Appeal numbers
UT/2016/0176-0177

Corporation tax – Purchase by traders of partnership interests and adherence to partnerships followed by realisation and distribution by partnerships of receivables – whether purchase price of partnership interests and contributions to capital of partnerships were capital or revenue expenditure – if revenue, whether incurred wholly and exclusively for purposes of traders' trades – if revenue incurred wholly and exclusively, whether HMRC entitled to raise further issue not in closure notice – whether partnership profits distributed to traders subject to two tax computations

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Appellants**
- and –	
(1) INVESTEC ASSET FINANCE PLC **(2) INVESTEC BANK PLC**	**Respondents**

Tribunal: The Hon Mr Justice Arnold and Judge Charles Hellier

Sitting in public at the Rolls Building, Fetter Lane, London EC4A 1NL on 30-31 January 2018

John Tallon QC and James Rivett, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Jonathan Peacock QC and Michael Ripley, instructed by Allen & Overy LLP, for the Respondents

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DECISION

Introduction

1. This is an appeal from a decision of the First-Tier Tribunal (Tax) (Tribunal Judge Howard M. Nolan and Elizabeth Bridge) dated 24 May 2016 [2016] UKFTT 356 (TC) on appeals by Investec Asset Finance plc ("IAF") and Investec Bank plc ("IBP"), collectively "Investec", against conclusions and amendments to their corporation tax returns contained in closure notices ("the Closure Notices") issued by the Commissioners of Her Majesty's Revenue and Customs ("HMRC") in respect of seven transactions involving Investec's participation in leasing partnerships ("the Leasing Partnerships"). In its decision, the FTT in effect decided six issues by way of preliminary issues. It did not proceed to issue a final decision, correctly anticipating that both parties were likely to appeal against its conclusions on one or other of the six issues.

The relevant transactions

2. Although Investec entered into transactions involving seven Leasing Partnerships, it was agreed between the parties that the transaction involving the Forty-Sixth Hong Kong Leasing Partnership ("HKP") would be treated as representative of the transactions involving four other Hong Kong Leasing Partnerships. Thus the FTT only had to consider three transactions, namely:
   (1) a transaction involving the Leasing Acquisitions General Partnership ("LAGP");
   (2) a transaction involving the Garrard No. 2 Leasing Partnership LP ("Garrard"); and
   (3) a transaction involving HKP.

3. The LAGP transaction was summarised by the FTT as follows:

> "3. The first transaction, generally referred to as the LAGP transaction, involved UK tax based leases of LNG tankers that had originally been written by companies in the National Australia Bank group. The majority of [Investec's] costs, following the purchase of the partnership shares from Merrill Lynch companies, involved contributing funds to the partnership, as required by the purchase terms with Merrill Lynch, to enable the partnership to retire the debt, owing to a company in the Merrill Lynch group that had indirectly funded the purchase of the leasing business. Following the acquisition of the partnership shares by [Investec], the partnership immediately received payments (in fact secured and actually paid by two banks pursuant to letters of credit) of guaranteed residual value payments owed to the partnership by the original suppliers of the LNG vessels that had been the subject of the leases and the relevant receipts were then distributed to the partners, i.e. to [Investec].
>
> …

25. Following a number of involved transactions, [Investec] ended up buying the LAGP partnership for the aggregate sum of £8,854,001 and together contributing £226,181,882 as capital to the partnership. This sum was used to purchase roughly £4 ¼ million worth of assets that were leased to various third parties, with the vast majority of the capital contributed being applied indirectly in repaying to the Merrill Lynch lender amounts that had earlier been advanced to fund the outstanding liability of a bridge company that had acquired the leasing business but left the consideration for it outstanding. Following a transfer of the leasing business by that bridge company to the LAGP partnership, then composed of [Investec], the leases were terminated (in fact pursuant to the exercise of the lessee's option) and the residual value payments were paid to the partnership under the letters of credit. The vast bulk of those receipts was then paid to [Investec] as distributions. The LAGP partnership remained in existence, seemingly conducting the residue of a leasing business with the assets acquired for the £4 ¼ million just referred to. Quite why the decision was made to acquire those other assets and to retain them in the small residue of the leasing business of the partnership was not particularly material."

4. The Garrard transaction was summarised by the FTT as follows:

"4. The second transaction was referred to as the Garrard transaction. This different in that although a relatively modest Schroders leasing partnership was acquired by [Investec], that partnership was acquired more with a view to leasing companies in the Investec group disposing of relatively new leases (most on current account but some on capital account) to the partnership, with the partnership's apparent objective being to maximise the later third party sales prices by dividing the great majority of the rental income streams from the residual value of the assets and the entitlement to capital allowances, and by then selling each to different purchasers respectively keen to purchase (i) the rental streams alone and (ii) the roles as the substantial majority partners, those roles carrying the residual values and the hoped-for entitlement to the capital allowances, along with a small residue of rentals.

…

28. The Garrard transaction commenced with the purchase of a small leasing partnership that had been owned by the Schroders group. The acquired partnership held a lease of a film that was leased to the BBC. The witnesses and [Investec's] counsel were not entirely clear whether this lease was in a positive tax-paying position though it eventually emerged that it probably

was, but only to a small degree. The acquisition of the partnership took the form of [Investec] acquiring a 95% partnership interest from a former Schroders partner, and the purchase of [Schrovest] that held the remaining 5% interest. In due course 4% of that 5% of the partnership interest was acquired directly by IAF, IAF making a contribution to the partnership and that contribution being returned to [Schrovest].

…

30. Following the acquisition of the partnership, [Investec] contributed substantial further capital to the partnership on a number of occasions, and that further capital was applied by the partnership in three different ways. First, some of the capital was applied in purchasing assets from unconnected third parties and leasing those assets to third parties. Most of the capital was applied in acquiring a fairly substantial portfolio of leased assets from the Investec company, Investec Asset Finance (No.1) Limited. We were told that this company had written its leases on a current account basis and that most of the leases transferred were leases that had been written fairly recently. The third contribution of funds was applied in purchasing other leased assets from another Investec company, namely Investec Asset Finance (Capital) Limited. The assets transferred by this company had been acquired on capital account, though again most of the assets had only recently been acquired so that the leases were not in a wholly tax-positive position.

…

32. It also appears that another, possibly the major objective of the Garrard transaction was that, whilst the vast majority of the future rental entitlement was to be sold to Lombard, and a return of capital was to be made to the partners out of the proceeds of that sale, the remaining interest in the partnership, carrying the entitlement to the residual value of some of the assets, and the hoped for entitlement to capital allowances, along with a minor interest in retained rentals, was to be sold, by way of transfers of partnership interests, to several companies in the SMBC group. …"

5. The HKP transaction was summarised by the FTT as follows:

"5. The third transaction involved the termination of a Hong Kong lease of an Airbus 340 in which the lessee was Cathay Pacific. This transaction had not previously been of any relevance for UK tax purposes, though for Hong Kong purposes by the time the relevant transaction was undertaken full capital allowances had been received by the lessors, and a Hong Kong ruling

made it inevitable that on the sale of the aircraft or the receipt of further rentals, the entire amounts would suffer Hong Kong tax. [Investec] procured, before they became partners in the leasing partnership, that there would virtually immediately be a payment of a fixed amount of accelerated rental (equivalent to the sales proceeds of the aircraft), and that that amount would be distributed to the partners (i.e. virtually entirely to [Investec]). Those steps were then undertaken and the residue of the partnership was sold to Cathay Pacific for 4 Hong Kong dollars. The key feature of this transaction was that the partners (i.e. substantially [Investec]) had to pay the Hong Kong tax pursuant to the ruling, and a significant issue is whether and how [Investec] can claim double tax relief in the UK for that tax.

…

36. As we indicated in paragraph 5 above, the Hong Kong transaction stemmed from a purely Hong Kong leasing transaction in relation to an Airbus 340. The lessors included two companies in the Cathay Pacific group, and by the time of the transaction with which we are concerned, all or virtually all the capital allowances had been claimed and position was that any future receipts of rentals or sales proceeds would be taxable in Hong Kong at 17.5%, pursuant to a ruling issued when the lease was entered into.

37. The lease originally made no provision for what was to happen at the end of the primary lease period (the point at which the present transactions were effected), the assumption presumably being that if the airline lessee wished to continue using the aircraft it would either have to purchase the aircraft or agree a new profile of rentals. Naturally [Investec] would not have purchased the partnership interests unless they were certain that a particular sum would be received by the partnership virtually immediately and to this end the lease was varied providing for replacement fixed rentals and for a prepayment of those rentals. The other change that was made was geared to the fact that if [Investec] became the principal partners in the leasing partnership the managing partner would remain one continuing, and independent, corporate partner with a very small percentage entitlement to rentals, and so [Investec] had to procure changes to the deed to make it inevitable that, following a receipt of the accelerated rental, there would immediately have to be a full distribution of those receipts to the partners, i.e. substantially to [Investec].

38. Following the making of the changes just referred to, [Investec] purchased the partnership interests. In this transaction the entire cost suffered by [Investec] consisted of the price paid for the

> partnership interests, and nothing was paid by way of contribution to the partnership, following the step in which [Investec] became the dominant partners."

6. The transactions were the responsibility of a trading team within the Investec group which specialised in bespoke financial transactions. The contractual arrangements were complex, but are not in dispute. They were set out in a Statement of Agreed Facts agreed between the parties for the purposes of the hearing before the FTT. As counsel for HMRC pointed out, slightly surprisingly, there is no reference to the Statement of Agreed Facts in the FTT's decision. No doubt the FTT took the Statement as read, and thought it would be more helpful to summarise the transactions. Given that counsel for HMRC submitted that it was important to understand, and take proper account of, the relevant contractual arrangements, however, we reproduce the contents of the Statement as an Annex to this decision.

7. The common theme in each of the transactions was that IAF and IBP each acquired an interest in a partnership entitled to lease receivables, and became a partner in that partnership, with a view to the partnership realising the receivables and making distributions to IAF and IBP. In the remainder of this decision, we will frequently refer simply to Investec purchasing partnership interests, but it is important to appreciate, since it is fundamental to HMRC's case and not disputed by Investec, that, as we will explain in more detail below, IAF and IBP became partners in each of the Leasing Partnerships.

8. The FTT found (at [64]-[65]) that it was "unrealistic" to say that Investec had, by buying the partnership interests, acquired the receivables, and "equally unrealistic" to say that the acquisition of the partnership interests was irrelevant. On the contrary, the purchase by Investec of the partnership interests was crucial to the tax planning of Investec's counterparties. Nevertheless, the FTT also found (at [71]) that, although in all three transactions Investec acquired partnership interests in partnerships which were conducting leasing trades, Investec had no interest in carrying on the leasing trades, but rather their aim was to effect pre-planned steps of terminating the leases (or the significant lease in the LAGP transaction) so as to receive distributions or (in the case of the Garrard transaction) to receive the distributions from the sale to Lombard and the proceeds from selling the remaining partnership interests to SMBC.

