Neutral Citation Number: [2019] EWCA Civ 1909

Case No: C1/2018/1975

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION (ADMINISTRATIVE COURT)
MR JUSTICE LEWIS
[2018] EWHC 1967 (Admin)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 07/11/2019

Before :

LORD JUSTICE UNDERHILL
(Vice-President of the Court of Appeal (Civil Division))
LADY JUSTICE ROSE
and
LADY JUSTICE SIMLER

- -

Between :

THE QUEEN (on the application of ALASDAIR LOCKE)	**Appellant**
- and –	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

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- -

David Ewart QC (instructed by **Ernst & Young LLP**) for the Appellant
Richard Vallat QC and David Yates QC (instructed by **Solicitor's Office, HMRC**) for the **Respondents**

Hearing date : 15 October 2019

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Approved Judgment

Lady Justice Rose:

Background

1. This appeal arises out of Mr Locke's involvement with a limited liability partnership called Eclipse Film Partners No 10 LLP ('Eclipse 10'). Eclipse 10's business was the exploitation of film rights. In March 2006 Mr Locke joined the Eclipse 10 partnership, making a contribution of £29,700,000. He financed that contribution by taking out two bank loans. When he came to complete his self-assessment tax return for the 2005/2006 year of assessment, Mr Locke responded to the question on the form asking whether he wanted to claim any of a list of reliefs by entering a figure in the box signifying that he claimed relief for interest on qualifying loans and arrangements. Mr Locke also completed the tax return supplementary page designed for members of a partnership. He described the Eclipse 10 partnership as for the "exploitation of film rights" and gave the date when he started being a partner as 4 April 2006. He stated that his share of the profits of the partnership for the year was nil. In an annex to his tax return he listed one of the loans he had taken out for Eclipse 10, being the one on which he had paid interest in that year, and described the purpose of the loan as "Purchase an interest in a film partnership". Mr Locke made similar claims for relief for the interest paid on the loans in subsequent years of assessment up to and including 2014/2015.

2. HMRC have opened enquiries into Mr Locke's tax returns for the years of assessment 2005/2006 to 2014/2015. When the follower notices I describe below were issued, those enquiries had not yet been completed and no closure notices had been served pursuant to section 28A of the Taxes Management Act 1970. HMRC argue that Mr Locke is not entitled to relief from income tax for those interest payments because the loan is not a qualifying loan. There has been correspondence between HMRC and Ernst & Young who act for Mr Locke. Both sides have set out their evolving arguments as to whether or not the interest payments qualify for relief.

3. On 8 March 2017 HMRC issued a series of 10 follower notices to Mr Locke under Part 4 of Chapter 2 of the Finance Act 2014, one for each year of assessment in which he had claimed interest relief. Follower notices are part of the regime designed, broadly, to discourage a taxpayer from persisting with a claim to be entitled to a tax advantage when a court has already ruled in an earlier case that that advantage does not arise for a taxpayer in his circumstances. HMRC stated in the follower notices that the conditions for the issue of the notices were met because on 17 February 2015, the Court of Appeal had handed down a ruling in *Eclipse Film Partners No 35 LLP v Revenue and Customs Commissioners* [2015] EWCA Civ 95, [2015] STC 1429 ('*Eclipse 35*'). HMRC consider that that case shows that Mr Locke is not entitled to relief on the interest payments. There is no statutory right of appeal against the issue of a follower notice so Mr Locke brought a judicial review challenge contending that the conditions for the issue of the follower notices were not met. That challenge was dismissed by Lewis J in the judgment under appeal, reported at [2018] EWHC 1967 (Admin), [2018] STC 1938.

The statutory provisions

4. I set out first the statutory provisions relating to claims for interest relief. The provisions set out here are those found in the Income and Corporation Taxes Act 1988

('ICTA 1988') which applied in the tax year 2005/2006. For subsequent tax years, sections 383 and 398 in Part 8 of the Income Tax Act 2007 applied but there is no material difference between those provisions and the provisions set out here.

5. Section 353 ICTA 1988 provides so far as relevant as follows:

> "**353 General Provision**
>
> "(1) Where a person pays interest in any year of assessment, that person, if he makes a claim to the relief, shall for that year of assessment be entitled (subject to sections 359 to 368 of this Act ….) to relief in accordance with this section in respect of so much (if any) of the amount of that interest as is eligible for relief under this section by virtue of sections 359 to 365."

6. The various kinds of loans for which interest relief can be claimed are set out in the sections following section 353. For example, section 359 deals with a loan used to buy machinery or plant, section 360 with a loan to buy an interest in a close company and section 364 with a loan to pay inheritance tax. The relevant kind of loan in this case is that described in section 362 of ICTA 1988:

> "**362 Loan to buy into partnership**
>
> Subject to section 363 to 365, interest is eligible for relief under section 353 if it is interest on a loan to an individual to defray money applied –
>
> (a) in purchasing a share in a partnership; or
>
> (b) in contributing money to a partnership by way of capital or premium or in advancing money to a partnership, where the money contributed or advanced is used wholly for the purposes of the trade, profession or vocation carried on by the partnership; or
>
> (c) in paying off another loan interest on which would have been eligible for relief under that section had the loan not been paid off (on the assumption, if the loan was free of interest, that it carried interest);
>
> and the conditions stated in subsection (2) below are satisfied."

