TC01743

Appeal number TC/2010/03181

Corporation tax – whether 'premium' in sale agreement revenue or capital – whether expenditure wholly and exclusively for purposes of trade – s74 ICTA 1988 - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

BLUESPARKLE LIMITED

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS (*corporation tax*) **Respondents**

TRIBUNAL: Judge Malachy Cornwell-Kelly
Mrs Shahwar Sadeque

Sitting in public at 45 Bedford Square London on 15 December 2011

Mr R Roberts of Handley Roberts, accountants, for the taxpayer

Mr M Faulkner of HM Revenue and Customs for the Crown

DECISION

Introduction

1 This appeal concerns a short point on whether part of the payment made by the taxpayer for the acquisition of a private hospital from its subsidiary Largeflag Limited, referred to as a ‘premium’, has in the circumstances of this case a capital or a revenue character; and, if it has a revenue character, whether it is an allowable deduction in computing profits for corporation tax purposes.

2 The matter comes before us as an appeal against a closure notice dated 6 October 2009 disallowing as a deduction in the accounts of the taxpayer of £400,000, which is the ‘premium’ to which we refer, for the accounting period ending 31 January 2006. We received 122 pages of documentary evidence, and oral evidence from Mr David Fulton, Mr Gerald Johnson and Mrs Sally Lavender.

3 For the taxpayer, it was submitted (i) that the premium was of a revenue character, (ii) because it was not interest, it was not deductible under the loan relationships legislation and (iii) the premium was paid wholly and exclusively for the taxpayer’s trade and so is deductible in computing profits for corporation tax purposes. It was submitted that the premium was an inducement for the making of a refinancing agreement between the taxpayer and a subsidiary company and part of the consideration for that agreement, but that it was not interest.

4 For the Crown, it was contended that the premium was of a capital nature and that, not being made wholly and exclusively for the purposes of the taxpayer’s trade, it was not deductible for corporation tax; it was common ground with the taxpayer that because the premium was not interest, it was not deductible under the loan relationships legislation.

Facts

5 We find the following facts established on the balance of probabilities.

6 Largeflag Limited was at all material times a wholly owned subsidiary of Bluesparkle Limited. On 2 May 2001, Largeflag contracted with Totty Developments Limited to build a new private hospital at Darlington, having previously purchased the development site from them. On 26 June 2001 Bluesparkle, which was to run the hospital, entered into an agreement ('the Acquisition Agreement'), to purchase the freehold from Largeflag with completion the same day, 26 June 2001, which was defined as the Completion Date.

7 The consideration for that purchase consisted of (i) an initial sale price of £1,323,404, or 5% of the open market value at the completion date if greater, and (ii) a final sale price to be determined on the third anniversary of the Acquisition Agreement - 26 June 2004 – by a Fellow of the Royal Institute of Chartered Surveyors as the open market value of the property.

8 The final sale price was to be paid in accordance with the following timescale provided in clause 6.6 of the Acquisition Agreement:

> 6.6 The Final sale Price once determined in accordance with clause 2.2.2 [the valuation] shall be paid in the following instalments:-
> The 4th anniversary of the Completion Date: 5% of the Final Sale Price plus £125,000 together with interest thereon from the Completion Date until the date of payment at the rate of 3% above LIBOR
> The 5th anniversary of the Completion Date: 5% of the Final Sale Price plus £125,000 together with interest thereon from the Completion Date until the date of payment at the rate of 3% above LIBOR

> The 6th anniversary of the Completion Date: 5% of the Final Sale Price plus £150,000 together with interest thereon from the Completion Date until the date of payment at the rate of 3% above LIBOR
>
> and thereafter in equal instalments of 7.5% of the Final Sale Price upon each subsequent anniversary of the Completion Date until payment in full has been made.

