TC07751

Corporation tax – oil royalties received by overseas bank and applied to outstanding debt of insolvent oil exploration borrower – whether bank's rights amounted to "immovable property" under UK/Canada double tax treaty Article 6(2) – whether royalty payments subject to corporation tax as ring fence profits of deemed UK permanent establishment under s 1313 CTA09 – whether certain discovery assessments invalid – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/06211

BETWEEN

ROYAL BANK OF CANADA **Appellant**

-and-

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

TRIBUNAL: JUDGE KEVIN POOLE

Sitting in public at Taylor House, Rosebery Avenue, London on 3-6 June 2019

Jonathan Peacock QC and Sarah Black of counsel, instructed by Norton Rose Fulbright LLP, for the Appellant

Jonathan Bremner QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This appeal considers whether UK ring fence corporation tax is properly payable by the Appellant ("the Bank" or "RBC") in respect of its receipt of certain sums paid to it during its accounting periods ended 31 October 2008 to 2015 inclusive.

2. In broad terms, the Bank had (through its Canadian head office) advanced loans of CAD $540 million in the early 1980s to Sulpetro Limited ("Sulpetro"), a Canadian company, to help fund the exploitation by its group of companies of rights to drill for oil, largely in the Buchan field of the North Sea. The Sulpetro group sold its interest in the Buchan oil field to the BP group in 1986, in exchange for various sums including (crucially, in the present appeal) an entitlement to contingent royalty payments on production from the oil field (linked to the excess of the market price of the oil in question above a benchmark level) ("the Payments").

3. Sulpetro was already in financial difficulties at the time of the sale to BP and ultimately went into receivership in 1993, by which time some Payments had started to be made due to the rise in oil prices. After the remainder of its assets were realised, Sulpetro still owed the Bank some CAD $185 million and its rights to all future Payments were formally assigned to the Bank with the approval of the Canadian courts for nominal consideration (though there does also appear to have been a purported prior assignment of those rights to the Bank when they were first created).

4. BP later sold its interest in the Buchan field to another UK company, Talisman Energy (UK) Limited ("Talisman"), as a result of which Talisman assumed the obligation to make the Payments. The Payments made by it have been accounted for as a deduction from its ring-fence profits of its UK oil exploitation trade.

5. The Bank has treated the Payments received by it as income of its banking business in Canada (which it has accounted for as a partial recovery of the bad debt it had previously recognised in respect of its loan to Sulpetro), and not reported it in any UK tax return. Although it has at all times had a permanent establishment in the UK, this transaction did not involve it.

6. HMRC[1] were checking Talisman's corporation tax return for 2013 when they became aware of the Payments being made by Talisman to the Bank. They now claim that the Bank ought to account for UK corporation tax on the Payments it received during the relevant years, as part of a ring-fence activity carried on through a deemed UK permanent establishment. This appeal covers the years from 2008 to 2015 and essentially involves three issues:

(1) whether the UK/Canada double tax treaty allocates taxing rights to the UK in respect of the Payments;

(2) if it does, whether the Payments fall within the scope of the UK taxing provisions; and

(3) whether the assessments for the years to 31 October 2008-11 (totalling some £10 million) raised by HMRC were made out of time under the "discovery" assessment provisions. The foundation of this argument mainly related back to certain correspondence involving Sulpetro, BP and HMRC in the period from 1986 to 1992.

[1] Where the context requires, "HMRC" refers also to the predecessor Commissioners of Inland Revenue.