<u>The Closure Notices and the Covering Letter</u>

9. By the Closure Notices HMRC disallowed expenditure claimed by Investec in their returns ("the Disputed Expenditure") on the grounds that it was capital expenditure not revenue expenditure, alternatively that, even if it was revenue expenditure, it was not incurred wholly and exclusively for the purposes of IAF's and IBP's trades (as opposed to the trades carried on by the Leasing Partnerships). The Closure Notices were served under the cover of a covering letter ("the Covering Letter") which stated that, if it was held that the Disputed Expenditure was revenue expenditure incurred wholly and exclusively for the purposes of IAF's and IBP's trades, HMRC would contend that the profits of

those trades should be computed and assessed to corporation tax separately from, and without reference to, the profits of the trades carried on by the Leasing Partnerships. The FTT set out the Covering Letter at [110] and one of the Closure Notices at [111].

The Disputed Expenditure

10. The Disputed Expenditure consisted, in summary, of (i) (in the case of each of the LAGP, Garrard and Hong Kong partnerships) sums paid for the acquisition of interests in each of the partnerships, (ii) (in the case of Garrard) sums paid for the acquisition of shares in Schrovest, which held a 5% interest in the Garrard partnership, and (iii) (in the case of LAGP and Garrard) additional substantial contributions of capital.

11. We were provided by HMRC with a helpful breakdown of the various items of Disputed Expenditure. By way of illustration, in the case of LAGP, the Disputed Expenditure consists of the following payments:
    (1) £8,411,301 paid by IBP to acquire a partnership interest in LAGP pursuant to the exercise notice under the LAGP Put Option on 21 August 2006 (see paragraph 18 of the Statement of Agreed Facts);
    (2) £442,700 paid by IAF to acquire a partnership interest in LAGP pursuant to the exercise notice under the LAGP Put Option on 21 August 2006 (see paragraph 18 of the Statement of Agreed Facts);
    (3) £11,309,094 paid by IAF as an additional contribution of capital to LAGP on 21 August 2006 (see paragraph 20 of the Statement of Agreed Facts); and
    (4) £214,872,788 paid by IBP as an additional contribution of capital to LAGP on 21 August 2006 (see paragraph 20 of the Statement of Agreed Facts).

The evidence before the FTT

12. In addition to the Statement of Agreed Facts, the FTT received written and oral evidence from three witnesses called by Investec, namely Alistair Crowther, Jo Jenner and Kevin Chong. The FTT found all three to be reliable witnesses and accepted their evidence. The FTT also had before it a large volume of documents. As a consequence, the hearing before the FTT occupied seven days.

The issues before the FTT and the FTT's conclusions on those issues

13. Before turning to consider the six issues before the FTT, it is important to note that the FTT first had to consider and decide a preliminary question, which was whether in each case Investec were conducting two trades or one trade. HMRC contended that they were conducting two trades: (i) the solo financial trade carried on by each of IAF and IBP and (ii) the trades carried on by each of IAF and IBP in partnership with the other partners in the Leasing Partnerships. Investec contended that they were carrying on a single trade. The FTT held at [40]-[58] that there were two trades.

14. Issue 1 was whether the Disputed Expenditure was capital or revenue in nature. The FTT decided at [72]-[95] that it was revenue in nature.

15. Issue 2 was whether the Disputed Expenditure should nevertheless be disallowed on the ground that it was not incurred wholly and exclusively for the purposes of IAF's and IBP's respective trades. The FTT decided at [96]-[100] that the expenditure was incurred wholly and exclusively for the purposes of their respective solo financial trades and should not be disallowed.

16. Issue 3 was whether HMRC were precluded by the Closure Notices from raising issue 4. The FTT decided at [101]-[129] that HMRC were not precluded from doing so.

17. Issue 4 was whether the Leasing Partnership's taxed profits – or the distributions of the Leasing Partnerships which represented taxed profits – needed to be brought into account when computing the tax on the solo financial trades. The FTT decided at [130]-[149] that they did not.

18. Issue 5 was whether HMRC were precluded by their closure notices from raising Issue 6. The FTT decided that HMRC were not so precluded for the same reasons as in relation to issue 3.

19. Issue 6 was whether there is a limitation on the foreign tax credits available to IAF and IBP in relation to the Hong Kong transactions. The FTT decided at [150]-[157] that there was no such limitation because the partnership trades were separate from the solo financial trades carried on by each of the partners.

The appeal

20. HMRC have appealed against the FTT's conclusions on issues 1, 2 and 4. Investec have appealed against the FTT's conclusion on issue 3. Neither side has appealed against the FTT's conclusion in relation to issue 6, and therefore Issue 5 does not arise in this Tribunal. Investec have not challenged the FTT's decision that there were two trades rather than one in each case.

21. Save in one small respect, there is no challenge by either side to the FTT's findings of fact. HMRC do challenge what they describe as an implied finding by the FTT at [81] that Investec carried on more transactions in partnerships than the seven in dispute as not being open to the FTT on the evidence, but (i) we do not read [81] as containing such a finding and (ii) if it does, then we consider that the finding was open to the FTT on the evidence of the witnesses. We are not sure that it makes any difference in any event.

Issue 1: was the Disputed Expenditure capital or revenue?

22. It is common ground that this issue is an issue of law, but that the issue of law must be decided by reference to the facts found by the FTT.

The law

23. The distinction between capital and revenue, whether receipts or payments, has a long history. While in principle the distinction is a clear one, it can be difficult to apply to a particular set of facts. One of the reasons for this is that, as is common ground, an asset which is commonly held on capital account by some taxpayers can be a trading asset for others. Another reason is that some features can point in one way, but other features the other way. No doubt for these reasons, the courts have repeatedly warned against automatically applying a formula which may have been useful in one context in a different context: see in particular *Tucker v Granada Motorway Services Ltd* [1979] 1 WLR 683 at 686 (Lord Wilberforce). In *BP Australia Ltd v Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224, Lord Pearce delivering the judgment of the Privy Council said at 264 that "a common sense appreciation of all the guiding features … must provide the ultimate answer". He went on to quote with approval the statement of Dixon J in *Hallstroms Pty. Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648 that the answer:

> "depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any secured, employed or exhausted in the process".

24. Earlier Lord Pearce had cited at 261 two passages from another judgment of Dixon J in *Sun Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337 at 362 and 363 as providing "a valuable guide":

> "… the expenditure is to be considered of a revenue nature if its purpose brings it within the very wide class of things which in the aggregate form the constant demand which must be answered out of the returns of a trade or its circulating capital [but] actual recurrence of the specific thing need not take place or be expected as likely."

> "There are, I think, three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment."

25. Counsel for HMRC particularly relied upon a passage from the speech of Lord Fraser of Tullybelton in *Tucker* at 694-695:

> "One well-known statement which has often been quoted in later cases is that made by Lord Cave L.C. in *British Insulated and Helsby Cables Ltd. v. Atherton* [1926] A.C. 205, 213–214 as follows:

> 'But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.'

… In the present case the fact that the payment was made once and for all is an indication, though not a conclusive indication, that the payment was of a capital nature. But the second limb of the *Atherton* test seems to me inappropriate in respect that it tends to concentrate attention too much on the reason why the expenditure was incurred ('with a view to' what purpose?). A more relevant test in the present case is to see for what the payment was made."

26. This passage has to be treated with a little caution given that the reasoning of the majority is to be found in the speech of Lord Wilberforce, but it receives support from the speech of Lord Edmund-Davies at 692-693. Moreover, it receives further support from a passage in the speech of Lord Goff of Chieveley (with whom Lord Keith of Kinkel and Lord Elmslie agreed) in *Lawson v Johnson Matthey plc* [1992] 2 AC 324 at 341 cited by counsel for Investec:

"It is important to observe that the payment does not become a revenue payment simply because J.M. Plc. paid the money with the *purpose* of preserving its platinum trade from collapse. That was the approach of the general commissioners, which I do not feel able to accept. The question is rather whether, on a true analysis of the transaction, the payment is to be *characterised* as a payment of a capital nature. That characterisation does not depend upon the motive or purpose of the taxpayer."

27. Counsel for HMRC also relied upon a passage in the judgment of du Parcq LJ in *Henriksen v Grafton Hotel Ltd* [1942] 2KB 184 at 195-196:

"In two Scottish cases, Lord Clyde (Lord President) formulated the question for decision as follows: 'Are the sums in question part of the trader's working expenses, are they expenditure laid out as part of the process of profit-earning; or, on the other hand, are they capital outlays, are they expenditure necessary for the acquisition of property or rights of a permanent character the possession of which is a condition of carrying on the trade at all?': see *Robert Addie & Sons Collieries, Ld. v. Inland Revenue Commissioners* 1924 SC 231, and *Inland Revenue Commissioners v. Adam* 1928 SC 738. It is true that the period for which the right was acquired in this

> case was three years and no more, and a doubt may be raised whether such a right is of 'enduring benefit' or 'of a permanent character'. These phrases, in my opinion, were introduced only for the purpose of making it clear that the 'asset' or 'right' acquired must have enough durability to justify its being treated as a capital asset. This is borne out, so far as Lord Clyde's judgments are concerned, by the fact that in Adam's case, the duration of the right acquired was eight years, and that his Lordship there spoke of its 'relatively permanent character'. 'Permanent' is indeed a relative term, and is not synonymous with 'everlasting'."

28. Counsel for Investec did not dispute that this passage was helpful guidance, although he pointed out that the actual decision in that case had been treated with some caution in later cases (see e.g. *Regent Oil Co Ltd v Strick* [1966] AC 295 at 324-325 (Lord Reid)).

The findings and reasoning of the FTT

29. The findings and reasoning of the FTT can be summarised as follows.

30. Both IAF and IBP were financial trading companies for whom dealing in receivables and, where appropriate, even dealings in partnership interests could easily rank as revenue transactions ([81]). IBP was the main financial trader in the group. It carried on a broad financial trade through various divisions. IAF, by the time of the relevant transactions, also had a broad financial trade and had on a number of occasions bought and sold portfolios of lease receivables as a natural extension of its lease finance business ([21]).

31. There was a shortage of regulatory capital which drove the companies to look for profits by taking a role in complex and novel transactions ([60]). The transactions had to be very short-term and they were: nine weeks in the case of LAGP, six months in the case of Garrard and two weeks in the case of HKP ([66]).

32. IAF and IBP only entered into the transactions when prior arrangements were made for realising their profits shortly afterwards ([67]. In the case of LAGP and HKP, the economic reality was that IAF and IBP were purchasing the mechanism that would deliver to them the pre-arranged termination sums payable under the leases ([68]-[69], [82]). In the case of Garrard, contributions were made to the partnership to enable it to acquire assets with a view to selling receivables to Lombard and the residue to SMBC ([49], [84]-[85]).

33. Investec viewed the transactions in substance as buying and selling the underlying lease receivables held by the Leasing Partnerships: the partnerships were "wrappers" in which the receivables were held that were largely irrelevant to them as bankers ([60], [64]). The FTT also found, however, that it was central to the (counterparties') tax planning that Investec purchased the partnership interests ([64]-[65]).