9 The payment dates were therefore 26 June 2005, 26 June 2006 and 26 June 2007. These terms were evidently not typical of a bargain made at arms' length and were in fact devised with VAT tax avoidance in mind. Before they could take effect, a Supplemental Agreement dated 23 June 2005 was entered into by the same parties under which the provisions of clause 6.6 were modified as follows:

> 1.3 The Sale Price payable by the Buyer to the Seller pursuant to the provisions of clause 6.6 has been determined and agreed as follows:
>
> the premium of £400,000 as set out in clause 6.6 of the Acquisition Agreement;
>
> the agreed Final Sale Price of £7,000,000;
>
> interest agreed in the sum of £445,204.82 as calculated in accordance with clause 6.6 of the Acquisition Agreement;
>
> the Initial Sale Price of £1,323,404.
>
> The total sum of £9,168,608.82 has been paid by the Buyer safe receipt of which is hereby acknowledged by the Seller.
>
> 1.4 The Seller and the Buyer hereby agree to vary the provisions of clauses 2.2 and 6.6 of the Acquisition Agreement *so as to give effect to the above mentioned calculation of the Final Sale Price* so that the performance by the Seller and the Buyer of their respective obligations under the Acquisition Agreement are deemed to have been performed by each party to the satisfaction of the other.
>
> [emphasis added]

10 None of our witnesses was connected with the Acquisition agreement or could speak to what it was intended to mean. Mr David Fulton was a director of both companies at the time of the Supplemental Agreement, but not the earlier one; Mr Gerald Johnson was the solicitor who prepared the Supplemental Agreement described below, but not the Acquisition Agreement; and Mrs Sally Lavender a

chartered accountant and the taxpayer's in-house accountant from 2002 to 2005 and was equally unable to give evidence about the Acquisition Agreement. Surprisingly, there were no written instructions to Mr Johnson, attendance notes by him or board minutes of either Bluesparkle or Largeflag to cast light on the characterisation of the £400,000 as a premium.

11 In oral evidence, Mrs Lavender and Mr Johnson considered that the premium described in the Supplemental Agreement corresponded to the three payments of £125,000, £125,000 and £150,000 mentioned in clause 6.6 of the Acquisition Agreement, but Mr Fulton was uncertain what it was replacing. Mr Fulton and Mr Johnson deposed that it was never intended to be part of the purchase price itself, and Mrs Lavender said that it was intended as "an early settlement premium"; all three insisted that it was intended to be treated as a revenue item.

12 Mr Fulton said that the premium was to compensate for interest Largeflag would lose under the revised deal on account of the early termination of the Acquisition Agreement; Mrs Lavender also said that the £400,000 was to reflect the early settlement, and said that the payment was "an early settlement premium". Mr Johnson did not address his mind to what character that payment had as he said that his instructions had not required him to; he did understand the payment to be additional to the sale price, but he could not recall why he had described the payment as a premium; he had probably just looked for something that seemed appropriate in the Encyclopaedia of Forms & Precedents.

13 Mr Fulton said that "at all times the directors of both companies acted upon expert accountancy advice"; Mrs Lavender said that "at all times the directors of both companies acted upon expert accountancy advice from outside accountants/auditors"; Mr Johnson's evidence

was that he was “aware that the directors of both companies had sought expert accountancy advice from outside accountants/auditors in respect of this transaction”, that Mrs Lavender in instructing him had on 11 March 2005 sent him “copies of the relevant documents” – though it is not clear what these documents were.

14 These statements were all recollections from memory, unsupported as we have noted by any contemporary documentation of the companies or the solicitor. There is, however, evidence in contemporary papers from Baker Tilly, who had evidently devised the VAT avoidance scheme, which sheds some light on the matter. As will be seen, the dates make it impossible that this material was among the “relevant documents” sent to Mr Johnson on 11 March, but it does give an insight into the “expert accountancy advice” that all three witnesses referred to and which they intended to give effect to.