THE FACTS

Introduction

7. Most of the facts (other than in relation to the discovery issue), whilst complex, were uncontroversial.

8. The parties provided a helpful statement of agreed facts, which after detailing the parties read as follows:

> 3. The Appellant carries on a banking business in Canada and in other jurisdictions through branches and subsidiaries. The Appellant carries on business in the United Kingdom through a branch based in London.
>
> 4. In the early 1980s the Appellant advanced a secured loan (the Loan) to Sulpetro Limited (Sulpetro), a Canadian company engaged in oil exploration and exploitation activities. Sulpetro carried on its oil exploration and exploitation activities in (inter alia) the Buchan Field of the North Sea. The Buchan Field lies within the United Kingdom sector of the continental shelf (i.e. within the areas designated by Order in Council under section 1(7) of the Continental Shelf Act 1964).
>
> 5. A licence to explore and exploit the Buchan Field (the Licence) was granted by the United Kingdom government to Sulpetro (UK) Limited (SUKL), a United Kingdom incorporated and resident subsidiary of Sulpetro. SUKL and Sulpetro agreed pursuant to an "Illustrative Agreement" that Sulpetro would incur all the development and exploitation costs in relation to the Buchan Field and, in return, Sulpetro would receive the Licence holder's share of the oil won from the Buchan Field.
>
> 6. Sulpetro entered into financial difficulties in 1985 and the Appellant appointed a receiver in 1987.
>
> 7. Sulpetro sold its interest in the Buchan Field to BP Petroleum Development Limited (BP) a United Kingdom incorporated and resident company on 7 December 1986 under a Sale and Purchase Agreement (SPA).[2]
>
> 8. As set out in the SPA, Sulpetro transferred to BP: (1) "the Shares", being 100% of the issued share capital in SUKL; and (2) certain "Tangible Assets", "Sulpetro's Licence Interests" (being all beneficial rights and interests in the Licences held by Sulpetro) and certain Data. Under Clause 4.1 of the SPA the cash consideration paid by BP was allocated between (a) Sulpetro's Assets other than the Shares and Sulpetro's Licence Interests, (b) Sulpetro's Licence Interests and (c) the Shares in SUKL.
>
> 9. Under the SPA BP agreed, in addition, to make a series of "other payments". These included (SPA clause 5.4) the payment of (what was described as) a royalty to Sulpetro in respect of (inter alia) all production from the Buchan field (the Payments). In broad terms, the Payments were payable where the market price per barrel of oil (less certain expenses) exceeded USD $20 per barrel. It is these Payments that are the subject of this appeal.
>
> 10. In 1993, Sulpetro was in financial difficulties[3] and went into receivership[4]. The Appellant was a creditor of Sulpetro. The receiver was discharged by court order from its obligations as receiver manager of all the undertaking, property and assets of Sulpetro. Pursuant to the court order the "BP Petroleum

[2] In fact, the SPA was dated 2 December 1986 and the sale appears to have been completed on 22 December 1986. Nothing turns on the discrepancy.

[3] This was a continuation of the previous difficulties, not a new situation.

[4] In fact the receivership had commenced on 17 June 1987, but nothing turns on the different date.

Limited royalty interest" (i.e. the right to the Payments) was assigned to the Appellant for nil consideration.[5] Sulpetro was also dissolved from the register of Corporations in Canada for "noncompliance" on 4 October 1993.

11. The unrecovered debt at the time of the court order was approximately CAD $185 million. The Appellant treated the loan of CAD $185 million to Sulpetro as a bad debt which was written off in its accounting period ended 31 October 1993, with an equivalent tax deduction obtained by the Appellant in Canada. Since that time, Payments received by the Appellant have been accounted for as a recovery of the bad debt and, for Canadian tax purposes, the Appellant has treated the Payments as taxable income in the year the amounts were paid.

12. BP's interest in the Buchan field was subsequently transferred to Talisman Energy Inc. *[In 1996, BP transferred its interest in the Buchan Field to Talisman Energy Inc (Talisman).[6] As of December 2012, Talisman ran its North Sea operations (including the Buchan Field) through a joint venture company called Talisman Sinopec Energy UK Limited, 51% of which was owned by Talisman Colombia Holdco Limited, a subsidiary of Talisman, and 49% of which was owned by Addax Petroleum UK Limited, a subsidiary of China Petrochemical Corporation (Sinopec Group). In 2015, Repsol SA acquired Talisman, including its 51% shareholding in Talisman Sinopec Energy UK Limited (and thus its rights to the Buchan Field) which was renamed Repsol Sinopec Resources UK Limited (Repsol Sinopec Resources) in July 2016.]*[7] As a result of that transfer, Talisman took on (and BP divested itself of) the legal obligation to make the Payments pursuant to the SPA. Talisman has made the Payments to the Appellant in the accounting periods to which this appeal relates. The position, therefore, is that Talisman had a legal obligation to make the Payments and the Appellant has a legal right to receive the Payments.