34. IAF and IBP had no interest in conducting the leasing trades of the Leasing Partnerships. Their sole aim was to effect the pre-planned, and effectively pre-contracted, steps of terminating the leases so as to receive the distributions or sale proceeds from the partnership interests in the short-term. These steps, and the profits made in them, were the reasons why the transactions were effected ([71]).

35. The FTT concluded its consideration of this issue at [95] as follows:

> "Our decision is that [Investec's] expenditure in acquiring partnership interests and contributing further capital to the partnerships in the LAGP and Garrard cases was all revenue expenditure, made in order to further their short-term venture of co-operating with the former owners and partners of the leases to terminate, or substantially terminate the leases and make the profit resulting from the pre-intended distribution to [Investec] of the proceeds of those terminations, and thereby to make the profits for which the transactions were all undertaken. This conclusion is reinforced by the fact that [Investec] were financial trading companies, periodically dealing in receivables and of course that both companies conducted seven very similar operations in the very transactions with which we are concerned."

HMRC's submissions

36. HMRC's submissions may be summarised as follows. First, the FTT made a fundamental error of law in approaching the issue by reference to what it regarded as the economic and business reality of the transactions. The FTT should have focussed on the true nature of the legal rights and obligations of the parties. Transactions with a similar economic result could be taxed in different ways depending on the forms of the transactions.

37. Secondly, the FTT correctly found that (i) the Disputed Expenditure consisted of sums paid for the acquisition of partnership interests and capital contributions, (ii) it was vital that Investec became partners in the Leasing Partnerships and (iii) Investec had not acquired the lease receivables. The FTT wrongly focussed on Investec's purpose in making the payments rather than what the payments were for.

38. Thirdly, a partnership interest was intrinsically an asset of a capital nature since (i) it comprised a bundle of enduring rights and obligations and (ii) it gave the purchaser of that interest the ability to carry on the trade of the partnership. Investec had purchased the partnership interests so that they could carry on the trades of the Leasing Partnerships as partners and enjoy distributions and profits as partners. The partnerships could not be dismissed as "wrappers" or a mere "mechanism". Moreover, in the case of LAGP, IAF and IBP had remained partners for some years after 2006.

39. Fourthly, the FTT had found at [34] (albeit somewhat tentatively) that Investec's capital contributions to Garrard were used to buy capital assets, and it followed that the contributions must be capital in nature.

Investec's response to HMRC's submissions

40. Investec's response to HMRC's submissions can be summarised as follows. First, the FTT was correct to have regard to the economic and business reality of the transactions as well as the nature of the advantage acquired by Investec. The FTT had not applied any doctrine of economic equivalence.

41. Secondly, the FTT had taken account of the fact that the payments were made to acquire partnership interests and as capital contributions, but it had been entitled to have regard to the manner in which those assets were to be used. They were not acquired in order to carry on the trades of the Leasing Partnerships, but in order to receive partnership distributions or proceeds from the sale of the partnership interests.

42. Thirdly, it was not correct to say that a partnership interest was invariably an asset of a capital nature. While that would often be the case, it was not necessarily so. In the circumstances of the present case, the features relied upon by the FTT led to the conclusion that the partnership interests were revenue items.

43. Fourthly, there was no difficulty with the capital contributions being made by Investec as revenue, but received by Garrard as capital.

Assessment

44. As we have already observed, it is fundamental to HMRC's case that Investec did not merely acquire partnership interests, but became partners in the Leasing Partnerships. Although this is not disputed by Investec, it is appropriate to say a little more about it. Counsel for HMRC took us on a swift guided tour of all the key documentation, for which we are grateful. For the purposes of this decision, however, it is sufficient to illustrate the point briefly by reference to LAGP. On 21 August 2006 IAF, MLSCI and Investco executed a deed of adherence and IAF, IBP and Investco executed another deed of adherence (see paragraph 19 of the Statement of Agreed Facts). By the deeds of adherence, first IAF and then IBP, as the New Partner in each case, agreed (among other things) "to become a Partner in the Partnership and to be bound by all of the provisions of the Partnership Deed applying to a Partner" (clause 2(A)).

45. In our judgment it has not been shown that the FTT erred in law. We accept Investec's responses to HMRC's submissions. Looking at the character of the advantage sought (in terms of duration and recurrence), the manner in which the advantage was to be enjoyed and the means used to obtain the advantage, we consider that the FTT was right to conclude that, although the transactions involved the acquisition of partnership interests and making capital contributions, they were short-term, recurrent transactions which had the

character of trading transactions; that, in those transactions, the partnership interests were exploited not by carrying on the trades of the Leasing Partnerships for any length of time, but by quickly extracting the lease receivables in distributions and sales proceeds; and that the way in which Investec achieved that was by means of pre-planned steps of terminating the leases etc. As the FTT recognised, in the case of Garrard, Investec were more involved in the business of the partnership because the assembly of numerous leases was required in order to persuade Lombard to enter into the transaction; but we agree with the FTT that this does not make a significant difference to the character of the transaction. Accordingly, we conclude that the FTT was correct to hold that the Disputed Expenditure incurred by IAF and IBP was on revenue account and not capital. HMRC's appeal on issue 1 is therefore dismissed.

Issue 2: was the Disputed Expenditure incurred wholly and exclusively for the purposes of IAF and IBP's respective trades?

46. It is common ground that this is an issue of fact, and therefore the FTT's decision can only be interfered with on *Edwards v Bairstow* [1956] AC 14 grounds.

The law

47. Section 74(1)(a) of the Income and Corporation Taxes Act 1988 ("ICTA 1988") provided (and section 54(1) of the Corporation Taxes Act 2009 provides) that, in computing the profits to be charged to corporation tax, no sum shall be deducted in respect of "any disbursements or expenses, not being wholly and exclusively laid or expended for the purposes of the trade".

48. It is common ground that a helpful and authoritative summary of the relevant principles was set out by Millet LJ (with whom Hirst LJ and Sir John Balcombe agreed) in *Vodafone Cellular Ltd v Shaw* [1997] STC 734 at 742-743:

> "The leading modern cases on the application of the 'exclusively' test are *Mallalieu v Drummond (Inspector of Taxes)* [1983] STC 665, [1983] AC 861 and *Mackinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co.* [1989] STC 898, [1990] 2 AC 239. From these cases the following propositions may be derived. (1) The words for the purposes of the trade mean to serve the purposes of the trade. They do not mean for the purposes of the taxpayer but for the purposes of the trade, which is a different concept. A fortiori they do not mean for the benefit of the taxpayer. (2) To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment. (3) The object of the taxpayer in making the payment must be distinguished

> from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment. (4) Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made.
>
> To these propositions I would add one more. The question does not involve an inquiry of the taxpayer whether he consciously intended to obtain a trade or personal advantage by the payment. The primary inquiry is to ascertain what was the particular object of the taxpayer in making the payment. Once that is ascertained, its characterisation as a trade or private purpose is in my opinion a matter for the Commissioners, not for the taxpayer. Thus in *Mallalieu v Drummond (Inspector of Taxes)* the primary question was not whether Miss Mallalieu intended her expenditure on clothes to serve exclusively a professional purpose or partly a professional and partly a private purpose; but whether it was intended not only to enable her to comply with the requirements of the Bar Council when appearing as a barrister in Court but also to preserve warmth and decency."

49. Counsel for HMRC submitted that the effect of Millett LJ's fourth and fifth propositions was that the taxpayer's subjective intentions were to be objectively assessed. Counsel for Investec disputed this, and submitted that the test was subjective, but constrained by the requirement objectively to take account of unarticulated purposes. We are not sure that there is a difference between this formulation and counsel for HMRC's formulation; but if there is one, we prefer counsel for HMRC's formulation, which we consider is supported by the reasoning of Moses LJ (with whom Lord Dyson MR and Patten LJ agreed) in *Interfish Ltd v Revenue and Customs Commissioners* [2014] EWCA Civ 876, [2015] STC 55 at [10]-[14]. (We would add that, in our opinion, much of the difficulty in this area of the law could be avoided if a wholly objective test were to be applied; but we recognise that it would take a decision of the Supreme Court to achieve that result.)

50. Counsel for Investec submitted that it did not follow from Millett LJ's statement of the law that any inevitable consequence must be taken to be a purpose of the payment, and cited a number of cases in which inevitable consequences had not been found to be purposes. We accept this.

51. Importantly, it was common ground between counsel that expenditure which is incurred by a company partly for its own trading purposes and partly for the trading purposes of another company is not wholly and exclusively incurred

for the purposes of the trade of the first company, even if they are members of the same group: see *Garforth v Tankard Carpets* [1980] STC 251 and *Lawson v Johnson Matthey plc* [1990] STC 149 at 158-159.

The FTT's findings and reasoning

52. The FTT's findings and reasoning are set out in the following passage of the decision:

> "97. In contrast [Investec] contended that if we had decided that the expenditure was trading and not capital expenditure of the sole trades, essentially the same reasoning would undermine [HMRC's] present contention. We agree.
>
> 98. We simply repeat the points that when [Investec] became partners in all the various partnerships, there was never an intention that the trades would be conducted for any stand-alone benefit within the leasing trades. In the LAGP and all the Hong Kong situations it was clear that [Investec] could do nothing to prevent the effective termination of the trades and of course that is precisely what they intended to do. The capital contribution made in the LAGP case was essentially part of the purchase price of the partnership interests and not a contribution made to discharge '*existing liabilities* ***incurred in the course of the pre-existing partnership trade***'. And while matters were rather more involved in the case of the Garrard partnership, it is still clear that every step, the acquisition of existing leases from the two Investec group companies and the purchase of assets and leased assets from third parties, was all entirely directed to the purpose, within [Investec's] sole trades. That purpose was to amass sufficient aggregate rental income to induce Lombard to take an assignment of 95% of the rentals, and to amass, on the instigation of SMBC, sufficient retained assets, carrying the hoped for continuing entitlement to capital allowances to sustain the attractive price to be paid by SMBC for the partnership interests, following the sale of 95% of the rentals.
>
> 99. A simple example that adds little but appears to us to support this analysis is the case of a corporate raider that acquires a company, solely for the purpose of breaking it up, probably in a pre-determined manner, so as to maximise value by transferring trades, parts of trades and assets to various purchasers such that the aggregate price for the parts exceeds the purchase price given for the company, and enables the asset stripper to make its intended profit. When the asset stripper is:
>
> - anyway taxed as a financial instrument and share dealer;
> - the operations have been undertaken on seven occasions, all with success and with the profits always intended being made;
> - all the transactions have been short-term transactions, and
> - the asset stripper had no interest in the activities and trade of the target company, other than to enable it to make the eventual profit,

> we find it difficult to doubt that expenditure incurred on acquiring the company could be anything other than revenue expenditure incurred wholly for the trading purpose of the asset stripper.
>
> 100. Our conclusion is accordingly that all the disputed expenditure incurred by the Appellants in the present case was not only revenue expenditure but also expenditure incurred wholly and exclusively for the purpose of each of the sole trades of the Appellants."