7. It is accepted here that Mr Locke satisfied the conditions in section 362(2).

8. Section 353(1B) provides that where a person is entitled to interest relief by virtue of section 362, that relief shall consist in a deduction or set off of that amount from or against that person's income for that year.

9. The other set of relevant statutory provisions in this appeal are those establishing the follower notice regime. Section 199 of the Finance Act 2014 ('FA 2014') provides an overview of Part 4 of the Act dealing with follower notices and accelerated payments. In that overview section 199 describes Chapter 2 of Part 4 as making provision for

follower notices and for penalties "if account is not taken of judicial rulings which lay down principles or give reasoning relevant to tax cases". Section 204 in Chapter 2, provides:

> "**204 Circumstances in which a follower notice may be given**
>
> (1) HMRC may give a notice (a "follower notice") to a person ("P") if Conditions A to D are met.
>
> "(2) Condition A is that—
>
> (a) a tax enquiry is in progress into a return or claim made by P in relation to a relevant tax, or
>
> (b) P has made a tax appeal (by notifying HMRC or otherwise) in relation to a relevant tax, but that appeal has not yet been—
>
> (i) determined by the tribunal or court to which it is addressed, or
>
> (ii) abandoned or otherwise disposed of.
>
> (3) Condition B is that the return or claim or, as the case may be, appeal is made on the basis that a particular tax advantage ("the asserted advantage") results from particular tax arrangements ("the chosen arrangements").
>
> (4) Condition C is that HMRC is of the opinion that there is a judicial ruling which is relevant to the chosen arrangements.
>
> (5) Condition D is that no previous follower notice has been given to the same person (and not withdrawn) by reference to the same tax advantage, tax arrangements, judicial ruling and tax period.
>
> (6) A follower notice may not be given after the end of the period of 12 months beginning with the later of—
>
> (a) the day on which the judicial ruling mentioned in Condition C is made, and
>
> (b) the day the return or claim to which subsection (2)(a) refers was received by HMRC or (as the case may be) the day the tax appeal to which subsection (2)(b) refers was made."

10. "Relevant tax" for this purpose includes income tax: see section 200(a) and a "tax advantage" includes relief or increased relief from tax: see section 201(2)(a). Arrangements are "tax arrangements" "if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements": see section 201(3). It is common ground before us that Conditions A, B and D were satisfied although there is a dispute as to the meaning of the term "the asserted advantage" used in Condition B.

The principal issue between Mr Locke and HMRC concerns whether Condition C is met in his case, in effect whether HMRC are entitled to serve a follower notice on the basis of their opinion that there is a judicial ruling that is relevant to Mr Locke's chosen arrangements and which denies him the tax advantage he asserts.

11. The use of the word "relevant" in Condition C at first sight suggests that only a fairly loose connection between the judicial ruling and the taxpayer's chosen arrangements is needed for Condition C to be satisfied. However, relevance is defined in section 205 as follows:

> "**205 "Judicial ruling" and circumstances in which a ruling is "relevant"**
>
> (1) This section applies for the purposes of this Chapter.
>
> (2) *"*Judicial ruling*"* means a ruling of a court or tribunal on one or more issues.
>
> (3) A judicial ruling is "relevant" to the chosen arrangements if—
>
> (a) it relates to tax arrangements,
>
> (b) the principles laid down, or reasoning given, in the ruling would, if applied to the chosen arrangements, deny the asserted advantage or a part of that advantage, and
>
> (c) it is a final ruling.
>
> (4) A judicial ruling is a "final ruling" if it is—
>
> (a) a ruling of the Supreme Court, or
>
> (b) a ruling of any other court or tribunal in circumstances where—
>
> (i) no appeal may be made against the ruling,
>
> (ii) if an appeal may be made against the ruling with permission, the time limit for applications has expired and either no application has been made or permission has been refused,
>
> (iii) if such permission to appeal against the ruling has been granted or is not required, no appeal has been made within the time limit for appeals, or
>
> (iv) if an appeal was made, it was abandoned or otherwise disposed of before it was determined by the court or tribunal to which it was addressed."

12. According to section 206, a follower notice issued by HMRC must identify the judicial ruling in respect of which Condition C in section 204 is met and explain why HMRC consider that the ruling meets the requirements of section 205(3). A taxpayer who receives a follower notice is entitled, pursuant to section 207, to make written representations to HMRC objecting to the notice on the basis, amongst other things, that the judicial ruling specified in the notice is not one which is relevant to the chosen arrangements. Having considered the representations, HMRC must determine whether to confirm the follower notice with or without amendment or to withdraw it.

13. What are the consequences for the taxpayer of receiving a follower notice? The first is that if he persists in claiming the asserted tax advantage by failing within the time specified in section 208(8) to amend his own tax return so that it reflects HMRC's view rather than his own view of his tax liability, he becomes subject to a penalty. That penalty is set by section 209(1) at 50 per cent of the value of the tax advantage although there may be a reduction down to a minimum of 10 per cent to reflect the taxpayer's cooperation with HMRC: see section 210. The taxpayer can bring an appeal against the penalty on the ground, amongst others, that the Conditions for issuing the follower notices were not satisfied. If he is ultimately proved to be wrong and HMRC's view of the matter is upheld, he will have to pay the penalty in addition to paying the tax and interest.