13. No end-date was specified in the SPA for the Payments. As a result, the Payments will continue for as long as the Buchan Field is productive and the conditions for the making of the payment of the Payments are met.

14. The SPA also provided for (what was described as) a royalty in respect of production from Humbly Grove, an onshore field in Hampshire. However, no payments have ever been made to the Appellant in respect of Humbly Grove.

15. On 31 October 2014, the Respondents sent the Appellant Notices of Assessment for the Accounting Periods ending 31 October 2008, 2009 and 2010. The Appellant appealed these discovery assessments to the Respondents on 24 November 2014.

16. On 29 October 2015, the Respondents sent the Appellant a Notice of Assessment for the Accounting Period ending 31 October 2011. The Appellant appealed this discovery assessment to the Respondents on 17 November 2015.

17. On 2 October 2017, the Respondents sent the Appellant a Notice of Assessment for the Accounting Period ending 31 October 2012. The

[5] As mentioned at [113] below, this was not the first purported assignment of those rights, and in fact a stated consideration of CAD $1 was given for this assignment.

[6] The transfer only appears to have been fully finalised on 5 May 1999, when Talisman entered into the novation agreement under which it assumed the liability to make the Payments.

[7] The italicized text in square brackets appeared as a footnote at the point where it has been inserted. Various other footnotes were also included but they merely cross-referred to the contents of various documents and did not contain any factual narrative. They are not therefore included.

> Appellant appealed this discovery assessment to the Respondents on 23 October 2017.[8]
>
> 18. On 3 October 2017, the Respondents sent the Appellant a notice of amendment to its corporation tax returns for the Accounting Periods ending on 31 October 2013, 2014 and 2015. The Appellant appealed these amended assessments to the Respondents on 23 October 2017 (collectively referred to as the Assessments).
>
> 19. The Respondents made the Assessments on the basis that the Payments are subject to UK tax under the "ring fence" trade regime governed by Part 8 of the Corporation Tax Act 2010.
>
> 20. On 4 August 2017 the Appellant filed a notice of appeal with the Tribunal against the assessments identified in paragraphs 15 and 16 above.
>
> 21. On 10 November 2017 the Appellant applied to the Tribunal for the appeals against the assessment and closure notices identified in paragraphs 17 and 18 to be consolidated into this appeal. The Tribunal granted the Appellant's application on 15 December 2017.

9. In addition, I received a bundle of documents and two witness statements (supplemented by oral evidence) from Sophia Thompson and Dr Alison Holloway (respectively a former and current HMRC officer). My findings of fact relevant to my decision on the discovery issue are set out in the section of this decision dealing with that issue (see [105] below).

10. A little more detail of some of the key documents is required.

The Illustrative Agreement

11. First in time was the Illustrative Agreement referred to at paragraph [5] of the statement of agreed facts set out above ("the Illustrative Agreement"). There are indications elsewhere in the documents that this agreement was entered into on 19 November 1982, by way of formalisation of a prior informal understanding. No copy of the actual agreement can now be found, but the parties agreed that it would have followed the pattern of an agreement which was included in the bundle of documents which had apparently been sourced from the National Archives at Kew. That agreement was made on 1 September 1971 between a UK company in the Signal Oil group ("the Licensee") which, together with unnamed others, had "applied for and expect to be granted a certain license… to conduct petroleum exploration, development and production activities in United Kingdom areas", and an obviously related American corporation ("Signal") which was willing to "provide a portion of the funds and equipment necessary to conduct all the operations under such license and necessary to discharge all the obligations of the Licensee thereunder as provided in this Agreement". The key provisions of the agreement were in Articles 2 to 6, which provided as follows:

> Article 2
>
> Subject to law, the Regulations, the licence and this Agreement, Licensee shall conduct petroleum exploration operations in and in connection with all the areas covered by the license and, if petroleum is discovered, shall develop the areas and shall produce the petroleum therefrom. Licensee shall be and at all times remain responsible to the Secretary for (a) the full and proper discharge of all obligations under the license, and (b) the conduct of the operations in accordance with law and with the Regulations. Licensee may enter into

[8] This assessment was superseded by an amendment to the Bank's self-assessment made on 6 August 2018, it having been belatedly realised by HMRC that an enquiry had been opened into the Bank's 2012 return on 31 October 2014 and not previously closed.

contracts with others to perform on its behalf and under its responsibility such operations as Licensee may desire to be so performed.

