[2018] UKFTT 205 (TC)

TC06449

Appeal number: TC/2016/02279
TC/2016/02282

INCOME TAX – corporation tax – permanent establishments in UK - applicability of intangible fixed assets election to transaction - election refused by HMRC – whether application of separate and distinct principle under UK/US Double Taxation Convention meant that transaction to be regarded as transfer of assets as appellants contended rather than sale of partnership units as HMRC contended – HMRC correct to refuse election - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) BLOOMBERG INC (UK PERMANENT ESTABLISHMENT) **Appellants**
(2) BLP ACQUISITION HOLDINGS LLC (UK PERMANENT ESTABLISHMENT)

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN
JOHN AGBOOLA

Sitting in public at Taylor House on 14, 15 and 16 November 2017
Further written submissions received from appellants on 27 November 2017 and Respondents on 22 December 2017

Julian Ghosh QC and Emma Pearce, counsel, instructed by Deloitte LLP for the Appellants

Jonathan Bremner, counsel (appointed as QC subsequent to hearing), instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appellants, who are liable to UK corporation tax through each having a permanent establishment ("PE") in the UK, appeal against HMRC's decision to refuse elections made under the regime in Schedule 29 of Finance Act 2002 for intangible fixed assets ("IFAs") (these assets include assets such as customer contracts, trademarks, software and certain other licenses). Schedule 29 allows a debit to be brought into account for corporation tax purposes in relation to the writing down of the capitalised cost of an intangible fixed asset on a fixed rate basis. The elections arose in relation to a transaction through which the appellants increased their holding of units in an entity (Bloomberg LP, a Delaware registered limited partnership). The appellants argue that, taking due account of the provisions of the United Kingdom/USA Double Taxation Convention ("the UK/US Treaty") and in particular Article 7 on taxation of business profits, and the strength of the fiction that a permanent establishment is to be treated as separate and distinct, the transaction must be viewed from the perspective of the PE and the notional accounts that are constructed for that PE. The IFA election, they submit, is valid because the PEs of the appellants must be regarded, in accordance with the UK/US Treaty as having acquired IFAs.

2. HMRC say it is relevant to take account that the trade carried on in the UK is one which is carried out in partnership and that when the relevant UK provisions relating to taxation of corporate partners are applied, the relevant accounts perspective is that of the partnership. At that level there was no change in IFAs; rather there was a change in ownership of the partnership. No IFAs were acquired at that level and the appellants' elections under Schedule 29 are therefore not valid.

3. The parties agreed a joint statement of facts which we have incorporated below with the omission of amounts of US dollar figures on the basis that nothing in this decision, which is a decision in principle, turns on the particular amounts paid in relation to the transaction or the valuations reached. Expert accountants' reports were prepared by each party and a joint report filed. The tribunal heard oral evidence from each expert which was subjected to cross-examination. Both witnesses were knowledgeable and credible. As will be seen, the accountancy evidence was largely agreed and the issue in this appeal turned on the prior legal question of what was the appropriate perspective or level from which to construct the accounts in respect of the permanent establishments of the appellants.

Factual background in summary

Statement of agreed facts

4. Bloomberg Inc. ("BI") is a US tax resident company incorporated on 11 January 1982 in accordance with the General Corporation Law of the State of Delaware. BI has a PE in the UK and pays corporation tax on the profits attributable to that PE.

5. Merrill Lynch L.P. Holdings Inc. ("ML") is a US incorporated and tax resident company.

6. Bloomberg Finance LP ("BFLP") is a Delaware registered limited partnership, established on 5 June 2007 in accordance with the Delaware Revised Uniform Limited Partnership Act.

7. Bloomberg LP ("BLP") is a Delaware registered limited partnership, established on 9 December 1986 in accordance with the Delaware Revised Uniform Limited Partnership Act.

8. Bloomberg (GP) Finance LLC ("GP LLC") is a US tax resident company, incorporated on 5 June 2007 pursuant to the Delaware Limited Liability Company Act. GP LLC is a 100% subsidiary of BLP.

9. BLP Acquisition Holding LLC ("BAH LLC") is a US tax resident company, incorporated on 14 July 2008 pursuant to the Delaware Limited Liability Company Act. BAH LLC has a PE in the UK and pays corporation tax on the profits attributable to that PE.

10. BI and BAH LLC have similar (but not identical) owners.

11. Bloomberg Finance Holdings LP ("BFH LP") is a Delaware registered limited partnership established on 5 November 2007 in accordance with the Delaware Revised Uniform Limited Partnership Act. Its members are GP LLC and BLP.

12. BLP Acquisition LP ("BA LP") is a Delaware registered partnership, established on 14 July 2008 in accordance with the Delaware Revised Uniform Limited Partnership Act. Its members are BI and BAH LLC.

13. For United States tax purposes:

(1) BLP, BFLP, BFH LP and BA LP are not charged to United States tax on their own profits;

(2) Rather, for United States tax purposes, the profits and/or losses of BFLP are treated as being realised directly by BLP and the profits and/or losses of BLP and BA LP are allocated to their members.

14. Immediately prior to 17 July 2008, BI and ML were partners in BLP. BI held an 80% interest in BLP and ML held the remaining 20%. ML's 20% interest in BLP consisted of 21.714286 units in BLP.

15. At all material times, BLP and BFLP have together undertaken the main operations of the Bloomberg Group. BFLP provides the Bloomberg Professional service to customers for a monthly fee, which comprises a number of items, including access to (1) proprietary and/or sophisticated analytics for evaluating financial products, and (2) a database of financial information. BLP provides services to BFLP (and to some third party clients). BLP's business remained unchanged after the acquisition.

16. At all material times, BLP and BFLP have carried on business at various locations worldwide (e.g. USA, Germany, Japan, Hong Kong, Singapore), including in relation to BLP, the UK. As of 31 December 2008, BLP had approximately 2000 staff in the UK. At all material times, BLP and BFLP have carried on business in the UK at various addresses in the UK (e.g. London).

17. On 17 July 2008, BI as to the 19.5% and BAH LLC (through BA LP) as to 0.5% purchased ML's 20% interest in BLP (i.e. the 21.714266 units in BLP previously held by ML) (the "Transaction") by way of a Limited Partnership Purchase Agreement ("the Purchase Agreement"). (Simplified diagrams setting out the transaction appear at Appendix 1 to this decision).

18. The total consideration for the 21.714286 units in BLP purchased from ML consisted of a US dollar sum (in cash and loan notes) and the deemed assumption by BI and BA LP of some liabilities from ML.

19. The categories of consolidated journal entries for the Transaction in BI's consolidated financial statements are set out in Appendix 2. Those accounts were prepared in accordance with US GAAP. At all material times neither BI nor its UK PE prepared solus accounts (i.e. accounts prepared on the basis the entity was a sole entity).

20. Note 1 to BI's consolidated financial statements for the year ended 31 December 2008 reported that BI and a newly formed affiliate, BAH LLC had:

> "completed the purchase of the 20% interest in [BLP] previously held by [ML] for an aggregate purchase price which included in relative terms a smaller sum of direct acquisition costs. As a result of this transaction BI and its affiliate own 100% of BLP."

21. It was further reported that:

> "The acquisition was accounted for as a business combination in accordance with SFAS No 141 Business Combinations, resulting in the total purchase price being allocated to the assets acquired and liabilities assumed based upon their fair values at the date of the acquisition."

22. The assets listed in the subsequent table were stated in the accounts to include, for US accounting purposes, intangible assets and goodwill.

23. BI and BAH LLC have claimed relief for intangible fixed assets ("IFAs") in the corporation tax returns for their respective PEs. The claims were made on the assumption that their PEs had acquired a proportion of the intangible fixed assets reported in BI's consolidated financial statements. That proportion of the value of the intangible fixed assets reported in BI's consolidated financial statements was calculated by BI and BAH LLC on the basis of the share of profits of the relevant Bloomberg entities attributed to the UK in accordance with the transfer pricing method that was applied in calculating the profits of the respective PEs of BI and BAH LLC. This transfer pricing method for calculating the share of profits was subsequently formalised in an advance pricing agreement ("APA") with HMRC

which was formally executed on 7 January 2014. The APA covered the accounting periods ending 31 December 2006 to 31 December 2016.

24. The APA is no longer in force, although an application has been made to renew it on the same terms. The parties were agreed that domestic UK tax legislation, not the APA, will determine if a claim for relief for IFAs can be made. However if it is determined that relief for IFAs is available under domestic UK tax legislation, the APA should be relevant in establishing the proportion of intangibles that are attributed to the UK, and thereby the quantum of relief. The quantum of any available relief is not presently before the tribunal.

25. BI and BAH LLC each made an election (pursuant to section 730 CTA 2009) to write down the intangible fixed assets at 4% per annum, with resultant annual deductions claimed.

26. Following HMRC's enquiries into BI and BAH LLC's corporation tax returns for the accounting periods ended 31 December 2008 to 31 December 2013, HMRC concluded that no relief could be claimed in relation to the intangible fixed assets.

27. The Amended and Restated Agreement of Limited Partnership of Bloomberg LP dated 6 August 1987 set out the following provisions which were referred to by the parties:

> "Section 1.4 - Partnership Purpose…the primary purpose and business of the Partnership shall be to provide information and analytic services and to engage in any and all other business activities in which the Partnership may lawfully engage as determined by the General Partner."

28. Article III dealt with Partners Capital containing sections on Partners (Section 3.1) and Additional Issuance of Units (Section 3.8). Article V dealt with allocations of profits and losses and distributions. Section 5.4 dealt with Distributions:

> "Distributions of Available Case Flow shall be made at such time or times and in such amounts as the General Partner in its sole discretion may determine, subject to the Act and [Delaware Revised Uniform LP Act] and the terms of the Purchase Agreement. Such distributions may be made from Partnership revenues, capital contributions or the proceeds of the Partnership borrowings."

29. Section 7.13 dealt with Indemnification of the General Partner, Section 7.14: Liability of General Partner. Article X covered Transfers of Units. Article XVII contained Miscellaneous Definitions and set out that "Unit" meant the beneficial ownership interest of a Partner or Assignee in the Partnership.

30. The Limited Partnership Interest Purchase Agreement dated 17 July 2008 was between Merrill Lynch L P Holdings Inc. (defined as "Seller") BI, BLP Acquisition LP defined as "New LP" and together with BI "Buyers".

31. The recitals stated as follows:

> "WHEREAS Seller…owns 21.714286 units of limited partnership interest (the "Units") in Bloomberg L.P., a Delaware limited partnership (the "Partnership") which represent a 20% ownership interest in the Partnership; and
>
> WHEREAS, BI and New LP desire to purchase all of Seller's Units (the "Interest") from Seller, and Seller desires to sell the Interest to BI and New LP, in each case upon the terms and subject to the conditions set forth in this Agreement.
>
> …
>
> Article 1 Sale and Purchase
>
> Section 1.1 Agreement to Sell and to Purchase…
>
> "Seller shall sell, convey, transfer, assign and deliver to New LP, all right, title and interest of the seller legal and equitable in and to 21.1711429 Units…"

32. Section 3.4, as highlighted by the appellants, provides for the seller to obtain good title to the units. There was also no suggestion that BLP is a unit trust or an opaque company.