14. The second consequence for the taxpayer of receiving a follower notice is that he may then receive an accelerated payment notice in accordance with Chapter 3 of Part 4 of FA 2014. Section 219 of FA 2014 sets out the conditions which must be satisfied before HMRC may give an accelerated payment notice to a taxpayer. One of the triggers, set out in section 219(4)(a), is that HMRC have given the taxpayer a follower notice under Chapter 2. The effect of the accelerated payment notice is, again broadly, that the taxpayer must pay an amount stated in the notice which is treated as paid on account of the disputed tax. The aim is, as Arden LJ put it in the opening paragraph of her judgment in *R (oao Rowe and others) v HMRC* [2017] EWCA Civ 2105, [2018] STC 462:

> "to change the financial benefit of tax avoidance arrangements by ending the economic benefit to taxpayers of retaining an amount equal to the disputed tax until the issue is finally determined against them (if the arrangements are ultimately held to be ineffective)."

15. Again, the provisions do not stop the taxpayer from later bringing a challenge before the tribunal to establish whether the tax advantage applies. But he must pay the disputed tax up front as well as take the risk that he will have to pay the penalty resulting from the follower notice if he is wrong about his tax position.

The Eclipse 35 litigation

16. In order to determine whether it is open to HMRC to form the opinion that the judgment of the Court of Appeal in *Eclipse 35* is a relevant judicial ruling, it is important to understand what it did and what it did not decide. Eclipse 35 was a limited liability partnership which made a partnership tax return for the year ended 5 April 2007 claiming that it was, in that tax year, carrying on a trade of acquiring and exploiting film rights. HMRC began an enquiry into that return and issued a closure

notice in which they decided that the partnership was not carrying on a trade. Eclipse 35 brought an appeal before the tribunal contending that it was carrying on a trade, that that trade was the acquisition, sub-licensing and marketing of rights in films and that it was carrying on that trade with a view to profit. The First-tier Tribunal ('FTT') (Judge Sadler and Judge Walters QC) held that it was not carrying on a trade: see the decision reported at [2012] UKFTT 270 (TC), [2012] SFTD 823. In outlining the dispute before it, the FTT noted that although the transactions which the members of Eclipse 35 had entered into were complex, the issue before the tribunal was, in concept at least, simple: in the tax year ended 5 April 2007, was Eclipse 35 carrying on a trade? The FTT recorded at [5]:

> "5. The Commissioners also pressed us to decide (should we find that Eclipse 35 was carrying on a trade) the further question of whether moneys borrowed by Eclipse 35's members and used by them to contribute capital to Eclipse 35 were moneys used for the purposes of such trade. For the reasons we give below we do not consider that that is an issue which is within the scope of the appeal we are required to determine."

17. The FTT went on to explain why the trading issue was subject to such substantial and protracted litigation even though Eclipse 35 had reported no profits or income chargeable to tax in the year of assessment. The explanation was that the significance of the appeal lay not in the tax position of Eclipse 35 itself but in that of its individual members who had claimed tax relief on the interest paid on the money they had borrowed to fund their investments in Eclipse 35. It was a necessary precondition to a successful claim to that relief on the part of members that Eclipse 35 be carrying on a trade with a view to profit in the tax year in which the members made their interest payments. The members, the FTT said, "wait in the wings, as it were, whilst [Eclipse 35] pursues its appeal against the Commissioners' decision on the trading issue": see [6]. Further, at [31], the FTT recorded that Eclipse 35 was "prepared to accept" that its members would need to establish that all the elements of section 362(1)(b) were present in order to succeed in obtaining tax relief.

18. Turning to the question of trading, the FTT recorded that the documentary evidence before it amounted to about 100 lever arch files and that six witnesses gave extensive oral evidence at the hearing. The findings of fact were set out in [80] to [252] and the further findings as to the nature of Eclipse 35's activities were set out in [253] to [367]. At [395] the FTT restated its conclusion that the manner in which, and the extent to which, the members financed their contributions to Eclipse 35 "is extraneous to whatever it was that Eclipse 35 did" although that was part of the context in which Eclipse 35 entered into the transactions with its business partners. The FTT's conclusion at [414] was that, viewed realistically, the activities of Eclipse 35 amounted to a business involving the exploitation of films which did not amount to a trade.

19. At the end of its judgment, the FTT again referred to HMRC having urged them to decide the further question of whether moneys borrowed by the members were moneys used for the purposes of Eclipse 35's trade, assuming it was carrying on a trade. That was not a matter that they needed to decide and it was in any event not a matter which they considered should be determined in these particular proceedings.

They said: "[i]t relates to any claim which the members might make for relief for the interest they have paid and as such is a matter which they, and not Eclipse 35 should argue": see [416].