15 On 22 February 2005, handwritten attendance notes obtained by the Revenue from Baker Tilly recorded a conversation with Mrs Lavender about Largeflag and Bluesparkle, and the need to restructure the finance arrangements in the Acquisition Agreement. The notes contained this reference to the revised payments proposed: “Largeflag need to make a profit on sale to show ‘commerciality’.” Further notes on 3 March 2005 recorded another conversation with Mrs Lavender as follows:-

> Check variation to payment terms – can it all be paid off at once now.
> Payment = value of building + interest (5%) + “profit of £150K p.a. from year 4.
> Agreement specifies profit of £400K over years 4/5/6 this would be charged to Bluesparkle even if payment made sooner, with interest of 5% on £400K + 5% of sale price up to date of payment.

16 The same day, 3 March, a Mr John Barnes at Baker Tilly's Leeds office minuted a colleague in the Birmingham office for advice prior to the Supplemental Agreement being put in place. What he said was this:

> Four years have elapsed since completion [of the sale to Bluesparkle], and Bluesparkle now wants to ascertain the consideration and pay Largeflag the final sale price. They are currently restructuring the mortgage, and really want it to be in Bluesparkle. The plan is for Bluesparkle to pay off Largeflag in one payment, rather than the instalments envisaged in para 6.6 of the agreement. Bluesparkle will however pay the full £400,000 "profit" that para 6.6 itemises, plus full interest up to the date the payment is made.
>
> Do you know if the agreement terms at para 6.6 are absolutely vital to this sort of scheme, or does it not really matter when payment of the final amount is paid (as long as it is after 3 years from completion). I can't see that it really matters when the final payment is made, as it will all be exempt. However, by paying the full £400,000 "profit" and interest, we are ensuring that Largeflag receives a good commercial deal that will stack up if we need to argue that the arrangements were commercially structured, and not just an inter-company scam.

17 Presumably Mr Barnes received the advice he was seeking, for he wrote to Mrs Lavender on 24 March 2005 as follows:

> You thought that there was the possibility that Largeflag could shortly start some commercial projects, possibly purchasing commercial properties to be let out. I agree that any such commercial activity would assist Largeflag in any future argument at Tribunal if the commercial nature of the company was in debate.
>
> With regards to your plans for Bluesparkle to pay in full for the property, rather than making the instalment payments specified in clause 6.6 of the 26.6.01 Acquisition Agreement, I can offer the following guidance-
>
> > 1 Payment of the "Final Sale Price" can be made in full rather than in instalments without causing any adverse impact on the VAT arrangements.
> >
> > . . .
> >
> > 3 The variation to clause 6.6 of the agreement should be made in writing, preferably by your solicitors.

> 4 We agreed that it would assist to reinforce the commercial nature of the transaction if the original calculation of the profit and interest to be charged by Largeflag to Bluesparkle could be retained in some form in the revised agreement.
>
> . . .

18 The principal reason for the making of the Supplemental Agreement was that Bluesparkle's shareholders wished to seek a buyer for the company which was not making a financial success of the hospital and the business was in danger of failing. The shareholders were surgeons who had clubbed together to start the hospital, but their ability in business terms had not matched their strengths in surgery. Thus, they decided to refinance the business away from Northern Rock, the previous lender, with Barclays bank as the lender instead. (Strangely, the loan by Northern Rock was to Largeflag, even though since the Completion Date, Bluesparkle had owned the freehold and was actually running the hospital.)

19 The intention in these circumstances was that there was to be a new loan followed, if possible, by a share sale. It was therefore necessary to consolidate the financial obligations arising from the Acquisition Agreement into a global settlement between the parties to improve, according to Mr Johnson, "the companies' financial standing in the eyes of both a prospective lender and purchaser". As we have noted, the payment schedule under the Acquisition Agreement had been inspired by a tax avoidance scheme rather than by arm's length commercial considerations.

