TC01550

Appeal number: TC/2010/08369

APPEAL – Strike out application – Jurisdiction to hear appeal – Appeal against closure notice – Following lodging of appeal Revenue seeking to rely on additional ground to defend closure notice – Whether additional ground to be struck out – R.8(2)(a) of Tribunal Procedure (FTT) Tax Chamber Rules (SI 2009/273)

FIRST-TIER TRIBUNAL

TAX

FIDEX LIMITED **Appellant**

- and -

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

TRIBUNAL: SIR STEPHEN OLIVER QC

Sitting in public in London on 10 October 2011

Michael Flesch QC, for the Appellant

John Tallon QC, instructed by the General Counsel for HMRC, for the Respondents

DECISION

1. The Appellant, Fidex Ltd seeks to strike out a part of the case pleaded by HMRC in their Statement of Case on the grounds that the Tribunal does not have jurisdiction to hear that part of HMRC's case.

2. The application is made pursuant to rule 8(2)(a) of the Tribunal Procedure (FTT) Tax Chamber Rules (SI 2009/273). This provides that:

> "The Tribunal must strike out the whole or part of the proceedings if the Tribunal does not have jurisdiction in relation to the proceedings or that part of them."

Brief summary

3. Fidex, it appears, was part of the BNP Paribas group of companies. Some £1m was spent in the purchase of a scheme designed to produce a loss of around €83m in the hands of Fidex; that loss was to be available for group relief throughout the BNP Paribas group of companies. The loss scheme was based on what are said to be consequences of the special computational provisions of the loan relationship code introduced by Finance Act 1996.

4. When an "enquiry" took place, the correspondence focussed on one aspect of the computational provisions. A closure notice was issued and this revised the loss downwards by adjusting a "debit" from €83m to £3.6m. The closure notice explained that Fidex had wrongly used paragraph 19A of Schedule 9 to FA 1996 and that the "derecognition" of certain listed bonds and preference shares should not have occurred on the transition of one set of accounting standards (UK GAAP) to another (IFRS). After the matter had been appealed, HMRC sought to contend that the debit was prevented from being taken into account for tax purposes by virtue of paragraph 13 of Schedule 9 FA 1996. This "new" argument was based on the contention that the loan relationships in question had an "unallowable purpose".

5. The strike out application is based on the proposition that the Tribunal's jurisdiction is limited to the "conclusion" in the closure notice that, having regard to the proper application of paragraph 19A, the debit to be brought into account is to be £3.7m and not, as claimed, €83m. As the operation of paragraph 13 was not mentioned in the closure notice it could not in law qualify as a "conclusion" falling within the jurisdiction of the Tribunal. The Tribunal's jurisdiction is, so the argument runs, limited to the scope of paragraph 19A of Schedule 9.

6. To give a flavour of the present issue, I need to summarise the background transactions. I have drawn these from the Statements of Case of the parties. But nothing in this decision should be taken as addressing the possible substantive issue in the appeal itself.

The Essential Facts

7. As of 22 December 2004, Fidex was a wholly owned subsidiary of Fidex Holdings Ltd; Fidex's ultimate parent company was (as noted) BNP Paribas. Fidex's only assets at the time were 22 bonds, maturing between 2005 and 2012. The bonds had all been acquired by Fidex in 1999 and 2000.

8. On 22 December 2004, Swiss Re Financial Products Corporation ("Swiss Re") subscribed for four different classes (classes A, B, C, and D) of redeemable preference shares in Fidex, for a consideration of approximately €84.5m. Each of the four classes of preference shares was referenced to a particular bond owned by Fidex; i.e. the rights attaching to each class of preference share were directly related to the amounts received by Fidex in respect of the reference bond in question. The Class A preference shares were referenced to a bond for €20m issued by Textron Inc, maturing on 14 March 2005. The Class B preference shares were referenced to a bond for €25m issued by IBM Corporation, maturing on 31 March 2005. The Class C preference shares were referenced to a bond for €20m issued by TCNZ Finance Ltd, maturing on 19 April 2005. The Class D preference shares were referenced to a bond for €20m issued by Coco Cola AG, maturing on 4 July 2005.