20. Eclipse 35 appealed to the Upper Tribunal where the appeal was dismissed by Sales J (as he then was). His decision is reported at [2013] UKUT 639 (TCC), [2014] STC 1114. He also recognised that the appeal focused solely on the trading issue because it was only if Eclipse 35 carried on a trade that important tax advantages would arise for the members of the Eclipse 35 LLP: [7]. Having set out section 362(1)(b) ICTA 1988 (but not section 362(1)(a)) he said at [11]:

> "11. It thus emerges that in order for a member to claim tax relief in relation to interest due in respect of borrowings made to contribute to the capital of Eclipse 35, it has to be shown that Eclipse 35 was carrying on a trade and that the borrowed money used to contribute to Eclipse 35 was used wholly for the purposes of that trade …"

21. He went on to note that although the formal question arising from the closure notices turned on the tax affairs of Eclipse 35 itself, the parties' primary interest was in the ability or otherwise of the members of Eclipse 35 to claim tax relief in respect of the interest on borrowings they made. That issue, he said, "turns on whether Eclipse was carrying on a trade (see s362(1)(b), ICTA 1988)". The appeal was therefore being used "as a vehicle to test HMRC's determination on the trading issue, with Eclipse 35 in effect representing the interests of its members": see [12].

22. Eclipse 35 appealed further to this Court which delivered a judgment of the court (Sir Terence Etherton C, Christopher Clarke and Vos LJJ) dismissing the appeal: reported at [2015] EWCA Civ 95, [2015] STC 1429. The introductory paragraphs referred to the underlying purpose of the appeal:

> "4. Members of Eclipse 35 borrowed money to contribute to its capital. They paid interest on the money borrowed. They may be able to claim tax relief in respect of that interest but only if Eclipse 35 was carrying on a trade and only if the borrowed money was used wholly for the purpose of that trade. That is the combined effect of the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA') s 863 and the Income and Corporation Taxes Act 1988 ('TA 1988') ss 353 and 362.
>
> 5. Although the closure notice (and so this appeal) relates to Eclipse 35 itself rather than the personal tax position of any of its members, what is important in practical terms is whether the members are entitled to tax relief in respect of interest on their borrowings. Accordingly, it is convenient to treat TA 1988, s 362(1) as the critical provision by way of background."

23. The Court of Appeal's judgment then set out section 362(1) but omitted subparagraph (a) and cited only subparagraph (b). As a final introductory matter, the Court noted that if the FTT's decision was not overturned there would be "very serious fiscal consequences" for the members of Eclipse 35 because they would be taxed on the

income from the arrangements without any relief for the interest they have already paid: see [9]. The Supreme Court refused permission to appeal on 13 April 2016 so the Court of Appeal's judgment became final.

Mr Locke's follower notices and accelerated payment notices

24. The follower notices given to Mr Locke all identified as the relevant judicial ruling the ruling of the Court of Appeal in *Eclipse 35*. HMRC explained why they considered that *Eclipse 35* was relevant to Mr Locke's tax arrangements. This was because the arrangements in *Eclipse 35* involved: (a) individuals borrowing money to contribute as capital to Eclipse 35 and paying interest on the money borrowed; (b) Eclipse 35 entering into a series of transactions in relation to the acquisition, distribution and marketing of film rights; (c) the individuals asserting a tax advantage by claiming relief in respect of the interest paid on the money borrowed on the basis that Eclipse 35 carried on a trade and that the borrowed money was used for the purpose of the trade. The Court of Appeal had held that Eclipse 35 was not carrying on a trade. That meant that tax relief was not available to the members of Eclipse 35 in respect of interest paid on money borrowed to contribute to the partnership. HMRC went on to describe Mr Locke's arrangements as being similar to those in Eclipse 35 because when he became a member of Eclipse 10, he:

> "• became a member in an LLP which entered into a series of transactions in relation to the acquisition, distribution and marketing of film rights;
>
> • used borrowed money to contribute capital to the LLP and paid interest on the money borrowed;
>
> • claimed relief in the year ended 5 April 2006 in respect of the interest paid on the money [he] borrowed on the basis that the LLP carried on a trade and that the borrowed money was used for the purpose of trade. The claim included a claim for relief against income arising from the LLP, and further a claim for relief against the remainder of [his] total income. The claim for relief against the remainder of [his] total income is the "asserted advantage" of the arrangements."

25. The follower notices went on:

> "Applying the reasoning in *Eclipse 35 v HMRC* to your arrangements would produce the result that Eclipse Film Partners No 10 LLP was not trading. The arrangements involving Eclipse Film Partners No 10 LLP were of the same character, and had the same results, as those involving Eclipse 35. Eclipse Film Partners No 10 LLP was therefore not carrying on a trade for the same reasons Eclipse 35 was found not to be carrying on a trade."

26. HMRC then told Mr Locke that he would be liable to pay a penalty if he did not amend his self-assessment tax return to "counteract the denied advantage".