HMRC's submissions

53. HMRC submitted in summary that, having rightly found that IAF and IBP were carrying on separate trades to the trades carried on by the Leasing Partnerships, the FTT erred in law in finding the Disputed Expenditure to have been wholly and exclusively for the purposes of their solo financial trades. Counsel for HMRC argued that this was an error of law because (as in *Vodafone v Shaw*) the FTT's conclusion was inconsistent with the FTT's own primary findings of fact. On the FTT's own findings, the purpose of the Disputed Expenditure was the acquisition of partnership interests and the making of capital contributions to the Leasing Partnerships. It therefore could not have been wholly and exclusively for the purpose of IAF and IBP's solo financial trades, but had been at least partly for the purposes of enabling IAF and IBP to carry on the Leasing Partnerships' trades in common with the other partners, and in the case of the contributions to the Garrard partnership to enable that partnership to engage in further leasing activities. The FTT's reasoning had failed to engage with this.

Investec's response to HMRC's submissions

54. Investec submitted in summary that the FTT had made no error of law and had been fully entitled to reach the conclusion that IAF and IBP had had only one purpose in making the payments, namely the purpose of their own financial trades.

Assessment

55. In our judgment it is necessary to distinguish between the elements of the Disputed Expenditure that consisted of the sums paid to acquire partnership interests and the shares in Schrovest on the one hand and the elements of the Disputed Expenditure that consisted of the sums paid by way of capital contributions on the other hand.

56. In the case of the sums paid to acquire partnership interests and the shares in Schrovest, we cannot see any flaw in the FTT's reasoning. In short, IAF and IBP acquired the partnership interests and shares for the purposes of their solo financial trades. IAF and IBP did not acquire the partnership interests or shares for the purposes of the Leasing Partnerships' trades. IAF and IBP paid the sums in question as solo traders, in order to become partners and thereby get access to the lease receivables. They did not pay the sums as partners for any purpose of the Leasing Partnerships.

57. In the case of the sums paid by way of capital contributions, however, we consider that the position is different.

58. On the FTT's findings of fact (see in particular [30] quoted above), the capital contributions made by IAF and IBP as partners of Garrard were made to enable the partnership to purchase assets which were either already leased or leased subsequently. These findings are supported by the Statement of Agreed Facts.

59. The capital contributions made by IAF and IBP as partners of LAGP totalled £226,181,882. On the FTT's findings of fact (see in particular [25] quoted above), £4,258,690 was used to enable the partnership to purchase assets which were leased, while (at least as we read the decision) the balance was used effectively to enable the partnership to pay for the acquisition of the leasing business. In submissions following the circulation of a draft of this decision, Investec have challenged these findings (or least our reading of the FTT's decision with respect to the balance).

60. So far as the sum of £4,258,690 is concerned, Investec have pointed out that paragraph 22 of the Statement of Agreed Facts records that this was expended by PEA Leasing, but the Statement of Agreed Facts does not show that it was contributed by either IAF or IBP by way of capital contribution. In that respect, therefore, the FTT appears to have misunderstood the position.

61. Investec contend that the sum of £226,181,822 contributed by IAF and IBP as partners of LAGP was not used to enable the acquisition of the partnership business, but to pay stamp duty on the purchase of PEA Leasing and to repay the amounts owed by LAGP to MLCSI (see paragraph 20 of the Statement of Agreed Facts). But this enabled LAGP to lend £209,198,662 to PEA Leasing to enable PEA Leasing to repay the inter-company loan to NAF LLP (see paragraph 21 of the Statement of Agreed Facts). HMRC say that it was in consideration of the discharge of LAGP's loan to PEA Leasing that LAGP acquired the leasing business from PEA Leasing. Although this is not spelled out in paragraph 23 of the Statement of Agreed Facts, it appears to us that HMRC are correct: see clause 5.1.2 of the agreement dated 18 September 2006. Accordingly, we consider that the money (or at least £209,198,662 of it) was used effectively to enable the partnership to pay for the acquisition of the leasing business.

62. The FTT reasoned that Investec's ultimate objective in making the capital contributions was that IAF and IBP should profit from distributions and sale proceeds and that such profits were made in IAF and IBP's solo financial trades. We accept that the FTT was entitled to make that finding as to Investec's ultimate objective. It nevertheless appears to us to be inescapable that the capital contributions were made by Investec at least partly for the purposes of Garrard's and LAGP's businesses, which the FTT found to be distinct from those carried on by IAF and IBP. This was not an incidental consequence, it was central to the way in which the Garrard and LAGP transactions were carried out. In the case of Garrard, it was the capital

contributions by the partners which enabled the partnership to acquire assets which enabled distributions and profits to be made. In the case of LAGP, it was the capital contributions by the partners which enabled the partnership to acquire the leasing business. The FTT held (at [98]) that these contributions were "effectively part of the purchase price of the partnership interests", but the leasing business was acquired subsequently effectively using the capital provided by IAF and IBP. In both cases, therefore, the FTT erred in law, because its conclusion was contrary to its own findings of fact.

63. We therefore dismiss HMRC's appeal on issue 2 in relation to the sums paid to acquire the partnership interests and the shares in Schrovest, but allow the appeal in relation to the sums paid by way of capital contributions to Garrard and LAGP.

Issue 3: can HMRC raise issue 4?

64. It is common ground that HMRC's case on issue 4 was not set out by HMRC in the Closure Notices, but was set out in the Covering Letter. The Covering Letter stated by way of introduction:

> "As you will be aware from correspondence, there are other arguments as to the possible tax consequences. These are not properly part of the closure notice as these are not our conclusion, but we thought it proper to note that the legal issues involved may go down these routes depending on the arguments raised, and depending on the direction taken by the Tribunal."

65. In those circumstances Investec contend that it is not open to HMRC to raise the issue on appeal to the FTT. Investec accept, however, that, given that the issue was clearly identified in the Covering Letter, they were not taken by surprise when HMRC sought to raise it on the appeal. Thus Investec make no complaint of procedural unfairness on the part of HMRC. Rather, Investec contend that the FTT had no jurisdiction to entertain this part of HMRC's appeal.

The legislative framework

66. Schedule 18 paragraph 24 of the Finance Act 1998 ("FA 1998") provides that HMRC may, if they give notice, enquire into a company's tax return. Paragraph 25 provides that an enquiry extends to anything contained in the return or required to be contained in the return. Paragraph 32(1) provided at the times relevant to these appeals that:

> "An enquiry is completed when an officer of Revenue and Customs by notice (a 'closure notice') inform the company that they have completed their enquiry and state their conclusions."

67. Paragraph 34 provided at the times relevant to these appeals that:

"(1) This paragraph applies where a closure notice is given to a company by an officer.

(2) The closure notice must–
(a) state that, in the officer's opinion, no amendment is required of the return that was the subject of the enquiry, or
(b) make the amendments of that return that are required–
(i) to give effect to the conclusions stated in the notice, and
(ii) in the case of a return for the wrong period, to make it a return appropriate to the designated period.

…

(3) An appeal may be brought against an amendment of a company's return under sub-paragraph (2) …."

68. Sections 49D and 50 of the Taxes Management Act 1970 provide, so far as relevant:

"49(1) This section applies if notice of appeal has been given to HMRC.

(2) The appellant may notify the appeal to the tribunal.

(3) If the appellant notifies the appeal to the tribunal, the tribunal is to decide the matter in question.

…

50(6) If, on an appeal to the tribunal, the tribunal decides-
(a) that the appellant is overcharged by a self-assessment
…
the assessment … shall be reduced accordingly …

(7) If, on an appeal to the tribunal, the tribunal decides-
(a) that the appellant is undercharged by a self-assessment
…
the assessment … shall be increased accordingly."

Applicable principles

69. The scope of appeals to the FTT, and the ability of HMRC to raise a new point on such appeals, were considered by the Supreme Court in *Tower MCashback LLP 1 v Revenue and Customs Commissioners* [2011] UKSC 19, [2012] 2 AC 457. In that case the conclusion set out in the closure notice was that a claim for capital allowances was excessive. HMRC sought to rely on a different reason for coming to that same conclusion and making the same amendments. The Supreme Court held that it was open to HMRC to do so. We note that

both Lord Walker of Gestingthorpe and Lord Hope of Craighead, with whom the other members of the panel agreed, described this as a "procedural" issue.

70. The principles established by that decision were recently summarised by Kitchin LJ, with whom Arden LJ and Sir Stephen Richards agreed, in *Fidex Ltd v Revenue and Customs Commissioners* [2016] EWCA Civ 385, [2016] STC 1920 at [45]:

> "In my judgment the principles to be applied are those set out by Henderson J [in *Tower MCashback LLP 1]* as approved by and elaborated upon by the Supreme Court. So far as material to this appeal, they may be summarised in the following propositions:
> (i) The scope and subject matter of an appeal are defined by the conclusions stated in the closure notice and by the amendments required to give effect to those conclusions.
> (ii) What matters are the conclusions set out in the closure notice, not the process of reasoning by which HMRC reached those conclusions.
> (iii) The closure notice must be read in context in order properly to understand its meaning.
> (iv) Subject always to the requirements of fairness and proper case management, HMRC can advance new arguments before the FTT to support the conclusions set out in the closure notice."

71. In that case HMRC had issued a closure notice to Fidex Ltd which denied the taxpayer the benefit of a loss, giving as the reason one particular statutory provision in the Finance Act 1996. HMRC subsequently sought to rely on a different statutory provision to the same computational effect. Kitchin LJ rejected the taxpayer's challenge to HMRC's reliance on the new provision in the following terms at [61]:

> "The scope and subject matter of the appeal to the FTT were defined by the conclusions stated in the closure notice and the amendments required to give effect to them. HMRC were not, however, restricted on appeal to the process of reasoning by which they had reached those conclusions and they were free to deploy new arguments in support of them, subject to the exercise by the FTT of its case management powers to ensure that Fidex was not ambushed."

The FTT's reasoning

72. The FTT's reasoning on this issue is encapsulated in the following paragraphs in its decision:

> "126. We consider it sensible, if possible, to seek to reach a conclusion that does not lead to an incoherent result and suggest that the statutory

provision is simply defective. We consider that when the closure notice identifies the subject matter and the closure notice does what it must do, which is to indicate one conclusion and related adjustments, if provisions in both the closure notice and the covering letter both make it absolutely clear to the taxpayer the arguments and contentions that HMRC may be forced to resort to, and they all relate to the perfectly obvious subject matter of the dispute, then the terms of the present closure notices do not preclude HMRC from raising other arguments such as those envisaged in Scenarios 1 and 2 in the covering letter.

127. The suggestion by [Investec's] counsel that a conclusion along these lines would destroy the intended protections of the closure notice machinery is incorrect. There may have been numerous other transactions undertaken by [Investec] and it is clear that none of them would have anything to do with the subject matter of the closure notices. They would not, therefore, be the possible subject of adjustments, save by assessments under the limited provisions of section 29 TMA 1988."

Investec's submissions

73. Investec submitted in summary that, applying principles (i) and (ii) in Kitchin LJ's summary, the FTT had no jurisdiction to entertain HMRC's case on issue 4 because the subject matter and scope of the appeal were defined by the conclusions and adjustments set out in the Closure Notices. The Closure Notices set out HMRC's case on issues 1 and 2 in the alternative, but made no mention of its case on issue 4. It was irrelevant that HMRC's case on issue 4 was set out in the Covering Letter. If HMRC wanted to be able to raise issue 4 on any subsequent appeal, they should have set out their case on it in the Closure Notice. The present case was to be distinguished from both *Tower MCashback* and *Fidex* because in those cases HMRC's alternative arguments did not alter the conclusions and amendments set out in the closure notices.

