TC04282

Appeal number: TC/2011/07135

Corporation Tax - whether the Appellant's activity in relation to the development of an office property was a trading activity or an investment - Penalties for alleged negligent return - Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TERRACE HILL (BERKELEY) LTD

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

TRIBUNAL: JUDGE HOWARD M. NOWLAN
JULIAN STAFFORD

Sitting in public at 45 Bedford Square in London on 20 to 23 October 2014

Timothy Brennan QC on behalf of the Appellant

Laura Poots, counsel, on behalf of the Respondents

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DECISION

Introduction

1. This Appeal raised a simple point and one that has frequently been in dispute, but in the particular circumstances we found it difficult to reach our decision, the outcome being finely balanced. It related to whether the Appellant's activity and motivations in relation to a major property development were of a trading or investment nature.

2. The Appellant was a special purpose vehicle or SPV that had been formed to hold the Terrace Hill group's 50% beneficial interest in a development of an office property in Mayfair known as 16 Berkeley Street. The Terrace Hill group was a property development group, substantially owned at the time by the family trusts of the Chairman, Mr. Robert Adair ("Mr. Adair"). The group also held property investments. The development was undertaken on a joint venture basis with the other 50% interest being held by an SPV called Longford Business Centres (Berkeley Street) Limited ("LBC(BS)") in a totally independent group, the Longford Group. When the freehold was acquired, it was acquired by a 50/50 company owned by the two respective groups, but that company was simply a nominee for the two beneficial owners.

3. When the property was acquired (in August 2000), there were sitting tenants on the various floors but all bar one of the leases was due to expire at the end of December and the final lessee agreed or was persuaded to leave early. It was always appreciated that the proposal was to demolish the existing building completely and to replace it with a grade A office property with a floor area of about 35,000 square feet in the desirable area of Mayfair.

4. Whilst the evidence given on behalf of both joint venture parties claimed that there had been little discussion between the two groups in relation to their long-term intentions, the two groups had been introduced by Vincent Taylor of Doherty Baines, the agents who happened to act periodically for both groups.

5. The particular contributions and expertise that each group brought to the joint venture was that the Terrace Hill group had great expertise in organising property developments, whilst the Longford group, 15% of the equity of which was owned by Bank of Scotland, had excellent contacts that enabled it to borrow from Bank of Scotland on more favourable terms than the Terrace Hill group could achieve, and in addition the Longford group conducted the trade of providing top quality serviced office accommodation, such that it was a potential lessee of the developed property. The Joint Venture Agreement contained various provisions relevant to the possibility that Longford might take a 15-year lease at £63 a square foot in certain circumstances, and the significance and role of the various rights and obligations in this regard are of some significance. Leaving this aside, it certainly appears that both groups considered the proposed development of a top quality Mayfair office to be an exciting and potentially very successful venture, and since neither group could undertake it on their own, each needed the other.

6. The construction was completed in September 2003. Whilst the dominant hope had been that the property would be let in its entirety to one AAA tenant, the rental market had declined during the development period, in part following the departure of American groups from London after 9/11, and the building had to be let on a floor by floor basis. The average rentals achieved were also disappointing. The investment value of the property was then somewhat diminished by the two facts that some of the tenants were not of the calibre that

had been hoped for, and all the leases contained break clauses. The property was substantially let by September 2004 and fully let by May 2005 and sold by July 2005.

7. KPMG had promoted a "capital loss" scheme to both groups, the effect of which was expected to be that losses in the capital loss groups could be set against the gains on the beneficial interests in the property held by each of the joint venture parties, so eliminating all tax. HMRC challenged this scheme but eventually conceded that on the various technical points advanced, the scheme could not be faulted save for the fundamental claim by HMRC that each group had in fact held its respective interest in the property from the outset as a trading asset, and not an investment. Were that to be sustained, the capital loss scheme would of course fail to achieve its objective, and the two groups would also be subject to Corporation Tax on their respective profits, without the benefit of indexation. We are only concerned in this Appeal with the outcome so far as it affects the Appellant and the Terrace Hill group.

The competing contentions

8. The outcome of this case revolves entirely around whether we accept the oral evidence advanced by the directors of the Terrace Hill group, or whether we accept the Respondents' case, founded largely on the terms of the Joint Venture Agreement entered into by the two groups, and other references in letters, e-mails and minutes of meetings said to support the Respondents' case that the Appellant always intended to sell its interest in the property once its maximum value had been achieved, in other words once the building had been both completed and fully let.

9. The basic threads of each case can best be illustrated by summarising each shortly in turn.

The Appellant's case in outline

10. The case advanced by the Appellant was that while the group accepted that it often held development properties on trading account, and certainly so held them when the developments had been pre-sold, the group also held investment properties, and was aiming to retain its stakes in suitable development properties as well. While this alleged status as regards two other development properties was also being disputed by HMRC, Mr. Adair said that his strategy was to retain completed developments where he anticipated good rental growth, so that the group would have more steady net rental income, rather than be subject to the humps and hollows of profits, losses, and periods when no developments had been completed, such that the group's fortunes very much varied, period by period. Accordingly his aim in particular was to retain the completed development of 16 Berkeley Street, following completion. Some equity might be "extracted" by incurring long-term secured borrowings on the property in amounts in excess of the original "project borrowings", and the equity extracted could still be applied in funding new developments, but the retained surplus of rentals over interest and amortisation of the long-term borrowings would still give the group some of the steady and hopefully rising income stability that he sought.

11. Consistently with that objective, 16 Berkeley Street was always treated as a capital asset for accounting purposes by the Appellant, and capital allowances were claimed and conceded by HMRC in relation to the plant and machinery component of costs.

12. When the development commenced, rental levels of £63 a square foot were anticipated, and one letter to the Bank of Scotland referred to some space having been let at £70 a square foot, with some mention of £80 a square foot also being referred to. As matters transpired,

by early- to mid-2004, rental levels in the region of £55 a square foot appeared more likely, and a capital value in the range of £30 million to £34 million was mentioned. In September 2004, Mr. Adair concluded that serious thought should be given to selling the property, partially because the rentals being achieved (and eventually achieved, when the property was fully let) were at the average level of £55 a square foot, and because the tenants all had break clauses and were not furthermore of the standing that had initially been hoped for and expected. Accordingly, holding the property now looked far less appealing. Nevertheless the multiples of rental income or yields had increased, and the Appellant was receiving very attractive unsolicited offers for the freehold. When the property was eventually sold in July 2005 for £39.4 million, this was regarded as being too good an offer to turn down, particularly when the potential benefit of holding for rental growth now looked so much less attractive than had initially been envisaged.

The Respondents' case in outline

13. The Respondents' case was that the Appellant had always intended to sell its interest in 16 Berkeley Street as soon as it had reached its maximum value, in other words as soon as the development had been completed and the building fully let. The contention was substantially based on:

1. the terms of the Joint Venture Agreement between the Appellant and LBC(BS) claimed by the Respondents actually to require, and certainly to contemplate, a sale of the completed development;
2. the representations made by Dominic David ("Mr. David") a director of LBC(BS) who gave evidence to us, and the representations by Nigel Turnbull ("Mr. Turnbull"), the CEO of the Terrace Hill group from 1995 until 2002, to Bank of Scotland in the negotiations to secure the purchase and development finance, to the effect that the property would be sold at the earliest possible occasion; and
3. other references in the various minutes of meetings.

In addition it was claimed that the potential benefit of being able to claim capital allowances, when the property was held as an investment, and the benefit of indexation on selling an investment property were factors likely to induce the Appellant to classify a property as an investment property rather than trading stock.

14. While the Respondents did not suggest to Mr. Adair, in the course of his cross-examination, that his evidence was untrue or biased, the Respondents did suggest to Mr. Turnbull that statements in his letters to the Bank of Scotland that the parties intended to achieve a quick sale either undermined the Appellant's claims, or that if Mr. Turnbull asserted that the statements had not been true, but had been designed to secure the finance on the best available terms, then Mr. Turnbull's credibility was seriously in question.

15. The Appeal involved not only the substantive point as to whether 16 Berkeley Street had been held as an investment or as trading stock, but a further claim that in reporting the sale as a disposal of an investment, the Appellant had been negligent, such that a penalty of approaching £1 million was imposed on the Appellant. The Appellant claimed that even if it had been wrong on the substantive issue, its return had not been negligent, and that if it had been negligent, the mitigation conceded in quantifying the penalty had been inadequate. This was claimed in part because the officer in question had been influenced by the fact that the Appellant had sought to eliminate all tax by effecting a tax avoidance scheme, which in the event (ignoring the more fundamental issue of whether the property had always been held as trading stock) was both legal and effective.

Our decision in summary form

16. As we said in paragraph 1 above, we have found this case to be finely balanced.

17. We start with the expectation that a group whose expertise lies in managing property developments (i.e. in acquiring the right sites, obtaining planning consents, devising the most appealing form of development, financing that development, organising every aspect of the construction, and then dealing with lettings or sales) will normally treat land acquired for development as trading stock. Once one development is completed, rather than retain it, the aim will often be to dispose of it at the best possible price and reinvest the proceeds in the next development project. Ideally developments may often be financed on a pre-sold basis, where an investor will immediately take the completed development at some formula price.

18. We accordingly start with a presumption that the developer will often hold development sites as trading stock, and that that will not be the analysis solely where there has been some form of pre-sale such that the point is then beyond all doubt.

19. We did, however, find Mr. Adair to be a very impressive and honest witness. We also accept that the strategy that he claimed to be pursuing, of seeking to retain developments where rental growth looked highly promising, and the strategy of trying to maximise the steady income of net rental profits, so as to diminish the fluctuating results and the delays in realisation of profits in the development activity, seemed entirely cogent. We also accept that as an accountant, Mr. Adair was entirely familiar with the factors that governed whether a property was rightly treated as held as an investment, so that it is significant that this property was always treated as a capital asset for accounting purposes. The accounting treatment throughout, treating 16 Berkeley Street as a capital asset, certainly tallies with Mr. Adair's evidence as to the intended treatment at the point of acquisition. It is also significant that, whilst several of the letters and minutes to which the Respondents referred us contained remarks that threw some doubt on the investment claims, whenever minutes referred to the views of Mr. Adair, they consistently supported his claims in evidence that he wished to retain what he hoped was going to be a very attractive Mayfair office development as an investment We also accept that, in being the Chairman, and the person responsible for advancing the fortunes of the Adair family trusts, it was Mr. Adair's objectives that entirely governed the strategy of the Terrace Hill group. Others (Mr. Turnbull and later Mr. Philip Leech ("Mr. Leech")) were the chief executives of the group, but they claimed to understand, and to be seeking to implement the strategy devised by Mr. Adair. We accept that they understood that strategy, and were indeed seeking to promote it.