20 There were, however, other considerations beside the prospect of a sale. Into the mix was the concern that we have seen in Baker Tilly's correspondence to demonstrate that Largeflag had had a good commercial deal, and this was apparently from the point of view of the VAT avoidance scheme, which had been challenged by the

Revenue and an appeal was awaiting the outcome of another case, referred to simply as ‘Halifax’. Mrs Lavender, agreeing with Mr Johnson and Mr Fulton, had indeed deposed that the directors “were anxious to ensure that Largeflag was not adversely prejudiced by the early termination of the Acquisition Agreement” and the concern about Largeflag clearly related to the danger that the company might be perceived as having no credible commercial reality to it.

Law

21 There was agreement as to the legislation and case law relevant to the case. Since there was also agreement between the parties that the premium, not being interest, was not deductible under the loan relationships legislation in chapter 2 of the Finance Act 2006 we do not refer to it, or to the authorities on what constitutes interest. Since we have found the agreed statement of the law presented to us by the parties unexceptionable, the following citations are drawn directly from it.

Capital or revenue?

22 Whether a payment is capital or revenue is a matter of law rather than accountancy. In *Heather v PE Consulting* 48TC 239 Lord Denning said, at 322:

> The Courts have always been assisted greatly by the evidence of accountants. Their practice should be given due weight; but the Courts have never regarded themselves as being bound by it. It would be wrong to do so. The question of what is capital and what is revenue is a question of law for the Courts. They are not to be deflected from their true course by the evidence of accountants, however eminent.

23 In *Vodafone Cellular Limited v Shaw* (1997) 69TC 376 Lord Millet said, at 433:

> Whether a payment is a capital or a revenue payment is a question of law: see *Strick v Regent Oil Co Ltd* 43TC1;

> [1966] AC 295 per Lord Reid at p. 313; CIR v Carron Co (1968) SC47; 45 TC 18 per Lord Wilberforce at p. 73; *Tucker v Granada Motorway Services Ltd* 53TC92; [1979] 1 WLR 683 per Lord Wilberforce at p. 688; *Beauchamp v FW Woolworth plc* 61TC542; [1990] 1 AC 478 per Lord Templeman at p. 492.

24 A payment that secures an asset or advantage that endures in the way fixed capital endures is likely to be capital. In *Atherton v British Insulated & Helaby Cables Limited* (1925) 10TC 155, Lord Cave said, at 193:

> … 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.

25 In *Anglo-Persian Oil Company Limited v Dale* (1931) 16TC 263 Rowlatt J clarified that:

> What Lord Cave is quite clearly speaking of is a benefit which endures, in the way that fixed capital endures; not a benefit that endures in the sense that for a good number of years it relieves you of a revenue payment. It means a thing which endures in the way that fixed capital endures. It is not always an actual asset, but it endures in the way that getting rid of a lease or getting rid of onerous capital assets or something of that sort as we have had in the cases, endures.

26 In *Tucker v Granada Motorway Services Limited* (1979) 53TC 92, the company leased a motorway service area from the government. The rent was calculated in part as a percentage of the company’s gross takings including tobacco duty. Tobacco duty rose sharply and consequently so did the rent payable. The parties agreed to vary the lease so as to exclude tobacco duty from the calculation. The House of Lords concluded that the payment was a capital one.

27 Lord Wilberforce said, at 107:

> There are a number of tests which have been stated in reported cases which it is useful to apply, but we have been warned more than once not to seek automatically to apply to one case words or formulae which have been found useful in another (see *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1964] AC 948).
>
> Nevertheless reported cases are the best tools that we have, even if they may sometimes be blunt instruments. I think that the key to the present case is to be found in those cases which have sought to identify an asset. In them it seems reasonably logical to start with the assumption that money spent on the acquisition of the asset should be regarded as capital expenditure.
>
> Extensions from this are, first, to regard money spent on getting rid of a disadvantageous asset as capital expenditure and, secondly, to regard money spent on improving the asset, or making it more advantageous, as capital expenditure. In the latter type of case it will have to be considered whether the expenditure has the result stated or whether it should be regarded as expenditure on maintenance or upkeep, and some cases may pose difficult problems.