27. Ernst & Young made representations to HMRC on Mr Locke's behalf by letter dated 9 June 2017. They pointed out that HMRC had incorrectly stated the basis on which Mr Locke claimed relief for the interest paid. The tax returns stated that the interest paid qualified for relief on the basis that the loan funds were used to "purchase an interest in a partnership". There is no requirement that Eclipse 10 be carrying on a trade in order for a loan for that purpose to qualify for relief. They asserted that since no reliance was being placed by Mr Locke on the existence of trade in order for relief to be due, HMRC could not reasonably hold the opinion that the not-trading decision in *Eclipse 35* was of any relevance to Mr Locke's claim for relief. Ernst & Young set out the wording of section 362(1) stressing that subsection (1)(a) did not impose a trade requirement like subsection (1)(b). Indeed, they pointed out that when section 362 had originally been enacted in Schedule 1 to the Finance Act 1974, all of the alternative qualifying conditions which were later included within section 362(1) required the partnership to be carrying on a trade, profession or vocation. This was removed by the Finance Act 1981 except for the condition that later became section 362(1)(b).

28. HMRC responded to Mr Locke's representations by letter dated 17 August 2017. HMRC said:

> "HMRC consider that the principles laid down or the reasoning given in the Eclipse 35 ruling would, if applied to your arrangements, deny the asserted advantage.
>
> Making a contribution to a partnership and buying a share in a partnership are two different things. The facts show that what you did was to make a contribution to a partnership. Consequently, if relief were to be available to you at all in relation to the chosen arrangements, it would need to be available under section 362(1)(b) ICTA. Therefore, when applied to the circumstances of your investment, the Eclipse 35 ruling has the effect that you are not entitled to relief under section 362(1)(b), or at all."

29. The author of the letter concluded on this point:

> "I consider that the chosen arrangements are sufficiently similar to those in Eclipse 35 for the principles and reasoning in Eclipse 35 to be applied. It is HMRC's view that Eclipse Film Partners No 35 LLP's business model is fundamentally the same as the other Eclipse LLPs (including Eclipse Film Partners No 10 LLP) and that applying the same principles and reasoning would result in the conclusion that those LLPs were also not trading.
>
> I am satisfied that the principles or reasoning given by the FTT in Eclipse 35, would, if applied to the chosen arrangements, result in the asserted advantage being denied in whole or in part and that Eclipse 35 is a "relevant" judicial ruling."

30. On 25 October 2017, HMRC issued accelerated payment notices to Mr Locke, one for each tax year for which a follower notice had been issued. The first notice, relating to the tax year ended 5 April 2006 stated that the amount due was £355,440 and that payment was due on 29 January 2018. It cited the corresponding follower notice as satisfying the condition set out in section 219(4)(a) of the FA 2014. Mr Locke's judicial review challenge to the accelerated payment notices does not raise any issue additional to his challenge to the follower notices. It is common ground that if the follower notices are quashed, then the accelerated payment notices must be quashed too.

The judgment below

31. Lewis J dealt first with identifying the tax advantage that Mr Locke was asserting. He held that the "asserted advantage" for the purposes of section 204(3) of the FA 2014 was relief under section 353 ICTA 1988:

> "41. The tax advantage in the present case is the claim for relief on the payment of interest. On the wording of section 353 ICTA, it is that section which gives rise to the right to claim relief as appears from its wording – if a person pays interest, and he makes a claim for relief, he is entitled to "relief in accordance with this section". That is the particular tax advantage which the claimant seeks in respect of the amount of interest as is eligible. The provisions in section 362 ICTA are ways of determining the amount of the interest which is eligible for relief under section 353 ICTA. In those circumstances, it would not be right to characterise section 362(1)(a) as giving rise to one type of tax advantage – relief on interest on borrowing used to purchase a share in a partnership – and section 362(1)(b) as giving rise to a different type of tax advantage – interest on capital contributions paid to a partnership. Each of those subsections set out conditions governing eligibility for a claim for interest rather than setting out the entitlement to claim relief on interest."

32. The judge then turned to the application of Condition C in section 204(4) of the FA 2014. He identified the critical question as whether HMRC could properly form the opinion that the principles laid down or the reasoning in the ruling in *Eclipse 35* would, if applied to the arrangements chosen by Mr Locke deny the asserted advantage. He held that they were so entitled:

> "46. … They are entitled to consider the nature of the arrangements in the *Eclipse 35* ruling and the chosen arrangements in the present case to determine if there is a sufficient similarity such that the reasoning in the ruling would apply."

33. He considered the wording of the contractual documentation for both the Eclipse 35 and Eclipse 10 partnerships and concluded that there was nothing to indicate that the chosen arrangements in Eclipse 10 were different from those in Eclipse 35. The only documents which suggested that a legally different transaction was intended to be

carried out was Mr Locke's tax return which referred to the purchase of an interest in a film partnership. The judge then considered whether his interpretation was consistent with the purpose underlying Chapter 2 of FA 2014. That purpose was to discourage taxpayers from making claims or maintaining appeals which seek tax advantages arising out of schemes which have already been the subject of final rulings by a court or tribunal. An interpretation of sections 204 and 205 which enabled follower notices to be issued in the present case was consistent with that purpose. The judge said:

> "53. I understand the point made by Mr Ewart that no tribunal or court has yet ruled on the question of whether becoming a member of a partnership on agreeing to provide finance to that partnership can be characterised as the purchase of a share in the partnership rather than a capital contribution to the partnership. However, the question is the proper interpretation of the provisions of Part 4 of the 2014 Act. Given the nature of the arrangements in the *Eclipse 35* case, and the similarity between those arrangements and the claimant's chosen arrangements, the defendants are entitled to form the view that the *Eclipse 35* ruling would, if applied to the claimant's chosen arrangements, deny the claimant the tax advantages he seeks. If he wishes to maintain that he is entitled to that relief because the chosen arrangements are to be given a different legal characterisation from that in the *Eclipse 35* case, then he must do so on the basis that he is liable to a penalty and cannot enjoy the benefit of the understated tax pending the outcome of that claim."