20. We are also struck by the way in which evidence about rental expectations, and capital values changed materially in this case. We accept that the multiple leases granted, with break clauses and at the reduced average rentals of £55 a square foot, turned out to be disappointing, and we also accept that the offered price of £39.4 million at which the property was sold did appear to be an extremely attractive offer. Accordingly the claim that the dawning realisation of these two factors led the Appellant, and notably Mr. Adair, to realise that the original strategy probably needed to be abandoned, and that the best option from September 2004 onwards was likely to be a sale, was totally realistic.

21. We will of course record all the competing pointers that make our decision a finely balanced one. In summary, however, the impressive nature of the evidence given by Mr. Adair and Mr. Leech, and much of the evidence given by Mr. Turnbull (notwithstanding the doubts cast on Mr. Turnbull's evidence by the Respondents, all of which we will record), coupled with the credible strategy that Mr. Adair claimed to be pursuing, and the entirely understandable manner in which changed circumstances led to a change in plan, lead us to

confirm that 16 Berkeley Street was held as an investment, and rightly accounted for throughout in that manner.

22. We accordingly allow the Appeal on the substantive matter.

The evidence

23. We will record most of the relevant evidence in giving the facts below. We ought, however, to comment on the standing of the three main witnesses for the Appellant, namely Mr. Adair, Mr. Turnbull and Mr. Leech.

Mr. Adair

24. We regarded Mr. Adair as an impressive, honest and knowledgeable witness. He had trained as an accountant with Arthur Andersen, was a member of the Chartered Institute of Taxation and had been executive chairman both of a listed oil and gas group, and of the Terrace Hill group. Prior to the appointment of Mr. Turnbull as CEO of the Terrace Hill group in 1995, Mr. Adair explained that he had divided his time between his two main responsibilities on a roughly 50/50 basis, and subject to the current demands of each role. As Chairman and CEO of the Terrace Hill group he was responsible for formulating the overall policy of the group in the interests of the Adair family trusts that were the controlling shareholders.

25. In his Witness Statement, Mr. Adair referred to the difficult trading conditions in the late 1980s, and to his decision to seek to build up the property investment activities within the group in order to increase the group's stable flow of income, and reduce its exposure to development downturns and the anyway sporadic recognition of profit in the development activity. Mr. Turnbull was appointed as CEO with a particular objective that he and Mr. Adair should together build up the investment portfolio. Some of it consisted of pure investment properties where the group had had no role in development. Others consisted of retained development properties, though HMRC disputed the degree to which the investment properties represented retained developments and we will refer to some of those facts below.

26. When the agents mentioned the possible acquisition of 16 Berkeley Street to Mr. Adair, he immediately regarded the acquisition and re-development of this property as a highly attractive prospect. He said in his Witness Statement that:

> *"its Mayfair location, available planning permission, its potential to be acquired and developed pre-let and the income stream available – were all influential in my decision to acquire the property as an investment. It was not my intention to purchase and improve the property in order to sell it for a profit."*

Mr. Turnbull

27. We will refer below to four respects in which the Respondents' counsel criticised Mr. Turnbull, and sought to discredit him as a witness, but we nevertheless regarded Mr. Turnbull also to be an honest and impressive witness. He was also an accountant, but had probably not been in practice to the extent that Mr. Adair had. He started his career at Hill Samuel, thereafter worked in several banks, generally dealing with property finance. From mid-1982 onwards he worked directly in the property sector, first as group Finance Director of the Hunting Gate Group, and then the Erecta Group. The latter group's activity was entirely property investment. Mr. Turnbull said that his aim in his role at Hunting Gate had been to

build up a consistent and quality revenue stream, to provide stability alongside the house building and construction activities.

28. Between 1990 and 1995, Mr. Turnbull was heavily involved in rescue situations, first as deputy chief executive, and then chief executive, of Rosehaugh, and then as consultant and Board nominee in troubled property groups for Barclays, National Westminster and Clydesdale banks.

29. From 1995 until his retirement as CEO in 2005 and his retirement altogether from the Board shortly thereafter, Mr. Turnbull finished his career running the Terrace Hill group. He said that he did this jointly with Mr. Adair, the two working together on all fundamental decisions, but Mr. Turnbull having full operational control of implementing those decisions and policies. He very much confirmed the basic desire to sell poor properties and to build up a retained portfolio of quality properties, and referred to the way in which he had done this at Hunting Gate.

Mr. Leech

30. The third witness who we should specifically mention at this point is Mr. Leech. He was again a highly-experienced property man. He was first employed by the group in 1993, then running the operations in the northern regions. He became a main board director in 2002 and Chief Executive in January 2005, in succession to Mr. Turnbull. While Mr. Leech accepted that he had not been directly involved in the policy decision as to whether 16 Berkeley Street should be held as an investment or not when it was acquired, he did say that he had often attended meetings at which the general investment strategy was mentioned, and at which the intentions in relation to 16 Berkeley Street were also discussed. This was particularly so after his appointment as a main board director. In relation to "intentions", he said in his witness statement:

> *"Throughout the development period and the initial letting phase, the intention of the Board to hold [16 Berkeley Street] as an investment remained constant. It was not being developed for immediate sale.* [On being cross-examined, he modified this reference and said that he meant "or sale, immediate or otherwise".]
>
> *The intention of the Board of Directors to hold the Property for investment purposes is evidenced in the Executive Committee meeting minutes dated 19 November 2003, a meeting at which I was present. The minutes state in relation to the Property: "TH keen to retain property in Mayfair as this would provide best prospects for rental growth in future." The minutes also acknowledge that there was some interest in the freehold, even though the freehold was not being marketed at that time.*
>
> *I have no direct knowledge of communications between Mr. Robert Lane and the letting agents, but it is my clear recollection that neither he nor anyone else in THG was instructed to offer the Property for sale prior to September 2004. If this had happened, I believe I would have known about it."*

31. We both agreed, at the end of the cross-examination of Mr. Leech, that we had found him to be an honest and very impressive witness, and a man of considerable integrity.

The facts in more detail

32. As we have indicated, there is considerable evidence that the objective of building up the group's property investments, and of retaining completed developments when they were

of high quality and offered good prospects of rental growth, was a genuine objective and one well understood by the senior management.

33. When Vincent Taylor of Doherty Baines approached the group in early 2000 with the proposition that companies within the groups of Doherty Baines' two clients, the Terrace Hill group and the Longford group, should acquire the property in a joint venture, both groups appeared to be keen on the proposal, notwithstanding that neither had had any previous connection. While the Terrace Hill's expertise and potential contribution were geared to its expertise in managing developments, Longford's was geared to its relationship with Bank of Scotland, and its apparent ability to arrange borrowings on very attractive terms, and its possible interest in taking a 15-year lease of the developed property for the purpose of its serviced office operation. In addition to Bank of Scotland having been a regular lender to the Longford Group, the Bank held a minority share investment in the Longford Group.

34. Both Mr. Turnbull and Mr. David, the principal Director of Longfords, said in cross-examination that there was little discussion between them in relation to each group's long-term objectives. This seems particularly odd if the Appellant was keen to retain its share of the developed property for investment purposes, because it would mean that unless the Longford group in fact had, or ended up with, the same objective, the Terrace Hill group would either have to buy out the Longford group interest, there would be an unwelcome sale of the entire property or some form of deadlock situation. Mr. Turnbull said that he had examined the accounts of the Longford group and concluded that they held their properties as capital assets, and that their obvious readiness to commit to take the 15-year lease of the property for their serviced office activity was consistent with the Appellant's claimed long-term aspirations for the property.

The various representations made to Bank of Scotland when seeking acquisition and development finance

35. The dealings with Bank of Scotland, however, and statements made by both Mr. David and Mr. Turnbull in their endeavour to secure short-term finance from Bank of Scotland appeared to indicate that the intention was either to achieve a pre-sale of the developed property, or at least to sell the property as soon as the development was completed, or as soon as it was fully let if that would enhance the investment value of the property and the profit to the two parties.

36. In a letter of 28 July 2000 to Ray Robertson, Mr. David listed the potential investors said to be interested in purchasing or funding West End developments, and the tenants currently looking for space, and rather naturally emphasised the attraction of the project. He said:

> *"In summary the yields and rents used in our appraisal appear very realistic and both investor demand and tenant demand appear to be strong, this would all point to a situation where it is highly unlikely that LBCL would ever get near to occupying the completed development. Furthermore I believe that a number of institutional investors will be very keen to acquire the completed scheme and therefore create a very healthy profit for the jv company.*
>
> *Given that it is so unlikely that LBCL will be able to occupy the scheme we would be looking to fund the development as quickly as possible and recover our cash for other projects."*

37. We will revert below to the comments in the first of those paragraphs about LBCL being unlikely to occupy the completed building, and to the comments about "funding" the development, but should first quote the following extract from Mr. Turnbull's letter to Ray Robertson of Bank of Scotland, dated 11 September about one month after the purchase had been effected. By this point, Bank of Scotland had advanced about £10 million towards the £13 million purchase price, so that the joint venture parties had contributed at least £1.5 million (or perhaps £2 million) each, and Mr. Turnbull was then seeking short-term development finance. The purpose of Mr. Turnbull's letter of 11 September was to secure the development finance from Bank of Scotland.

38. In a section of the letter, headed ***"The Joint Venture",*** Mr. Turnbull explained that the joint venture was a 50/50 one and that Terrace Hill would be responsible for progressing the development. He then explained the arrangement for Longford to take the 15-year lease, to which we will refer below, and he then said:

> *"The Joint Venture partners intend to on sell the completed development and to that end the partners will endeavour to secure a prelet at a higher rent than that specified in the above agreement for lease.* [i.e. the contemplated 15-year lease to Longford] *…… In the event that this is not achieved six months prior to [practical completion] then the existing agreement for lease is binding."*

39. In his oral evidence, Mr. Turnbull said that it was not in fact Terrace Hill's intention to on sell the completed development, and that he had merely said that an early sale was intended when writing to Ray Robertson, as part of the game played with lending bankers, and in order to make matters easier for her in securing credit committee approval for the requested development loan. The Respondents' counsel contended that Mr. Turnbull's statement to Ray Robertson either went some considerable way to undermining the Appellant's claim that the property was purchased for long-term investment purposes, or (if the statement about a proposed sale of the completed development was untrue) then it undermined the credibility of Mr. Turnbull as a witness. We will deal with this issue in giving our decision, but simply confirm at this stage that Mr. Turnbull persisted in saying that it was never the intention to effect a quick sale, and that the statement was made just to make the loan request to the bank specialising in short-term lending, simpler and more attractive.