28 The character of the payment does not depend on the motive or purpose of the taxpayer. In *Lawson v Johnson Matthey* (1992) 65TC 39, Lord Goff of Chieveley said, at 79:

> It is important to observe that the payment does not become a revenue payment simply because the taxpayer 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. Here it depends upon the question whether the sum was paid for the disposal of a capital asset.

> I have come to the conclusion that, on a true analysis, the sum was not paid for the disposal of the shares. It was paid by the taxpayer as a contribution towards the rescue of JMB which the taxpayer knew the Bank was going to mount immediately in the public interest. As such, it is in my opinion to be properly characterised as a revenue payment.

29 The character of the payment may be different for the payer and for the recipient. The cases of *CIR v Church Commissioners*(1976) 50TC 516 and *CIR v Land Securities Investment Trust* (1969) 45TC 495, both decided by the House of Lords, show a different characterisation of the same transaction in the hands of the vendor and purchaser. The Church Commissioners sold various freehold and leasehold interests to Land Securities in consideration of rentcharges reserved for 10 years. In *Land Securities* the House of Lords held that the rentcharges were the cost of acquiring capital assets and so were not deductible in calculating the company's profits; in *Church Commissioners* the House of Lords held that the payments to the Commissioners were wholly of an income nature.

30 *Lomax v Peter Dixon & Son Limited* (1943) 25TC 353was cited to us. There, the subsidiary company issued loan notes to its parent at a discount, bearing commercial interest and repayable at a premium. We do not, however, see the decision of great assistance in this case, as it deals with the lending and repayment of money rather than the acquisition of an asset by instalments.

Wholly & Exclusively?

31 Section 74 of the Income and Corporation Taxes Act 1988 provides that:

> (1) Subject to the provisions of the Corporation Tax Acts, in computing the amount of the profits to be charged to

corporation tax under Case I or Case II of Schedule D, no sum shall be deducted in respect of-

(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade or profession;

32 In *Vodafone*, Millet LJ said, at 437:

> The leading modern cases on the application of the 'exclusively' test are *Mallalieu v Drummond* 57TC330; [1983] 2 AC 861 and Mackinlay *v Arthur Young McClelland Moores & Co* 62TC704; [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* 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.

Submissions

33 For the taxpayer, it was submitted that the term ‘premium’ is not defined in the Supplementary Agreement and should therefore be accorded its ordinary dictionary meaning of being a reward or bounty, an excess over the original price or anything offered as an alternative. Its payment did not bring into existence anything that endures or is an asset, and it did not involve Bluesparkle in divesting itself of an onerous capital asset.

34 Equally, the premium was not interest, but a sum payable as part and parcel of restructuring the financial arrangements for the purchase of the hospital by Bluesparkle from Largeflag. Mr Roberts submitted that the premium was additional to the payments provided for by clause 6.6 and was the consideration moving from Bluesparkle to Largeflag to induce the latter to enter into the Supplementary Agreement.

35 On the ‘wholly and exclusively’ test, the taxpayer’s case was that since Largeflag was a wholly owned subsidiary of Bluesparkle any benefit to Largeflag was also a benefit to Bluesparkle. Even if, therefore, an analysis of the Supplementary Agreement in general and the payment of the premium in particular showed that they were partly for Largeflag’s benefit, the entire advantage flowed to Bluesparkle as the parent company. Section 74 of ICTA was not concerned with establishing the predominant purpose of the expenditure but with whether that expenditure was for the purpose of Bluesparkle’s trade.

36 The logic of this led to the conclusion that since the Supplementary Agreement merely varied the Acquisition Agreement, and since the expenditure under that agreement was admitted to be deductible as being for the purposes of Bluesparkle’s trade, the expenditure under the second agreement must likewise be deductible as being for the same purpose.

37 Put differently, Bluesparkle’s financial obligations under the Acquisition Agreement were an integral part of its trade and therefore any costs associated with varying that agreement must also be part of the expenses of the trade. The objection that the Supplemental Agreement was made only in order to facilitate a sale of Bluesparkle’s shares missed the point that the prospective sale of shares was itself intended exclusively for the purpose of preserving the very existence of the trade and no other.