34. He therefore held that all the conditions for issuing a follower notice in section 204 of FA 2014 were satisfied and he dismissed the claim for judicial review.

Ground 1 of the appeal

35. Mr Locke appeals against Lewis J's ruling on two grounds. Ground 1 concerns the identification of the asserted tax advantage. Is the advantage to be identified in terms of a broad description such as *relief for interest payments*? Alternatively, is the advantage to be defined with a greater degree of granularity as *relief for interest payments on loans used to purchase an interest in a partnership* so that it is different from *relief for interest payments on loans used to contribute money to a partnership by way of capital or premium*?

36. On this ground I agree entirely with Lewis J's analysis in paragraph 41 set out above. This construction of the term "asserted advantage" is supported by two further indications in the wording of the legislation. First, the term "tax advantage" is defined in section 201(2) by listing a number of broad categories of advantage:

> "(2) "Tax advantage" includes—
>
> (a) relief or increased relief from tax,
>
> (b) repayment or increased repayment of tax,

(c) avoidance or reduction of a charge to tax or an assessment to tax,

(d) avoidance of a possible assessment to tax,

(e) deferral of a payment of tax or advancement of a repayment of tax, and

(f) avoidance of an obligation to deduct or account for tax."

37. This suggests that Parliament was referring to broad classes of tax advantage and not creating a plethora of narrow kinds of tax advantage. The approach for which Mr Ewart QC appearing for Mr Locke contends raises the question of quite how finely one must slice up the individual subsections describing the different circumstances in which relief is available in order to arrive at the "asserted advantage". Within section 362(1)(b) are various alternative scenarios in which relief might be available – the contribution made by the taxpayer might be by way of capital or by way of premium; the partnership might be carrying on a trade, or a profession or a vocation. It would not be clear whether there is a different tax advantage claimed for each of the six permutations or only one. This approach would also lead to the question of what precisely was "asserted" by the taxpayer at what time. The taxpayer's analysis and HMRC's understanding of and response to that analysis may well evolve over the course of correspondence between them. That does not, in my judgment, mean that there had been a change in the tax advantage "asserted", provided it remains within the basket of, in this case, relief for interest payments under section 353(1).

38. The second indicator in the statutory wording is that each of the subsequent sections describing a different purpose for a qualifying loan expressly states that the individual who pays interest on such a loan "is eligible for relief under section 353" if he satisfies the conditions. That wording is found in all the subsequent sections, including those sections relating to loans where interest relief has been repealed such as sections 354 (loans to buy land etc) and section 356 (job related accommodation). This in my judgment points clearly to the intention that the asserted advantage is the relief on interest payments and that relief is granted by section 353 and not by the subsequent provisions fleshing out the circumstances in which the relief can be claimed under that general section.

39. In any event, Mr Ewart accepted in the course of his submissions that the potential relevance of a judicial ruling is not limited to a subsequent case in which a taxpayer asserts the same tax advantage as had been denied in the earlier ruling. That must be right because section 205 does not stipulate that the same tax advantage is being claimed by the recipient of the follower notice as was denied to the previous unsuccessful taxpayer. Whether or not, as Mr Ewart submitted, each subparagraph of section 362(1) is a different tax advantage, the ruling in *Eclipse 35* would be a relevant judicial ruling if the question of whether Eclipse 35 was carrying on a trade became relevant to any other tax advantage that the partnership or its members might claim.

40. That is demonstrated by the present proceedings because, as I have described, the ruling in *Eclipse 35* was not in fact a ruling in respect of a claim by the members of Eclipse 35 to interest relief by virtue of section 362(1)(b) but was an appeal by the partnership itself against the closure notice issued by HMRC to the partnership on the basis that it was not carrying on a trade. In those proceedings, Eclipse 35 was not

asserting any particular tax advantage. Yet Mr Ewart accepted that if the members of Eclipse 35 had later brought proceedings claiming interest relief under section 362(1)(b), HMRC would clearly have been entitled to issue follower notices on them relying on the Court of Appeal's ruling. He further accepted, rightly in my view, that if Mr Locke had claimed relief for his loans in respect of moneys paid to Eclipse 10 on the basis of section 362(1)(b), HMRC would have been entitled to issue a follower notice relying on *Eclipse 35* as a judicial ruling which establishes the principle that partnerships whose business is the same as the business of Eclipse 35 are not carrying on a trade for the purpose of that provision. A follower notice could be based on the Court of Appeal's ruling provided, of course, that the test to be applied to determine whether the partnership was trading or not was the same as that considered in that case.