> "Capitalization; Title to Interests. The authorized equity interests in the Partnership consist solely of…the Interest and the general and limited partnership interests of the Partnership owned by BI and New LP…BI and the New LP will have good title to all of the outstanding general and limited partnership interests in the Partnership."

Issues

33. It was common ground that 1) the intangibles that BI seeks relief for, are all in BFLP, and 2) the relevant taxpayers are BI and BAH LLC; activities and profits of both BFLP and BLP were taxable in hands of BI and BAH LLC (which are US incorporated and US resident) because each of BI and BAH LLC has a UK PE and the profits of both BFLP and BLP are attributable to BI's PE and BAH LLC's PE.

34. The appellants' primary case is that when the UK/US Treaty obligations and, in particular the obligation to treat the permanent establishment as a separate and distinct entity are applied, the transaction must be treated as including an acquisition of intangible assets by the PE. The notional accounts for the PE would accordingly reflect this enabling an election in respect of the IFAs to be made. The appellants maintain they are entitled to elect to claim a deduction for expenditure on acquisition of intangible fixed assets.

35. HMRC disagree. They argue no acquisition of such assets was made by the appellants because when, as required under the relevant provisions applying to taxation of non-resident companies who are partners, which they say apply, the transaction must be viewed from the perspective of the partnership. The notional accounts for the permanent establishment that are derived accordingly recognise that from the partnership's perspective there was no change in assets. Rather there was a change in the ownership. HMRC accept that under the terms of the UK/US Treaty,

and the UK's domestic legislation (which they say is consistent with the Treaty obligations), UK corporation tax can only subject the profits attributable to the PE to tax. When a non-UK company is a partner, the legislation requires the profits and losses at partnership level to be worked out and then attributed to each partner according to the partner's share.

Legal framework

36. As indicated above both parties agree that BI and BAH LLC are non-UK resident companies which are not prima facie chargeable to UK corporation tax. BI and BAH LLC are only brought within the scope of UK corporation tax by virtue of their UK permanent establishments, a concept defined by the UK/US Treaty, which allocates taxing rights between the United Kingdom and the United States of America. The Treaty was signed on 24 July 2001, with an amending protocol signed 19 July 2002. The current version of the UK/US Treaty entered into force on 31 March 2003 and became effective in the UK from 1 April 2003 for corporation tax purposes. The relevant law was set out in the parties' skeletons, which with some minor adaptations, we gratefully adopt.

UK/US Treaty, Articles 5 and 7

37. The current version of the UK/US Treaty was incorporated into domestic law by the Double Taxation Relief (Taxes on Income)(The United States of America) Order 2002 (SI 2002/2848).

38. The relevant articles of the UK/US Treaty are described below.

39. Article 1 defines the scope of the UK/US Treaty. It states that the UK/US Treaty applies to "persons" (including partnerships, see Article 3(1)(a)) who are "residents" of one or both "Contracting States" (i.e. the US and the UK).

40. Article 5 defines the concept of the "permanent establishment", namely "a fixed place of business through which the business of an enterprise is wholly or partly carried on", including a branch or an office.

41. Article 7 deals with Contracting States' rights to tax business profits. This article (relevantly) states as follows:

> "(1) The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carried on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in that other State but only so much of them as is attributable to that permanent establishment.
>
> (2) Subject to the provisions of paragraph (3), where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and

separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

(3) In the determination of the profits of a permanent establishment, there shall be allowed as deductions those expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere.

(4) For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is a good and sufficient reason to the contrary.

[…]

(6) Where business profits include items of income that are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

(7) In applying this Article, paragraph 5 of Article 10 (Dividends), paragraph 3 of Article 11 (Interest), paragraph 3 of Article 12 (Royalties), and paragraph 2 of Article 22 (Other Income) of this Convention, income or profits attributable to the permanent establishment may, notwithstanding that the permanent establishment has ceased to exist, be taxed in the Contracting State in which it was situated."

42. It should be noted that the post 2010 version of Article 7(2) and 7(3) are worded as set out below. In their skeleton argument the appellants submit their interpretation and application to the facts are consistent with both the pre and post 2010 version and that consequent to *The Queen v Prevost Car Inc.* [2009] FCA 57 at [9] to [12] and the 2014 commentary [33] to [36.1] both versions should be taken into account when interpreting the treaty.

43. After 2010, Article 7(2) and (3) provided as follows:

"(2) For the purposes of this Article and Article 23A/23B, the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

(3) Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly

> profits of the enterprise that have been charged to tax in that other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other."

44. The UK's domestic provisions imposing a charge to or providing a relief from corporation tax are made expressly subject to double taxation arrangements between the UK and foreign states. (ICTA 1988, s788(3) and the Taxation (International and Other Provisions) Act 2010 ('TIOPA'), s6).

45. It was largely agreed that the UK/US Treaty should be interpreted in light of the following:

> (1) The Exchange of Notes between the UK and the USA dated 24 July 2001.
>
> (2) The Organisation for Economic Cooperation and Development ('OECD') Model Convention and attendant Commentaries.
>
> (3) The OECD Partnership Report on the Application of the OECD Convention to Partnerships.
>
> (4) The OECD Report on the Attribution of Profits to Permanent Establishments.
>
> (5) The principles of interpreting international treaties set out by Mummery J in *IRC v Commerzbank AG* [1990] STC 285 at pp.297 to 299 (as subsequently approved by, for example, the Court of Appeal in *Memec v IRC* [1998] STC 754).
>
> (6) The Vienna Convention on the Law of Treaties 1969, in particular, article 26 (international treaties are binding upon the parties to them and must be performed in good faith); article 27 (a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty); article 31 (the general rule of interpretation); and article 32 (supplementary means of interpretation).

46. Although there was disagreement as to the interpretative significance of the Technical Explanation of the UK/US Treaty little turns on this so we do not discuss this further. (In brief HMRC highlight that as the document is only a record of US Treasury and not a joint document and therefore the justification for looking at it falls away under the Vienna Convention. The appellants point out however that Article 31(2) of the Vienna Convention states that if one party produces instrument which is accepted by other as relating to then one can look at it under the Vienna Convention).

Corporation tax non-UK resident companies

47. BI and BAH LLC are each chargeable to corporation tax on all their profits wherever arising that are attributable to their UK PE (such profits being the "chargeable profits") (TA s 11(2)).

48. TA s 11(2A) identifies the profits attributable to a permanent establishment for corporation tax purposes as follows:

> "(2A) The profits attributable to a permanent establishment for the purposes of corporation tax are –
>
> (a) trading income arising directly or indirectly through or from the establishment,
>
> (b) income from property or rights used by, or held by or for, the establishment, and
>
> (c) chargeable gains falling within section 10B of the 1992 Act [i.e. the Taxation of Chargeable Gains Act 1992] –
>
> (i) by virtue of assets being used in or for the purposes of the trade carried on by the company through the establishment, or
>
> (ii) by virtue of assets being used or held for the purposes of the establishment or being acquired for use by or for the purposes of the establishment."

49. TCGA s 10B provides (so far as material) that:

> "**10B Non-resident company with United Kingdom permanent establishment**
>
> (1) Subject to any exceptions provided by this Act, the chargeable profits for the purposes of corporation tax of a company not resident in the United Kingdom but carrying on a trade in the United Kingdom through a permanent establishment there include chargeable gains accruing to the company on the disposal of -
>
> (a) assets situated in the United Kingdom and used in or for the purposes of the trade at or before the time the gain accrued,
>
> (b) assets situated in the United Kingdom and used or held for the purposes of the permanent establishment at or before the time the gain accrued or acquired for use by or for the purposes of the permanent establishment.
>
> (2) Subsection (1) does not apply unless the disposal is made at a time when the company is carrying on a trade in the United Kingdom through a permanent establishment there.
>
> (3) This section does not apply to accompany that, by virtue of Part 18 of the Taxes Act (double taxation relief arrangements), is exempt from corporation tax for the chargeable period in respect of the profits of the permanent establishment.
>
> (4) […]"

50. So far as the attribution of profits to PEs is concerned, TA s 11AA and Sch A1 apply for the purpose of determining the amount of profits of a non-UK resident company that are attributable to the permanent establishment of the company in the United Kingdom (TA s 11AA(1) and (6)). In particular, TA s 11AA(2) provides that there shall be attributed to the PE the profits it would have made if it were a distinct

and separate enterprise, engaged in the same or similar activities under the same conditions, dealing wholly independently with the non-UK resident company.

51. The profit attribution in TA s 11AA and Sch A1 is subject to the terms of any applicable double taxation arrangements (TA ss 788(1) and (3)).

UK domestic provisions and fixed intangible assets regime

52. The accounting periods which are under appeal include periods both before and after the enactment of CTA 2009 and the Corporation Tax Act 2010 ("CTA 2010"). Prior to the enactment of those statutes, the relevant provisions were contained at FA 2002 Schedule 29 (intangible fixed assets) and TA. CTA 2009 came into force on 1 April 2009 and has effect for corporation tax purposes for accounting periods ending on or after 1 April 2009 (CTA 2009 ss 1329(1) and 1329(1)(a)). CTA 2009 Schedule 2 contains transitional provisions.

53. In correspondence, the parties have focused on the provisions of CTA 2009. Nothing is thought to turn on any difference in wording between the provisions of TA and/or FA 2002 (on the one hand) and the rewritten provisions in CTA 2009 and CTA 2010 (on the other).

54. It should be noted however, that the elections which have resulted in these appeals were originally made in relation to a purported acquisition of intangible assets which, on the appellants' case, took place on 17 July 2008, during the accounting period ending 31 December 2008 (and therefore before the entry into force of CTA 2009). Those elections were therefore originally made under FA 2002 Schedule 29 paragraphs 10 and 11 (see CTA 2009 s 1329(1) and Schedule 2 paragraph 4(3)). If (contrary to HMRC's case), those elections are effective, then pursuant to CTA 2009 Schedule 2 paragraph 4(3), they are treated as having been made under CTA 2009 ss 730(1) in respect of the accounting periods ending 31 December 2009 to 31 December 2013 inclusive.

55. It is therefore the effectiveness of the original elections made by each appellant that is ultimately in issue on this appeal. Accordingly, reference is made below to the provisions of TA and FA 2002 which, strictly, are the applicable statutory provisions.

