



TC07965

Procedure – Issues remitted from Court of Appeal – Whether appellant should be permitted seek to amend its tax computation to reflect any unrecognised fair value reductions in its derivative contracts – Whether proposed amendment only apparent following Court of Appeal judgment – Applicable principles to be applied – Application dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2013/03525 P

**ON REMITTANCE FROM THE
COURT OF APPEAL (CIVIL
DIVISION)**

BETWEEN

**THE UNION CASTLE MAIL STEAMSHIP
COMPANY LIMITED**

Appellant

-and-

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

Respondents

TRIBUNAL: JUDGE JOHN BROOKS

The application was determined on 30 November 2020 without a hearing on the basis of the written submissions of the appellants dated 4 August 2020 and its reply, dated 23 November 2020, to the written submissions of the respondents dated 9 September 2020

DECISION

INTRODUCTION

1. The Court of Appeal, by its order of 23 April 2020, dismissed the appeal of the Union Castle Mail Steamship Company Limited (“Union Castle”) and remitted the following issues to the First-tier Tax Tribunal (“FTT”):

(1) whether Union Castle should be permitted to seek to amend its tax computation for the period ended 31 March 2009 to reflect any unrecognised fair value reductions in its derivative contracts between 22 November 2008 and 31 March 2009; and

(2) if so, whether any such amendment should be allowed and the amount thereof.

2. By application to the FTT, dated 4 August 2020, Union Castle seeks to amend its tax computation for the period ended 31 March 2009 by way of a deduction in the computation of profits for corporation tax purposes, in the sum of £4,613,169. The application is opposed by the respondents, HM Revenue and Customs (“HMRC”).

BACKGROUND

3. Union Castle appealed against a closure notice, issued by HMRC. This disallowed a deduction of £39,149,128 in the computation of its profits in its corporation tax return for the year to 31 March 2009. Union Castle had claimed this in respect of a debit arising from the derecognition of 95% of a financial asset, cash-flows of FTSE based derivative contracts, which it had entered into for commercial hedging reasons.

4. The appeal was dismissed by the FTT (myself and Michael Sharp FCA) on 27 July 2016 (neutral citation [2016] UKFTT 0526 (TC)), the Tax and Chancery Chamber of the Upper Tribunal (“UT”) (Fancourt J and Judge Berner) on 2 October 2018 (neutral citation [2018] UKUT 316 (TCC)) and the Court of Appeal on 22 April 2020 (reported at [2020] STC 974).

5. In the Court of Appeal, the sole judgment was given by David Richards LJ, with whom Flaux and Lewison LJ agreed. He observed at [6]:

“The facts as they relate to Union Castle were not in dispute before the FTT or the UT and were set out in an agreed statement. They were helpfully summarised by the UT in their Decision at [10] which I gratefully adopt:

‘(1) Prior to 21 November 2008 Union Castle had issued share capital consisting of 502 shares of £1 each, fully paid, held by Caledonia.

(2) From about May 2007, the board of Caledonia wished to implement a hedging strategy, using put options against a FTSE index. The board was concerned about a possible substantial fall in UK equity markets.

(3) The board was concerned that purchase of such put options might prejudice Caledonia's investment trust status. Accordingly it was envisaged that Union Castle might purchase the put options instead.

(4) Between 20 June and 31 December 2007, five FTSE put options at an aggregate cost of £10 million were acquired by Union Castle, and a further put option was acquired in January 2008 at a cost of £2 million.

(5) In July 2008, accounting guidance for investment trusts and venture capital trusts clarified their right to invest in derivatives, such that it appeared that Caledonia could safely hold such investments in its own name.

(6) During the financial year ending 31 March 2009, some of the put options were exercised and further put options were purchased. As at 31 October 2008 Union Castle held three put options and three put spreads ("the Contracts").

(7) On 19 November 2008, Caledonia's audit committee considered novating the Contracts from Union Castle to Caledonia but realised that this would crystallise a tax charge in Union Castle owing to the current value of the Contracts. The committee therefore considered the possible issue by Union Castle of a new kind of share capital to Caledonia with dividend rights, whereby the economic benefit of the Contracts would effectively be transferred to Caledonia. They noted that this would oblige Union Castle to write off the value of the Contracts, thereby crystallising a tax loss.

(8) On November 2008, Union Castle made a bonus issue to Caledonia of 5020 "A Shares", ten for every one existing ordinary share held by Caledonia.

(9) The A Shares carried a right to receive a dividend equal to 95% of the cash flows arising on the close-out of the Contracts, such dividend to be paid within five business days following receipt by Union Castle of the cash flows.