The general evidence in relation to the different categories and providers of property finance

40. We were given a general explanation of the categories, and roles, of property finance by Mr. Adair and other witnesses.

41. One desirable form, so far as the pure developer was concerned, was to achieve a pre-let or a pre-sale of a development project. With a pre-sale, the role of the developer would then inevitably be that of trader.

42. Where there was no pre-sale (albeit that there might still be a pre-let), the developer would need to borrow to buy the land and to fund the development, and loans at this stage were often provided on a short-term basis by the commercial banks, seeking to recover their money at the end of the development stage. This was essentially the objective of Bank of Scotland.

43. Following the completion of a development, and assuming that the initial purchase and development loans were due for repayment, the developer would have essentially two choices; either to sell (possibly enhancing the value by achieving lettings on good terms), or

to raise secured long-term funding from one of the banks or institutions providing finance for the retention of property investments. The developer then had two further choices. In Mr. Adair's terminology, it could extract equity. In other words if the total initial purchase and development loans were for £24 million, and the property was worth £39 million, and the developer wished to extract equity to fund new development projects, it might end up borrowing, say, £34 million. It would thereby have extracted £10 million of the value increase of the property, though with a continuing borrowing of £34 million, and rentals on a property worth £39 million, the net rental surplus (i.e. the factors that would contribute to Mr. Adair's hoped-for stream of stable annual profit) might be very modest. If, however, the developer could only borrow say £29 million, or only wanted to extract equity of £5 million for funding new projects, it would then be left with a greater level of net rental surplus.

44. Three implications of these funding choices are obvious:

1. It seems likely that an outright sale would almost always achieve a higher total receipt than might be raised by secured borrowing, though any gain realised would be taxable.
2. Notwithstanding the benefit of indexation in relation to an investment sale, on which the Respondents placed much stress, and thus the feature that the tax charge on an investment sale would be less than that on a trading disposal, where cash was raised on the security of an investment property by borrowing (either borrowing £34 million or £29 million in accordance with the above examples), there would be no tax charge at all, and no stamp duty or SDLT cost to anybody since the property would simply have been retained. Naturally the bank's profit, any excess of interest rates over initial rental receipts and the bank's insistence that the original investor retain some equity in the building, will limit the amount that can be raised by such long-term finance. Such finance does however give the investment developer considerable flexibility and potential advantage, and it inherently eliminates any realisation and thus any tax charge.
3. The third obvious fact is that the developer cannot have its cake and eat it. In other words, the more equity extracted in outright cash (available for other projects) the less the continuing "stable surplus income flows". The more the developer wishes to enhance its stable cash flow, naturally the long-term secured borrowings must then be reduced, and the less available cash there will be for other projects.

45. The relevance of the above points in relation to the Bank of Scotland borrowing was that it was always known that the Bank of Scotland was lending on a short-term basis and would be an unlikely provider of the longer term funding mentioned above. Mr. Turnbull's claim therefore was that his assertion that the two parties intended to sell on completion of the development was designed to stop the Bank concerning itself about the prospects of the parties obtaining long-term funding, and thereby make it easier for the credit committee to sanction the requested development loan. The loan anyway had fixed repayment dates, so that had the bank demanded repayment, and had the parties been unable to repay the Bank of Scotland loan by raising replacement finance, then they might very well have had to sell to repay the loan. In the meantime, however, if the parties were reasonably confident that they would be able to repay the loan without effecting a sale, such that Bank of Scotland's desired end result could be achieved without there having to be a sale, there was no purpose in Bank of Scotland having to consider these possibilities. As Mr. Turnbull said, had other aspirations been mentioned, *"there would probably have had to be a discussion"*. The logic might eventually have prevailed and any retention aspirations might not have prejudiced the amount or terms of the original loans. But it was better to put the simplest case to the bank.

The proposed 15-year occupational lease to Longford

46. Before we consider more generally the terms of the Joint Venture Agreement, it will be worth dealing specifically with the important term to the effect that Longford would take a 15-year lease of the completed property. This, after all, was said to have provided some comfort to the Terrace Hill group, and Mr. Turnbull asserted that it made him more confident that Longford would retain their interest in the freehold.

47. Having now read the Joint Venture Agreement in its entirety, it seems that we were only given a simplified version of these arrangements in the hearing. One significant additional point appears to be that instead of having a general call right to take the 15-year lease, Longford rather had a pre-emption right to take the lease if and when the joint venture parties gave notice that they had an acceptable third party proposal for a lease of the whole property. While Longford could then elect to take their lease at the rental price of £63 a square foot etc, there had to be calculated the amount by which the freehold would have been devalued in consequence of Longford taking the lease, rather than the third party taking the lease (the assumption being that Longford's poorer covenant would diminish the value) , and on a later sale, before the balance of the proceeds were to be divided on a 50/50 basis, 50% of the relevant "value reduction" would be paid out of the proceeds to the Appellant. The significance of this provision is debatable. On the one hand it protects the Appellant against any fall in value resulting from Longford's covenant down-valuing the freehold. On the other, it rather points to the distinct possibility that Longford's covenant would indeed down-value the freehold.

48. Matching the pre-emption right is an obligation on Longford to take the 15-yrear lease if there has been no third party offer. It is then far from clear whether or not the same value protection clause operates. Logic and the definition of "Relative Investment Value" and the reference to Clause 19(3) suggests that the value protection would not apply in this situation. Clause 19(4)(b) and its reference to clause 19(6) rather suggests the reverse.

49. We are not concerned ourselves to pursue the confusion just mentioned. A point that is reasonably material, however, is that these provisions do clearly reflect the reality that it was appreciated that the freehold value would be likely to be down-valued if Longford took the lease. In giving evidence Mr. David said that while his sister, his co-director, might have been keener on the prospect of actually taking the lease, he never considered it likely that the lease would be taken. This appeared to be on the basis that the freehold would be considerably down-valued were Longford to take the lease. On the assumption that the Appellant's value protection (i.e. the receivable mentioned in paragraph 47 above) only fell to be paid if Longford exercised the pre-emption right, and not if Longford was required, as a matter of obligation as mentioned in the previous paragraph, to take the lease, it emerges that the commitment of Longford to take the lease would not have been as appealing, effectively as a guarantee, as was supposed during the hearing.

50. Whether of course Mr. Turnbull still regarded the protection as worth having, or whether he effectively shared Mr. David's confidence at the outset that third party interest in taking a lease of the entire building would be so great that nobody would ever think of needing, let alone resorting to, the "Longford fall-back lease obligation", is impossible to discern.

The Respondents' claim that the terms of the Joint Venture Agreement indicated that the parties intended a sale of the developed property, possibly only when fully let

51. It was the terms of the Joint Venture Agreement that initially prompted HMRC to challenge the Appellant's claimed investment motives and to assert that both parties intended a sale, albeit possibly deferred until the property had reached its maximum value by being fully let.

52. This argument was founded on certain clauses in the Agreement. Even the third Recital provided that *The Beneficial Owners have agreed to enter into this Deed in order to establish a joint venture between them for the carrying out of the Development, the funding of Expenditure and the Letting and Sale of the Developed Site and to set out certain provisions covering the relationship of the Parties."* Clause 2 consistently said that *"the Beneficial Owners have established the Joint Venture for the purposes of the Project and to maximise the financial returns to the Beneficial Owners",* and the term *"the Project"* is defined to include all the obvious steps in the development phase, such as *"acquiring or extinguishing any necessary rights or interests", "obtaining any Consents required", demolishing the existing buildings on and clearing the site"* etc. ending with:

> *"(g) achieving Lettings;*
> *(h) achieving a Sale of the freehold interest in the Developed Site including the negotiation of a forward commitment or forward funding if the Beneficial Owners so agree; and*
> *(i) distributing the Proceeds;*
> *(j) such other matters as the Beneficial Owners shall agree."*

53. Before addressing the overall tenor of the joint venture agreement, and seeking to put some of the provisions just quoted into context, it is first worth noting that one of the points made clear in the Joint Venture Agreement was that its ambit extended only to the development of the particular building and the agreement provided that there was no other relationship between the parties, either in relation to other properties or in any other manner. This might be read to suggest that the delineation of "the project" was not drafted to ensure that everything said to be comprised in the project was intended to happen, or was bound to happen, but rather that if it did happen then it was amongst the steps and transactions meant to be conducted "jointly" by the parties and that clauses in the agreement might well be directed to facilitating those steps, rather than requiring them to be undertaken. Another point worth emphasising is the obvious one that the great majority of the terms of the Joint Venture Agreement related to promoting the orderly development of the property.

54. In challenging the claims on behalf of the Respondents that any of the above terms of the agreement indicated a clear intention on the part of the parties that the development should be sold at the earliest opportune moment, i.e. certainly by the time that all lettings had been granted, two particular arguments were advanced. One, advanced in his witness statement by Mr. Turnbull, very much along the lines of the point made in the previous paragraph, was as follows, broadly to the effect that the various clauses were designed to provide a flexible structure that would operate sensibly whatever the parties eventually chose to do, and that it was not intended to require any particular steps, such as a sale, actually to occur. In Mr. Turnbull's words, the points were made as follows:

> *THG was used to undertaking many of its activities through joint ventures. I was extremely familiar with joint ventures and I had developed over the years a fairly standard approach to the structure of joint ventures for the development of properties by THG. I had a close relationship with a firm of solicitors, Denton Wilde Sapte ("DWS") which had acted for THG vehicles in the past and which was attuned to the operating processes of THG. When the Berkeley Street opportunity arose I*

instructed the same firm of solicitors. The solicitor most directly involved was Mr. Martin Quicke. The terms of the Joint Venture Agreement dated 18 August 2000 ("the Joint Venture Agreement") were produced in broadly standard terms.

From my experience negotiating and managing joint ventures before, I appreciated the importance of joint venture agreements being drafted to protect both parties while being broad enough in their terms to allow the venture the flexibility to operate commercially.