56. For completeness, HMRC notes that the partners in BLP are strictly BI and BA LP (of which BAH LLC is itself a partner). However, it is BAH LLC that is chargeable to UK corporation tax in respect of the share in BLP held by BA LP. Accordingly, we refer to the partners in BLP as being BI and BAH LLC.

57. It is convenient first to address the regime applicable to intangible assets in FA 2002 Schedule 29 (which, as discussed above for accounting periods ending on or after 1 April 2009, has been rewritten to CTA 2009 Part 8), before turning to the charge to corporation tax on non-resident companies (such as the appellants).

FA 2002 Schedule 29

58. FA 2002 Schedule 29 Part 2 provides for debits to be brought into account by a company for tax purposes in respect of (inter alia) writing down the capitalised cost of an intangible fixed asset on a fixed-rate basis (FA 2002 Schedule 29 paragraph 7(1)(b)(ii)). In particular: FA 2002 Schedule 29 (a) sets out how a company's gains in respect of intangible fixed assets are chargeable to corporation tax as income and (b) has effect for determining how a company's losses in respect of intangible fixed assets are brought into account for corporation tax purposes (FA 2002 Schedule 29 paragraph 1).

59. Paragraph 1 provides:

> "1 (1) A company's gains in respect of intangible fixed assets are chargeable to corporation tax as income in accordance with this Schedule.
>
> (2) This Schedule also has effect for determining how a company's losses in respect of intangible fixed assets are brought into account for the purposes of corporation tax.
>
> (3) Except where otherwise indicated, the amounts to be brought into account in accordance with this Schedule in respect of any matter are the only amounts to be brought into account for the purposes of corporation tax in respect of that matter."

60. For these purposes: The term "intangible asset" has the meaning it has for accounting purposes (FA 2002 Schedule 29 para 2(1)).

61. The term "intangible fixed asset", in relation to a company, means an intangible asset acquired or created by the company for use on a continuing basis in the course of the company's activities (FA 2002 Schedule 29 para 3(1)).

62. Except as otherwise indicated, FA 2002 Schedule 29 applies to goodwill as it applies to an intangible fixed asset (FA 2002 Schedule 29 para 4(1)).

63. "[G]oodwill" has the meaning it has for accounting purposes (FA 2002 Schedule 29 para 4(2)).

64. By FA 2002 Sch 29 para 76(1)(c), Schedule 29 does not apply to an asset "to the extent that it represents […] the interest of a partner in a partnership". FA 2002 Schedule 29 para 76(1)(c) does not apply, however:

> "to an interest that for accounting purposes falls to be treated as representing an interest in partnership property that is an intangible fixed asset to which this Schedule [i.e. Schedule 29] applies".

65. FA 2002 Schedule 29 para 10(1) provides that:

> "A company may elect to write down the cost of an intangible fixed asset for tax purposes at a fixed rate."

66. If an election is made under FA 2002 Schedule 29 para 10 for writing down at a fixed rate, a debit equal to (a) 4% of the cost of the asset, or (b) if less, the balance of the tax written-down value, must be brought into account for tax purposes in each accounting period beginning with that in which the relevant expenditure is incurred (FA 2002 Schedule 29 para 11(1)).

67. For these purposes the "cost of the asset" is, subject to any adjustment required for tax purposes, the same as the amount capitalised for accounting purposes in respect of expenditure on the asset (FA 2002 Schedule 29 paras 11(3) and (4)).

68. FA 2002 Schedule 29 Part 6 determines how credits and debits to be brought into account for tax purposes under FA 2002 Schedule 29 are given effect (FA 2002 Schedule 29 para 30(1)).

69. HMRC's position throughout the proceedings has been that the trade in question is the trade carried on in partnership by BI and BAH LLC. This, they say, therefore engages TA Part IV Chapter VII. (As will be seen the appellants' position at the hearing was that the status of BLP and BFLP is irrelevant.)

70. Where a trade or profession is carried on by persons in partnership, the partnership is not, unless the contrary intention appears, treated for corporation tax purposes as an entity which is separate and distinct from those persons (TA s 111).

71. However, the profits and losses of the partnership trade are calculated at partnership level. In particular TA s 114(1) provides:

> "So long as a trade, profession or business is carried on by persons in partnership, and any of those persons is a company, the profits and losses (including terminal losses) of the trade, profession or business shall be computed for the purposes of corporation tax in like manner, and by reference to the like accounting periods, as if the partnership were a company and, subject to section 115(4), as if that company were resident in the United Kingdom, and without regard to any change in the persons carrying on the trade, profession or business…"

72. There are certain exceptions, none of which are relevant for the purposes of these appeals.

(1) TA s 114(2) provides that:

> "A company's share in the profits or loss of any accounting period of the partnership […] shall be determined according to the interests of the partners during that period, and corporation tax shall be chargeable as if that share derived from a trade, profession or business carried on by the company alone in its corresponding accounting period or periods; and the company shall be assessed and charged to tax for its corresponding accounting period or periods accounting.

> In this subsection 'corresponding accounting period or periods' means the accounting period or periods of the company comprising or together comprising the accounting period of the partnership, and any necessary apportionment shall be made between corresponding accounting periods if more than one."

(2) TA s 115 provides (so far as material):

> "(4) So long as a trade, profession or business is carried on by persons in partnership and any of those persons is a company which is not resident in the United Kingdom, section 114 shall have effect in relation to that company as if-
>
> (a) the reference in subsection (1) to a company resident in the United Kingdom were a reference to a company that is not so resident; and
>
> (b) in subsection (2), after 'carried on' there were inserted 'in the United Kingdom through a permanent establishment'.
>
> […]
>
> (7) For the purposes of section 114 'profits' shall not be taken as including chargeable gains"

73. The deemed non-UK resident company is therefore treated as carrying out of the activities carried on by the partnership, and in particular as trading in the UK through the PE through which the partnership business is carried on. It is therefore necessary to determine the profits of that trade and attribute that to the UK PE in accordance with the profit attribution methodology described above.

74. The Explanatory Notes to CTA 2009 s 1259 (at paragraphs 3193 and 3194) set out:

> "If the company partner is not resident in the United Kingdom the profits of the firm are determined as if the firm were a company not resident in the United Kingdom. That determination is restricted to the profits arising from a permanent establishment in the United Kingdom. So there is no need to rewrite the requirement in section 115(4)(b) of ICTA that the partner's share of the profits is treated as arising from such a permanent establishment.
>
> The profits of the firm are determined by reference to the extent to which they would be chargeable to corporation tax. So, in the case of a non-UK resident, the profits of which the partner has a share are those attributable to a permanent establishment in the United Kingdom."

75. The computation of the trading profit of the partnership is to be carried out without regard to any changes in the partners in the partnership unless no company which carried on the trade before the change continues to carry it on after the change (TA s 114(1)(c)).

76. Once that trading profit has been calculated, a company partner's share in the profits (or loss) for any accounting period of the partnership is determined in accordance with the interests of the partners during that period (TA s 114(2)). Thus,

the profits of the partnership as computed at the partnership level are allocated between the partners in accordance with their profit shares.

Expert evidence: Joint expert report

77. As indicated by the parties, this is not a case which turns on resolving disputed expert evidence. The key question for resolution is the prior question of what level or perspective the profit calculation in respect of the PE, is performed at. That is a question of tax law. When that question is answered the experts are basically agreed as to the consequences.

78. Following reviews by each expert of the others report, a meeting which took place on 26 June 2017, and subsequent e-mail correspondence, the experts produced a joint statement which set out the issues they agreed. The appellants' expert was Mr Philip Barden, HMRC's expert was Mrs Rachel Poole. Mr Barden and Mrs Poole are both chartered accountants. Mr Barden is a partner at Deloitte LLP and heads up Deloitte's Expert Advisory Panel on revenue recognition and amongst various other accounting committee roles, chairs the Financial Reporting Editorial Board of the ICAEW. Mrs Poole has been employed by HMRC as an Advisory Accountant in Large Business since September 2015, and before that held other roles as a Financial Reporting Specialist at the National Audit Office and in auditing complex financial groups and UK GAAP and US GAAP financial statements when working at Deloitte. As between the experts four scenarios were considered.

79. The experts agree the relevant financial reporting framework would be the version of the UK GAAP or IFRS as extant at 31 December 2008. The conclusions for scenarios 1, 2 and 3 apply whichever framework is used. Scenario 4 was a scenario Mr Barden had been asked to consider, which was similar to scenario 3, but in relation to which, he had been instructed to make certain detailed assumptions. In particular he had been asked to assume that on 17 July 2008 BI and BAH LP (BAH LLC's subsidiary) "acquired the assets used by ML PE and these assets were of a type, on a line by line basis, of each of the assets and each of the liabilities of BLP".

80. Also, whereas in scenario 3 the party making the disposal was not identified, in scenario 4 that party was explicitly identified as the UK PE of ML.

81. Mr Barden's instructions did not ask him to consider IFRS so both he and Mrs Poole only considered scenario 4 in a UK GAAP framework.

82. Mr Poole's instructions for her report of 31 January 2017 directed her to look at the accounting treatment in the "solus" financial statements under IFRS and UK GAAP in the three scenarios as follows:

> (1) If the "distinct and separate enterprise" that constitutes the UK PE of BI is 100% of the trade carried on in partnership by BI and BAH LLC (previously BI and ML);
>
> (2) if the Transaction is the acquisition of increased partnership units in BLP; and

(3) if the Transaction is the acquisition of the underlying trade and assets of BLP.

83. The experts agreed the following:

Scenario 1

84. If it were found that the "distinct and separate enterprise" that constituted the UK PEs of BI and BAH LLC was the partnership (BLP), that UK GAAP required such an entity to report its own financial performance and position only, the transaction would simply constitute a change in the ownership of the UK PE without changing any of its assets or liabilities. Accordingly the transaction would not impact either the financial performance or financial position of the UK PE and therefore there should be no accounting entries in the "solus" financial statements of the UK PE for the Transaction.

Scenario 2

85. Should BI and BAH LLC each be found to have separate UK PEs, the accounting treatment that applied to the notional financial statements for the UK PE of BAH LLC would be the same as the accounting treatment that applied to the notional financial statement for the UK PE of BI.

86. If it were found the transaction was the acquisition of increased partnership units, the experts agreed that each UK PE would have increased its investment in BLP and this should be accounted for by recording the increase in partnership units as an investment at cost in the "solus" financial statement of each UK PE with cost being the fair value of the consideration paid to ML for the partnership units.

Scenario 3

87. The UK PE of BI and UK PE of BAH LLC would each increase their individual assets and liabilities on a line by line basis to reflect the additional assets and liabilities acquired from the UK PE of ML. Mrs Poole assumed the transaction was a business combination but agreed Mr Barden's approach of considering whether the transaction was a business combination or an acquisition of assets and liabilities was valid. In both cases the experts agreed they would expect the assets to be recognised to include intangible assets.