9. The rights of each class of preference shares were restricted to 95% of the amounts actually received by Fidex in respect of the referenced bond on its maturity.

Accounting treatment of the Bonds – Paragraph 19A of Schedule 9 to FA 1996

10. For its accounting period ended 31 December 2004, Fidex drew up accounts in accordance with UK GAAP, i.e. UK Generally Accepted Accounting Practice. For its following accounting periods, commencing 1 January 2005, Fidex drew up its accounts in accordance with IFRS, i.e. International Financial Reporting Standards. The aim was to bring paragraph 19A of Schedule 9 to Finance Act 1996 ("paragraph 19A") into play.

11. The scheme was designed to bring Fidex within paragraph 19A. Four bonds were creditor loan relationships of Fidex. In Fidex's accounting period ended 31 December 2004, applying UK GAAP, the four bonds were shown on Fidex's balance sheet at their full value. Following the adoption of IFRS from 1 January 2005, and as a result of the issue of the preference shares to Swiss Re, the four bonds were no longer reflected, as to 95% of their value, in Fidex's balance sheet on 1 January 2005. The scheme was based on the proposition that following the change to IFRS the four bonds were to be derecognised as to 95%, leaving the remaining 5% on Fidex's balance sheet as at 1 January 2005. Consequently the scheme was designed to secure that the difference between the value (100%) of the recognised bonds as at 31 January 2004 and the value (5%) of those bonds as at 1 January 2005 gave rise to a debit of approximately €84m pursuant to paragraph 19A(3).

Procedural History of Appeal

12. On 29 March 2007 Fidex submitted its self-assessment return for the year ended 31 December 2005.

13. Fidex notified HMRC that it had employed a scheme designed to engineer a tax deduction. The scheme had been code-named as "Project Zephyr".

14. HMRC gave notice under paragraph 24 of Schedule 18 of Finance Act 1998 of their intention to enquire into Fidex's return. The notice was given on 3 September 2007. On 13 November 2007 Fidex made certain amendments to its self-assessment return.

15. On 2 August 2010, under paragraph 32 of Schedule 18 of Finance Act 1998, HMRC gave notice of completion of their enquiry and stated that the loss of the Appellant was to be revised from €89,270,434 to €5,421,035.

16. Fidex gave notice of appeal to HMRC. Pursuant to a request from Fidex, HMRC reviewed the matter and concluded, by letter to Fidex of 21 October 2010, that the downward adjustment reflected in the notice of completion of enquiry should be upheld.

The Closure Notice

17. Before setting out the terms of the Closure Notice, I refer to two further provisions in Schedule 18 to Finance Act 1998.

18. Paragraph 32(1) provides that –

> "An enquiry is completed when [HMRC] by notice ("a Closure Notice") inform the company they have completed their enquiry and state their conclusions".

19. Paragraph 34(1) provides that –

> "This paragraph applies where a closure notice is given to a company by [HMRC]".

20. Paragraph 34(2) provides, so far as relevant, that –

> "The closure notice must:
>
> (a) … or
> (b) make the amendments of that return that are required
>
> (i) to give effect to the conclusions stated in the notice …"