HMRC's response to Investec's submissions

74. HMRC submitted in summary that it had not been possible for them to set out their case in the Closure Notices, because the Closure Notices were required to set out a single amendment. HMRC had been able to set out their cases on issues 1 and 2 in the alternative in the Closure Notices because they led to the same conclusion and amendment, but HMRC's case on issue 4 led to a different conclusion and amendment, as was explained in the Covering Letter. Counsel for HMRC pointed out that a taxpayer might not contest the conclusion in a closure notice, in which case the amendment would take effect automatically.

Assessment

75. We are not convinced this issue is accurately characterised as one of the FTT's jurisdiction, but we will assume that Investec are right about that. We do not accept HMRC's argument that they were unable to set out HMRC's case on

issue 4 in the Closure Notices. It is correct that a closure notice must set out HMRC's conclusion and any amendment required, but we do not see why that prevents HMRC from also setting out an alternative conclusion and amendment if they are wrong as to the primary conclusion and amendment they contend for. But in our judgment that does not mean that issue 3 should be decided in Investec's favour. Kitchin LJ's third principle is that a closure notice must be read in context. In the present case a key aspect of the context was the Covering Letter. The two documents must be read together; and when read together, they made it clear in each case that, if HMRC were unsuccessful on issues 1 and 2, then in the alternative they would raise issue 4. Counsel for Investec submitted in his skeleton argument that what was at stake was an important point about procedural propriety and fairness, but as noted above he rightly accepted in his oral submissions that there was no procedural unfairness to Investec. Accordingly, we conclude that the FTT was right to hold that it had jurisdiction to entertain HMRC's case on issue 4. Investec's appeal on this issue is therefore dismissed.

Issue 4: whether the partnership profits should be subject to two tax assessments?

76. It is not in dispute that, given that the FTT found that there are two trades in each case, there must be corporation tax assessments in respect of both trades, namely IAF's and IBP's trades and the Leasing Partnerships' trades. Investec contend that, once the partnership profits have been assessed to tax in the hands of the Leasing Partnerships, they do not fall to be assessed to tax again in the hands of IAF and IBP as part of IAF and IBP's trades because that would amount to double taxation. HMRC dispute this.

77. It should be noted before proceeding further there are two very odd features to HMRC's case on issue 4. First, HMRC only advance their case on issue 4 in the alternative to their cases on issues 1 and 2. As is common ground, however, if HMRC are right on issue 4, that would result in a larger sum being payable in tax than if HMRC are right on either issue 1 or issue 2. Normally parties advance as their primary cases the contention which is most beneficial to them and advance as alternative cases contentions which are less beneficial to them, but HMRC's stance in this matter is the other way round. Secondly, there is no analytical reason why HMRC should be constrained to advance their case on issue 4 only in the alternative to their case on issues 1 and 2. If the case is a good one, it runs anyway.

78. It should also be noted that there is no dispute that all of the relevant accounts were prepared in accordance with generally accepted accounting practice. Investec's tax computations were explained in a helpful note prepared for the FTT. A minor point is that Investec contend that they made a mistake in computing their tax for LAGP, which resulted in an overpayment of tax, although Investec have not sought to recover that overpayment. More importantly, a complicating factor when trying to understand the accounts and tax computations is that, in the case of LAGP and HKP, the appropriate shares of the partnership profits were brought into account by IAF and IBP on a "look through" basis, whereas in the case of Garrard, the distributions from

and sales proceeds of the partnership were brought into account by IAF and IBP on a "non-look through" basis.

The legislative framework

79. Section 111(1) of ICTA 1988 provided at the relevant time:

> "Where a trade or profession is carried on by persons in partnership, the partnership shall not, unless the contrary intention appears, be treated as for corporation tax purposes as an entity which is separate and distinct from those persons."

80. Section 114 of ICTA 1988 set out special rules for computing profits and losses, which required that the profits and losses of a trade carried on by a partnership be computed separately "as if the partnership were a company" and each corporate partner was taxable on a share of that profit. Accordingly, corporate partners in trading partnerships were assessed to tax on their share of the profits and losses under Schedule D, Case I (section 18 of ICTA 1988).

81. Since IAF and IBP carried on their own solo financial trades, the profits and losses of those trades were also chargeable to tax under Schedule D, Case I. Section 42 of FA 1998 provided at the time:

> "For the purposes of Case I or II of Schedule D, the profits of a trade ... must be computed in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law."

Relevant principles

82. The parties invoke two different general principles of tax law in support of their respective cases on issue 4. HMRC rely upon the "source doctrine". This is a general principle that, as it was put by Park J in *Pumahaven Ltd v Williams* [2002] EWHC 2237 (Ch), [2002] STC 1423 at [19], "taxpayers are not taxed on income in the general sense of the term, but rather on specified kinds of income from specified sources". The most important application of this principle is that income cannot be taxed in a particular year unless there is a source in that year.

83. Investec rely on the general principle that tax legislation is to be interpreted, in the absence of clear words that compel a contrary conclusion, as not requiring profits that have been taxed once on one basis then to be taxed again on another basis. The operation of this principle is exemplified by three cases to which we were referred.

84. In *Fry v Salisbury House Estates Ltd* [1930] AC 432 the House of Lords concluded that the same income could not be included under a Schedule A (land) computation and under a Schedule D (trade) computation. Viscount Dunedin said at 439:

> "Now the cardinal consideration in my judgement is that the income tax is only one tax, a tax on the income of the person whom it is sought to assess and that the different schedules are the modes in which the Statute direct this to be levied. In other words, there are not five taxes which you might call income tax A, B, C, D and E, but only one tax. That tax is to be levied on the income of the individual whom it is proposed to assess, but then you have to consider the nature, the constituent parts, of his income to see which Schedule you are to apply."

85. *Dawson v Counsell* [1938] 3 All ER 5 concerned a stud farm of which Mr Dawson was the tenant. He was subject to tax under Schedule B on his occupation of land, in particular on all profits he derived from the various activities undertaken as occupier of the land. One of the mares looked after on the farm was owned in partnership with his son. That partnership carried on its own separate trade of breeding the mare and the Inland Revenue assessed the profits of the partnership under Schedule D. The Court of Appeal upheld Mr Dawson's appeal on the ground that the charge to income tax under Schedule B prevented a further charge to tax under Schedule D. Sir Wilfred Greene MR said at 10:

> "The partnership is not in law a separate entity. J.A. Dawson's share is a profit derived by him from his own occupation, and the circumstance that the remaining share belongs to his partner cannot alter this fact. The principles laid down with reference to Sched A in the Salisbury House case appear to me to be applicable so as to prohibit an assessment under Sched D in respect of J.A. Dawson's share of the profits of the partnership."

86. In *FS Securities Ltd v Commissioners of Inland Revenue* (1964) 41 TC 666 the House of Lords decided that a share dealer must leave out of its Case I trading account any profits it receives on shares held as trading assets. The basis for the decision is encapsulated in Lord Reid's statement at 693 that "money taxed cannot again be subjected to Income Tax", or as Viscount Radcliffe put it at 698 "dividends that had borne tax … before receipt are, to use Viscount Dunedin's phrase in *Salisbury v Fry*, 'exhausted as a source of income'".

The FTT's decision

87. The FTT's reasoning is encapsulated in its decision at [144]:

> "Reverting to the facts of the present case, it is noteworthy that the double taxation of which [Investec] are complaining is relatively clear-cut double taxation. This is essentially the position in all seven transactions but it is particularly obvious in the case of the LAGP and Hong Kong partnerships because [Investec] calculated their sole trading profits by looking through to their share of partnership profits, i.e. the very profits that we have already concluded are plainly to be brought into account under section 114. In the *FS Securities* case the

respect in which the dealing company originally claimed its tax loss and repayment (i.e. the analysis of the transaction that the House of Lords eventually confirmed), was that it was the dividend paying company's income tax on its profits that were later paid to the dealing company by way of dividend that led to the exclusion of the dividends from ranking as receipts in the dealer's Case I calculations. Notwithstanding that the relevant transaction in respect of which the tax was originally paid was rather more remote than the situation in the present case, it was still held that the dealer should exclude the dividends received from its Case I calculations."

HMRC's submissions

88. HMRC submitted in summary that the FTT had failed to follow through the legal consequences of its decision that IAF's and IBP's solo financial trades were separate trades from the trades carried on by each Leasing Partnership. HMRC were not seeking to tax income of the same source twice. Rather, HMRC were seeking to tax the profits and losses of the separate sources in accordance with the source doctrine.

89. Having identified the existence of different trades, the only answer that was correct in law was that the taxable profits of those different trades had to be computed separately for each trade as required by section 42(1) FA 1998. In consequence, the taxable profits of IAF and IBP were the aggregate of (i) the returned share of the profits of the partnership trades to which each of IAF and IBP were entitled and (ii) the excess of the amounts received by each of IAF and IBP in the form of the distributions made to them over the costs of acquiring partnership interests and making contributions to the Leasing Partnerships (and including in the case of Garrard, the proceeds of sale of the partnership interest).

Investec's response to HMRC's submissions

90. Investec's response in summary was that the source doctrine did not mean that the profits of two trades carried on by a taxpayer must be computed for tax purposes without reference to each other. On the contrary, taxation of income from one source prevented any charge to tax on the same income arising from a different source recognised by the legislation. Accordingly, the FTT was correct.

Assessment

91. In our judgment the FTT was correct to hold that profits which had been taxed in the hands of the Leasing Partnerships did not fall to be taxed again in the hands of IAF and IBP. As the FTT said, to hold otherwise would be a clear case of double taxation, and particularly so in the case of LAGP and HKP. We accept that the *FS Securities* case is factually different from the present case, but we agree with the FTT that the principle applied in that case is equally applicable here. We do not accept that the source doctrine has the effect contended for by HMRC in the present case, because the source doctrine does

not justify taxing the same income twice over. We accept that, given that there were two trades in each case, there needed to be two tax computations, but it does not follow that the same income needed to be brought into account in both computations.

92. While we are clear as to the basic principle, however, we are less clear as to its application to the facts. While writing this decision, we have become concerned that there is a point which was not explored in argument at the hearing although it was touched on in paragraph 74 of HMRC's skeleton argument. This is that, in the cases of LAGP and Garrard, the distributions received by IAF and IBP were in large part repayments of earlier capital contributions. It occurs to us that it may be arguable that, to the extent that IAF's and IBP's receipts were returns of capital contributions rather than profits, they were not deductible when computing IAF's and IBP's taxable profits. This may depend on the accounting treatment (look through or non-look through).