Scenario 4

88. According to Mr Barden, it was relevant to consider whether the transaction was a business combination or an acquisition of assets and liabilities. The experts agreed that if the transaction was a business combination, merger accounting would not be appropriate as neither IFRS nor UK GAAP would allow merger accounting in the circumstances of the scenario (or scenario 3).

89. The experts agreed they would expect the assets to be recognised to include intangible assets.

90. In summary the experts' views on scenarios 1 and 2 on the one hand (treatment as an investment) and 3 and 4 on the other (recognition of intangible assets) provide the end point to the parties' competing legal analyses. If HMRC are right, and the correct level is the partnership level, then it follows the accounting treatment is that of an increase in investment (and the Schedule 29 election is not valid). If the appellants are correct, and the correct perspective is that of the PE's, then according to the appellants, it would then follow that intangible assets were recognised and the election would be valid. But, in that case HMRC maintain a further argument in the alternative, that even if the level is that of the PE there is a further question of whether, on the facts there was a transfer of assets. That assumption, HMRC say, is not borne out in the particular circumstances of this case.

91. In cross-examining Mr Barden, HMRC suggested that accounting for proportional consolidation was an unusual step. The appellants agreed that Mr Barden noted in his report that it was unusual to account on a line by line basis for proportions of assets and liabilities but that he had clarified in his evidence that the reason that this unusual assumption could be validly be made to produce GAAP compliant notional accounts of the PEs of BI and BAH LLC was precisely because what was being looked at was the notional accounts of a "strange" entity (in the sense that it was constructed by a "tax fiction") and because that entity owned the entirety of a business which could consist of proportions of assets. For the reasons the appellants put forward, in essence that the relevant task was to construct the accounts for a hypothetical entity which might require usual approaches to be adapted, we agree the question of whether adopting proportional consolidation was an unusual step was not one which assisted in the issue before us.

Issues before the Tribunal

92. As can be seen, once a decision on perspective is taken (a tax law question on which the parties have different views), the experts do not disagree on the outcome. Although the appellants appeared to indicate that the tribunal was not equipped, as it had been in *Memec v IRC* [1998] STC 754 and *Anson v HMRC* [2015] UKSC 44 with evidence and submissions on foreign law in order to make any finding on tax transparency i.e. whether profits which arose belonged to the members of the entity or to the entity itself, looking at the parties submissions as a whole, what was crucial was that neither party was arguing that BLP and BFLP were taxable in their own right as entities. Both were agreed BI and BAH LLC were the relevant taxable entities. In fact in their skeleton argument we noted the appellants had highlighted HMRC's acceptance that BLP and BFLP were "transparent" for UK tax purposes (i.e. that they were not taxed as entities in their own right) and that the only taxable entities as regards business carried on in the UK through BLP and BFLP were BI and BAH LLC by virtue of their UK PEs. At the hearing, the appellants raised for the first time the argument that the tribunal had no need to make a finding on whether the nature of BLP and BFLP amounted to an English law partnership; the issue was, they submitted, wholly irrelevant to the case they were making. The appellants argue there

was in any event no evidence that BLP / BFLP were English law partnerships. (This was also a reason, as argued for the first time at the hearing, as to why the appellants maintained that Schedule 29 paragraph 76 could not apply. (As regards that argument made by HMRC in the alternative, the appellants argue the burden lay on HMRC to show BLP and BFLP were such partnerships).

93. As to why the appellants say the classification of BLP and BFLP was irrelevant, the appellants referred to TA s11AA and Article 7.2 of the UK/US Treaty. These provisions, they submit, indicate that the tax reporting entity is the PE. Accordingly the PEs have to be identified and attributed on a company by company basis. The factual and functional analysis (as required by UK/US DTA, the *Technical Explanation*, the *2000 OECD commentary*, the *2010 OECD commentary* supplemented by the *2014 OECD commentary*, and various other reports such as the *OECD partnership report* require the economic ownership of the assets generating the profits to be assumed. The application of the separate and distinct principle requires that the transaction is viewed as an assets transfer.

94. We set out HMRC's primary arguments as to why the appellants' election is not valid in more detail below, but in broad summary it relies on the application of the UK's partnership taxation provisions as applied to non-UK companies. These, HMRC say, do not conflict with the UK/US DTA and lead to the conclusion that the accounting treatments in scenarios 1 and 2 above are relevant (namely that the transaction is treated as a cost of investment).

95. HMRC objected to the appellants raising the argument as to the nature of BLP and BFLP at so late a stage in the proceedings. Although the submission on the irrelevance of a finding on the nature of the partnership did not feature in the appellants' pleadings or skeleton, that point is in our view implicit in the appellants' primary argument and (taking account of the way HMRC have formulated their response) we can see no real prejudice to dealing with the appellants' argument. We will tackle the appellants' argument (that the application of the separate and distinct principle results in an asset transfer irrespective of whether a partnership is found) first. That issue also encompasses the tax law question of what the correct level or perspective from which to construct the accounts is. A further point of contention encapsulated in the above argument is that HMRC say that, even if the perspective for constructing the relevant accounts for the purposes of Schedule 29 FA 2009 is that of the PE rather than the partnership, the appellants' case cannot necessarily assume that there was an assets transfer. The appellants' position by contrast is that the one follows inevitably from the other.

1) Issue 1: Does the Treaty principle that the permanent establishment should be treated as a separate and distinct entity require that the Transaction be treated as a transfer of assets to each of the PEs of the appellants?

96. Much of the background context of the Treaty provisions and the relevance of those provisions, as a matter of principle, to the UK's domestic law is common ground between the parties. The Treaty overrides domestic law subject to the terms of UK/US Treaty. As pointed out in the FTT's decision *Irish Bank Resolution*

Corporation Limited (in special liquidation) and another v HMRC [2017] UKFTT 0702 (TC) (at [111) the DTC prevails where there is an inconsistency with domestic law provisions. In that case the particular UK legislative provision denying an interest deduction in respect of the notional capital attributed to the UK PE was found not to be inconsistent with the treaty provision. Section 788 ICTA 1988 and TIOPA give double taxation agreements their force in UK law and none of the provisions relevant to this case are so-called "treaty overrides" (in other words provisions which specifically state that they override the treaty position).

The appellants' arguments

97. The appellants' argument, in essence, is that Article 7.2 of the UK/US Treaty, as interpreted by the various OECD commentaries and reports, and the economic attribution thereby required to be carried out on factual and functional basis, not just permit but *require* the ML transaction to be viewed as a transfer of assets rather than as a transfer of something else such as units. The accounting treatment (scenarios 3 and 4) follow from that treatment. The conclusion rests on the following propositions the appellants put forward. These were developed in some detail by reference to various treaty and OECD interpretative provisions to which we were referred in detail and which were summarised in a written note handed up at the hearing:

> (1) Where a transparent entity is referred to, the transparent entity is not a taxable person in its own right; instead each "partner"/member is taxable by reference to its partners'/members' PEs.
>
> (2) The collective business of a transparent entity can have a single PE, in the sense that there is a single collective business with a single place of business; however each individual "partner"/member is taxed by reference to its own PE.
>
> (3) Each PE of each individual "partner"/member is taxable by reference to the separate enterprise principle
>
> (4) The separate enterprise principle is an extremely strong fiction.

98. Proposition 1) is not disputed and is simply a description of what the concept of transparency entails for treaty purposes. So for instance, as the appellants referred to, the commentary to Article 1 of the *2000 OECD model convention* indicates that if a partnership is fiscally transparent then it is ignored and the partnership cannot be resident. Furthermore where there is a difference in treatment between the two relevant states the partnership is treated as resident in the state that treats it as opaque and partners are resident in the state that treats it as transparent. The common thread to the various commentaries on the 2000, 2008, 2010 and 2014 versions of the treaty is that, where an entity is transparent for tax purposes, one must look through to the position of partner/member.

99. As to proposition 2), while BI and BAH LLC are taxpayers, the relevant computation is as to their UK taxable profits and HMRC take no issue with the proposition that each partner has a PE. (They go on to say this is beside the point

because that partner is being charged to tax on its share of profits; we consider the statutory basis for that later).

100. In relation to propositions 3) and 4) there is no real dispute, as we understand it, as to the requirement that the separate and distinct principle should be applied; rather the question is as to how the principle is applied and whether it has the effect which the appellants contend for. We therefore focus on the treaty materials relating to propositions 3) and 4).

Treaty materials and domestic legislation on 3) and 4)

101. The appellants rely on various interpretative documents for the proposition that each PE of each individual partner is taxable by reference to the separate enterprise principle. It is further argued that the principle "is an extremely strong fiction".

Physicality of premises – key feature of concept of PE

102. The appellants also refer to the *Technical Explanation* commentary on Article 5, the *OECD convention 2000 commentary* on Article 5 to support the same point that there needs to be a physical place of business in order for there to be a PE, and that that it is the use of the place of business and the activities in the state which create the PE. The appellants argue Article 5 sets important limits on the notion of a PE which in turn helps to inform the scope of the separate enterprise principle. The definition of "enterprise" in the UK/US Treaty draws a distinction between the "enterprise" and the PE. That, the appellants submit, is why a partnership cannot be a PE. A partnership, as a legal description, cannot be a physical fixed place of business. Article 5 shows that simply being an agent is not enough, and that furthermore subsidiaries are not caught. Given that, being a member of a partnership could not result in a PE.

103. Similarly in the UK's legislation, in s148 FA 2003, the PE is defined as literal locations, e.g. office, factory etc. The significance of this to the appellants' case is that it does not, the appellants argue, include doing business with someone else. In particular the notion of being in partnership with someone else does not constitute a PE.

The separate and distinct principle entails a functional and factual analysis. Not a "step in shoes" but a "bottom up" approach. Strength of fiction.

104. In brief the appellants' case is that the treaty requires a "bottom up" approach, meaning that the starting point is to carry out a functional and factual analysis of the assets and risk attributable economically to the PE. This is to be contrasted with a "step in shoes" fiction, in other words a fiction where one imagines the PE is the head office and then attributes the total profits to the PE. In fact that approach is one which is discouraged.

105. Under Article 7, as applied to the facts, each partner is taxable as a separate enterprise in its own state and ii) each partner is only taxable in another state (of which it is not a resident) by virtue of a PE therein. The *Exchange of Notes* emphasise

that in determining the nature of the relationship between a PE and the rest of the enterprise of which it forms a part (i.e. head office) the separate enterprise principle must be applied.