(10) As a consequence of issuing the A Shares, Union Castle was required to "derecognise" 95% of the value of the Contracts for accounting purposes, amounting to £39,149,128.

(11) Between January and August 2009 Union Castle closed out the Contracts for aggregate proceeds of £25,042,545 and paid dividends to Caledonia in a sum equal to 95% of those cash flows.

(12) On the issue of the A Shares, the following debits and credits were recognised by Union Castle:

Cr Financial asset £39,149,12825

Dr income statement £39,149,128

Cr share capital £5,020

Dr share premium £5,020

(13) The A Shares were added to Caledonia's investment ledger as a new security, with no cost attributed, but they were ascribed at fair value, reflecting the "pass-through" right to 95% of the future cash flows from the derivatives. Caledonia did not include an entry in its income statement, but reallocated a part of the fair value from the Ordinary Shares in Union Castle to the A Shares.

(14) Union Castle agreed for the purpose of the proceedings that its accounting treatment in accordance with GAAP should more appropriately have debited the value of the cash flows to the statement of changes in equity rather than to income.”

6. The principal issues in the case, which concerned the application of the relevant legislation (Schedule 26 to the Finance Act 2002) to those agreed facts, were identified by David Richards LJ, at [27] of his judgment, as:

(1) Did the accounting loss resulting from the derecognition constitute a “loss” for the purposes of paragraph 15(1) of schedule 26 (the “loss” issue)?

(2) If there was a “loss”, did it “arise from” the derivative contracts for the purposes of paragraph 15 of schedule 26 (the “arise from” issue)?

(3) If there was a “loss”, did the relevant debit “fairly represent” a loss arising from derivative contracts for the purposes of paragraph 15 (the “fairly represent” issue)?

A fourth issue, described by David Richards LJ as the “Gateway Issue” (whether the debits recognised under paragraph 25A subject to the requirements of paragraph 15), is not relevant for present purposes.

7. The Court of Appeal agreed with the conclusions of the UT on the “loss” and “arise from” issues but came to a different conclusion on the “fairly represent” issue and, as David Richards LJ observed, at [90] dismissed “the appeal on that ground as well”. In reaching its conclusions the Court of Appeal endorsed its reasoning in *GDF Suez Teesside Limited v HMRC* [2018] STC (“Suez”) and *HMRC v Smith and Nephew Overseas Limited* [2020] STC 673 (“Smith and Nephew”). Having acknowledged, at [50], that the application of the “fairly represents” test is neutral and can work in favour of the taxpayer or in favour of HMRC, it was determined, at [58]:

“... that the debit required by IAS 39 to be made in Union Castle's accounts by the derecognition did not, as a matter of legal analysis or economic reality, fairly represent a loss to Union Castle for the purposes of paragraph 15(1) [of Schedule 26 to the Finance Act 2002].”

8. David Richards LJ concluded his judgment saying:

“91. After distributing our judgments in draft to the parties, the court received a submission from Union Castle seeking an order for the matter to be remitted to the FTT “for determination of the relevant figures [of its corporation tax liability for the period ended 31 March 2009] in accordance with the judgment” of this court. It was submitted that because the debit in respect of the derecognition in Union Castle's accounts for the period ended 31 March 2009 had been disallowed, it followed that the total net reduction in the fair value of its derivative contracts between 22 November 2008 and 31 March 2009 should be recognised, with a corresponding reduction of some £4.6 million in its corporation tax liability for that period. It was submitted that one consequence of our decision is that losses not recognised in GAAP-compliant accounts should be brought into account for corporation tax purposes. HMRC opposed this course, pointing out that this alternative case could and should have been raised at a much earlier stage.

92. I consider that, having dismissed the appeal before us, we should remit the matter to the FTT for it to decide (i) whether Union Castle should now be permitted to seek to amend its tax computation in this way and (ii) if so, whether it has a good case for such an amendment. Having not heard argument on either issue, I express no views on them, nor do I express any view on Union Castle's submissions as to the consequences of our decision.”

REMITTED ISSUES

9. I now turn to the issues remitted to the FTT by the Court of Appeal and first consider whether Union Castle should be permitted to amend its tax computation for the period ended 31 March 2009.

10. Union Castle contends that it should. It accepts, in the light of the decision of the Court of Appeal at [58], that the £39,149,128 accounting debit recorded in its accounts, prepared in accordance with Generally Accepted Accounting Principles (“GAAP”), should not be taken into account for corporation tax purposes as the accounting debit did not “fairly represent” a loss for tax purposes. However, as a result of the accounting derecognition of the derivatives

concerned it submits that subsequent movements on the derivatives should have been recognised in its corporation tax computations. It is argued that, in effect, once it is appropriate, for tax purposes, to disregard the accounting debit, Union Castle must be taxed as if it continued to hold the derivatives in full, taking subsequent movements (whether up or down) into its corporation tax computations.