93. Furthermore, this may relate to another point which was discussed in argument. Where Investec adopted look through accounting, the nature of the receipts and deductions appearing in the accounts might be such that they could be said to reflect only its participation as a partner and so should be merely replaced by the section 114 result, that being required by law for the purposes of section 42. There being no other accounting entry for the solus trade, section 42 would then have the effect that, for that trade, the taxable profit was nil; and since the profits or income of the partnerships had not been brought into account in arriving at that figure of nil, there would be no requirement to deduct any amount on the basis that it was profit which had already been taxed.

94. We are unsure as to the extent to which this issue is rendered academic by our decision in relation to issue 2. As we understand it, Investec consider that it is, but HMRC disagree. Accordingly, we invite the parties to restore the appeal for further argument on this issue in order to address the points set out above.

Summary of conclusions

95. For the reasons given above, we dismiss HMRC's appeal on issue 1, allow HMRC's appeal on issue 2 in part and dismiss Investec's appeal on issue 3. Issue 4 we leave undetermined pending further submissions.

MR JUSTICE ARNOLD AND JUDGE HELLIER

Release date: 4 April 2018

Annex: Statement of Agreed Facts

A. The LAGP transaction

Transaction steps

1. *The original lease arrangements*. The arrangements referred to at paragraphs 2 to 7 below were each entered into on 28 October 1999.

2. National Australia Finance (Equipment Leasing) Ltd ("NAFEL") signed two hire purchase agreements ("the LNG Vessels HP Agreements"). NAFEL was and is a wholly-owned member of the National Australia Bank group of companies.

3. The first HP Agreement was entered into with a company called Optima Leasing SA ("Optima") and related to a vessel known as MV *SK Splendor*. The second HP Agreement was entered into with a company called Celeste Maritime SA ("Celeste", and together with Optima "the Owners") and related to a vessel known as MV *SK Supreme* (the MV SK Splendor and the MV *SK Supreme*, hereafter collectively referred to as "the LNG Vessels").

4. Under each LNG Vessel HP Agreement, which were on similar terms, the Owner hired the Vessel to NAFEL for a single upfront payment, and NAFEL was entitled to exercise an option at the end of the term of each of the LNG Vessels HP Agreements to acquire the LNG Vessel upon making a payment.

5. In respect of each LNG Vessel, NAFEL entered into a charterparty by way of demise whereby it agreed to lease the relevant LNG Vessel to SK Shipping Europe Ltd. Rentals were payable annually under the Leases on 14 July of each year. The rentals were in fixed amounts. The term of each Lease was to end on 14 April 2010 (subject to early termination and provisions contemplating extension on terms to be agreed).

6. In respect of each LNG Vessel, NAFEL entered into a return guarantee agreement with the Owner (each, an "RGA"). The two RGAs were on similar terms and provided for the payment of a "Guaranteed Residual Value" by the Owner to NAFEL.

7. Westdeutsche Landesbank Girozentrale ("West LB") issued a letter of credit to NAFEL in respect of the *MV SK Supreme* and the Canadian Imperial Bank of Commerce ("CIBC") issued a letter of credit to NAFEL in respect of the MV *SK Splendor*.

8. *Transfer of the original leasing arrangements to National Australia Finance (Asset Leasing) LLP*. An agreement dated 30 September 2005, between NAFEL and National Australia Finance (Asset Leasing) LLP ("NAF LLP"), transferred NAFEL's position in the leasing arrangements described at paragraphs 4 to 7 above to NAF LLP for a consideration of £212,000,000 which was left outstanding on inter-company loan account. The members of

NAF LLP were and are wholly owned members of the National Australia Bank group of companies.

9. *Leasing Acquisitions General Partnership*. On 26 July 2006, Merrill Lynch Capital Services, Inc. ("MLCSI") and Investco LLC, Series 2003-1 ("Investco") (both members of the Merrill Lynch group of companies and incorporated in Delaware) signed and delivered a Partnership Deed which formed a UK general partnership under the Partnership Act 1890, to be named the "Leasing Acquisitions General Partnership" ("LAGP"). Clause 2.5 of the Partnership Deed provided that the purpose of LAGP was to carry on leasing business and the acquisition, management and disposal of certain permitted investments with a view to profit.

10. *The Put Options*. On 10 August 2006, National Europe Holdings Ltd ("NEHL"), LAGP and Merrill Lynch International signed a Put Option Agreement ("the PEA Put Option") under which LAGP granted to NEHL the right to sell the one ordinary share in PEA Leasing Ltd ("PEA Leasing") to LAGP. NEHL was and is a wholly-owned member of the National Australia Bank group of companies. PEA Leasing was a wholly-owned subsidiary of NEHL, which at this point did not have any material assets or liabilities.

11. The price payable by LAGP for the ordinary share in PEA Leasing would be £1 or, if the transfer to PEA Leasing of NAF LLP's business of leasing the Vessels had completed before the exercise of the option (as referred to at paragraph 14 below), £16,899,720.

12. On 10 August 2006, MLCSI, Investco, Merrill Lynch International (as guarantor of the obligations of the partners of LAGP) and Investec signed a put option agreement ("the LAGP Put Option") under which Investec granted to MLCSI and Investco the right, subject to conditions, to sell their partnership interests to Investec for a price to be calculated pursuant to a formula contained within the LAGP Put Option.

13. *The Deed of Consent*. On 17 August 2006, NAF LLP, National Australia Bank Ltd, NEHL, the Owners, SK Shipping Europe Ltd, SK Shipping Co. Ltd, PEA Leasing and LAGP executed and delivered a deed of consent ("the Deed of Consent") pursuant to which (i) the parties gave their consent to certain transactions and (ii) amendments were made to the Leases and the RGAs. Those amendments included a right for SK Shipping Europe Ltd to terminate the Leases on 19 October 2006 and, if the Leases were not so terminated, a right for the lessor to terminate the Leases on 31 October 2006. On termination, the "Guaranteed Residual Values" would become payable by the Owners in an amount equal to the maximum amount which could be claimed under the letters of credit.

14. *The NAF LLP Business Sale Agreement*. On 17 August 2006, NAF LLP and PEA Leasing signed an agreement under which NAF LLP agreed to sell and PEA Leasing agreed to buy NAF LLP's business of leasing the Vessels as a going concern together with all goodwill, assets, rights, undertaking, obligations and liabilities relating to or arising in connection with the leasing

of the Vessels ("the Business Sale Agreement"). The consideration for the sale was £209,063,836 to be left outstanding by way of inter-company loan, and repayable on demand. Completion occurred after signing.

15. *Exercise of the Put Options*. On 21 August 2006, NEHL issued to MLCSI and Investco an exercise notice pursuant to the PEA Put Option, thereby requiring LAGP to purchase PEA Leasing from NEHL at a price of £16,899,720. At this time the partners of LAGP were MLCSI and Investco.

16. On 21 August 2006, MLCSI and LAGP signed a credit agreement facility letter pursuant to which MLCSI agreed to advance to LAGP £226,097,383 for the purposes of paying the price owed to NEHL under the PEA Put Option (referred to at paragraph 11) and for the purposes of lending to PEA Leasing so that it could repay the inter-company loan due to NAF LLP (referred to at paragraph 14).

17. On 21 August 2006, a stock transfer form was executed which transferred the one issued ordinary share in PEA Leasing to Investco (on behalf of LAGP).

18. On 21 August 2006, MLCSI and Investco issued to Investec an exercise notice pursuant to the LAGP Put Option, thereby requiring Investec to purchase their partnership interests in LAGP on 21 August 2006 for £8,854,001.

19. On 21 August 2006, IAF, MLCSI and Investco signed and delivered a deed of adherence and Investec and Investco signed and delivered another deed of adherence, by which Investec replaced MLCSI and Investco as partners of LAGP.

20. Following the execution of the two deeds of adherence, IAF made an additional contribution of capital in an amount equal to £11,309,094 to LAGP and IBP made an additional contribution of capital in an amount equal to £214,872,788 to LAGP. The aggregate amount of £226,181,882 was used to pay stamp duty on the purchase of PEA Leasing and to repay the amounts owed by LAGP to MLCSI under the credit agreement facility letter referred to at paragraph 16 above.

21. On 22 August 2006, LAGP (through its new partners, Investec) and PEA Leasing signed an intra-group loan agreement pursuant to which LAGP agreed to provide £209,198,662 of finance to allow PEA Leasing to repay the intercompany loan due to NAF LLP (referred to at paragraph 14).

22. *New Leases*. Between 22 August 2006 and 15 September 2006, PEA Leasing incurred in aggregate £4,258,690.60 of expenditure on assets to be leased on operating lease terms to Capital Bank plc, MAN Financial Services plc, ING Lease (UK) Ltd and Fortis Lease UK Ltd.

23. *The PEA Leasing Business Sale Agreement*. On 18 September 2006, PEA Leasing and LAGP signed an agreement under which PEA Leasing agreed to sell and LAGP agreed to buy PEA Leasing's entire business of leasing together with all goodwill, assets, rights, undertaking, obligations and

liabilities relating to or arising in connection with its leasing business. Completion occurred after signing.

24. *Termination of the Leases*. On 11 October 2006, SK Shipping Europe Ltd and the Owners together notified LAGP of their intention to terminate the leasing of the Vessels under the Leases on 19 October 2006.

25. On 11 October, LAGP:
    (1) issued a demand notice to West LB for payment on 19 October 2006 of the full amount owed under the letter of credit issued by West LB; and
    (2) issued a demand notice to CIBC for payment on 19 October 2006 of the full amount owed under the letter of credit issued by CIBC.

26. LAGP received a total amount equal to £248,302,590 from West LB and CIBC on 19 October 2006.

27. On 19 October LAGP made distributions amounting to £248,103,633 to the partners in LAGP (£12,405,182 in the case of IAF and £235,698,451 in the case of IBP).

Accounting for the transaction by Investec

28. IAF and IBP reflected these transactions in their statutory accounts in accordance with generally accepted accounting practice for the purposes of section 42 of the Finance Act 1998.

29. Each of IAF and IBP "looked through" the partnership, and the Leases were accounted for directly in each company's accounts. The profit earned by each company being the excess of the fair value of its share of the lease receivables over the aggregate of the cost of its partnership interest and the cost of its capital contributions, was shown in its profit and loss account.

LAGP's profit allocation

30. A calculation of LAGP's UK taxable profits by Investec for the purposes of section 114 of the Income and Corporate Taxes Act 1988 was prepared and LAGP's profits and losses were allocated to IAF and IBP. In particular:
    (1) £206,028,337 of the £248,302,590 received under the letters of credit was brought into account as trading income on receipt; and
    (2) the remaining £42,274,253 of the £248,302,590 received under the letters of credit was not treated as taxable trading income, on the basis that it constituted a disposal receipt for the purposes of the Capital Allowances Act 2001.

B. Garrard transaction

Transaction steps

31. *Establishment of Garrard Leasing Partnership LP*. Garrard Leasing Partnership LP ("Garrard") was formed on 21 March 2007 under a Limited

Partnership Agreement (the "Partnership Agreement") executed by JHSW Leasing (12) Ltd ("JHSW12", as general partner) and Schrovest Leasing 12/07 Ltd ("Schrovest", as limited partner). The business of Garrard was to carry out the trade of leasing by way of acquiring and investing in permitted investments.