106. Referring to Article 7(2) the appellants argue the principle directs one to consider the individual assets, risks and activities actually performed by the PE. The explanatory notes emphasise that the liability must be computed by looking to the profits, assets, risk and activities of the PE itself. The *Technical Explanation* refers to the determination of whether a PE exists and the taxing rights depend on actual activities in the state. The principle is so strong, so the appellants argue, that even agents, who, in order to be recognised have to be to sufficiently closely related, must under the separate and distinct principle then be treated as though they were dealt with independently. The appellants also highlight that under the *Technical Explanation*, the separate enterprise principle is sufficiently strong that deductions shall be allowed for the expenses of the PE that are incurred for its purposes regardless of which entity in fact accounts for them and that a PE may deduct payments made to its head office in a compensation for services performed for the benefit of the latter. The *OECD 2000 commentary* refers to Article 7(2) as containing the "central directive" that attribution of profits to the PE is to be made on the basis of the separate enterprise principle. The *OECD 2010 commentary* clarifies the fiction does not create notional income for the enterprise but is sufficiently strong that it can operate to require the deduction of notional rent in determining the profits of the PE where the head office is deemed (under Article 7(2)) to have economic ownership of the building used by the PE. It is also noted that Article 7(2) can operate to treat a transfer of assets between a PE and the rest of the enterprise of which it is as a dealing giving rise to profits or gains.

107.As regards allocating ownership and costs of creation of intangible assets the *OECD 2000 commentary (2000)* notes the difficulties in as regards intangible rights and that it is preferable "for the costs of creation of intangible rights to be regarded as attributable to all parts of the enterprise which will make use of them and as incurred on behalf of the various parts of the enterprise to which they are relevant accordingly". The *PE Report* (pages 550-554) notes that the economic ownership of intangible assets held by an enterprise should be determined by carrying out a "functional and factual analysis" to determine whether and how to attribute economic ownership of intangible assets to the enterprise's PE.

108.As the appellants note the *OECD 2010 model convention* is not substantively different from the *2000 convention*. The OECD's commentary on the 2010 convention indicates a two-step process the first of which involves a functional and factual analysis which involves inter alia identification of significant people functions relevant to attribution of economic ownership of assets to PE. The second step is pricing the transactions between the PE and associated enterprise on broadly arm's length terms looking at "particular factual circumstances of the PE". The steps are described in more details as follows.

> "20. As explained in the Report, the attribution of profits to a permanent establishment under paragraph 2 will follow from the calculation of the profits (or losses) from all its activities, including

> transactions with independent enterprises, transactions with associated enterprises (with direct application of the OECD Transfer Pricing Guidelines) and dealings with other parts of the enterprise. This analysis involves two steps which are described below. The order of listing of items within each of these two steps is not meant to be prescriptive, as the various items may be interrelated (e.g. risk is initially attributed to a permanent establishment as it performs the significant people functions relevant to the assumption of that risk but the recognition and characterisation of a subsequent dealing between the permanent establishment and another part of the enterprise that manages the risk may lead to a transfer of the risk and supporting capital to the other part of the enterprise).
>
> 21. Under the first step, a functional and factual analysis is undertaken which will lead to:
>
> - the attribution to the permanent establishment, as appropriate of the rights and obligations arising out of the transactions between the enterprise of which the permanent establishment is a part and separate enterprises;
>
> - the identification of significant people functions relevant to the attribution of economic ownership of assets, and the attribution of economic ownership of assets to the permanent establishment;
>
> - the identification of significant people functions relevant to the assumption of risks, and the attribution of risks to the permanent establishment;
>
> - the identification of other functions of the permanent establishment;
>
> - the recognition and determination of the nature of those dealings between the permanent establishment and other parts of the same enterprise that can appropriately be recognised, having passed the threshold test referred to in paragraph 26; and
>
> - the attribution of capital based on the assets and risks attributed to the permanent establishment."

109. Various extracts from the OECD's *Report on attribution of profits to PEs* similarly emphasise that a functional and factual analysis is to be undertaken.

110. As regards the UK's domestic provisions, the nature of the fiction not being a "step in shoes" fiction, and the need to carry out a factual and functional analysis are similarly apparent. Section 148(2) ICTA and Schedule A1 are not a "step into shoes" fiction in the sense they still envisage the existence of the Head Office. So the appellants submit the PEs cannot be holding a partnership interest because the Head Office is still there. Paragraph 4(2) Schedule A1 specifically does not prevent the deduction in respect of the contribution by the permanent establishment to costs of creation of an intangible asset (and incurring costs in adding to intangible assets is consistent with this provision). There is nothing in the schedule about attributing the Head Office's transactions to the PE. The need to carry out a functional analysis is dealt with in TA s11 and s11AA and Schedule A1 read in accordance with UK/US treaty. These provide that one must look to the PE of the non-UK company as the

relevant taxable person and consider the assets used, the risk assumed, and activities performed by the PE.

Irrelevance of partnership and need to look at economic ownership of property

111. Together with the points on physicality of the PE, and relying on the treaty and interpretative extracts, the appellants disagree with HMRC's submission that the fact the trade is carried on in partnership is a relevant similar circumstance when it comes to applying the separate and distinct principle.

112. As indicated above a common thread to the commentaries is that where the business model is fiscally transparent one looks to the member because it is their business. The partnership is disregarded.

113. The appellants refer to the *Technical Explanation* at paragraph 1(8) (which as regards to fiscal transparency) suggests there are two steps to concluding income profit or gain is derived by a resident of a contracting state: 1) Is the entity treated under that state's law as resident? 2) Does that state's law treat the entity as deriving the income; it does not matter that the other member state would treat income differently.

114. According to the appellants the language of the partnership having a PE, as set out in *Partnership Report adopted by fiscal affairs committee 1999*, suggests a PE still requires a further step of an attribution of a PE to each and every partner thereby equating fiscal transparency with economic ownership of the partnership property. We were referred in particular to Example 14 set out in that report which we consider in more detail below.

115. Applying the various propositions above to the facts the appellants then argue: that the profits of PEs of BI and BAH LLC must be computed on the basis that each of them is a separate and distinct enterprise. If one were to look at the notional accounts of the PEs one would see the trading assets of the BLP business and the BFLP business. The accounts after the transaction would show increase in intangible assets. The crux of the appellants' case is that the starting point is the separate and distinct PE. There is no question of attributing the Head Office level transaction to the PE.

Respondents' arguments

116. HMRC do not dispute that the separate and distinct principle applies but where they part company is in how the principle is applied. Crucially, in their submission, the fact the trade is carried on by BI and BAH LLC in partnership cannot be ignored. This leads to a different concept of the legislation which applies as TA Part IV and Chapter VII (s114/s115) ICTA are engaged and the following two-step process:

> (1) The trading profits of BI and BAH LLC arising directly or indirectly through or from PE in accordance with UK domestic rules applicable to calculation of trading profits must be identified. Although the partnership

is not a separate entity the profits and losses are calculated at partnership level. (HMRC do not argue the partnership chargeable to corporation tax in own right). The consequence is that the partnership computation provisions s114 and s115 are engaged.

(2) The next step is then to determine the amount attributable to BI and BAH under s11AA and Schedule A1 subject to override if the attribution is different under the Treaty. Under s114(2), profits of the partnership are computed at partnership level allocated in accordance with their profit shares. Looking at the share of profits of partnership; that share is treated as derived from the trade carried on through a PE.

117. The above exercise, HMRC argue, is perfectly compatible with the Treaty. In their submission, the purpose for the separate and distinct principle is to attribute profits. The appellants' argument that Article 7(2) mandates the PE to be treated as holding assets misunderstands the function and scope of the treaty which is to allocate taxing rights. The treaty sets a ceiling on chargeable profits that each contracting state can charge but it does not go as far as treating the PE as holding or acquiring intangible assets for purposes of UK tax rules in Schedule 29 FA 2002. Article 7(2) cannot "bridge the gap" which arises under the appellants' analysis to show there has been an acquisition of intangibles.

Discussion on Issue 1

Function of Double Taxation Treaties

118.Given the central importance of the US/UK Treaty article it is important to put the article in its proper context and consider the function of the Treaty. We note the following from the interpretative materials.

119.The *OECD 2010 commentary* on Article 7(1), which the appellants referred us to, explains:

> "the permanent establishment criterion is commonly used in international double taxation conventions to determine whether a particular kind of income shall or shall not be taxed in the country from which it originates but the criterion does not itself provide a complete solution to the problem of double taxation of business profits."

120.Article 7 is concerned with rules as to what, if any, are the profits on which the PE should pay tax. It is further noted that a state may tax profits of enterprise but only so much of them as is attributable to the PE.

121.The *OECD 2000 commentary* on Article 7 (paragraphs 11-14) deal with attribution. Paragraph 14 concerns Article 7(3), recognising that in calculating profits of the PE, allowances are to be made for expenses, where incurred, that were incurred for the purposes of the PE.

122.At paragraph 17 the *OECD 2010 commentary* notes:

> "the main part is made up of chapters III to V which settle to what extent each of the two contracting states may tax income and capital and how international double taxation is to be eliminated"

123. The commentary goes on to explain in paragraphs 19-21 that in relation to a number of items of income and capital, an exclusive right to tax is conferred on one of the contracting states and that as a rule it is conferred on the state of residence. (Article 7, which covers profits of a permanent establishment situated in that state, is listed among such items).

124. As regards the purpose of a double taxation treaty we note what was said in the FTT's decision in *Irish Bank Resolution Corporation Ltd* at [63] (it was explained earlier at [3] in that decision that the reference to "parent" was a convenient shorthand for the corporate entity Irish appellants as distinct from their PEs in the UK).

> "The clear, and as I understand it uncontroversial, purpose of art 8(2) of the UK-RI DTC [*The analogous provision in that treaty to article 7 in the UK/US Treaty*] is to segregate the profits of an entity resident in one of the two contracting countries so that those earned, on a fair assessment, by a PE carrying on business in the other country are taxed there, and not in the parent's country, while the parent's profits, excluding those of the PE, are taxed in the parent's country of residence. The underlying aim, equally clearly and uncontroversially, is to avoid double taxation or an escape from taxation."

125. Pausing there, taking the above extracts into account, there is ample support, in our view, for HMRC's submission that the function of the treaty is the allocation of taxing rights.

126. The appellants highlight various features of the separate and distinct principle in support of their argument that the transaction is required to be treated as a transfer of assets. While we largely agree with the depictions of the principle, for the reasons below, we are not persuaded the principle goes so far as to enable the appellants to make good their argument. Although some aspects of the principle do not necessarily stand in the way of the transaction being treated as a transfer of assets they do not require it to be so treated.

127. The appellants put a lot of store by the fiction of the PE not being a "step into the shoes one" one; in other words one which requires a hypothesis that the transaction was carried out at the company level. The appellants argue it cannot therefore be said that because ML sold units in BLP that means one has to be pretend that BI's PE and BAH LLC's PE also acquired units.