38 For the Crown it was submitted that the agreements in the present case were to enable Bluesparkle to acquire the premises from which it traded, which are undoubtedly an enduring asset, and that a payment to secure an identifiable asset is likely to be capital; the asset in

Bluesparkle's case was the hospital and Bluesparkle's trade was the operation of a hospital. The transaction had been structured so that part of the price was payable on completion, with the balance payable at specified later dates, and there could be no presumption that the difference was attributable to revenue account.

39 If it were to be held that the payment is of a revenue character, but not interest, it would be more appropriately described as a "facility fee" or a "penalty for early termination". The taxpayer had not pointed to specific legislation allowing a deduction, so it had to show that the payment was "wholly and exclusively laid out or expended for the purposes of the trade". The material from Baker Tilly made it clear that a purpose of the expenditure was an attempt to protect Largeflag's claim to repayment of VAT, which was not "for the purposes of the trade".

40 Moreover, it had to be noted that the Acquisition Agreement appeared extremely disadvantageous to Largeflag: interest was only payable by Bluesparkle on a small amount of the purchase price, and Largeflag had to fund the interest on its borrowing from Northern Rock;[1] the agreement was correspondingly advantageous to Bluesparkle which effectively had interest free credit from Largeflag.

41 The Supplemental Agreement reversed the position completely: Bluesparkle paid everything (other than adjusting the interest for early payment) that Largeflag would have been entitled to under the Acquisition Agreement. Far from benefitting from the early termination of the agreement, Bluesparkle replaced an interest free facility with an interest bearing bank loan; by contrast, Largeflag had completely divested itself of an onerous agreement.

[1] Though Baker Tilly's notes indicate that the interest was in fact funded by Bluesparkle.

Conclusions - the nature of the 'premium'

42 We do not see the premium as being in the nature of a 'bounty' or an ancillary sweetner of the kind submitted by Mr Roberts, nor does the evidence support the proposition that it was additional to the payments specified in clause 6.6. The first use of the term 'premium' was in the Supplemental Agreement and in our construction of that agreement the words we have emphasised above in quoting clause 1.3 make it clear that the intention of the clause was to *reconfigure* the payment timetable in clause 6.6, rather than to alter the character of the payments themselves or to add to them; the £400,000 was to be "as set out in clause 6.6".

43 As we have seen, the provision in clause 6.6 for the three payments never came into force, but the premium in the 2005 agreement was treated for accounting purposes as a revenue item. As will be seen from the case law cited above, that is not necessarily conclusive and we must examine the overall context of clause 6.6. The three quantified payments provided for in 2001 consisted of three elements: (i) 5% of the Final Sale Price (once ascertained) and (ii) £125,000 or £150,000 with (iii) interest thereon at 3% above LIBOR.

44 We have therefore what is clearly a capital payment - an instalment of the sale price, what is clearly a revenue payment - the interest on the quantified sums, and one in the middle - the quantified sums themselves. On the face of it, any payment under a sale agreement must in the hands of the payer be presumed to be in the nature of capital, unless it is clearly otherwise. Our conclusion on the evidence is that the 2005 premium was a rolling up of the three quantified payments mentioned in clause 6.6, and that those payments were part of the payment, however calculated, for the overall sale of the land and buildings of the hospital.

45 That construction of clauses 6.6 and 1.3 is supported by the evidence from Baker Tilly, whose advice all three witnesses confirmed was intended to be reflected in the Supplemental Agreement; the premium reflected ‘profit’ on the sale, and if in 2001 the base cost and a profit element were distinguished for some reason in the minds of those making the Acquisition Agreement, that does not alter the character of an element of what was clearly part of the consideration for the disposal, and it is agreed was not interest on delayed payment.