11. Additionally, Union Castle contends this is the first proper opportunity that it has had to seek to make such adjustments as, until the Court of Appeal handed down its judgment in *Smith and Nephew* on 3 March 2020, it was not clear that the “fairly represents” test could favour a taxpayer by excluding profits which appear, or including losses which do not appear, in GAAP compliant accounts from a tax computation. Neither, it submits, was it clear before the Court of Appeal handed down its judgment in the present case that any adjustment would be required as, until then, the interpretation of “fairly represents” was being developed and refined by the courts and had not previously been considered in such a way.

12. Also, by permitting it to amend its corporation tax computation, Union Castle argues that the Tribunal will give effect to the “overriding objective” of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 to deal with cases “fairly and justly”, comply with the requirement under s 50 of the Taxes Management Act 1970 (“TMA”) to find the correct amount of tax and serve, as it was referred to by the Court of Appeal in *Investec Asset Finance Plc and Another v HMRC* [2020] EWCA Civ 579 (“*Investec*”) at [60], the “venerable principle” of tax law, namely that there is a public interest in the correct amount of tax being collected.

13. HMRC contend, as they did before the Court of Appeal, that it is now too late for Union Castle to raise, what is in effect, a new alternative ground of appeal against the amendment of its 31 March 2009 corporation tax return when it could have done so earlier in these proceedings. HMRC say that as the Court of Appeal held in the present case, having applied *Suez*, that the debit required by IAS 39 to be made in Union Castle's accounts by the derecognition did not, “as a matter of legal analysis or economic reality”, fairly represent a loss to Union Castle, nothing further is required to implement its decision and that should be an end of the matter. Union Castle's corporation tax computation has been determined and HMRC's amendment to it in the closure notice should therefore stand.

14. Clearly a party is not entitled to raise a new ground of appeal after judgment has been given in a case (see eg *Re Waring deceased, Westminster Bank Ltd v Burton-Butler and Others* [1948] Ch 221). However, that is not the position in the present case where the issues which were remitted to the FTT by the Court of Appeal have yet to be determined. In such circumstances the question that arises is whether Union Castle should be permitted to advance, what was described by David Richards LJ, as its “alternative case” at this, very late, stage in the proceedings.

15. In *Investec* the Court of Appeal, at [60], cited the observation of Henderson J, as he then was, in *Tower MCashback LLP 1 and Another v HMRC* [2008] STC 3366 (“*Tower*”) in which he said, at [115]:

“There is a venerable principle of tax law to the general effect that there is a public interest in taxpayers paying the correct amount of tax, and it is one of the duties of the Commissioners in exercise of their statutory functions to have regard to that public interest. ... For present purposes, however, it is enough to say that the principle still has at least some residual vitality in the context of section 50 [TMA], and if the Commissioners are to fulfil their statutory duty under that section they must in my judgment be free in principle to entertain legal arguments which played no part in reaching the conclusions set out in the closure notice. Subject always to the requirements

of fairness and proper case management, such fresh arguments may be advanced by either side, or may be introduced by the Commissioners on their own initiative.

That is not to say, however, that an appeal against a closure notice opens the door to a general roving inquiry into the relevant tax return. The scope and subject matter of the appeal will be defined by the conclusions stated in the closure notice and by the amendments (if any) made to the return.”

16. In addition to this “venerable principle”, Union Castle relies on s 50(6) TMA (which provides that if the Tribunal decides that an appellant is overcharged by a self-assessment it “shall be reduced accordingly”) and the general case management powers contained in Rule 5, particularly Rule 5(2), of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the “FTT Rules”) under which:

The Tribunal may give a direction in relation to the conduct or disposal of proceedings at any time including a direction amending, suspending or setting aside an earlier direction.

This, Union Castle contends, gives the Tribunal the power to determine the remitted matters in light of the decision of the Court of Appeal in accordance with the overriding objective of the FTT Rules to deal with cases “fairly and justly” (see Rule 2 FTT Rules).

17. While the Tribunal clearly has such power, as Henderson J observed in *Tower*, this is subject to the requirements of “fairness and proper case management”. In *Fidex Limited v HMRC* [2016] STC 1920 Kitchin LJ, as he then was, similarly observed, at [45], that, “subject always to the requirements of fairness and proper case management” new arguments can be raised before the Tribunal to support the conclusions set out in the closure notice. Although not addressed by either party, I consider that the question in the present case, whether to permit Union Castle to rely on an alternative case is comparable to that of an application for a late amendment to pleadings.

