the motive was tax avoidance and *therefore* the transaction was not a trading transaction. The reasoning is shortly expressed but that is not what it is saying. The FTT were saying that the transaction was artificial and therefore not a trading transaction. That is demonstrated by the example that it gives (the late payment of the consideration). The FTT is illustrating artificiality there, not tax avoidance. Its consideration of all the circumstances of the transaction inevitably required it to note, at the very least, the taxation motive, and it was justified in doing so, but it did not go on to elevate that factor to some impermissible status. It was doing what *Lupton* required and justified.

43. Mr Thornhill criticised the particular example given by the FTT to demonstrate artificiality, saying that the delay in paying the money was probably explicable by banking delays and it was not surprising that one working day's delay did not lead to a re-negotiation of the price. That criticism is in my view misplaced. While it might be that the example given by the FTT is not be the best example, it is not a wholly bad one. The transaction was calculated so as to give the Partnership a certain return on its money. If its seller had been an arm's length seller that seller might well have sought to change the price when it was deprived of half the period during which it should have had its money and if it was to forgo the dividend to which it would otherwise have been entitled just a few days later. That did not happen, and it is obvious from the structuring of the arrangements that there is no question of its ever happening. That is because the arrangements were not an arm's length commercially negotiated deal. But of more significance for present purposes is the fact that the FTT demonstrated by this example that it was looking at the overall factual picture and the nature of the transaction or transactions, not relying impermissibly on the tax avoidance aspect or motive.

44. Mr Thornhill's other main submissions revolved principally around his criticism that the FTT had wrongly concluded that fiscal considerations were sufficient to mean that the transaction was not a trade. For the reasons given that is not a fair criticism. That is not the basis of the FTT's decision. He went on to seek to maintain that the

transaction was not artificial and was in line with the Partnership's trading strategy, pointing to the evidence given by Mr Derricott. I have already observed that the question which the FTT had to decide was an assessment based on findings of fact, and that an appellate court should not lightly interfere, and then only on *Edwards v Bairstow* principles. In my view there is no basis for interference in line with those principles with the carefully set out and reasoned decision of the FTT.

45. In support of the relevance of his submission that the subject transaction was in line with the Partnership's trading strategy and was evaluated in the same way, Mr Thornhill's skeleton argument relied on *Commissioners of Inland Revenue v Livingston* (1926) 11 TC 538. A ship repairer bought a ship, worked on it and sold it as a profit. The question which arose was whether this was a venture "in the nature of trade" bearing in mind that the business of the taxpayer did not involve deals of that nature. Lord Clyde said (at p 542):

> "I think the test which must be used to determine whether a venture such as we are now considering is, or is not, "in the nature of trade" is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made."

His case was that that exercise in the present case meant that the transaction was a trade. However, his reliance on this case, like all his other submissions about the nature of the transaction, focused just on the bare facts of the acquisition of the dividends for money and ignored the rest of the background. That is not the correct approach. When one looks at the rest of the background it is quite apparent that the purchase of the Helios dividend was nothing like a normal arm's length dividend purchase. It was the purchase of a dividend in a company set up for the express purpose of being funded to pay the dividend and then paying it, by a holding company which provided the funds in the first place. Loans were in place which funded the various circles of moneys and which were carefully structured to make sure that the lenders had control of the money at all times as it moved through its pre-defined circle, and the director of the declaring company was a lender's nominee. There is nothing at all normal about that structure. True it is that the transaction narrowly viewed yielded a profit of about £42,000, but (and this in my view is very significant) it was conceded by Mr Thornhill that when one looked at the closed nature of the funding in the transaction, that £42,000 must have originated in moneys that the Partnership itself had put in in the first place. Bearing in mind the money flows, there was nowhere else it can have come from, though the particular flow that got it there cannot necessarily be identified. The closed nature of the flows means that the Partnership must have provided it. It is an odd trade where the trader finances his or her own profit. In my view it is appropriate to use Lord Templeman's phraseology in *Coates v Arndale Properties Ltd* [1984] 1 WLR 1328, and to describe the paper profit as a "timid veil".

46. The much vaunted evidence of Mr Derricott does not assist the taxpayer. Mr Derricott's cross-examination (to which I was taken) showed the limits of his

function. It seems he was presented with the proposed transaction and asked to consider "the merits of the minimum yield of the dividends in comparison with the rate specified in the fund's trading strategy". He said that having studied the proposed arrangement:

> "… it seemed to us to be directly comparable with all the other instruments we'd been trading".

47. While he went on to suggest that he had been party to some sort of negotiation with Dickens, it was not clear what that was or that it was of any significance to the terms or nature of the overall deal which had been previously set up. His evidence in no way detracts from the artificiality of the arrangements, or from the differences between the arrangements and what one would call a normal arm's length deal.

48. There is another factor which, to my eyes, is strongly indicative against this being a normal trading transaction. As recorded in paragraph 49 of the FTT decision, all the partners lost their personal contributions to the capital of the Partnership (over £3.5m in aggregate) and there was no evidence of any complaint about that or to the effect that the Partnership had performed badly in relation to this transaction. The FTT found that the limited partners regarded their personal contributions to the capital as payment for tax losses which they hoped would result from the arrangements. Although the Partnership had trades other than the subject transaction, as always intended, it is plain that the subject transaction was, as I have observed, the centrepiece of the purpose of the Partnership. It would seem that the partners put up their money for that purpose knowing that they would not get it back as such, and they did not get it back. That is not indicative of a genuine trade; it is indicative of something else. The actual characterisation does not matter; it suffices that it was not a trade.

49. All the other indicia of this not being a trade are set out in the FTT decision. Its factual analysis has not been criticised. There was ample, if not overwhelming, material for saying that this transaction was not a trade but had a different nature, in line with *Lupton*. The FTT so concluded on the basis of unimpeachable analysis and reasoning. There is no basis for criticising its approach. Furthermore, if I had to reach a conclusion on the point on this appeal I would have arrived at the same conclusion as the FTT.

Conclusion

50. I therefore dismiss this appeal on the grounds that it falls at the first hurdle (Issue 1). Having come to that clear conclusion it seemed to me that it would not be appropriate to waste time and costs on considering Issue 2, which would not arise, and little purpose would be served by opining on it in a form which would be obiter in the light of my conclusion on Issue 1. It follows that the appeal also fails in relation to Issue 3 (the Mercury fees).

51. My having thus pronounced, it will be for the parties to make submissions in writing in the normal way as to costs and ancillary matters.

MR JUSTICE MANN

RELEASE DATE: 19 OCTOBER 2017