It was essential, as I had learned over the years (and doubtless the solicitors would have advised it, anyway) to ensure that the drafting of joint venture documentation was sufficiently flexible to cover all eventualities. Among many others, one critical aspect of a joint venture agreement is to make provision for orderly termination of the joint venture. Mr Quicke would himself have known that, and would have accommodated that critical need for flexibility and predictability. I cannot now recall any specific discussions on the matter, and it may well be that there were none, because this was one among many joint venture arrangements I had undertaken. The Joint Venture Agreement was a relatively standard document which covered most obvious areas of potential future dispute whilst retaining flexibility for both parties. In particular, it did not commit either party to sell the Property."

55. In addition to the points about the Agreement being in relatively standard form, and being designed to provide in a flexible manner for any steps on which the parties might later agree, the Appellant's counsel also made the point that any joint venture agreement would always deal with and provide some form of exit provisions.

56. We were not taken by either counsel through any of the detailed drafting of the joint venture agreement, and having now read it in full the following points seem to us to be relevant. Our ultimate objective in considering the overall tenor of the agreement is to decide whether it is appropriate to say that it reflected a clear joint intention that the developed property be sold, or alternatively the type of flexible framework that Mr. Turnbull had claimed.

57. The first obvious point to make is that the developers of a property would be bound to contemplate that following completion, the property would either be sold to an owner/occupier, leased and then sold or leased and re-financed in one way or another. It is therefore bound to be the case, with parties being jointly involved in the project that the clauses of the joint venture agreement would deal with these possible outcomes.

58. It is then worth noting three somewhat related provisions.

59. Clauses 6.4 and 7.3 provided that the management of the joint venture and the management of the nominee company were to be conducted "jointly", and that neither party was to have a casting vote.

60. Clause 3.1 and 3.3 contained the following two provisions:

"3.1 The Beneficial Owners shall following Completion apply to HM Land Registry for registration of a restriction in the Proprietorship Register of the title to the Site in the following form:

> *"Except under an Order of the Registrar no disposition or dealing by the proprietor of the land is to be registered without the written consent of Terrace Hill and Longford."*

3.2 … …

3.3 Where a disposition or dealing is authorised pursuant to this Deed Terrace Hill and Longford shall forthwith issue written consent sufficient to satisfy the foregoing restriction."

61. To somewhat similar effect Clauses 7.1 and 30 then addressed the normal legal rule that land held in common is held on a trust for sale and that if one party wishes to sell and the other wishes to retain, there will then be a sale. This rule is clearly qualified. Clause 7.1 provided that:

> *"[The nominee company] shall hold the Site upon trust absolutely for the Beneficial Owners as tenants in common. Neither Beneficial Owner shall be entitled to call for the trust for sale of the Site to be executed other than in accordance with the terms hereof."*

Clause 30.1 then dealt with the provisions of the Trusts of Land and Appointment of Trustees Act 1996, and more generally Clause 30.2 provided that:

> *To the extent the law permits the Beneficial Owners declare that any trust for sale arising as a result of this Deed shall not operate to require or permit a sale of the Site other than as contemplated by the specific provisions of this Deed."*

62. We turn now to the critical question of when proposed dispositions would be *"authorised pursuant to this Deed"* (within the meaning of Clause 3.3); when a Beneficial Owner would be entitled *"to call for the trust for sale of the Site to be executed .. in accordance with the terms hereof"* (within the meaning of Clause 7.1), and when *"a sale of the Site [would be] contemplated by the specific provisions of this Deed"* (within Clause 30.2).

63. Clause 10 deals with lettings and sales, and that clause clearly contemplates that if a letting or a sale is proposed and there is some dispute as to the terms of the letting or sale, that dispute might be settled by arbitration by relevant property agents. In relation to the more substantive dispute where one party might propose the grant of a lease or a sale, and the other might oppose whichever was proposed, Clauses 14 and 15 address the deadlock situation. In short the ultimate effect of these provisions is that if one party proposed a sale, for instance, and the other resisted that, then both parties would state the case that each advanced for arbitration. Ultimately the decision of the arbitrator would be binding, and therefore if the arbitrator decided that there should be a sale, and the arbitrator ordered that to occur, then it seems to us that all three issues addressed by paragraph 62 above would have been satisfied. Accordingly there would be a sale.

64. Three points of significance appear to result from these provisions. Firstly, it is clear that the ordinary rule providing for an automatic sale when one party proposes a sale and the other objects is over-ridden. Secondly, there is no presumption that the arbitrator should necessarily favour a sale when there is a deadlock. Thirdly, it seems realistic to suppose that if, say, Longford proposed a sale, and Terrace Hill objected to a sale and undertook to buy out Longford's interest at a price equivalent to the share of proceeds that Longford might obtain on a third party sale, the arbitrator would presumably order that that buy-out should

occur, rather than order a sale of the entire Site. This outcome, we will see, happens to tally with the way in which Mr. Adair explained that when he realised that Longford's long-term intentions might be in conflict with his own intentions, he arranged for an equity issue by the group holding company in order to be ready to fund a buy-out of the Longford stake.

65. The tentative conclusions that we reach at this stage are therefore that Mr. Turnbull's claim that the object of the joint venture agreement was simply to provide for all possibilities in a flexible manner is tenable, and that the agreement did not contain provisions providing automatically for a sale in some circumstances because that was the plainly agreed joint intention of the parties. We will need in due course to further address the right inferences to draw from the terms of the joint venture agreement when we have considered other evidence. For instance Mr. Adair's crucial evidence was always clear. He said that from the outset he wished to retain the developed property as an investment. As we will see, Mr. Turnbull offered a rather more confusing explanation. This was based on the apparent acceptance that the joint venture agreement did evidence a clear intention to sell once this had been asserted by HMRC, whereupon Mr. Turnbull claimed that immediately after the property had been acquired, and without reference to the drafting of the agreement (whatever it might imply) the two parties did agree to retain the developed site as an investment. We will defer further consideration of these claims until we have recorded more of the evidence, and the exchanges of correspondence between HMRC and Ernst & Young on behalf of the Appellant.

Other pointers to the investment or trading nature of the Appellant's acquisition of 16 Berkeley Street

The accounting treatment

66. The Accounts of the Appellant for the period ending 31 July 2001, and indeed the accounts for all later periods as well, treated the company as an investment company and the purchase of 16 Berkeley Street as an investment purchase. In giving his evidence, Mr. Martin Heffernan, then a manager with the auditors, Thompson Taraz, confirmed that while the Terrace Hill companies made the initial designation of projects as trading or investment projects, before Thomson Taraz signed the accounts there would always be, and were in the case of 16 Berkeley Street, discussions between the directors, including Mr. Adair, and the relevant partner at Thomson Taraz, to confirm the relevant treatment. He said that in discussions with Mr. Adair, Mr Turnbull and the chief internal accountant at Terrace Hill, it was confirmed that 16 Berkeley Street was acquired for development and retention as an investment. We are not convinced by a further remark in his witness statement that the designation as an investment asset was further enhanced by the fact that following acquisition rentals were received from sitting tenants, since it was obviously the intention to develop as soon as the tenancies ended. Since, however Mr. Adair had been seeking to retain the properties with the best potential for rental growth as investments, and since he said in evidence to us that he considered this property to be an ideal candidate for such treatment and retention, we nevertheless conclude that the auditors had ample ground on which to accept the treatment adopted by Terrace Hill. We note, in particular, that as an experienced accountant Mr. Adair struck us as being someone who would have taken his responsibilities as a director seriously, as indeed he claimed that he did, and that the auditors were plainly entitled to rely heavily on his statements.

The consideration of the proposed claim on behalf of the Appellant for capital allowances in relation to the plant and machinery acquired

67. On 10 July 2002 there was a meeting between Terrace Hill and the auditors to discuss the intended claim by the Appellant for capital allowances, i.e. allowances plainly only

available if the asset was held as an investment. Mr. Heffernan made a note of the meeting. While not mentioned in the note, he said that the principal concern in relation to capital allowances apparently related to the plant and machinery content of the building on acquisition and to whether there was any significance in the fact that the building had, by July 2002, been demolished. As regards more fundamental investment motives, the note confirmed that *"the plan from the outset had been for the development of the property with a view to investment."* That then appeared to have been balanced against what Mr. Heffernan said in oral evidence to us was a plain misunderstanding on his part, namely a remark that Longford had an option to acquire the Terrace Hill share of the joint development. Mr. Hefferman said that of the other three more senior members of Thomson Taraz who also attended the meeting, he was sure that they had not also laboured under this misapprehension, though he accepted that nobody had chosen to correct the erroneous reference in his note to the effect that Longford had a right to acquire the Terrace Hill share of the developed property. When, however, the meeting concluded that the property was appropriately treated in the accounts as an investment, and this treatment would have been clearer had the right, rather than a materially wrong, summary of the Longford option and obligations been referred to, we assume that the full discussion at the meeting further confirmed the investment status.

68. We might mention that capital allowances were then claimed, and although some matters were discussed with HMRC, doubtless in relation to the allocation between plant and machinery items and other costs, HMRC did not suggest that the property was not a capital asset. We do not suggest that that tacit acceptance is of any present significance because the Respondents claimed before us that the officers had not then been aware of other information that emerged when they opened an enquiry on the disposal of the property.

Executive Committee Minutes and Minutes of Marketing Meetings

69. We were referred to various minutes. Occasionally they recorded a discussion solely in relation to 16 Berkeley Street, but generally the minutes recorded meetings, either of the Executive Committee, or marketing meetings, that dealt with numerous properties. In these minutes, there was generally a comment, running often only to two or three lines, in relation to all or most of the properties in relation to which there was anything to report. We consider it appropriate to treat these very short references with some caution.

70. On 22 August 2002, a meeting of the Executive Committee referred to 16 Berkeley Street under a head *"Existing Schemes with potential to release equity."* The short comment was *"We are aware that a number of institutions are looking at funding office developments in the West End"*. Since the reference to "equity release" and to institutions "funding developments" are equally, if not more, consistent with the notion of releasing equity by raising long term borrowings on the security of a retained 16 Berkeley Street, we cannot treat this particular minute as being particularly significant, and certainly not as any sort of evidence of an intention to sell.