18. The principles to be applied in considering such an application were summarised by Carr J, as she then was, in *Quah Su-Ling v Goldman Sachs International* [2015] EWHC 759 (Comm) (“*Quah*”) as follows:

“36. An application to amend will be refused if it is clear that the proposed amendment has no real prospect of success. The test to be applied is the same as that for summary judgment under CPR Part 24. Thus the applicant has to have a case which is better than merely arguable. The court may reject an amendment seeking to raise a version of the facts of the case which is inherently implausible, self-contradictory or is not supported by contemporaneous documentation.

37. Beyond that, the relevant principles applying to very late applications to amend are well known. I have been referred to a number of authorities : *Swain-Mason v Mills & Reeve* [2011] 1 WLR 2735 (at paras. 69 to 72, 85 and 106); *Worldwide Corporation Ltd v GPT Ltd* [CA Transcript No 1835] 2 December 1988; *Hague Plant Limited v Hague* [2014] EWCA Civ 1609 (at paras. 27 to 33); *Dany Lions Ltd v Bristol Cars Ltd* [2014] EWHC 928 (QB) (at paras. 4 to 7 and 29); *Durley House Ltd v Firmdale Hotels plc* [2014] EWHC 2608 (Ch) (at paras. 31 and 32); *Mitchell v News Group Newspapers* [2013] EWCA Civ 1537.

38. Drawing these authorities together, the relevant principles can be stated simply as follows :

a) whether to allow an amendment is a matter for the discretion of the court. In exercising that discretion, the overriding objective is of the

greatest importance. Applications always involve the court striking a balance between injustice to the applicant if the amendment is refused, and injustice to the opposing party and other litigants in general, if the amendment is permitted;

b) where a very late application to amend is made the correct approach is not that the amendments ought, in general, to be allowed so that the real dispute between the parties can be adjudicated upon. Rather, a heavy burden lies on a party seeking a very late amendment to show the strength of the new case and why justice to him, his opponent and other court users requires him to be able to pursue it. The risk to a trial date may mean that the lateness of the application to amend will of itself cause the balance to be loaded heavily against the grant of permission;

c) a very late amendment is one made when the trial date has been fixed and where permitting the amendments would cause the trial date to be lost. Parties and the court have a legitimate expectation that trial fixtures will be kept;

d) lateness is not an absolute, but a relative concept. It depends on a review of the nature of the proposed amendment, the quality of the explanation for its timing, and a fair appreciation of the consequences in terms of work wasted and consequential work to be done;

e) gone are the days when it was sufficient for the amending party to argue that no prejudice had been suffered, save as to costs. In the modern era it is more readily recognised that the payment of costs may not be adequate compensation;

f) it is incumbent on a party seeking the indulgence of the court to be allowed to raise a late claim to provide a good explanation for the delay;

g) a much stricter view is taken nowadays of non-compliance with the Civil Procedure Rules and directions of the Court. The achievement of justice means something different now. Parties can no longer expect indulgence if they fail to comply with their procedural obligations because those obligations not only serve the purpose of ensuring that they conduct the litigation proportionately in order to ensure their own costs are kept within proportionate bounds but also the wider public interest of ensuring that other litigants can obtain justice efficiently and proportionately, and that the courts enable them to do so.

19. *Quah* was applied by the Upper Tribunal (Newey J and Judge Bishopp) in *Denley v HMRC* [2017] UKUT 340 (TCC). In *Asiana Limited v HMRC* [2019] UKFTT 267 (TC) (“*Asiana*”) the Tribunal (Judge Mosedale), having referred to the principles summarised in *Quah* said, at [15]:

“... the law on pleadings is clear: the appellant must state what are its grounds of appeal. If it does not, it cannot rely on those grounds. And if it wants to rely on a new ground of appeal, as it does here, it must apply for permission to amend. And *Quah* and *Denley* set out the principles the Tribunal will consider in determining such an application.”

Clearly, as no hearing date has been lost, the present case cannot be described as “very late” in the sense described by Carr J. However, like Judge Mosedale at [27] in *Asiana*, I consider that “it is extremely late in all other senses as the appeal has been running many years.”

20. The appellant in *Asiana*, as Judge Mosedale noted at [27] in that case, had “many opportunities” to raise the ground issue concerned at an earlier stage of the proceedings but did not do so. HMRC contend that this is the position in the present case whereas Union Castle says that this was not possible before the Court of Appeal decisions in *Smith and Nephew* and the present case when the proper construction of the term “fairly represents” became clear.