Paragraph 34(3) provides that –

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

21. The Closure Notice dated 2 August 2010 reads as follows:

> "**Company Tax Return – Year ended 31 December 2005**
>
> I have completed my enquiry into the company's Tax return for the period 1 January 2005 to 31 December 2005 and my conclusions are:
>
> The derecognition of the listed bonds and preference shares should not have occurred on transition to IFRS. Therefore the sum of €83,849,399 representing the value of the derecognised listed bonds should not have been included in the change in basis adjustments following the adoption of IFRS.
>
> The loss for corporation tax purposes is therefore as follows:
>
> | | | |
> |---|---|---|
> | Loss for the period based on return as amended | | €89,270.434 |
> | Reduction as noted above | | €83,849,399 |
> | Revised loss | | €5,421,035 |
> | €1=£0.68371393 | Revised loss for period | £3,706,437 |
>
> Please note that the loss figure of €89,270.434 takes into account a Taxpayer Amendment made during the enquiry (letter from Michael Deriaz dated 12 November 2007) and deferred under paragraph 31(3) Schedule 18 FA 98.
>
> Further analysis may reveal additional grounds supporting the conclusions I have reached.
>
> This notice amends the return to give effect to my conclusions. If the company does not agree with the amendments I have made to the company's Tax Return it may appeal, by notice in writing within 30 days after the amendments were notified to it.
>
> 268/89598 11746/HD
>
> The amount available for the company to surrender as group relief has been reduced. I draw your attention to the company's obligation under paragraph 75 Schedule 18 FA 95 to withdraw, or amend, as many notices of consent as is necessary to bring the amount surrendered within the new amount available of £3,706,437. The company has 30

days to send a copy of any new notice of consent to each company affected and to HMRC."

The correspondence with HMRC leading to the Closure Notice

22. The correspondence leading to the Closure Notice focussed on the application of paragraph 19A. In essence the question addressed in the course of correspondence was whether or not there was a paragraph 19A debit of some €84m which in turn depended upon the correct accounting treatment of the four bonds (a) as at 31 December 2004, when UKGAAP applied, and (b) as at 1 January 2005 when IFRS applied. HMRC questioned whether or not there was a paragraph 19A(3) "difference" between the accounting values of the four bonds as at 31 December 2004 and 1 January 2005 and accordingly whether was a paragraph 19A debit.

The New Argument adduced by HMRC

23. In their Statement of Case of 7 January 2011 HMRC advanced the following argument:

> "In the alternative, if a debit is prima facie found to arise for accounting purposes on 1 January 2005, [HMRC] contend that such debit may not be brought into account for tax purposes by reason of the application of paragraph 13 of Schedule 9 of Finance Act 1996 on account of the Appellant having an "unallowable purpose" in being a party to a loan relationship (i.e. holding the legal title to the Relevant Assets) within the meaning of paragraph 13. In support of this contention, [HMRC] rely on the following features:
>
> > (a) The scheme was designed as a tax scheme and was formally notified to HMRC on 28 October 2004 by the scheme promoter … . [Fidex] notified their use of the scheme in their corporation tax returns … .
> > (b) Swiss Re was to be paid fees to share in the anticipated tax saving resulting from bringing into account a debit arising on adoption of IFRS.
> > (c) The Relevant Assets were separated out from the otherwise "orderly disposal of [Fidex's] remaining assets".
> > (d) [Fidex] retained the legal right to collect the cashflows of the Relevant Assets, whilst effecting a "synthetic" disposal of them to Swiss Re … .
> > (e) Having regard to the very unusual and contrived rights attaching to the Preference Shares, the only relevant commercial purpose served in retaining the bare legal title to the Relevant Assets was that of seeking to engineer a tax deduction – i.e. tax avoidance."

Fidex's case for striking out the "New Argument"

24. Fidex rely on the wording and the proper application of paragraph 34(1) to (3) of Schedule 13 to FA 1998 : see paragraph 19 above. Paragraph 34, according to paragraph 24(1), applies where a Closure Notice is given by HMRC to a company. Paragraph 34(2), as already noted, provides that the Closure Notice must "… make the amendments of that return that are required … to give effect to the conclusions stated in the notice". Paragraph 34(3) provides, as noted, that – "An appeal may be brought against an amendment of any company's return under subparagraph (2)". It follows that the appeal of Fidex, in the present case, will be against the amendment that is "required to give effect to the conclusions" set out in the Closure Notice. The "conclusion", it was argued, was (to summarise the second paragraph of the Closure Notice) that there was no paragraph 19A difference because the derecognition of the listed bonds and preference shares should not have occurred on transition to IFRS; therefore the loss for corporation tax purposes is revised from €89m (as per the self-assessment return) to £3.7m.