32. JHSW12 held a 95% interest in the profits and losses and assets of Garrard and Schrovest held the remaining 5%.

33. An application was made by JHSW12 and Schrovest for the registration of Garrard as a limited partnership at Companies House using form LP5 on 16 March 2007 and Garrard was issued with a certificate of registration on 27 March 2007.

34. On 28 March 2007, JHSW12 executed and delivered a deed poll declaring that it held its leasing business including, among other things, a film lease as general partner of Garrard and beneficially for Garrard. On the same day, JHSW12 and Schrovest entered into a supplemental agreement pursuant to which they agreed that Schrovest would pay to JHSW12 an amount equal to 5% of the purchase price referred to in the deed poll and that £100 be credited to the capital account of JHSW12 and £6 to the capital account of Schrovest.

35. On 30 March 2007 JHSW12 and Schrovest executed and delivered two deeds of rectification to rectify certain errors in the drafting of the deed poll and the supplemental agreement.

36. *Transfer of Garrard to Investec*. On 2 April 2007, IBP, Schroder Investment Company Ltd ("SICL") and JHSW12 entered into a transfer agreement ("the Transfer Agreement") pursuant to which IBP replaced JHSW12 as general partner and acquired the entire issued share capital of Schrovest from SICL. The consideration for the shares was £7,877 and the consideration for the partnership interest was £4,899,625.

37. Schrovest notified JHSW12 that it had nominated IBP as its successor general partner and each of Schrovest and JHSW12 notified each other of their consent.

38. The transfer of the share capital of Schrovest was completed by way of stock transfer form dated 2 April 2007.

39. On 2 April 2007, SICL, as sole shareholder in Schrovest, resolved by way of written resolution to change the name of Schrovest to Investec Asset Finance (Capital No.3) Ltd ("IAF3").

40. On 2 April 2007, JHSW12, Schrovest and IBP executed and delivered a deed of undertaking and accession pursuant to which IBP undertook JHSW12's rights and assumed JHSW12's obligations as general partner of Garrard, and IBP became the general partner of Garrard. On 2 April 2007 JHSW12 and IBP executed and delivered a deed of assignment transferring legal title to the assets beneficially owned by Garrard from JHSW12 to IBP.

41. *Admission of IAF as limited partner of Garrard.* On 10 April 2007, IAF acquired a 4% interest in Garrard from IAFC3. Each of Investec and IAF3 executed and delivered a supplemental deed, pursuant to which:
    (1) £200,000 of capital was to be returned to IAF3 (reducing IAF3's capital to £50,000); and
    (2) IAF contributed £200,000 of capital to Garrard.

42. IAF paid £200,000 directly to IAF3 in satisfaction of the return and contribution of capital. IAF then became a limited partner of Garrard and was entitled to 4% of the profits and losses and assets of Garrard. IBP was then entitled to 95% and IAF3 to 1%.

43. *The Capital Bank leases.* On 12 April 2007, Garrard acquired certain commercial vehicles at a total cost of £723,664.76 which were then leased to Capital Bank plc on operating lease terms. This acquisition was funded by a call, made by IBP as General Partner of Garrard, for additional capital contributions of:
    (1) £687,481.52 from itself;
    (2) £28,946.59 from IAF; and
    (3) £7,236.65 from IAF3.

44. *Amendment and Restatement of the Partnership Agreement.* On 25 May 2007, each of the partners resolved to convert Garrard into a limited partnership. On 25 May 2007, Investec and IAF3 executed and delivered an amended and restated limited partnership agreement. Garrard was renamed "Garrard No.2 Leasing Partnership LP".

45. On 25 May 2007, the partners submitted a new form LP5 to Companies House, and Garrard was registered as a limited partnership on 29 May 2007.

46. *The First Lease Acquisition.* On 25 May 2007, IBP (as general partner of Garrard) resolved to purchase:
    (1) certain machinery, vehicles and plant subject to operating leases to Bank of Ireland Business Finance Ltd, Capital Bank plc, Fortis Lease UK Ltd, ING Lease (UK) Ltd, MAN Financial Services plc, VFS Financial Services (UK) Ltd and Tesco Distributions Ltd from Investec Asset Finance (No.1) Ltd (a member of the same group of companies as Investec);
    (2) certain machinery, vehicles and plant subject to operating leases to Alliance & Leicester Commercial Finance, Bank of Ireland Business Finance Ltd, Capital Bank plc and ING Lease (UK) Ltd from Investec Asset Finance (Capital) Ltd (another member of the same group of companies as Investec); and
    (3) certain commercial vehicles from one or more third party suppliers to be leased to MAN Financial Services PLC by way of operating leases.

47. The purchases were funded by additional capital contributions, called for by IBP as general partner of Garrard, of:
    (1) £48,759,415 from itself;

(2) £2,053,028 from IAF; and
(3) £513,257 from IAF3.

48. On 29 May 2007, IBP (as general partner of Garrard), Investec Asset Finance (No.1) Ltd and Investec Asset Finance (Capital) Ltd signed a sale and purchase agreement in relation to the machinery, vehicles and plant subject to leases referred to at paragraphs 46(1) and 46(3) above. Garrard paid £40,171,700 to Investec Asset Finance (No.1) Ltd as consideration and £5,944,000 to Investec Asset Finance (Capital) Ltd.

49. The transfers of title to the machinery, vehicles and plant were completed by two bills of sale executed by Investec Asset Finance (No.1) Ltd and Investec Asset Finance (Capital) Ltd respectively on 29 May 2007.

50. On 31 May 2007, IBP (as general partner for Garrard) acquired certain commercial vehicles at a total cost of £5,680,825 which were then leased to MAN Financial Services PLC by way of operating leases.

51. *Guinness Mahon Leasing Ltd*. On 19 July 2007, Guinness Mahon Leasing Ltd ("GML") and IAFC3 signed a transfer agreement and GML replaced IAFC3 as a limited partner of Garrard. The consideration payable by GML to IAF3 was £576,137.

52. On 19 July 2007, Investec, IAF3 and GML executed and delivered a deed of adherence and GML became a limited partner of Garrard in accordance with the Partnership Agreement.

53. *The Second Lease Acquisition*. On 23 July 2007, IBP (as general partner of Garrard) resolved to purchase certain machinery, vehicles and plant subject to operating leases to Alliance & Leicester Commercial Finance plc, Bank of Ireland Business Finance Ltd, Capital Bank plc, ING Lease (UK) Ltd, MAN Financial Services plc and VFS Financial Services (UK) Ltd from Investec Asset Finance (No.1) Ltd.

54. Garrard raised the capital required to acquire these leases by way of additional capital contributions and a loan from its partners. On 23 July 2007, IBP (as general partner of Garrard) called for additional capital contributions of:
(1) £20,480,670 from itself;
(2) £862,344 from IAF; and
(3) £215,586 from GML.

55. GML did not agree to make any additional capital contribution to Garrard. Instead, GML advanced £215,586 to Garrard by way of a loan. GML and IBP (as general partner of Garrard) signed a letter on 23 July 2007 setting out the terms of that loan.

56. On 23 July 2007, IBP (as general partner of Garrard) and Investec Asset Finance (No.1) Ltd signed a sale and purchase agreement in relation to the machinery, vehicles and plant subject to leases referred to at paragraph 55

above. Garrard paid to Investec Asset Finance (No.1) Ltd £21,558,600 as consideration.

57. The transfer of title to the machinery, vehicles and plant was completed (by a bill of sale executed by Investec Asset Finance (No.1) Ltd) on 23 July 2007.

58. *Sale of receivables to Lombard*. On 15 August 2007, IBP (as general partner of Garrard) and Lombard signed a receivables purchase agreement, under which IBP agreed to assign absolutely to Lombard all its rights, title and interest in and to 95% of certain of Garrard's lease receivables to Lombard and Lombard agreed to pay to Garrard £63,501,141.72.

59. On 15 August 2007, Investec Asset Finance (Management) Ltd, IBP (as general partner of Garrard), Lombard and IBP (as guarantor of Investec Asset Finance (Management) Ltd's obligations) signed a management agreement, by which Investec Asset Finance (Management) Ltd was appointed as manager of the leased equipment and the payments made in respect of or under the leases.

60. On 15 August 2007, IBP and Lombard signed a performance guarantee letter pursuant to which IBP guaranteed the performance and payment obligations of Investec Asset Finance (Management) Ltd under the management agreement.

61. *The return of capital to IBP and repayment of debt to GML*. On 21 August 2007, Investec and GML (as partners in Garrard) executed and delivered a supplemental deed by which:
    (1) the partners agreed that Garrard would pay £62,500,000 to IBP by way of a return of capital contributed by IBP;
    (2) the partners agreed that IBP's capital account would thereby be reduced to £12,177,566.52; and
    (3) IBP (as general partner of Garrard) confirmed to IAF and GML (as limited partners of Garrard) that Garrard would repay to GML the loan which GML had advanced to Garrard (and referred to at paragraph 55), together with accrued interest.

    £62,500,000 of capital was returned to IBP on 22 August 2007 and £216,667.90 was paid to GML in repayment of the loan on 23 August 2007.

62. On 10 September 2007, Investec and GML (as partners in Garrard) executed and delivered a further supplemental deed by which:
    (1) the partners agreed that Garrard would pay £260,000 to IBP by way of a return of capital contributed by IBP; and
    (2) the partners agreed that IBP's capital account would thereby be reduced to £11,917,566.52.

63. £260,000 of capital was returned to IBP on 10 September 2007

64. *The sale of partnership interests to SMBC Leasing and to Mithras*. On 11 September 2007, Investec, SMBC Leasing (UK) Ltd ("SMBC Leasing"), Mithras Leasing No.1 Ltd ("Mithras") and SMBC Leasing and Finance Inc. ("SMBC Inc.") signed a transfer agreement (the "SMBC Sale Agreement").

SMBC Leasing, Mithras and SMBC Inc. were and are all members of the SMBC group of companies. The transfer agreement provided for:

(1) a sale by IBP of its interest in Garrard to SMBC Leasing for £15,216,321; and

(2) a sale by IAF of its interest in Garrard to Mithras for £3,224,319.

65. On 11 September 2007, Investec, SMBC Leasing and GML executed and delivered a deed of undertaking and accession pursuant to which SMBC Leasing replaced IAF as partner of Garrard.

66. On 11 September 2007, IBP (as retiring general partner of Garrard) and SMBC Leasing (as new general partner of Garrard) executed and delivered a deed of assignment pursuant to which IBP transferred to SMBC Leasing legal title to the assets and obligations beneficially owned by Garrard.

67. On 11 September 2007, Lombard, SMBC Leasing, Investec Asset Finance (Management) Ltd and IBP executed a deed of novation in respect of the management agreement signed on 15 August 2007 (and referred to at paragraph 59).

68. On 11 September 2007, Investec, Mithras and GML executed and delivered a deed of adherence pursuant to which Mithras replaced IBP as partner of Garrard.

69. On 11 September 2007, SMBC Leasing, Mithras, GML and IBP executed and delivered a supplemental deed making certain changes to the arrangements between the partners of Garrard, and changing the name of Garrard to "Mithras Leasing Investment LP".