41. Mr Ewart argues that the words "relief in accordance with this section" used in section 353 are intended only to specify how the relief is to be given, in Mr Locke's case by deduction from income. I do not agree that that is the correct reading, given the reference back to section 353 in the later sections such as section 362.

42. I would therefore dismiss the first ground of appeal.

Ground 2 of the appeal

43. Ground 2 concerns whether, regardless of the answer to Ground 1, HMRC were entitled to form the opinion that the principles or reasoning in *Eclipse 35* as applied to Mr Locke's arrangements would deny the asserted advantage. On this ground I consider that Lewis J asked himself the wrong question and so came to the wrong answer. The focus of the statutory provisions is not on whether the particular chosen arrangements from which the tax advantage is said by the taxpayer to arise are identical or similar to the arrangements considered by the court or tribunal in the earlier judicial ruling. The question is rather whether the principles laid down or reasoning given in that ruling would, if applied to the chosen arrangements, deny the asserted advantage or part of it. To decide that one must identify the legal issues that arise from Mr Locke's dispute with HMRC over his entitlement to interest relief and consider what *Eclipse 35* has to say about those legal issues.

44. Approaching the point that way, it is clear first that Mr Locke is basing his claim to interest relief on the application of section 362(1)(a) and not section 362(1)(b). Parliament has decided that the requirement that the partnership was carrying on a trade, profession or vocation is a requirement only for subsection (1)(b) and not for (1)(a). The question of whether Eclipse 10 is carrying on a trade is not, on the basis of Mr Locke's claim, an issue that needs to be resolved in order to decide whether the asserted advantage of interest relief arises from the Eclipse 10 arrangements. Rather what needs to be resolved is whether the payment Mr Locke made to Eclipse 10 from the moneys he borrowed is to be treated as a payment to purchase a share in a partnership within the meaning of subsection (1)(a) or as a contribution of money by way of capital or premium within the meaning of subsection (1)(b).

45. HMRC have formed the opinion that the only way that Mr Locke's payment can be properly characterised is as a contribution to capital and not as a purchase of a share. They construe section 362(1)(a) as limiting the purchase of a share in a partnership to a situation where the taxpayer purchases a share from an existing partner. Where the

taxpayer obtains a new partnership interest rather than replacing an existing partner, HMRC believe that he only contributes money by way of capital or premium. In any future tribunal proceedings Mr Locke will contend to the contrary, that the purchase of a new share in a partnership falls within subsection 1(a) just as much as the purchase of an existing share. He argues that the wording of the Eclipse 10 documentation which Mr Locke signed does not point to the payment he made being only a contribution of capital and not also, or instead, a purchase of a share. It might well, he would say, fall within both section 362(1)(a) and (1)(b).

46. Does *Eclipse 35* decide which of those arguments is right and which is wrong? In my judgment it does not; *Eclipse 35* does not deal with that question at all. It is true that the case was argued before the FTT, the Upper Tribunal and the Court of Appeal on the basis that the only route by which Eclipse 35's members could claim interest relief would be section 362(1)(b). Although some comments by the tribunals such as that in [11] of Sales J's judgment taken in isolation might be read as deciding that, the point was not argued and there is no judicial decision on it. No tribunal or court has yet laid down any principle that HMRC's construction is the correct legal position or given any reasoning as to why Mr Locke's payment cannot be characterised as the purchase of a share in Eclipse 10 for the purposes of section 362(1)(a).

47. HMRC rely for their submissions on the inclusion in Condition C of the words "HMRC is of the opinion that" the judicial ruling is relevant. That wording is intended to confer some scope for HMRC to come to a view about the relevance of a judicial ruling. HMRC argue that provided that it was reasonably open to HMRC to conclude that the proper characterisation of the facts in Mr Locke's case was that his money was a contribution of capital and not the purchase of a share, the test for Condition C is satisfied.

48. In his submissions on the scope of HMRC's entitlement to form an opinion, Mr Ewart referred us to the decision of this Court in *R (oao Haworth) v HMRC* [2019] EWCA Civ 747, [2019] 1 WLR 4708. In that case the issue between the taxpayer and HMRC was whether the taxpayer was entitled to claim a tax advantage in respect of capital gains tax arising from the double taxation arrangements between the United Kingdom and Mauritius. The Court of Appeal (Newey LJ giving the leading judgment with which Gross LJ and Sir Timothy Lloyd agreed) considered first whether the words "or reasoning given" in Condition C were intended to expand or narrow the reference to the "principles laid down" in a case. The Court held that the effect of those words was that "principles" and "reasoning" were both relevant. HMRC were not therefore constrained to rely only on the *ratio* of the earlier case but could also take into account other reasoning to be found in it: see [34]. The second question raised by the taxpayer was the degree of certainty with which HMRC had to hold the opinion that the earlier ruling was relevant. HMRC argued that this required no more than that HMRC consider that the principles or reasoning are "more likely than not" to result in the advantage being denied. At [37] the Court rejected that submission, holding that HMRC:

> "must be of the opinion that the principles or reasoning in the ruling in question *would* deny the advantage, not merely that they would be more likely than not to do so."