HMRC's contention

25. HMRC say that the relevant conclusion from the enquiry was that there was no loss in the amount of €83,849,399; the loss, said by Fidex to have been €89,270,434, should therefore be reduced by the amount of the disputed loss to €5.4m.

Decision on present issue

26. I agree with HMRC. The expressed grounds for the conclusion in the Closure Notice (set out in full above) were indeed that there was no paragraph 19A(3) difference/debit; but, on the proper reading of paragraph 34(2) and (3), the conclusion stated in the Closure Notice was that there was no loss in the amount of €83.9m.

27. *Tower MCashback LLP 1 v Revenue and Customs Commissioners* [2001] STC 1143 and [2011] UK SC19 (a case concerned with provisions in similar form but concerned with partnership appeals) reinforces the view I have taken. Referring to the decision of Henderson J in the High Court, Lord Walker stated (in paragraph 15) that the judge had correctly observed that:

> "What matters at this stage is the conclusion which the officer has reached upon completion of his investigation of the matters in dispute, not the process of reasoning by which he has reached those conclusions".

The matter in dispute to which the investigation related was, in the present case, whether the scheme (Project Zephyr) had succeeded in establishing that the disputed loss arose.

28. Henderson J had gone on to say, in a further passage approved by Lord Walker (in paragraph 15) that if the appeal tribunal (in that case this had been the special commissioners) were to fulfil their statutory duty to ascertain the proper amount of the tax chargeable, it must be –

> "free in principle to entertain legal arguments which played no part in reaching the conclusions set out in the closure notice … . That is not to say, however, that an appeal against the closure notice opens the door to a general roving enquiry into the relevant tax return. The scope and subject-matter of the appeal will be defined by the conclusions stated in the closure notice and by the amendments (if any) made in the return."

29. The enquiry in the present case was directed at whether a scheme designed to produce a loss through the operation of the loan relationships provisions was successful in achieving that result. The enquiry did not involve "a general roving enquiry" into Fidex's tax returns. The sole question, as already noted, was whether, having regard to the terms of the loan relationships code in Schedule 9 to FA 1996, the implementation of the scheme served to increase for tax purposes the loss shown in Fidex's self-assessment tax return. That was the point of the enquiry. The stated effect of the contribution notice was that in the circumstances the loan relationship provisions did not produce that result. To confine the Tribunal to an analysis of one provision in the Code, i.e. paragraph 19A, while ignoring the possible impact of paragraph 13, would be to impose an unacceptable restriction on the judicial function of the Tribunal. I am satisfied in the circumstances that the Tribunal has the jurisdiction in relation to the paragraph 13 arguments now being adduced by HMRC. It would not therefore be proper to strike out that part of HMRC's case that relies on paragraph 13.

30. For those reasons I dismiss the application.

31. For completeness I need to address a point taken by Fidex in relation to the "review" provisions (found in sections 49A to 49I Taxes Management Act). These had not been in force when the *Tower MCashback* litigation was underway. It was pointed out for Fidex that HMRC, had, in compliance with section 49C(2) stated, for the purposes of the review, what their deciding officer's view of the matter had been; the explanation had referred to letters from the deciding officer that had focussed exclusively on the question of whether there was a paragraph 19A(3) "difference"/debit. That (it was said for Fidex) had been "the matter in question" for all purposes of the review provisions and particularly for purposes of section 49I(1)(a) which provides that the matter in question is "the matter to which an appeal relates". Thus, it was argued, the only matter to which Fidex's appeal relates and can therefore come within the jurisdiction of the Tribunal is the correctness of the accounting treatment of the bonds as at 31 December 2004 and 1 January 2005. I do not see that the scope of the Tribunal's jurisdiction can be so limited. The question for the Tribunal is whether, having regard to the statutory code covering loan relationships

and having regard to the circumstances of Project Zephyr, Fidex sustained the loss for which it has claimed relief.

32. Application refused.

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

SIR STEPHEN OLIVER QC
TRIBUNAL JUDGE

RELEASE DATE: 7 November 2011