128. We agree there is nothing in the Treaty to suggest that an attribution of the transaction to the company is required and note that the explanatory material positively discourages an approach whereby global profits are first ascertained and

then apportioned to the PE[1]. It follows, in our view, that the mere fact that the transaction was treated at the level of the corporate entities BI and BAH as an acquisition of partnership units would not necessarily mean the PE was similarly to be regarded as acquiring partnership units. The counterpoint to the lack of a "step in shoes fiction" was what the appellants described as a "bottom up" approach and that required a factual and functional analysis. There cannot, in view of the treaty provisions and welter of supporting materials, be any doubt that that is what is required. But the effect of such an approach should not be overstated. It is perhaps not surprising that the interpretative materials emphasise that a factual or functional analysis needs to be carried out because the alternative of looking at matters from a legal perspective would be a non-starter given the PE has no legal personality. Fundamentally, what is lacking is any meaningful support for the view that a "bottom up" approach *requires* the transaction to be viewed as an acquisition of assets. Simply put, the fact there is a factual / functional analysis does not inevitably mean the transaction must be viewed as an asset transfer. Although there was some suggestion that an example given in the *OECD Partnership Report* supported the idea, that where an entity was fiscally transparent, that meant the PE was to be regarded as economic owner of the underlying partnership property we do not agree that is a proper reading of the example as we explain further below.

129. Example 14 in the report reads as follows:

> "Example 14: Partner A, a resident of State R, sells his interest in P to D, a resident of State P, for an amount that exceeds A's adjusted basis in the interest. Under State R's domestic law, State R treats P as a company and would regard the gain as a capital gain of a resident of State R. Under State P's domestic law, State P treats P as fiscally transparent and would regard the gain as attributable to a State P permanent establishment.
>
> In this example State P therefore considers that the alienation of the interest in the partnership is, for the purposes of its Convention with State R, an alienation by the partner of the underlying assets of the business carried on by the partnership, which may be taxed by State P according to paragraph 1 or 2 of Article 13…"

130. Article 13 on Capital Gains provided:

> "1. Gains derived by a resident of a Contracting State from the alienation of immovable property…and situated in the other Contracting State may be taxed in that other State.
>
> 2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State

[1] See for instance The *OECD 2000 Commentary on Article 7(2)* which explains the paragraph "…does not seek to allocate the overall profits of the whole enterprise to the permanent establishment and its other parts…"

…

4. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, and 3 shall be taxable only in the Contracting State of which the alienator is resident."

131. In order to understand why the reference to the alienation of interest being considered as an alienation of underlying assets does not assist the appellants, it is necessary to set out the context in which the example arises.

132. The starting point is that the commentary seeks to explain a particular point in relation to Article 23 and obligations under the treaty to eliminate double taxation. As explained at [104] of the report the state of residence has a treaty obligation to apply the exemption or credit method to item of income where the tax convention authorises taxation of that income by state of source (referenced by words in article "in accordance with the provisions of this Convention, may be taxed").

133. Example 14 can be broken down as follows: 1) State P (who views partnership as transparent) thinks State P can tax a gain on underlying assets. 2) State R (who views a partnership like a corporate and therefore sees the gain as arising on a company share) thinks according to its view that State P is not allowed to tax (because under Article 13(4) as it then stood, State R, is the state of the alienator of the company share (paragraphs 1, 2 or 3 of Article 13 not being applicable). 3) Nevertheless, for the purposes of the Article 23 obligation on the state of residence to provide exemption or credit, State R must give exemption or credit even though, if state of source's (State P's) law were the same as resident state R (and therefore treated the gain as a company share gain) state of source P would not be allowed to tax (under 13(4)), and no double taxation would arise.

134. In other words the example addresses the situation where the source state applies different rules than those which the state of residence would have applied. The purpose of the example is to demonstrate the circumstances in which the income is still being taxed "in accordance with the …convention" (i.e. looking at the treatment from the viewpoint of the state of source, it would be allowed to tax the income even though from the viewpoint of the state of residence it would not). It illustrates that the state of residence must give relief from double taxation even though it would not tax the income as the state of source would.

135. As HMRC indicate, the appellants' reliance on example 14 as a basis for using economic ownership as a means of looking through to the underlying assets, is misplaced. The point of the example is not to endorse a "look through" to the assets; rather that approach serves as an example of a different view of the law being taken by the state of source. Furthermore, echoing a similar point above, the suggestion of taking an economic approach is at least in part necessary because, by definition, the PE has no legal personality.

136. As to the appellants' emphasis on the fiction being a "strong" one we have some difficulty with the premise of this type of argument. It is not possible, in our view, to attribute strength or weakness to a fiction and then to meaningfully reason from that

what other matters the fiction covers. The fiction must be construed by what the words of it cover, taking into account the purpose of the fiction.

137.An inherent feature of any fiction is that it assumes certain things to be the case when they are not in fact the case. The extent of the fiction in this particular case, for instance that notional expenses as between the PE and head office are acknowledged, is a reflection of that. But, it does not follow that because certain notional relationships are created that a transaction in units must be treated as a transaction in the underlying assets. The separate and distinct principle does not mandate treating the transaction as an acquisition of IFAs.

Partnership / in business together a "similar condition"?

138.The appellants' case does not end there because they say HMRC are wrong in their view that the partnership is one of the "similar conditions" to be taken account of when applying the separate and distinct principle. As set out above they maintain the reference to "similar conditions" refers to similar *commercial* conditions. Partnership, the appellants argue, is a legal description; it is not sufficient to constitute a PE which requires a physical place of business. The OECD commentary emphasises the need to look at facts about the PE not about legal constructs such as partnership.

139.However, taking account of the various references to partnership in the OECD materials, we prefer HMRC's view that there is nothing in treaty or OECD interpretative materials which allows or requires the fact that the trade is one which is carried on in partnership to be ignored. As can be seen from various paragraphs (e.g.[38] to [40]) of the OECD's report on partnership, the OECD has no difficulty with an approach under which income computed at the level of the partnership before it is allocated to the partners. That is what ss114 and 115 achieve. At [80] the report explains:

> –"The purposes for which each partner is being considered to have a permanent establishment in State S, it is for the purposes of a taxation of their share of the business profits derived by the partnership".

140.The OECD clearly does not have any issue with the idea that the partner company may be taken to have a PE in the state for purposes of taxation of share of business profits derived by the partnership from State S.

141.We also note the *1998 OECD Partnership report* at [40] and [81], the *2000 OECD commentary* on Article 5 [19.1] and the proposed amendments to the commentary on Article 5 of the *Model Convention*. A new Article 10.3 is proposed under which the term "enterprise" covers any form whether company or partnership. Paragraph 10.4 also sets out how the PE concept applies in case of fiscally transparent partnerships explaining that PE's profits attributable to a partner are prima facie profits of enterprise in contracting state. These paragraphs show there is nothing inconsistent with computing at the partner level or assessing at partner level but the partnership remaining transparent (and the partnership therefore not itself being liable to tax).

142. In the *2014 update of model convention* (paragraphs 42 and 43 before 10.3 and 10.4) it is recognised that the "enterprise" can be the partnership:

> "…any form of enterprise carried on by resident of a contracting state, whether this enterprise is legally set up as a company or partnership…"

143. These extracts go as far as showing, unsurprisingly, that as far as the double taxation treaties are concerned partnership is not some off limits or irrelevant subject. But we accept they do not specifically address the question of whether partnership may be taken account as a similar condition for the purposes of the application of the separate and distinct principle. However, the answer to that issue follows, in our view, from the nature of the factual and functional analysis that is required to be conducted.

144. Although partnership is indeed a legal construct it has real world factual and functional effects (in the same way that at the existence of an agency agreement, also a legal construct, might necessitate an analysis as to its nature and effects for the purpose of determining whether there was a PE). Rather than offending the separate and distinct principle, taking account of the partnership is consistent with it.

145. In fact, because of the "strength" of the fiction of imagining that the PE is a separate entity, there is no difficulty in imagining that it holds capital, or for that matter that it holds investments rather than trade assets. The call to a functional analysis of the facts suggests there is nothing inappropriate in taking account of the way in which the trade is conducted, namely on a shared basis with another entity subject to an agreement (whether that agreement is a partnership or something else). That factor, we agree with HMRC, is just as much a relevant factor to take account of. It is just as much a fact, or risk in its economic life of the PE as any other factor. The appellants' further argument that, even if the PE could be described as operating in partnership that would not require an attribution to each and every partner, does not take the matter further. The nature of the attribution required and whether underlying assets, as opposed to partnership units, were attributed, is precisely what is at issue.

146. We therefore disagree with the appellants. The partnership is a relevant factor to take account of. Sections 114/115 are consistent with the UK/US Treaty. Furthermore, as HMRC point out, on the facts of this case there is no evidence to suggest the PEs of BI and BAH LLC carry out any activity independently of the trade they carry on together.

147. In summary, while it is the foreign entity which is taxable the existence of a PE is a precursor to taxability, and sets the limits to what profits may be taxed. If that can be described as each partner being taxable by reference to the separate and distinct principle by reference to the PE, then that is not controversial, but the separate and distinct principle does not provide the answer the appellants seek. The application of that principle must, furthermore, take account that the PE is carrying out trade with another PE and that it derives its income from the trade carried on together with another. That is not the same as saying the PE is a partnership (which the appellants say it cannot be because the PE is an enterprise). HMRC are clear they are not arguing the PE is the partnership, rather the relevance of the partnership is that it informs the calculation mechanism through which the profits of the PE are calculated. There is

nothing in the separate and distinct principle or the strength of that which requires the transaction to be regarded as an acquisition of assets by the PE.

148. According to the appellants however, that analysis and the conclusion that the Schedule 29 IFA election by BI and BAH LLC is not valid cannot be correct because it leads to anomalous tax results.

Conclusion that no IFA election available leads to anomalous results?

149. The appellants argue HMRC's analysis cannot be correct as it leads to anomalies because: 1) it treats the sale by Merrill Lynch (ML) of partnership interest as a "tax nothing" (meaning ML "walks off" with tax free profits and BI and BAH get no relief for "real money" spent on a "real thing") and ii) on HMRC's view it makes all the difference whether one company retains a small interest in the partnership (leading, the appellants say, to a "tax nothing", whereas if ML and BI had completely divested their interests to two different companies X and Y then, because this is treated under s114 as a transfer by one company to another, with the attribution of s115 where it is a PE, then that would not entail a "tax nothing").

150. HMRC, the appellants say, are simply wrong to say s59/60 TCGA 1992 taxes gains on ML's disposal. Paragraph 118 of Schedule 29 (in Part 14 which deals with Commencement and Transitional provisions as in force from 5 December 2005 to 31 March 2009) applied Schedule 29 only to IFAs which were created or acquired after commencement (referred to in the appellants' submissions as "new IFAs". New IFAs are subject exclusively to Schedule 29 (because of the priority rules para 1(3) Schedule 29). In respect of any IFAs that were acquired or created before commencement ("old IFAs") whether the Schedule 29 priority provision (paragraph 1(3)) nevertheless applied) so as to oust the application of ss59/60, and assuming HMRC's view that no IFAs were acquired were followed through leading to a "tax nothing" as described above would depend on i) the accounting treatment (Schedule 29 paragraph 120), ii) the relevant rules governing timing of any TCGA disposal (paragraph 124) or iii) in certain cases whether capital allowances were being claimed (paragraph 125).