21. By way of example of how “fairly represents” had been considered before *Smith and Nephew* and the present case, Union Castle refers to *Stagecoach Group Plc v HMRC* [2016] UKFTT 120 (TC) (“*Stagecoach*”), *Greene King Plc Greene King Acquisitions Ltd v HMRC* [2016] EWCA Civ 782 (“*Greene King*”) and *Suez*.

22. In *Stagecoach*, which Union Castle accepts is not directly relevant as it concerns the loan relationships code, the FTT held, albeit obiter, that the “fairly represents” requirement only has an allocation and/or timing role and was a means of identifying from entries in the accounts those things which have to do with derivatives, and secondly identifying that which is appropriate in a particular accounting period.

23. In *Greene King* the Court of Appeal noted, at [77], that in considering “fairly represents”:

“what is in issue is the fair representation of credits and debits in accordance with ‘an authorised accounting method’ for the purposes of s 84(1) [Finance Act 1996]. There is no scope for some other method set by the court itself.”

24. In *Suez* the Court of Appeal acknowledged that “fairly represents” is intended to be a separate and additional requirement/override. As Henderson LJ, with whom Asplin and Kitchin LJ agreed, said in that case, at [96]:

“Once the overriding nature of the fair representation test is recognised, the remainder of the analysis seems to me to fall into place without difficulty. Looking in the round at each Claim and the assignment of it by TPL [Teesside Power Limited, the previous name for GDF Suez Teesside Limited] to TRAIL [Teesside Recoveries and Investments Limited] in return for shares in TRAIL of equivalent value, I see no difficulty in concluding that a profit or gain of a capital nature thereby arose to TPL from the disposal of the Claim, and that such profit or gain can only be fairly represented by a loan relationship credit in the hands of TPL equal to the value of the Claim at the date of the disposal. In this way, the profit or gain is brought into charge to tax at the same value as is recognised for accounting purposes in the hands of TRAIL, and a symmetrical outcome is assured. The alternative treatment, based solely on the GAAP-compliant treatment of the transactions in the books of TPL, would not “fairly represent” the profit or gain arising to TPL because it would lead to the value received by TPL in return for the Claims falling out of any charge to tax at all in the hands of either TPL or (by virtue of its non-UK tax resident status) TRAIL. Parliament could not rationally have intended such an outcome, and application of the fair representation test is in my opinion the appropriate means by which it is prevented.”

25. It was therefore *Suez*, rather than *Smith and Nephew* and the present case, that established that “fairly represents” should be constructed so that, irrespective of the accounting treatment, if a company makes either a commercial profit or a commercial loss on a derivative then, unless prohibited from doing so by the derivatives code, it can be recognised in its tax computation even if it cannot in its GAAP compliant accounts. No other limit, such as a tax avoidance purpose or that it could only benefit HMRC and not the taxpayer, was placed on such a construction by the Court of Appeal.

26. As such, it was apparent from at least 5 October 2018, when the Court of Appeal handed down its judgment in *Suez*, three days after the decision of the UT in the present case, that “fairly represents” was an economic override allowing the economic reality to take priority over the accounting treatment. However, Union Castle should have been aware of this even earlier as the decision of the FTT in this case, which it heard in June 2016, records at [54] that even at that stage of proceedings HMRC had argued, that “fairly represents” might “constitute some form of override”. It was therefore open for Union Castle to raise the alternative case on which it now seeks to rely not only before its appeal was heard by the Court of Appeal but somewhat sooner than that.

27. In the FTT, in the present case, we dismissed an application by HMRC that had been made 18 days before the commencement of the hearing. At [15] of the decision we explained that one of the reasons for doing so was that the application could have been made sooner and, in the absence of an explanation for the delay, it was “simply too late”. Union Castle’s current application to amend its corporation tax computation is similarly too late. For the reasons above, I consider it could have been made at an earlier stage of the proceedings and do not accept that it was unable to do so as justification for what, in the sense describe by Judge Mosedale in *Asiana*, is undoubtedly a very late application.

28. Having regard to all the circumstances of the case, particularly that the “fairly represents” argument on which Union Castle now wishes to rely could have been run at an earlier stage in proceedings, I have come to the conclusion that it should not be permitted to seek to amend its tax computation for the period ended 31 March 2009.

29. Its application is therefore dismissed.

COSTS

30. In view of the agreement between the parties I make no direction as to the costs of this application.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

31. 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 FTT Rules. 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.

JOHN BROOKS

TRIBUNAL JUDGE

RELEASE DATE: 4 DECEMBER 2020