70. On 11 September 2007, Investec Asset Finance (Management) Ltd, SMBC Leasing (as general partner of Garrard) and IBP (as guarantor of Investec Asset Finance (Management) Ltd's obligations) signed a further management agreement, by which Investec Asset Finance (Management) Ltd was appointed as manager of the leased equipment and the payments made in respect of or under the leases held by Garrard.

71. The consideration referred to in paragraphs 64(1) and 64(2) was received by Investec on 11 September 2007.

72. *The amendment to the transfer agreement*. On 27 March 2008, Investec, SMBC Leasing, Mithras and SMBC Inc. signed an agreement which amended the transfer agreement signed on 11 September 2007. The agreement increased the purchase price paid by SMBC Leasing to IBP by £275,000.

Accounting for the transaction by Investec

73. IAF and IBP reflected these transactions in their statutory accounts in accordance with generally accepted accounting practice for the purposes of section 42 of the Finance Act 1998.

74. Each of IAF and IBP treated Garrard as a separate entity such that its interest in that entity was accounted for as a separate asset (rather than showing the underlying lease receivables).

75. Each of IAF and IBP initially recognised the partnership interest which it acquired (from IAF3 in the case of IAF and from JHSW12 in the case of IBP) at cost. Each of IAF and IBP recognised capital contributions to Garrard by increasing the book value of its interest in Garrard by an amount equal to the capital contributed.

76. IBP recognised returns of capital to it by decreasing the book value of its interest in Garrard by an amount equal to the capital returned.

77. Each of IAF and IBP accounted for the sale of its partnership interest in Garrard on 11 September 2007 by derecognising its investment in Garrard and showing the excess of its sale proceeds over the then book value of its interest in Garrard as a trading profit in its profit and loss account.

Garrard's profit allocation

78. A calculation of Garrard's UK taxable profits by Investec was prepared and its profits and losses were allocated to IAF and IBP.

79. £63,501,142 received from Lombard for the sale of the Receivables on 15 August 2007 was brought into account as trading income on receipt.

C. HKP transaction

Transaction Steps

80. All of the documents referred to below were governed by Hong Kong law.

81. *The establishment of the Forty-Sixth Hong Kong Leasing Partnership.* The Forty-Sixth Hong Kong Leasing Partnership ("HKP") was constituted on 18 September 1997 under a partnership deed ("the Partnership Deed") executed and delivered by Bombo Ltd ("Bombo"), The Bank of East Asia, Ltd ("BEA") and Carrabelle Ltd ("Carrabelle"). Both Bombo and Carrabelle were and are wholly-owned indirect subsidiaries of Cathay Pacific Airways Ltd ("Cathay").

82. HKP was formed for the purposes of hiring an Airbus A340-300 together with its engines (together, the "Aircraft") from Cathay under a hiring agreement, and for leasing the Aircraft back to Cathay. Each of Bombo and Carrabelle contributed HK$9,544 to HKP's capital and was entitled to 0.0025% of the profits and losses and assets of HKP. BEA was entitled to the remaining 99.995% and contributed HK$127,600,865 and US$32,828,307 to HKP's capital. HKP's business was managed by Bombo as managing partner and carried on in Hong Kong.

83. *Funding of HKP.* The following steps took place on 18 September 1997.

84. HKP and Kleinwort Benson Ltd ("Kleinwort", acting through its Hong Kong branch) executed and delivered a Loan Agreement pursuant to which Kleinwort agreed to advance up to HK$708,891,946 by way of loan finance to HKP ("the 1997 Loan").

85. HKP and Kleinwort executed and delivered a Security Agreement, under which HKP (by way of continuing security for its obligations to repay the 1997 Loan) assigned to Kleinwort its right to receive certain rentals under the Lease.

86. HKP, BEA, Carrabelle and Cathay executed and delivered a Retirement Option Deed, by which HKP granted BEA the option to retire from HKP and Carrabelle agreed to purchase BEA's partnership interest on BEA's retirement. BEA was entitled to exercise its option to retire between 1 January 2000 and 1 February 2000, and was in any event required to exercise that option by 1 February 2000. The amount payable to BEA if it exercised its option to retire was to be US$37,197,554.

87. *The Lease Documents*. The following steps took place on 18 September 1997.

88. Cathay and HK P executed and delivered a Hiring Agreement, by which Cathay hired the Aircraft to HKP until 11 December 2015. HKP paid Cathay HK$1,090,602,995 on delivery of the Aircraft and was given the option to purchase the Aircraft for HK$1.

89. HKP and Cathay executed and delivered an Aircraft Lease Agreement (the "Lease"), by which HKP leased the Aircraft to Cathay until 11 December 2015. Cathay was required to pay to HKP:
    (1) specified rentals as shown in Schedule 5 to the Lease (annually on 11 December each year from and including 11 December 1998 to 11 December 2007, and in Hong Kong dollars totalling HK$1,110,209,493 in aggregate); and
    (2) on and from 12 December 2007 such "Additional Rent" as HKP and Cathay mutually agreed as being commercially reasonably.

90. *The Hong Kong Inland Revenue Department Ruling*. Cathay applied for and received a ruling from the Hong Kong Inland Revenue Department on 5 August 1997 relating to the Hong Kong tax treatment of the leasing arrangements described above.

91. *Exercise of the Retirement Option Deed*. BEA exercised its option to retire from HKP in accordance with the Retirement Option Deed in January 2000. As a consequence, Carrabelle was entitled to 99.9975% of the profits and losses and capital of HKP and Bombo to the remaining 0.0025%.

92. *The ruling application under Section 88A of the Inland Revenue Ordinance*. On 28 August 2007, KPMG, acting on behalf of both Cathay and Investec, applied for an advance ruling from the Hong Kong Inland Revenue Department in relation to the Hong Kong profits tax position for HKP, Cathay,

Carrabelle and Investec in relation to these arrangements. A ruling was given on 14 November 2007.

93. *The purchase of the Partnership interests.* On 7 December 2007, Carrabelle, Investec, Bombo and Cathay executed an Agreement for Sale and Purchase pursuant to which IAF agreed to purchase a 4.9975% interest in HKP and IBP agreed to purchase a 95% interest in HKP, in each case from Carrabelle. The price payable by IAF was HK$31,457,561 and the price payable by IBP was HK$597,992,662. Bombo retained its 0.0025% interest in HKP.

94. The steps at paragraphs 95 to 101 below took place on 10 December 2007.

95. Bombo and Investec executed and delivered an amended and restated partnership deed. The amendments to the Partnership Deed included a requirement for Bombo to deposit sufficient rentals received under the Lease into a "Tax Reserve Account" as a provision for Hong Kong profits tax, and to distribute excess rentals to the partners in accordance with their profit shares.

96. Cathay and Bombo (as managing partner of HKP) signed an amendment agreement to the Hiring Agreement and an amendment agreement to the Lease. The amendments to the Lease included:
   (1) a provision for "Additional Rents", payable on 11 December 2007, 11 December 2008, 11 December 2009 and 11 December 2010, in each case in an amount equal to HK$160,115,580; and
   (2) a right for Cathay to prepay, on or after 11 December 2007, all Additional Rent outstanding at that time as a lump sum.

97. HKP, Bombo, Cathay and Investec executed and delivered a Put Option Deed under which Investec were each granted an option to require Cathay to purchase their interests in HKP. IAF and IBP together paid HK$40,000,000 as consideration for the grants of the put options by Cathay. The prices payable by Cathay (or its nominee) for the purchase of the partnership interests on exercise of the put options depended on whether or not the Additional Rents had been paid and, if the Additional Rents had not been paid, whether or not a "Contingent Event" had occurred. If the Additional Rents were paid in full, then Cathay would pay HK$1 to IAF and HK$3 to IBP.

98. A "Contingent Event" covered breach by either IAF or IBP, a fall in Investec's credit rating to Baa2/BBB- or below, insolvency of either IAF or IBP or the occurrence of certain early termination events under the Lease.

99. HKP, Bombo and Investec executed and delivered a Call Option Deed under which Bombo was granted options to require Investec to sell their interests in HKP for prices calculated on the same basis as set out above at paragraph 97 in relation to the Put Option Deed. Bombo was entitled to exercise its call options on the occurrence of an "Acceleration Event" (an "Acceleration Event" being the same as a "Contingent Event" under the Put Option Deed).

100. HKP (through each of its partners) and Bombo executed a security assignment by which HKP assigned its right to acquire the Aircraft under the Hiring

Agreement from Cathay for HK$1 to Bombo as security for Investec obligations under the Call Option Deed.

101. HKP (through each of its partners) and Bombo executed a Charge Over Account Deed pursuant to which HKP charged the Tax Reserve Account in favour of Bombo as security for HKP's Hong Kong tax liabilities.

102. *Payments and Prepayments*. On 10 December 2007, Investec paid the HK$629,450,223 purchase prices for the partnership interests acquired by Investec, and paid the HK$40,000,000 price under the Put Option Deed. Investec acquired Carabelle's partnership interests in HKP on that date.

103. On 11 December 2007, HKP received rentals of HK$267,979,819 due on that date under the Lease. This amount comprised the final instalment of rentals referred to at paragraph 89(1) in an amount equal to HK$107,864,239 and the first instalment of Additional Rent). Investec received HK$224,227,775 of distributions from HKP, and Bombo deposited HK$43,746,129 into the Tax Reserve Account.

104. On 14 December 2007, Cathay issued a prepayment notice to HKP and Bombo (as managing partner of HKP) notifying them that it would prepay all of the outstanding Additional Rent (HK$480,346,741) on 20 December 2007. On 20 December 2007, HKP received that prepayment, Investec received HK$401,922,593 of distributions from HKP and Bombo deposited HK$78,413,780 into the Tax Reserve Account.

105. *Payment of Hong Kong tax*. On 11 August 2008, HKP received an assessment for payment of its Hong Kong profits tax from the Hong Kong Inland Revenue Department. The amount due was HK$112,730,734 for 2007/08. The HK$112,730,734 liability for 2007/08 was due for payment (and paid) by 3 November 2008.

106. *Exercise of the Put Option*. On 27 November 2008, IAF and IBP each exercised their put options under the Put Option Deed. This process was completed on 1 December 2008. Investec waived the exercise price of HK$4 which would otherwise have been due from Cathay.

Accounting for the transactions by Investec

107. IAF and IBP reflected these transactions in their statutory accounts in accordance with generally accepted accounting practice for the purposes of section 42 of the Finance Act 1998

108. Each of IAF and IBP "looked through" the partnership, and the Leases were accounted for directly in each company's accounts. The profit earned by each company, being the excess of the fair value of its share of the lease receivables over the aggregate of the cost of its partnership interest and the cost of the put options, was shown in its profit and loss account.

HKP's profit allocation

109. The calculation of HKP's UK taxable profits by Investec was prepared and the HKP's profits and losses were allocated to IAF and IBP. The HK$267,979,819 rentals received on 11 December 2007 and the HK$480,346,740 rental prepayment received on 14 December 2007 were brought into account as trading income on receipt in computing HKP's UK taxable profits.