49. That implied, Newey LJ said, "a substantial degree of confidence in the outcome": [37]. The reasons given by Newey LJ for concluding that the threshold must be a high one are pertinent here. He said that the wider construction proposed by HMRC would allow follower notices to be given in a surprisingly wide range of cases making it theoretically possible for HMRC to use follower notices routinely in relation to disputes pending before the FTT. However, the explanatory notes from which he quoted at [30] of his judgment showed that follower notices were meant to be available to HMRC only in relatively exceptional circumstances. He also considered that the serious consequences flowing from a follower notice were important. The risk of a 50 per cent penalty indicated that Parliament intended the regime only to be applicable in a limited number of cases. Newey LJ also referred to the statement of Lord Reed JSC in *R (Unison) v Lord Chancellor* [2017] 3 WLR 409 at [80] that:

> "even where a statutory power authorises an intrusion upon the right of access to the courts, it is interpreted as authorising only such a degree of intrusion as is reasonably necessary to fulfil the objective of the provision in question."

50. In his concurring judgment in *Haworth*, Gross LJ also referred to the draconian nature of the powers conferred in HMRC and concluded that it was "right that they should be carefully circumscribed, not least – amongst other reasons – because of their impact on access to the courts and the rule of law": [66].

51. I respectfully agree with the Court in *Haworth* as to the caution that must be used to ensure that the serious consequences for the taxpayer of HMRC's power to issue follower notices and accelerated payments notices mean that that power must be kept within narrow bounds. The insertion of the words "HMRC is of the opinion that" in Condition C is intended in my judgment to cover a situation where, for example, the arrangements chosen by the taxpayer are slightly different as a matter of fact from those that were considered in the earlier judicial ruling. In those circumstances HMRC are entitled to form the opinion that they are confident to the necessary standard that the judicial ruling is still determinative of the question whether the tax advantage arises, despite those factual differences. If the reasonableness of that opinion comes to be considered by the court, the exercise is one of considering whether the change in the facts is sufficient to distinguish, legally speaking, the chosen arrangements from those in the judicial ruling – an exercise in legal analysis with which the courts are very familiar. That is not the exercise that HMRC have engaged in here because it is accepted that the factual position is materially the same for Eclipse 10 as for Eclipse 35. What HMRC cannot do in my judgment is rely on those words in Condition C to jump over the issue that Mr Locke's tax return raises, namely whether the chosen arrangements fall within section 362(1)(a) or only within section 362(1)(b).

52. As to the opinion formed by HMRC in Mr Locke's case, Ernst & Young pointed out in their response to the follower notices that HMRC did not themselves seem to be "of the opinion" that the Eclipse 10 arrangements did not qualify for relief. In published guidance about the ambit of section 362(1)(a), HMRC appear to suggest that a contribution of capital in return for being admitted as a partner constitutes the buying of a share in a partnership within the meaning of section 362(1)(a). Ernst & Young went on:

> "That public statement of HMRC's opinion demonstrates that HMRC does not hold the opinion that the question of trade determines the question of the availability of interest relief pursuant to a claim made under section 353 ICTA 1988, given that our client clearly made a "subscription for capital in a Limited Liability Partnership".

53. HMRC accepted in their response to Ernst & Young that their published guidance was "open to being understood in a way that is misleading". But that did not have the effect that relief should be available where it is not available under the law.

54. Although Mr Locke may therefore question whether HMRC can have formed their professed opinion to the degree of confidence required by *Haworth* that is not I think the issue here. There may be cases in which the alternative legal characterisation that a taxpayer puts forward to circumvent the relevance of a judicial ruling is, in HMRC's view, clearly unsustainable. That does not entitle HMRC to issue a follower notice if there is no prior judicial determination to that effect. Rule 8(3)(c) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (S.I. 2009/273 (L.1)) confers on the FTT a power to strike out the whole or part of proceedings if the Tribunal considers that there is no reasonable prospect of the appellant's case or part of it succeeding. That is the route that can be pursued without invoking the powers in Part 4 of the FA 2014.

55. I do not agree with Lewis J that an examination of the purpose of the legislation leads to the conclusion that Condition C bears the meaning for which HMRC contend. In paragraph 51 of the judgment, Lewis J described the aims of the legislation being to deter litigation on points already decided in order to reduce the administrative and judicial resources needed to deal with such claims. That may well explain why the follower notice regime was enacted but it does not help in deciding more precisely how far Parliament intended the regime to extend and where the legislation draws the line in furthering that aim. The construction which I consider correct does not deprive the regime of any application. Mr Locke accepts that he cannot impose on the tribunal the same 100 lever arch files that the FTT dealt with in *Eclipse 35* to demonstrate that Eclipse 10 is carrying on a trade. Mr Locke is, however, entitled to seek a determination of the legal issue that his chosen arrangements raise and to do so without the threat of a penalty being imposed if he turns out to be wrong and without having to pay the disputed tax now.

56. In my judgment, HMRC could not have lawfully held the opinion that the *Eclipse 35* decision, if applied to the Eclipse 10 arrangements would deny the advantage that Mr Locke asserts given the legal issue that arises as a result of Mr Locke's claim to entitlement to relief for the interest he has paid. I would allow the appeal and quash the follower notices and the accelerated payment notices.

Simler LJ

57. I agree.

Underhill LJ

58. I also agree.