46 The oral evidence of Mrs Lavender and Mr Fulton does not explicitly support this interpretation, however. Mr Fulton was uncertain how to characterise the £400,000 payment, and Mrs Lavender thought it was “an early settlement premium” - which scarcely takes the matter any further; and Mr Johnson did not know how to characterise it. In the circumstances, we prefer the definite characterisation which flows from the natural construction of the 2001 agreement, is consistent with the expert advice which all parties intended to implement in the 2005 agreement, and is not - save as regards its accounting treatment – actually contradicted by the oral evidence.

47 The question then is: does this analysis of the premium as organically linked to the three quantified payments in clause 6.6, and as being an integral part of the purchase price, better fit the criteria for capital or for revenue? We note from the dicta cited in *Johnson Matthey* above that the test to be applied is an objective one, not depending on the motives or purpose of the taxpayer; the purpose will become relevant when we consider the application of section 74, but here the question is rather ‘what was the premium paid for?’.

48 The House of Lords' dicta in *Granada* requires that we should look to see if an identifiable asset was obtained by Bluesparkle in return for the premium, or whether it was essentially to secure maintenance or upkeep. Rowlat J in *Anglo-Persian Oil* contrasts something that endures for a good number of years and relieves one of a revenue payment, and an asset which endures "in the way that fixed capital endures", which we take to mean, in principle, 'permanently' - in so far as anything is ever truly permanent.

49 We have found that the premium fell into the same category as the three payments in clauses 6.6 and that these three payments were in the nature of profit to Largeflag on the sale to Bluesparkle. In the circumstances of this case, our conclusion is that the characterisation of a profit on sale is that it is part of what is given for the undoubtedly capital asset of the land and buildings making up the hospital. We conclude therefore the premium referred to in clause 1.3 had the nature of a capital payment.

Conclusions – 'wholly and exclusively'

50 If we are wrong in our conclusion that the premium was not of a revenue character, it must be decided whether it was given wholly and exclusively for the purposes of Bluesparkle's trade.

51 We have found that there was more than one purpose for the expenditure on the premium, namely to enable the refinancing which would preserve Bluesparkle's trade as a going concern and to enhance the commerciality of Largeflag's position in order to protect it from attack in the context of the value added tax avoidance scheme which had been entered into. In *Vodafone* the question is whether the expenditure had a dual purpose, not whether a secondary effect of the expenditure existed.

52 Having regard to our conclusions at paragraph 20 above, our finding is that the most immediate objective of the Supplemental Agreement was to secure the future of Bluesparkle's business as a hospital operator by putting its finances on a sounder basis, which would initially enable the business to be refinanced and, it was hoped, then sold on to persons better able to make a commercial success of it. But part and parcel of the transaction was also the desire to reinforce the commercial character of the transaction and of Largeflag itself, to try to establish in Baker Tilly's words, that the arrangements overall in regard to Largeflag were "not just an inter-company scam".

53 We find that in these circumstances the Supplemental Agreement and the payments made pursuant to it had a dual purpose, and that the premium was not therefore expended wholly and exclusively for the purposes of Bluesparkle's trade; the purpose of supporting the commerciality of Largeflag was not a purpose of Bluesparkle's trade of owning and running a private hospital.

54 Attractive though Mr Roberts's argument is, that what was done for the benefit of Largeflag was inevitably also done for the benefit of Bluesparkle since they were in economic terms one unit, we must reject it: the two companies were separate legal entities with distinct interests, and it has not been suggested that either agreement was a sham, or that we should look through the corporate veil.

Decision

55 The premium provided for in clause 1.3 of the Supplemental Agreement was of a capital nature, and the expenditure was in any event not wholly and exclusively for the purposes of Bluesparkle's trade. The appeal therefore does not succeed and we confirm the disallowance for corporation tax purposes of the deduction of £400,000 for the accounting period ending 31 January 2006.

Appeal rights

56 This document contains the 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 no 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.

Malachy Cornwell-Kelly
Tribunal Judge

RELEASE DATE: 12 January 2012