71. A Minute of a Marketing Meeting on 21 March 2003 dealt specifically with 16 Berkeley Street. It was prepared by DE&J Levy; was attended by six representatives of three firms of agents, and by Mr. Robert Lane ("Mr. Lane") of Terrace Hill, and Mr. David of Longford. It recorded that:

> *"It was agreed that the joint agents will meet in the near future to agree marketing recommendations, which will be submitted to the client for further discussion at the next marketing meeting.*

……

Some discussion took place regarding indicative rents and values for a freehold sale. It was agreed that at this stage of the marketing, no rents or prices should be disclosed however should a tenant/purchaser show keen interest in the building and upon obtaining their identity, an indicative rent in the mid sixties should be quoted and an indicative in freehold price in the order of £35m should be stated."

Mr. Lane was the development director of the Terrace Hill group, and he was responsible also for marketing and for liaising with the various agents. He confirmed that his understanding had always been that at the start there was reality to the expectation that Longford would take the operational lease, though there had been a hope that if the building could be let to one single AAA tenant at an equivalent or higher rent, that would be more attractive. By the date of the meeting on 21 March 2003, the Terrace Hill group had taken the decision to release Longford from the obligation to take the relevant lease, and correspondingly the Longford pre-emption right had been surrendered. We were never given clear information why the Longford obligation had been released, and while it is now clear that well before March 2003 Longford had been experiencing financial difficulties, and was being pressed by Bank of Scotland to reduce numerous of its borrowings, it seems that Terrace Hill had probably not been aware of these difficulties. The more likely explanation for the release of the obligation may have been the continuing expectation that rentals from a tenant with a superior covenant to Longford might well be obtained, and as we see from the meeting note, rental levels in the mid-sixties were still being discussed.

72. In relation to the fact that the Meeting note referred to a freehold price, this was explained by Mr. Lane in his witness statement as follows:

"The Property was marketed for the purpose of achieving lettings and not, at that stage, for sale. This was because it was not our intention to sell it at that stage. Nonetheless, a freehold price was quoted, because quoting a freehold price to prospective tenants demonstrates the quality and positioning of a property in the market and can attract higher quality tenants.

73. Mr. Lane also explained to us that when in September 2003 he wrote to the letting agents, specifying his suggested letting fees, he also mentioned fees in relation to a freehold sale. He said that even if the intention was only to let a property, fees would always be quoted for both letting and sale in case an unexpected offer to purchase was received and accepted, and so that in that situation there would be no dispute about the resultant sale fee.

74. A further Marketing Meeting in relation to 16 Berkeley Street was held on 5 August, again attended by agents and Mr. Lane and Mr. David. The note of the meeting contained the following paragraphs:

"Discussed letting policy (disposal of part, quoting rent, freehold price) etc. Agents to provide joint advice on these issues prior to next meeting.

TH/Longford to consider implications/practicality of disposal of restaurant interest as part of freehold sale."

We were told that cooking smells in a restaurant were likely to diminish both rental values of the office floors and freehold values, so that the possibility of granting a lease of the basement for restaurant use was problematic. We note that the point dropped away because the basement was eventually let to a gym operator.

75. On 5 September 2003, the Statement of Practical Completion was issued.

76. At a property meeting on 6 November 2003, the two-line comment in relation to 16 Berkeley Street, alongside comments in relation to numerous other properties was:

> *Launched on September 12. Basement restaurant under offer to Pizza Pomadora. 2 enquiries for 6,000 sq ft and 3 freehold enquiries. Final account to be agreed with Kier."*

77. A more material meeting note was made of an Executive Committee on 19 November 2003, as follows:

> *16 Berkeley Street - Pursuing a letting campaign for this building but also some freehold interest. TH keen to retain property in Mayfair as this would provide best prospects for rental growth in the future. If unlet this would also require addit funding of £800k in next 12 months. Need to be aware that Longford may have different aspirations for the property to TH"*

We should add that we were told in evidence both that Longford plainly did have different aspirations to Terrace Hill by this point, but that Terrace Hill had not been informed of the financial difficulties that Longford were encountering. The market for serviced offices had apparently been very badly affected by the attack on the Twin Towers, and the resultant departure of a number of American groups from London. As a result, Bank of Scotland was putting considerable pressure on Longford to reduce its various Bank of Scotland borrowings. By this time, therefore, Longford was keen to sell, but we were told that until Longford's problems became relatively public, Terrace Hill was unaware of them.

78. Mr. Adair also said in evidence that in early 2004, Terrace Hill raised further capital by issuing shares, so somewhat diminishing the interest of the family trusts in the group. We were not shown documentation in relation to this but were told that the capital raising was at least partially directed to raising the funds to buy out the Longford interest in 16 Berkeley Street, and that this was mentioned to the potential investors.

79. At a Marketing Meeting on 16 March 2004, again with the same attendees, the notes mentioned that:

> *RL stated that he wanted to review the potential freehold sale in order to determine if the agents are to cease offering the building on a freehold basis."*

This was a somewhat curious reference, and the note was drafted by one of the agents and not Mr. Lane. It was curious because Mr. Lane had not been instructed by the Board to offer the property for sale at this stage.

80. In terms of judging intentions, a rather more informative e-mail was sent on the very next day, 17 March 2004 by Mr. Lane to Mr. David, in the following terms:

> *"I looked at our costs to date on the current cash flow and based upon an assumption of a sale completing in 3 months' time total costs including interest rolled up to that point would be approx. £28.0 excluding sale costs and current letting fees. So I feel that we are in a comfortable position.*

Robert [Adair] has asked that I put together a report with our options as he feels v positive about rental growth here and if we consider our ability to regear the loan in say Oct, when hopefully we are reasonably well let, to release some of the equity then we should reasonably be looking at a 2/3 yr hold unless the investment market is telling us towards the end of this year that it is a sell.

In summary I think there is no reason to get off at this stage and we should give a clear message that we are not sellers during the letting phase.

Let me know what you think."

81. The Appellant's claim was that while the intention had been to retain 16 Berkeley Street as an investment from the outset until September 2004, the Executive Committee decided on 16 September 2004 that the change in market conditions meant that the property should be sold. The minute reads as follows:

16 Berkeley Street - A decision has to be made whether to hold or sell this investment. Mr. Adair initially thought we should hold the property however if the yield is dropping then we should sell. Yields have moved down recently. It was agreed that the property should be sold and should be marketed at £33.5 million. An early sale should be sought as there are break options.

The dates on which the leases were granted

82. Without referring to the detail, we should record that leases of the various floors were let from mid-2004 to March 2005. All bar two floors and the basement had been let by the date of the Executive Committee meeting held on 16 September, just referred to. As we have already recorded, the average rental per square foot was the disappointing figure of £55; all the leases contained break clauses and the covenants of at least some of the tenants were inferior to the covenant that had been hoped for at the outset.

Other suggested pointers to intentions

83. Three other topics were raised in argument, with the suggestion that they might have some bearing on the issue of whether the Appellant intended to retain 16 Berkeley Street as an investment until the change of decision on 16 September 2004. We will refer to each and explain why we are giving them little attention.

84. The Respondents referred to various valuations of 16 Berkeley Street, and pointed out that the valuations always assumed a freehold sale. The Appellant explained that the RICS Red Book basis of valuation always required a valuation to value the freehold, based on a notional sale between a willing seller and willing buyer, and that this approach to valuation was undertaken annually in relation to all properties held, regardless of whether there was any intention to sell them or not. We accept this response which the Respondents did not seek to dispute, and so we consider the valuations, and the basis of calculating values to be irrelevant to the question that we must decide.

85. The Bank of Scotland loans were initially for a two-year period but the amount of the loans and their duration were periodically increased and extended. At one point there was a delay, beyond the then repayment date, in agreeing an extended facility. The Respondents seemed to consider this failure to agree an extension prior to the repayment date to be significant. We agree that, particularly if at the time there were on-going negotiations with

the Bank, the delay would not be particularly unusual, and we altogether fail to see that it has any bearing on the question that we must address.

86. Finally, we have ignored various letters received by Terrace Hill and the agents, in which unsolicited offers were made for the freehold of 16 Berkeley Street. They were invariably responded to in a polite manner, indicating roughly that "At this time we are not offering the freehold for sale, but should the position change we will let you know." Insofar as any of these letters gave any slight indication that the freehold might be available for purchase, and that the potential buyer, or more often agent, would be informed, we consider that these responses were entirely explicable on the basis that a major property company would always wish to retain good contacts with agents, and would not wish to give some "out of hand" rejection of an indication of interest.

The eventual sale

87. Following various other offers for the freehold, at progressively increasing prices, the property was sold to Mayfair Commercial Limited under a contract dated 19 July 2005 for £39.4 million.

88. Prior to that sale, however, as we have already indicated, KPMG had suggested that each party might like to implement a capital loss scheme. Discussions prior to the implementation of that scheme have some relevance to the critical question of the trading or investment objectives of the Appellant and we will now turn to the relevant exchanges.

89. The capital loss scheme was intended to be a conventional capital loss scheme under which, assuming that both the Appellant and Longford wished to implement the scheme, each of the Appellant and LBC(BS) would transfer their interests in 16 Berkeley Street to a new subsidiary and then in some way on the eventual third party disposals of the beneficial interests by those new subsidiaries, available capital losses in some bought-in loss group would be set against the gains. The detail of the schemes is irrelevant.

90. Rather presciently, Owen O'Callaghan, the finance director of Longford wrote to Nigel Turnbull in the following terms:

> *"Thank you for forwarding the tax planning structure. Our tax advisers have reviewed it and said if the Revenue wanted to block this they would just claim the disposal was of trading not of an investment asset. Has KPMG addressed this issue do you know? It would be useful to see their advice on this before proceeding further if possible."*

Two hours after receiving that e-mail, Nigel Turnbull sent an e-mail to the Appellant's tax adviser at Ernst & Young in Glasgow in the following terms:

> *"16 Berkeley Street is a property in the West End of London which is owned in joint venture with the Longford Group.*
>
> *While a redevelopment, we have treated it as an investment because:-*
> 1. *initially there was rental income*
> 2. *we claimed capital allowances on the old building and also on the new once it was built;*
> 3. *the time frame would give us several year ends before we sold;*
> 4. *there was the possibility we might hold as it is a trophy asset.*

I am sure you have the tax comps for the last year or so plus the accounts of the various companies

You may need a copy of the original j/v agreement with Longford

As far as I am aware there has never been any challenge by the revenue on its tax status.

As the West End market has gone crazy we have taken a decision to sell and my intention was to undertake a capital loss scheme to shelter the gain. I shall send you under separate cover an e-mail setting out the steps etc.