151. By contrast, the appellants submit their approach is simple, symmetrical and coherent. Where the transaction is an acquisition of assets rather than as sale and acquisition of membership interest, there is a disposal of IFAS (whether "old" or "new") by ML giving rise to a profit (under TCGA 1992 for old IFAs and Schedule 29 for new IFAs) and relief for BI and BAH LLC under Schedule 29.

152. HMRC submit the above analysis is incorrect in that the appellants have ignored provisions dealing with corporation tax on chargeable gains. On their case if the analysis is that at partnership level intangible fixed assets are not recognised, then it makes perfect sense at partnership level that there is no change in assets. The position is the same before and after. The second anomaly suggested by the appellants (that it makes all the difference whether partner hangs on to the interest or divests entirely) does not arise because it requires the assumption that the appellants are right on the first anomaly that if Schedule 29 does not apply then that is a "tax nothing".

153. HMRC explain that the treatment in s59 for CGT purposes does not carry through to Schedule 29; it is not right to say just because one look through the partnership for CGT purposes one ends up with IFAs for Schedule 29. Schedule 29 asks whether, for accounting purposes, an IFA is acquired. The gain on the disposal of the partnership interest is a gains tax matter in the light of para 76 of Schedule 29 and the accounting view.

154. HMRC further point out, in their written note, that the appellants are wrong in their assumption that ML would have recognised intangible fixed assets for accounting purposes. They highlight there is no evidence to support this assumption. The appellants had at no stage before the hearing sought to rely on the accounting treatment by ML of assets held by BLP so it is not open to the appellants to rely on proposition that the ML PE should be treated for accounting purposes as holding intangible fixed assets. On the basis that ML has not, for accounting purposes recognised any IFAs there is no question of Sch 29 applying (Sch 29 paras 1(1), 2(1). On the sale of its partnership interest in BLP there would be a disposal by ML for purposes of corporation tax on chargeable gains to which TCGA s59 applied. The disposal proceeds less relevant acquisition costs would be chargeable to corporation tax on chargeable gains under TCGA.

155. Even if ML had recognised assets on its balance sheet which were within Sch 29 FA 2002, then there would be a debit or credit and disposal which would be taxed accordingly. But that would not inform whether each appellant was holding Sch 29 assets – that question depends on whether each appellant recognised IFAs for accounting purposes (para 1(1) and 2(1) of Schedule 29). The commercial reality was that BI and BAH LLC acquired a partnership interest in BLP from ML. If disposed of then that disposal would count for the purposes of CT on chargeable gains. The expenditure incurred would constitute an acquisition cost for purpose of TCGA s38 and would be taken into account so it was incorrect to say that any profit for ML must escape tax altogether with no relief for expenditure by BI or BAH LLC. Consequently contrary to the appellants' suggestion no absurd consequence arises.

Tribunal's views

156. In our judgment the appellants' "tax nothing" argument amounts to nothing. The tribunal is ill-equipped, as HMRC point out, to investigate the tax treatment of the transaction from ML's point of view and would be ill-advised to draw any conclusions which might call into question the tax affairs of a person who was not party to these proceedings. But, in any event, this is not a situation where we place weight on any alleged lack of symmetry or coherence because in relation to the statutory provisions this appeal has focussed on, there is nothing to suggest such symmetry or coherence was intended. Furthermore for the reasons explained by HMRC there is no indication that absurd consequences would necessarily follow from their analysis.

Appellants' other arguments on why HMRC's analysis on application of partnership taxation provisions wrong

157. The appellants also dispute HMRC's argument that s114 and s115 ICTA (on the taxation of corporate partners apply). These provisions, the appellants submit, are irrelevant to taxation of partners as regards dealing with membership interest so as to change profit sharing ratios, and *a fortiori* where the reporting tax entities are the PE of a non-UK resident company. That is not to say such dealings escape tax because the CGT code taxes changes in partnership ratio (under s59 TCGA and Statement of Practice D12 para 4.1 to 4.5 in accordance with analysis that partners have interest in the underlying assets of the partnership (as confirmed by *IRC v Gray (surviving executor of Lady Fox deceased)* [1994] STC 360 pg 277 and *Major v Brodie* [1998] STC 491 (which we come onto shortly). The appellants argue that changes in partnership sharing ratios as regards non-UK resident corporate partners are dealt with in ICTA ss11, 11AA and Sch A1 read in accordance with UK/US Treaty. These provisions say one must look to the PE.

158. In support of their case the appellants also refer to what they say are general statements of law in relation to partnerships as set out in *Gray*, *Major v Brodie*, and in *HMRC v Vaines* [2016] UKUT 2 (TCC) (the latter case being one HMRC referred the tribunal to) to the effect that money spent by partners was not prohibited from deduction and that a partner's share in profits had to be computed so as to accommodate the partners' expenditure in profits. The fact that a partner was assessed on its share had nothing to say about whether expenditure by partner was deductible at PE level following a functional and factual analysis in computing the profit share.

159. In *Gray*, a case concerning capital transfer tax legislation Hoffman LJ explained:

> "…As between themselves, partners are not entitled individually to exercise proprietary rights over any of the partnership assets. This is because they have subjected their proprietary interests to the terms of the partnership deed which provides that the assets shall be employed in the partnership business, and on dissolution, realised for the purposes of paying debts and distributing any surplus. As regards the outside world, however the partnership deed is irrelevant. The partners are collectively entitled to each and every asset of the partnership, in which each of them therefore has an undivided share. It is this outside view which identifies the nature of the property to be valued for the purpose of capital transfer tax…"

160. The facts of *Major v Brodie* concerned a partnership ("partnership 1") which was itself a member of another partnership ("partnership 2") and the question of whether money borrowed by members of partnership 1 was to be viewed as a loan for the purposes of partnership 2. It was held that the borrowed money which had been used wholly for the purposes of partnership 2 had thereby been used wholly for the purposes of the trade carried on by the partners in partnership 1. In rejecting the argument that the relevant legislation, when it referred to partnership, was referring to contributions to partnership 1 wholly for the trade carried on by partnership 1, Park J explained that:

> "…this ignores the true legal nature of a partnership and its members…a trade carried on by a partnership is a trade carried on by its members and each of them."

161. HMRC referred the tribunal the Upper Tribunal's decision in *HMRC v Vaines* [2016] UKUT 2 (TCC). The facts concerned the deductibility a payment a partner in a law firm had made to avoid litigation in relation to another firm which the partner feared might, if it were not made, result in bankruptcy thereby losing his position as partner in the law firm. HMRC say the case illustrates how the partnership calculation mechanism worked in relation to similar provisions in ITTOIA. The Upper Tribunal explained, at [25], that following the introduction of self-assessment:

> "…each partner is assessed to tax on their share of profits by reference to the basis period determined according to their notional trade. It is, however, as the language of the Act recognises, a notional trade only for the purposes of the assessment. The actual trade remains that of the partners collectively and it is the profits of that collective trade that must be computed before being allocated or shared among partners to provide each partner's share of the profit that is the profit of their notional trades for the purposes of their self-assessment."

162. The appellants accept that in that case the deduction was prohibited but this was because it was spent for reasons personal to the partner. The case nevertheless shows the principle that money spent by the partners is not prohibited from deduction At [31] the Upper Tribunal explained:

> "It is in the context of the partnership trade conducted collectively that Mr Vaines [the appellant partner] must justify the deduction of his payment)".

163.HMRC's response is that it does not follow from the fact that for the purposes of CGT and corporation tax on chargeable gains the partners are treated as having an interest in the underlying assets, that for accounting purposes the UK PE of each of the appellants has acquired IFAs. They refer by analogy to the FTT's decision in *Armajaro Holdings Limited v HMRC* [2013] UKFTT 571 (TC) which showed that a fiction for corporation tax purposes did not extend for the purposes of accounting. The issue in that case concerned whether the appellant was entitled to intangibles relief under Schedule 29 in respect of the acquisition of other members' interests in a LLP. That in turn depended on the issue of whether s118ZA ICTA required the LLP to be treated as a general partnership or whether it should be "looked through" so that the appellant was treated as having a direct interest in the assets of the LLP. In dismissing the appeal the FT explained at [32]:

> "…AHL argues that, by virtue of Section 118ZA(1) ICTA, AAM is "looked through" as an entity for all tax and corporation tax purposes. We agree that section 118ZA(1) and (2) provides for a "look-through" but that only applies "for corporation tax purposes" and "for all purposes … in the Corporation Tax Acts". Nothing in section 118ZA requires or permits a corporate member of an LLP to treat the assets of the LLP as its own for accounting purposes. The words "For all purposes, except as otherwise provided, in the Corporation Tax Acts

> …" in section 118ZA(2) clearly contemplate the existence of exceptions, such as that in Schedule 29, where it is necessary to look at the treatment of a transaction for accounting purposes. We do not accept that section 118ZA provides for a general look-through and, specifically, it does not apply for accounting purposes. Relief under Part 2 of Schedule 29 is given by reference to expenditure written off or written down for accounting purposes. If accounting rules or practice do not permit the expenditure on acquiring an interest in an LLP to be treated as the acquisition of the LLP's intangible fixed assets included then section 118ZA does not change the accounting rules or practice or deem the accounts to include something that they do not include."

164. As regards *Gray* and *Major v Brodie* HMRC submit these cases turn on the particular statutory context in issue in those cases. In *Gray* this was the construction of the term "value at any time of property…" in the context of legislation relating to capital transfer tax and the question of the Land Tribunal's jurisdiction. In *Major v Brodie* the relevant provision was s362(1)(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…". Hoffman LJ's observations were for the purposes of answering the question "for what purposes has that money been used?" His conclusion, HMRC say, was that as a matter of construction of the particular provisions in the context of partnerships, the money was being used for the purposes of both partnerships.

Tribunal's view on authorities

165. In our view, although the above cases do assist on some general background points as set out below, they do not ultimately help on the issue of the viewpoint from which the notional accounts which are to be constructed on the facts of this case.

166. Despite HMRC's arguments, there are some observations on the general law of partnership that may be drawn from *Gray* (in so far as Hoffman LJ highlighted the relevance of considering whether, the perspective from which the partnership was to be viewed from, was a "between themselves" view, or an "outside view"), and Park J's explanation in *Major v Brodie* (that a trade carried on by a partnership is a trade carried on by its members and by each of them).