Our partner has now suggested per a second e mail that the revenue could challenge the investment status and the scheme would fall by the wayside.

QUESTION What is your view on the tax status etc. Over to you."

91. Before summarising subsequent events, we need to comment immediately on this e-mail. We do regard it as very damaging to the Appellant's case because, aside from the fact that all four reasons for having suggested that the property was rightly treated as an investment were wrong, Mr. Turnbull failed altogether to mention the point that has consistently been advanced in the Appeal before us, namely that the justification for treating the property as an investment was that Mr. Adair and Mr. Turnbull had both regarded the property from its acquisition onwards as one that should be retained as an investment because of its potential for rental growth, and to further the objective of maximising steady net rental profit. Of the four reasons actually referred to in Mr. Turnbull's e-mail the first was plainly wrong because the purchase was not made to derive the rental income. The parties wanted to terminate the leases as quickly as possible in order to commence the intended redevelopment. The second was the wrong way round because capital allowances are available if a property is held as a capital asset, and a claim for capital allowances, or indeed the acceptance (possibly in ignorance) by HMRC that capital allowances are available does not make an asset a capital asset. The third reason is wrong because any elapse of time prior to the disposal was equally accounted for by the time it took to develop the property, and lease all floors, since it was not until that had all been achieved that the best price could be commanded on sale. The fourth reason is wrong, or at least would only have been compelling had it asserted that the property was always intended to be retained as an appreciating "trophy" asset, rather than there being merely a possibility that it might be retained as such. In fact, rather perversely, the only remark in the e-mail that slightly advanced the Appellant's case was the remark that *"As the West End market has gone crazy we have taken a decision to sell"*.

92. We repeat, however, that the damaging feature of Mr. Turnbull's e-mail was the failure to refer to the point, advanced so strongly before us, namely that both Mr. Adair and Mr. Turnbull claimed to be determined to increase the good quality investment assets of the group, and both (particularly Mr. Adair) said that they regarded 16 Berkeley Street as an ideal developed property to hold as a long-term investment. It was conceded by the Respondents' counsel during the hearing that Mr. Turnbull had somewhat dashed off a quick e-mail within two hours of receiving the e-mail from Owen O'Callaghan, and that it might be unrealistic to read too much into the points that he referred to. It also occurs to us that he might have been seeking to list more objective factors, rather than to advance just the basic point of his and Mr. Adair's intentions since it might always be difficult to prove that such intentions were genuinely held.

93. In the event, Ernst & Young chose to seek the Opinion of Mr. David Milne QC on the issue of whether he considered that the property was held as an investment, and doubtless the material issue of whether the Appellant would be able to sustain that proposition in the context of implementing a tax avoidance scheme that HMRC would be likely to find provocative. While we were not shown either the full Instructions sent to Mr. Milne or any Opinion or File Note of the conference, we were told that Mr. Milne was firmly of the view that the property had been acquired as an investment. In a later Ernst & Young letter it was said that his view was based on *"the length of time the building has been held for, and the treatment of the building for accounting and tax purposes."* The Respondents' comment on this alleged opinion was that, as with the earlier decision of the auditors to accept fixed asset treatment for accounting purposes, the opinion of experts, whether auditors or tax counsel, would only be as good as the information that they were given, and when nobody revealed what facts had been given to Mr. Milne, it was difficult to pay too much regard to the conclusion that it was said that he had reached. We might add ourselves that we do not find the fact that the property was retained for several years to be remotely material, because had the intention been to hold it as a trading asset and to realise it at the first opportune moment, we are inclined to accept, with the Respondents, that that opportune moment would have been deferred until both final completion of the development and the finalisation of the leasing exercise, as in fact occurred.

94. At the conference with Mr. Milne, it seems that Mr. Milne must have suggested that Mr. Turnbull should prepare a file note summarising the factors that supported the investment analysis and Mr. Turnbull wrote the following file note on 3 May 2005. It read:

"NOTE FOR FILE

16 Berkeley Street

1. The property, 16 Berkeley Street, is owned 50/50 by TH and Longford via their SPVs Terrace Hill (Berkeley) Limited and Longford Business Centre (BS) Limited.

2. The property was first purchased in August 2000 and the commercial arrangements between the Parties were detailed in a Joint Venture Agreement.

3. Shortly after purchase the parties agreed that, notwithstanding the terms of the Agreement, the property represented a prime West End asset and steps should be taken to retain the property as an investment.

4. Accordingly, the Accounts of both Parties' SPVs have been prepared consistently on the basis of the asset being an Investment Property and tax computations submitted claiming Capital Allowances. Further, this accounting treatment was followed through to the TH Group accounts and the Investments merits of the Property referred to on several occasions.

5. Although the funding of the property purchase was partly short-term debt from Bank of Scotland, the logic behind the use of short-term debt is

(a) long-term loans normally carry a higher rate of interest (or fixed) and certainly higher fees because of the more onerous capital adequacy tests on Banks;
(b) the Group borrowing from Bank of Scotland has normally been on a short-term rather than a fixed term basis. Note that TH was responsible for arranging the loan.

(c) while short-term debt has its risks, both Principals have a long and satisfactory relationship with BOS and judged the risks on non renewal/rollover to be negligible.

6. While the original intention was for Longford to occupy the space for its Business Centre activities, the Parties concluded that greater rental income and investment value could be obtained by the letting to third party tenants."

95. We will obviously have to comment in due course on this note, and in particular on paragraph 3.

The tax avoidance scheme

96. The details of the tax avoidance scheme are presently irrelevant save for the one fact that the Respondents again criticised Mr. Turnbull for two related matters in connection with the implementation of the scheme. It seems that the various advisers who were putting the steps of the scheme together were concerned that the latent gain could only be rolled as a latent capital gain into the new SPVs to which each of the original beneficial owners would be transferring their interest in the property if the acquiring SPV asserted that it was an investment company, acquiring the property for investment purposes, and the repayment date of some loan stock had to be extended to further support this longer term nature of the acquisition. The Respondents criticised Mr. Turnbull for the fact that he had signed Directors' Minutes that had been prepared for him by the advisers, asserting these long term intentions, when the Respondents claimed Mr. Turnbull knew perfectly well that the aim of transferring the property to the new SPV was for that company to effect a broadly arranged third party deal very shortly after purchase. Mr. Turnbull said that he was acting in accordance with the advice and effectively instructions from the relevant lawyers and accountants, and we are inclined to think this further criticism of Mr. Turnbull to be of minimal significance.

Information about other investment properties and the retention of properties that had been developed as long term investments

97. A very material element in the Respondents' challenge of the Appellant's claim that the property had always been acquired with a view to the retention of the completed development as a long-term investment was that the property was in fact disposed of at the earliest sensible opportunity, and exactly the same thing had occurred in relation to other development properties where the Terrace Hill group had asserted that they were purchased with a view to long-term investment.

98. Particular reference was made to two other properties that were to be developed, ostensibly to be held as long-term investments, whereupon they had been sold in one case only part-way through the letting process, and in both cases as soon as a sale could be effected. These two properties were referred to as Vine Street, a property in Uxbridge, and 11 Berkeley Street, obviously a property in the same West End street as the one with which we are strictly concerned in this Appeal.

99. The Respondents' case was that with the potential to benefit from capital allowances and indexation, it would be more attractive to treat properties as fixed assets even in borderline situations. Moreover (though the Respondents did not refer to this point) if properties were retained, and they had been held as investment properties from acquisition, then there would be no tax charge at all, regardless of whether increased long-term borrowings were raised, such that there was an element of equity release. If, in the reverse

direction, properties initially accounted for as trading assets were in fact held indefinitely as investments, there would be a tax charge at the point of appropriation from stock to fixed asset. Accordingly it was suggested that the group would be influenced by a temptation to classify properties as fixed assets, when this treatment was remotely tenable, and that this approach was undermined by the invariable fact, so the Respondents claimed, that the properties were in fact disposed of at the earliest possible opportunity.

100. The information that we were given in relation to the Vine Street property was that it was developed on a joint venture basis with the American real estate investment trust, Liberty Property Trust ("Liberty"). We were told that Liberty had an 80% interest in the joint venture, and that Liberty decided to sell its interest, and indeed decided to pursue no further property interests in the United Kingdom. We were not told whether the Terrace Hill group's 20% interest had to be sold as a result of Liberty's decision to sell, but this seems entirely credible. Equally we were not told whether for instance it was envisaged at the outset that, had Liberty chosen to retain its investment, there was any plan to buy out the Terrace Hill stake. When all that we know (beyond the fact that we understood that the development was actually sold at a loss) is that Liberty's unanticipated decision to sell may well have influenced what the Terrace Hill group should do with its remaining 20% interest, we find it difficult to conclude that the group's initial designation of this development as a capital asset was discredited by the outcome.

101. The only information that we were given about the development and sale of 11 Berkeley Street was that, although it was claimed to have been acquired as an investment property, it was sold part way through the letting process. Mr. Adair had said in his evidence that he did not like the property as much as the property at 16 Berkeley Street, and he was also influenced to sell it when he realised that some of the leases, already granted, had been granted to companies that he knew, from his other role in the oil industry, might become troublesome or defaulting tenants. So he decided to sell. We gathered that his concerns about the tenants did indeed prove justified. We were not told whether he was ignorant of the concerns when the leases were granted. Common sense would suggest that he would not then have had the relevant concerns when the leases were granted, but since we were only marginally interested in 11 Berkeley Street, this was never made clear.

102. We were told that a property in Haymarket had been refurbished on a floor by floor basis as tenants surrendered their leases or as leases terminated, and this property had apparently been held for some time as a fixed asset. We were also told that there were two adjacent properties, in one of which the Terrace Hill group has its own office premises on one of the four or five floors. The other floors and all the floors in the second of the two properties were sub-let to tenants. This property was, however, leasehold and we were told that when the previous freeholder sold its freehold interest, the Terrace Hill group joined into that transaction receiving significantly more than £1m for surrendering some of the value of their head leasehold interest (i.e. presumably by accepting an increase in rent payable to the new freeholder), and as a result we do not know to what degree the Terrace Hill group's leasehold interest had much capital value. Obviously it will have had some value if the sub-lease rents exceeded the head lease rents and there were not too many void periods.

103. Aside from the enquiry into whether properties that the group had developed or refurbished had been held, following completion, as investment assets, we were certainly told that the group had significant investment properties, in relation to many of which no development work had been undertaken. Many appeared to have been acquired indirectly in the sense that since the development of 16 Berkeley Street, the Terrace Hill group had acquired or had merged with two other property companies in both of which there appeared to be a considerable number of investment properties. Many, we were told, were residential

properties, though we believe that there were some retail and office properties that were also held as investments.

104. The Respondents appeared to judge the credibility of the present Appellant's claimed investment intentions by considering whether the group as a whole had retained properties than had been developed as long term investments, whilst ignoring all the other investment properties that the group appeared to own but had not developed. It seems to us that the policy decision that Mr. Adair claimed to have made, namely that it was prudent to increase the group's steady rental profits from investment properties, and the same policy decision that Mr. Turnbull claimed to have understood and sought to achieve, were being confirmed by the increase in investment properties generally, and that it was inappropriate just to test the credibility of Mr. Adair's claimed policy of increasing investments by looking solely at properties that the group had actually developed.

105. We naturally accept that if the group could minimise its risks in developing a property by achieving a pre-sale, then that transaction would inevitably rank as a trading transaction. We can also understand that when, as was commonly the case, developments were undertaken on a joint venture basis (often presumably to share risk), the motivations of the joint venture partner might well have a bearing on what the Terrace Hill group might be able to do with its interest. In relation to Vine Street, for instance, had Liberty chosen to retain its investment, it might have followed that the Terrace Hill group would have done the same. Its interest might have been bought out by Liberty. But if by far the majority owner wished to sell and take no further interest in UK property development, the great likelihood is that this would render it extremely likely that the Terrace Hill 20% interest would also have to be sold.

106. Whilst thus pre-sale arrangements, and other arrangements with joint venture partners might heavily influence the chance of the Terrace Hill group retaining long-term investment interests in those developments influenced by such arrangements, we can see no remote reason why the retention of development properties, uninfluenced by those considerations, should be regarded as improbable, particularly when it was clear that as a general matter the group did appear to be increasing its interest in investment properties generally. Indeed, if the group embarked on a development of an office property in the West End, where a very considerable uplift in value was anticipated, and where either the co-investor might wish to occupy or might anyway wish to retain its investment, there would appear to be more compelling sense to the retention of a property of this nature, than for that property to be realised and the proceeds perhaps invested in other properties where no development was undertaken. For the feature of simply retaining the enhanced value of the developed property, and extracting some equity profit by borrowing would appear to confer all the advantages of obtaining equity release from the property, eliminating any form of realisation of the property, and thus any tax charge, and also of eliminating liability to stamp duty or SDLT.

107. Our factual conclusions in relation to the issue of whether other developed properties had been realised as long term investments by the group companies are thus that:

- the Haymarket and "own office" properties appear to be examples of refurbished properties being retained as long-term investments;
- there appears to be ample evidence that the group was progressively increasing its interest in investment properties generally;
- there is an obvious explanation why it might be impossible for that policy to be pursued in relation to some developments, according to the way in which they were financed; but

- where major developments afforded the developer an opportunity to retain a completed development, there was every reason to suppose that the general policy of seeking to build up the portfolio of long-term investment properties would render it not only feasible, but indeed particularly appealing for a developed property whose value had been considerable enhanced, and whose nature and location offered good rental growth to be one ideally suited to the progressive aim to build up property investments.

The question of whether the Appellant claims that 16 Berkeley Street was originally acquired with a view to retention or whether this decision was only made shortly after purchase, and "notwithstanding the terms of the Joint Venture Agreement"

108. This Appeal has been rather confused in the one respect that while Mr. Adair's evidence and Mr. Turnbull's evidence, both as advanced in the hearing, was that 16 Berkeley Street was always acquired as an investment asset, at one point, Ernst & Young conceded in correspondents to HMRC on 29 February 2008 that:

> *"We acknowledge, as you point out, that the Joint Venture Agreement indicated an original intent to develop and subsequently sell the property at 16 Berkeley Street. However, shortly after its purchase, [the two Beneficial Owners} decided to retain the property as an investment as it represented a prime London West End property with good rental prospects. In addition, in considering whether the property would be a suitable trading asset or not, it soon became apparent that the existing tenants of the property would prove more difficult to remove than first thought. As an investment asset, on the other hand, the situation with the tenants did present some opportunities in terms of potential benefit to be derived from rental income."*

109. While there was no evidence that this letter had been reviewed by the Appellant, it seems inconceivable that it would not have been seen by the Appellant, not least because it was a very considered reply to a letter from HMRC received about 5 months earlier. We are also inclined to believe that this notion of some post-acquisition decision to retain the property as an investment may have derived from a concern on the part of the Appellant, quite possibly aired with Mr. Milne at the conference back in 2005 that the terms of the Joint Venture Agreement suggested that the property was intended to be sold on or shortly after completion. There thus emerged the suggestion that the parties agreed the retention strategy immediately after the acquisition and the parties' signature of the joint venture agreement. This approach appeared to be reflected in paragraph 3 of the Note that Mr. Turnbull was asked to prepare, following the conference with Mr. Milne, which we quoted in paragraph 94 above. Reference was made during the hearing to this third paragraph, and the suggestion then made was that paragraph 3 was not suggesting that there was any change of plan, or that there was an appropriation of stock to fixed asset shortly after purchase. The gloss put on paragraph 3 was that it was still consistent with the proposition that the property had always been acquired for investment purposes, and all that paragraph 3 of the Note was seeking to do was to make it clear that the parties agreed to put their pre-existing intentions rather more clearly, notwithstanding any confusion caused by the terms of the Joint Venture Agreement.

110. There is therefore some considerable confusion. As the Appellant's case was put to us, it was always Mr. Adair's intention that the property should be held as a long-term investment. There is however this confusion, stressed by the Respondents, conceded in the Ernst & Young letter in 2008, quite possibly aired in the discussions preceding, and in the conference with Mr. Milne, and certainly fostered by paragraph 3 of Mr. Turnbull's note that the terms of the Joint Venture Agreement did tend to undermine the Appellant's fundamental case.

111. We will of course address this confusion in giving our decision.

The law

112. There was little dispute between the parties as to the relevant law that we should apply in this case.

113. Both parties accepted that the most fundamental issue for us to determine was the factual one of whether it was indeed true that when the Appellant acquired 16 Berkeley Street, it intended to retain it as an investment, subject to the reality that if circumstances changed radically, the property might have to be sold. Were that the reality, the property would be held as an investment. If on the other hand, the property was acquired in the manner that many development properties were acquired, namely that the Appellant's and the group's interest would be confined to undertaking the development in a profitable and efficient manner, whereupon the property would immediately be sold at the best possible price, then the transaction would be a trading transaction. That would remain the case even had there been some secondary expectation that the property might be retained as a trophy asset if events, possibly unexpected events, changed the basic expectations and the property was eventually retained. In that situation there would be an appropriation from trading stock to fixed asset, and the trading gain at the point of appropriation would be chargeable.

114. As a technical matter, we consider that the question that we must answer in this case is whether 16 Berkeley Street was acquired as a trading asset. The capital gains provisions apply to all assets, and not simply to investments and capital assets, and all that excludes the trading profit from the charge to tax on capital gain is the deduction of proceeds and costs taken into account on trading account as ranking as proceeds and costs for capital gains purposes. The technical issue, therefore, remains that of whether 16 Berkeley Street was acquired as trading stock.

115. We accept, however, that in the case of a property development company, where most properties will be acquired on trading account, the point made in the previous paragraph is of little significance. In the case of a property development group where the entire expertise and focus is on undertaking developments efficiently and profitably, and the aim is to move to the next development as soon as one is completed, inevitably purchases of land are likely to be regarded, and rightly regarded, as trading purchases, where profits on realisation will be trading profits. In order, thus, to distance a property purchase by a development group which generally or always realises its developed properties following completion, there will need to be a marked difference in approach that will distance a particular purchase from those normal trading expectations. In other words while the technical question will remain the question of whether the property was purchased on trading account, in order to break the natural pattern, there will need to be clear evidence that a particular property has been acquired with a very different motivation. So in reality in this case, we must decide whether 16 Berkeley Street was acquired with a view to its retention, meaning retention as the prime aim and not just retention as an outside possibility.

116. We will now address that issue.

Our decision

117. The first obvious point to mention is that the burden of proof falls on the Appellant. It is for the Appellant to establish that on the balance of probability, 16 Berkeley Street was

acquired in the manner that all of the Appellant's witnesses asserted, and it is not for the Respondents to establish the reverse.

118. The critical question then is to weigh up the respective cases in relation to factual intention.

119. There is a consistency to the Appellant's case. We start with the observation that back in 2000 the Terrace Hill group was substantially owned by the Adair family trusts, and we unhesitatingly reach the conclusion that whatever strategy and decisions Mr. Adair took would govern the policy of the group. Mr. Adair was also an apparently truthful witness and a very able accountant and businessman and we certainly accept his general evidence to the effect that he wanted the Terrace Hill group to increase its interest in long-term property investments, and thus reduce its dependency on the profits, losses and delayed recognition of profitability in its development activities where developed properties were always sold off at the first opportune moment following completion.

120. Mr. Adair clearly said that he regarded 16 Berkeley Street from the outset as a highly attractive asset, and that he wanted to retain the completed investment because it would be a high quality office property in virtually the best street in the United Kingdom, and thus a property (with the scarcity of property in that area) with great potential for rental growth.

121. We consider that Mr. Adair's policy of gradually building up good quality investment properties has been pursued. For the reasons mentioned in paragraphs 104 to 106 we can readily understand that pre-sale arrangements and other arrangements with joint venture partners might preclude the retention of developed properties following completion or the completion of the full letting process in many cases. Where, however, the absence of pre-sale arrangements, and the reality of a joint venture arrangement (in other words with Longford appearing to be ready to take a lease of the entire developed property at £63 a square foot) made retention of a development property a feasible proposition, we accept that 16 Berkeley Street appeared to be a prime candidate for such retention. In those circumstances, we consider that the inevitable feature, on medium- or long-term retention that there would be no realisation of the property, no tax charge or SDLT liability at that point would actually render the retention of a successfully completed high quality developed property more appealing to the group than a purchase of a fully let investment property where no development had been undertaken by the group.