167. We note, as regards *Major v Brodie,* that Henderson LJ in the Court of Appeal's decision *Vaines* [2018] EWCA Civ 45 (issued after the hearing in this case) endorsed the view that *Major* involved "unusual facts" but also that it contained general propositions as to the general law on partnership. At para [37] he stated:

> "Finally, I should mention that Mr Vaines referred us to, and placed considerable store by, the decision of Park J in *Major v Brodie* 70 TC 576, [1998] STC 491. Again, however, I do not consider that it helps Mr Vaines. It was a case on unusual facts, involving a Scottish partnership, and concerned different statutory provisions. In so far as Park J referred to the general law of partnership in his characteristically

> lucid judgment, I find nothing there which casts any doubt on the basic principles which I have sought to explain. In particular, when he said at 597 that "a trade carried on by a partnership is a trade carried on by its members and by each of them", he clearly did not mean to suggest that each individual partner carries on a trade separate from that of the firm."

168. Fundamentally however, none of the cases help on informing the accounting view which is to be taken for the purposes of Schedule 29. *Gray* illustrates that, as regards the application of a statutory provision to partnerships, there is an issue of whether as a matter of statutory construction a "between themselves" view or an "outside view" is taken but has nothing to say on which view is to be taken for the purposes of attribution to a PE for the purposes of corporation tax as regards the Schedule 29 regime.

169. While the appellants query whether the FTT's decision on the limited deeming effect of the relevant provision in *Armajaro* was correctly decided, it is not necessary to consider that point because, as they rightly highlight, the case was not considering what accounts were to be constructed in the context of a PE.

170. As regards *Vaines* and *Major v Brodie* and the proposition confirmed that the trade carried on by a partnership is a trade carried on collectively by the partners, while it is correct that the partnership's profits will reflect a partners' expenditure for the purposes of the partnership, none of this detracts from the point that at the level of the partnership trade the question for the purposes of Schedule 29 is an accounting one. As identified above there is nothing in the treaty provisions which requires the accounts to regard the expenditure as having been in relation to intangible fixed assets as opposed to partnership units. Similarly there is nothing in the authorities which indicates the expenditure must be treated in the way the appellants suggest.

Conclusion on Issue 1:

171. We reject the appellants' argument that the separate and distinct principle must mean the transaction is treated as a transfer of assets. The perspective to construct the accounts is the partnership level, and the accounts generated accordingly show no acquisition of intangible assets. The appellants' claim for the election is invalid.

172. This conclusion is sufficient to dispose of the matter before us. The appeal is therefore dismissed. However we shall briefly set out some of the parties' alternative arguments, and so far as appropriate, our views on those, in case these are of assistance in any onward appeal.

New Argument on Article 7(3) of DTA

173. At the hearing, the appellants sought for the first time, to raise an argument that by virtue of Article 7(3) of the DTA (which required a deduction of expenses that were incurred "for the purposes of the PE") and s11AA(4), to the extent it did not conflict with the treaty provision, the appellants would get the deduction because money spent by BI and BAH must have been for the purposes of PE in that it was spent for the

purposes of the BLP and BFLP trade in the UK. The appellants invite a finding of fact, by inference, that the money paid to ML was paid for the purposes of the PE. They submit that, if that finding was made, then there is no basis to deny BI and BAH LLC (as corporates let alone as PEs) a deduction. They argue that the "tailpiece" in s11AA(4) (i.e. the text which restricted allowable expenses to those "of a kind of which a deduction would be allowed for corporation tax purposes if incurred by a company resident in the United Kingdom") should be disregarded. That text did not appear in, and went beyond, 7(3) of Treaty and to that extent was overridden by the Treaty provision.

174. HMRC took objection to the point being raised for the first time at the hearing and submitted it should not be considered but in any case argued that looking where burden lay, there was no evidence of any expenditure for the purposes of the two offices and data recovery centre (making up the PEs in the UK). There was therefore no evidence the expenditure fell within Article 7(3). Further, HMRC argued there was no conflict between the DTA and the tailpiece in s11AA(4). The function of 7(3) in the DTA was attribution of expenses not deductibility. By contrast s11AA(4) dealt with deductibility.

175. In our view the fact the appellants have had to resort to inviting the tribunal to make an inference on a critical fact (if their submission is accepted) illustrates why this argument is not one this tribunal should entertain so late in the proceedings. If notice was given of this point earlier it is likely that the parties' marshalling of the evidence could have taken a different course and the tribunal would then have been equipped with a satisfactory foundation on which to build any relevant findings of fact on the point. We therefore agree with HMRC that this new point should not be considered at this stage by the tribunal given the basis upon which the parties had prepared their respective cases. But, were it necessary to consider the point we do not agree with the appellants' analysis of the significance of Article 7(3). As made clear by the interpretative materials (see for instance the *OECD 2000 commentary* on Article 7 paragraphs [14] which concerns Article 7(3)) it is recognised that in calculating the profits of the PE allowances need to be made for expenses incurred for the purposes of the PE. This shows Article 7(3) must be read in conjunction with Article 7(2) as part and parcel of the exercise of deriving the profit figure; it is not intended, it seems to us, to provide a free standing test which operates to provide a deduction independently of the calculation of the income from which the deductions are made in order to derive profits. As explained above there is nothing in the fact the appellants' share of profits is calculated at partnership level (which is also the level at which deductions are considered takes place at) which is inconsistent with the UK/US Treaty provisions.

HMRC's further arguments in the alternative

176. HMRC make two sets of further arguments in the alternative. First, HMRC argue that even if the appellants' argument that the relevant notional accounts were to be drawn up from the perspective of the PE then the assets would nevertheless be excluded as "the interest of a partner in a partnership under s76(1)(c). The expert evidence scenarios (3 and 4) in which the intangible assets are recognised require a

further assumption to be made, not just that one looks at matters from the PE's perspective but that, contrary to actual facts and the terms of the purchase agreement, the transaction resulted in an increase in assets rather than partnership units. The appellants' argument that the exception in s76(3) to the exclusion in s76(1)(c) applies was incorrect as looking at the actual transaction that took place the accounting treatment required that it be dealt with as a cost of investment rather an as an acquisition of intangible assets. Further it is not, as the appellants suggest, for HMRC to show that there was a partnership. That issue had not been raised until the hearing, and in any case the entities had been filing partnership tax returns. Finally, there was nothing in the appellants' argument that the fact the draftsperson felt the need to go to the trouble of excluding partnership interests meant that such interests were prima facie within scope as intangible fixed assets.

177. The second set of arguments is that HMRC say the expenses are precluded by TA s11AA(4) because they are not expenses of a kind in respect of which a deduction would be allowed for corporation tax purposes if incurred by a company resident in the UK. HMRC argue that, had a UK resident company acquired a partnership interest in the circumstances of the present case, then no debit could have been brought into account in respect of any intangible asset (whether pursuant to FA 2002 Schedule 29 or otherwise).

178. We agree with HMRC that it is neither correct, nor at this late stage, open for the appellants to say it is for HMRC to prove that BLP and BFLP are English law partnerships. But although we do not need to consider the detail of the appellants' arguments in response to HMRC's, what the appellants have correctly identified, in our view, is that HMRC's alternative arguments do not satisfactorily address or acknowledge the changed set of circumstances that would arise if the appellants were successful in their primary argument. (That is perhaps not surprising given the difficulty we have found in articulating exactly how the appellants might be successful in that primary argument.) In relation to HMRC's first set of arguments, it must be assumed that the application of the separate and distinct principle would mean (if the appellants were successful in their argument) that there would, contrary to the face of the transaction documentation, be a deemed transfer of assets. In that case HMRC's points assuming an acquisition of partnership interest and the ensuing accounting treatment would be irrelevant. As to the second set of arguments, as the appellants point out, if it is assumed the appellants' primary argument were correct, then it could not be assumed that a UK resident company who acquired a partnership interest rather than intangible assets was the proper comparator. There would not necessarily be the odd result, as HMRC suggest, that the non-UK company could obtain a deduction in circumstances where a UK resident company could not.

179. In the absence of a precise explanation of the basis upon which the appellants' argument would succeed we consider it unwise to consider in any greater detail whether HMRC's arguments in the alternative would be successful.

180. As requested by the parties the tribunal's decision is given in principle. If amendments to the relevant figures consequent to our decision are required, the

parties may revert to the tribunal in the event they cannot reach agreement on those. The appellants' appeals are dismissed.

181. 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.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 16 APRIL 2018

Appendix 1

Fig 1: Historic Group Structure (Abbreviated)

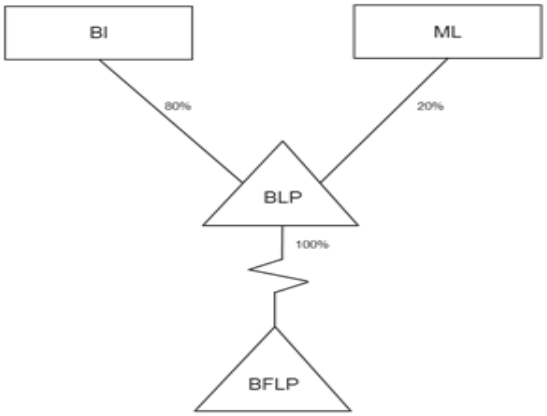
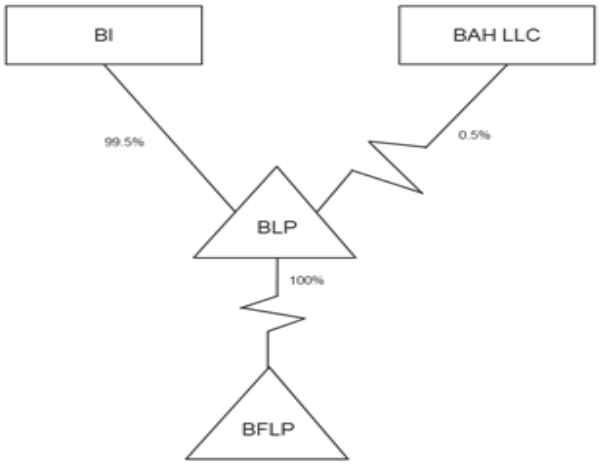


Fig 2: Current Group Structure (Abbreviated)



Appendix 2

Consolidated Journal Entries

Debit	Customer Relationships
Debit	Technology
Debit	Content
Debit	Trade Name
Debit	Favourable Lease (1)
Debit	Deferred Revenue Valuation Adjustment (2)
Debit	Debt Revenue Valuation Adjustment (3)
Debit	Goodwill
Debit	Deferred Taxes (4)

(1) Represents fair value adjustment for debt as of the acquisition date.

(2) Represents fair value adjustment for certain below market leases.

(3) Represents fair value adjustment for deferred revenue to reflect obligation if it were necessary to outsource the provision to a third party.

(4) Represents deferred tax asset related to a component of Goodwill.