122. We then accept the consistent way in which the property was always treated for accounts purposes as a fixed asset, the way in which capital allowances were claimed for the plant and machinery content of the old and new buildings, and the fact that whenever minutes of Executive Committee meetings referred to the views of Mr. Adair, those minutes always reflected his desire to retain this property as an investment, until the minutes of the meeting on 16 September 2004.

123. Mr. Adair's clear evidence was also that the share issue that raised finance, and that diluted the family trust's interest in the Terrace Hill group, a dilution of interest that Mr. Adair was reluctant to occasion, was designed to provide the funds to buy out the Longford interest when it became clear that the interests of the Terrace Hill and the Longford group might no longer coincide. We were admittedly shown no documentation that confirmed this intention, but there was no obvious reason to doubt it.

124. We then have to address whether the evidence was credible when it was said that the letting experience had proved disappointing, that average rents of only £55 a square foot had been achieved when something in the region of £63 a square foot had been expected at the

outside, and yet higher figures had been mentioned. In the event, with some tenants being of more doubtful quality, and all the separate tenancies for all the floors containing break clauses, we do accept that the letting experience proved to be a considerable disappointment. Equally we accept that, having seen numerous figures quoted from time to time to reflect the capital value of the freehold, it certainly appeared that the sale consideration eventually received of £39.4 million did indeed represent a very good offer, and one that should be grasped if there was a fear that yields would soon start to fall.

125. We also record that while the Respondents sought (certainly with an element of success as regards his email that we quoted in paragraph 90 above) to discredit Mr. Turnbull, the Respondents failed to undermine our view that Mr. Turnbull was fundamentally honest, and that he supported and understood the strategy of Mr. Adair in seeking to build up the investment portfolio, and specifically to retain 16 Berkeley Street as a long-term asset. We also re-confirm that we regarded Mr. Leech as a man of very great integrity, and we were influenced by the way in which he explained that while he had had nothing to do with the original intentions, he nevertheless accepted that his understanding of the approach to the retention of 16 Berkeley Street was exactly as it was portrayed by Mr. Adair.

126. As the Appellant's counsel remarked, if we were to decide the substantive issue in this case in favour of the Respondents, it would involve our acceptance that most of the Appellant's witnesses had been lying in relation to all the critical evidence, and we cannot reach that conclusion.

127. We should also address the other possible conclusion along the lines that there may have been a hope that matters would eventually emerge such that 16 Berkeley Street could sensibly be retained, but that that was never regarded as more than an outside possibility. Such an approach would enable us to conclude that all the Appellant's witnesses had merely exaggerated those hopes, rather than fabricating a wholly false case. In view of Mr. Adair's basic strategy, the consistent accounting treatment and the fact that whenever minutes referred to Mr. Adair's intentions they did reflect the claimed intention that the property was an ideal one for retention in view of its potential for rental growth, we consider that possible analysis to be unrealistic.

128. The Respondents' case was advanced in essentially four different ways. First, great attention was paid to the terms of the Joint Venture Agreement, and to the implicit acceptance at one point even by the Appellant that the decision to hold the property for long term investment was only decided by the two Beneficial Owners after, and "notwithstanding the terms of the Joint Venture Agreement". Secondly there were the representations made to Bank of Scotland, when seeking first acquisition and then project finance, to the fact that an early sale was contemplated. Thirdly, considerable significance was attached to the occasional references in Marketing and Executive Committee Minutes where, in particular those involved with marketing, agents made references to freehold values and the possibility of selling the freehold. Finally there was the claim that the Appellants had advanced claims that several development properties were going to be held as long-term investments, and that in the event they had all been sold at the first opportune moment.

129. There is much in this case that makes our decision a finely balanced one, and we do not suggest that any of the Respondents' contentions have been groundless or that they have not caused us considerable difficulty.

130. As regards the first point mentioned in paragraph 128 above, we consider that excessive attention has been paid to the terms of the joint venture agreement in relation to judging the Appellant's initial intentions. Beyond the fact that Mr. Adair's evidence was

that he regarded 16 Berkeley Street as an ideal property to retain from the very outset, the evidence from Mr. Turnbull and Mr. David suggested that there had been little or no discussion between the two groups in relation to their long-term intentions prior to the drafting of the agreement. These claims must either be untrue, or they must suggest that Denton, Wilde Sapte can hardly have been drafting the agreement to reflect intentions that both parties had discussed and explained to them but rather providing an agreement in relatively standard form that catered for all eventualities. We also consider that the terms of the agreement are consistent with this latter supposition, and that Mr. Turnbull's claim that the agreement was in broadly standard form, not reflecting any particular disclosed intentions on the part of the parties, was realistic. We certainly concede that at one point Mr. Turnbull appeared to accept, and Ernst & Young appeared to concede, that the agreement evidenced an intention to sell, albeit that this was corrected shortly after acquisition. The confused references to long-term investment objectives being agreed later (or merely clarified later if that is the right interpretation of paragraph 3 of Mr. Turnbull's note) appear to result from a mis-reading of the Joint Venture Agreement, and a poor effort to explain away a concern that was far less material than the parties believed at the time, and certainly less material than HMRC had contended.

131. So far as the representations about "a sale at the first opportunity" that were made to Ray Robertson at Bank of Scotland, we can reach no conclusion in relation to Mr. David's stance in relation to these. While Mr. Turnbull appeared to derive some confidence from the Longford commitment, or at least "fall-back commitment" to take the occupational lease, it certainly appears that Mr. David considered the prospect of better rental offers from companies with superior credit rating to be highly likely, such that Longfords would be unlikely ever to be called on to take the relevant 15-year lease. Whether then he expected to retain the freehold or to dispose of it we cannot tell. When Mr. Turnbull was pursuing Mr. Adair's policy, however, and placing some reliance on the belief (from considering their accounts) that Longford held its properties as capital assets, and might take or have to take the occupational lease, we consider it likely that when Mr. Turnbull was mentioning an early sale to Bank of Scotland, this could well have been part of the "game" that he referred to with lending banks, rather than a true statement of intention. Furthermore we do not regard it as a particularly serious deception. It was not as if in some way Mr. Turnbull was lying about the value or the potential value of the property. As we have already said, had the Appellant not been able to raise long-term borrowings when it had to repay Bank of Scotland, it would have had to sell the property if repayment was being demanded. Not worrying Bank of Scotland about other retention possibilities seems to be of very modest significance. We are also influenced by the fact that, in talking about dealings with banks, and securing credit committee approval, and in juggling with short and long term borrowings for property finance, Mr. Turnbull had very much been on all sides of such transactions throughout his career, and the views that he expressed in relation to such matters were based on very considerable experience. If, therefore, the conclusion has to be that he presented Bank of Scotland with half-truths or at worst untrue propositions, we do not regard that materially to discredit Mr. Turnbull or to undermine his evidence to us that in fact retention was intended.

132. As regards the periodic references to 16 Berkeley Street in the various minutes, we are first influenced by the fact that any comments attributed to Mr. Adair consistently referred to the intention to retain the property. Other references, sometimes minor references, have to be balanced against the consistent evidence given by the Appellant's witnesses. Insofar as most of the marginally damaging minutes were contained in Marketing Minutes, most of these drafted by agents, reflecting the discussion at meetings attended largely by agents, and certainly never by Mr. Adair, it is pertinent to note that agents would invariably be seeking to promote transactions in order to earn fees, and they would be less concerned with, or possibly wholly ignorant of, Mr. Adair's more fundamental intentions.

In any event, as Mr. Leech said, in the paragraph of his witness statement that we quoted last in paragraph 30 above, he was unaware of any instruction to Mr. Lane and others involved in marketing to sell the property until September 2004, and he believed that had there been an intention to sell before that time, he would have known about it. We consider the paragraph that we have just referred to be of considerable significance.

133. Turning finally to the Respondents' suggestion that in all three cases where development properties had been classified as investments, but nevertheless still sold at the earliest opportune moment, we do not purport to reach any conclusions in relation to Vine Street and 11 Berkeley Street. The point about Liberty wishing to sell and abandon any further projects in the United Kingdom may well have explained the sale of the group's relatively modest investment in the Vine Street property. But that was not explored. All that we were told about 11 Berkeley Street was that Mr. Adair actually preferred 16 Berkeley Street to 11 Berkeley Street, and as regards the latter he was disturbed about (and we were told eventually proved to have been rightly disturbed about) the standing of more than one of the tenants. Accordingly he considered that the property should be sold.

134. In summary we decide this case first because we simply cannot reject all the impressive evidence given by Mr. Adair and other witnesses. Secondly we consider there to be a consistent and credible thread to the Appellant's case, along the following lines:

- The strategy of building up retained properties with potential for rental growth and to produce a steady stream of rental income, to iron out the significant variations in profits of the pure development activity, appears to have influenced Mr. Adair and the group from well before the acquisition of 16 Berkeley Street, and to have been genuine.
- We accept that with many development properties, that strategy would have been precluded by otherwise desirable, risk-reducing, pre-sale arrangements, or by the terms of joint venture agreements.
- Where however, such factors did not preclude retention, it would appear obvious that it was even more appealing to retain high quality properties that had been developed, than to purchase fully-let investment properties. This is because such a retention (whether or not coupled with long term financings that facilitated equity release) would inherently avoid all tax in relation to the uplift in value consequent upon the successful development, and would also avoid transactions for stamp duty and SDLT purposes. In this context, the Respondents' attention to the advantages of capital allowances and indexation would only apply if the retention objectives were abandoned, and there would appear to be an even greater, and wholly unexceptionable, advantage to continuing the initial strategy, and thus to retaining a high quality developed property with the potential in Mayfair for rental growth.
- The accounting treatment throughout confirms the Appellant's claimed strategy.
- Until September 2004, no reference to any intention on the part of Mr. Adair indicated anything other than his continuing desire to retain 16 Berkeley Street.
- Finally we find the disappointing letting experience, the break clauses, the lower rents and the lower standing of some of the tenants to render the decision to sell at £39.4 million to be a more than adequate reason to justify the change of plan, and the decision to sell.

135. We accordingly allow the appeal on the substantive matter. We consider that the property, 16 Berkeley Street, was acquired from the outset and then held as an investment.

The penalty issue

136. The penalty imposed for filing a negligent return obviously drops away in the light of the conclusion just reached. Were our decision on the primary matter to be overturned on appeal, we nevertheless consider that there was no neglect in the filing of the return, since we conclude that the Appellant honestly and credibly believed that its case was correct, and that its return was also therefore correct.

Right of Appeal

137. 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.

HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASE DATE: 12 February 2015