Article 3

Licensee shall pay to the Department of Trade and Industry during the term of the license the consideration by way of royalty or otherwise for the grant of such license, determined by the Secretary with the consent of the Treasury and specified in the license, at the times and in the manner specified.

Article 4

Licensee shall ensure that all petroleum won and saved from the licensed area other than petroleum used therein for the purpose of carrying on drilling and production operations or pumping to field storage or refineries shall be delivered on shore in the United Kingdom unless the Secretary gives notice of his consent in writing to delivery elsewhere, and in such case Licensee shall ensure compliance with any conditions subject to which that consent is given.

…

Article 5

Signal shall provide nineteen percent of one hundred percent (19% of 100%) of all funds and equipment required for the exploration, development and operations under the license, and for all investment therefor and all expenses thereof, including the payment of royalty and other payments called for by the Regulations, the Schedules thereto, and the license, and for all activities for the full and proper discharge of all obligations under the license. Licensee shall provide the remaining five percent of one hundred percent (5% of 100%) of all such funds and equipment. With respect to its interest, Signal shall provide the budget and work programs, which shall comply in all respects with law, the Regulations, the license and other obligations of the Licensee, and such programs shall be carried out.

Article 6

Signal shall own and receive nineteen percent of one hundred percent (19% of 100%) of all the petroleum won and saved to which the licensee as defined in the license (i.e., all co-licensees) is entitled under the license. Signal shall receive no reimbursement of any kind for any investment made or expenses incurred, and Signal must look solely to income derived from the extraction of petroleum for the return of any capital so invested or expenses incurred. The disposal by Signal of petroleum won and saved from the licensed areas shall be in accordance with law, the Regulations and the license. Licensee shall own and receive the remaining five percent of one hundred percent (5% of 100%) of all such petroleum.

12. The parties were agreed that this agreement was clearly tailored for a situation in which a number of companies were co-licensees in respect of a particular area, and the "Signal group" share in the license was 24%; and that 5% out of that 24% was to be reserved to the Licensee, with the remaining 19% effectively going to Signal. It was agreed that the situation in respect of Sulpetro and SUKL was more straightforward: whilst the underlying license only conferred on SUKL a 12.7% interest in the Buchan field (see [16] below), Sulpetro would be entitled to the oil deriving from 100% of that interest and, in return, would provide 100% of the funds required to explore and exploit it. In consequence of this, it would "own and receive" 100% of the oil won by SUKL from its 12.7% share in the Buchan field.

The SPA

13. The SPA referred to in the statement of agreed facts was entered into on 2 December 1986 (see [114] below). It was made between BP Petroleum Development Limited and Sulpetro. SUKL was not a party. The SPA recited as follows:

> (A) Sulpetro owns directly or indirectly the whole of the authorised and issued share capital of Sulpetro (UK) Limited (hereinafter referred to as "Sulpetro (UK)");
>
> (B) Sulpetro wishes to sell and BP wishes to purchase the whole of such issued share capital on terms hereinafter set out;
>
> (C) Sulpetro and Sulpetro (UK) own interests in certain assets within the United Kingdom and on the United Kingdom Continental Shelf as are more fully described hereinafter;
>
> (D) Sulpetro wishes to sell and BP wishes to purchase such assets on terms hereinafter set out;

14. Completion of the sale agreed under the SPA was conditional upon a number of events, including "clearances having been obtained from the Inland Revenue satisfactory to BP and Sulpetro in respect of the letter dated 19th November, 1986[9] attached hereto…"

15. The SPA provided for the sale of "Sulpetro's Assets", which was defined as meaning "the Assets other than those held by Sulpetro (UK)". The associated definitions were as follows:

> "Assets" means the Tangible Assets, Sulpetro's Licence Interests, the Data and the Shares.
>
> "Tangible Assets" means the undivided percentage interests whether held legally or beneficially of Sulpetro and Sulpetro (UK) in the plant, equipment, machinery and other physical assets relating to the Licences which percentage interests are more fully described in Appendix B and which assets are more fully described in Appendix C.
>
> "Sulpetro's Licence Interests" means all beneficial rights and interests in the Licences held by Sulpetro;
>
> "Data" means all information of whatsoever nature relating to the Licences owned in whole or in part by Sulpetro or Sulpetro (UK);
>
> "Shares" means the whole of the issued share capital of Sulpetro (UK);
>
> "Licences" means all exploration, appraisal, development or production licences issued by the Secretary of State in respect of both the United Kingdom and the United Kingdom Continental Shelf and currently held by, inter alia, Sulpetro (UK) and which are more fully described in Appendix B;

16. Appendix B to the SPA was headed "Sulpetro UK Holdings" and listed a number of locations, including crucially "Buchan Unit", extending to 29.7 square kilometers (or 7,339 acres) in which the "Cost interest" and "Working interest" were both 12.706793 (I infer this is a percentage figure, as the "Net area acres" is then given as 933, which is 12.7% of 7,339). The "Expiry Date" was noted as "In Perpetuity".

17. Appendix C included a list of "Buchan Unit Tangible Assets", which included eight "production wells", the Buchan Alpha production platform and various associated equipment.

[9] I infer this was the letter referred to at [111] below.

18. The Consideration for the sale was stated as £16,866,176 in respect of Sulpetro's Assets (other than the Shares and Sulpetro's Licence Interests), £250,000 in respect of Sulpetro's Licence Interests and £10,000 in respect of the Shares, totalling £17,126,176. In addition, BP was required to pay to Sulpetro on 1 March 1988 the sum of £1,873,824, the amount of an Advance Petroleum Revenue Tax Credit which would be paid or credited to BP as the new operator of the Buchan field, by reference to payments made by Sulpetro before the sale. Normal balancing payments were to be made in respect of cash balances and stocks of oil as at the effective date of the transfer (which was intended to be retrospective to 1 November 1986) and by reference to subsequent income and expenses between that date and completion of the sale.

19. Finally, clause 5.4 of the SPA provided for a royalty in the following terms:

> 5.4.1 Subject to Clause 5.4.2, with effect from the Effective Date, BP shall, in respect of each Quarter pay a royalty to Sulpetro in respect of all production from Buchan…
>
> For each Quarter, a royalty rate, per barrel in US Dollars, to be applied to actual production from Buchan and Humbly Grove respectively, will be calculated for each field in accordance with the following formula:
>
> 50% (A-B)
>
> where:
>
> 'A' is the Actual Market Value (as hereinafter defined) per barrel of Petroleum production from Buchan and Humbly Grove attributable to the interests in those fields acquired by BP pursuant to this Agreement, less Royalty and Production Taxes payable per barrel…
>
> 'B' is the notional market value per barrel of such Petroleum production in the same Quarter on the basis of a US$20 per barrel selling price less any Royalty and Production Taxes that would be payable on such notional market value.
>
> *[The clause went on to define "Actual Market Value", essentially as the "free into pipeline" price at the refinery or tankship, subject to a "floor" of the lowest spot price for comparable oil]*
>
> 5.4.2 The Royalty Payments contemplated in clause 5.4.1 shall only be made in respect of any Quarter where A is greater than B.

The 1986 Novation Agreement

20. Clause 8 of the SPA provided that on Completion, "Sulpetro and BP shall enter into the novation agreements set out in Appendix G". Included in those agreements was an "Offshore Illustrative Agreement Novation", to which BP, Sulpetro and SUKL were to be parties. This agreement referred to the existing Illustrative Agreement entered into between Sulpetro and SUKL on 19 November 1982 "to clarify and formalise the relationship between Sulpetro (U.K.) and Sulpetro with reference to Sulpetro (U.K.)'s obligations under a Petroleum Production Licence in respect of Block Nos 21/1 and 21/6 of the United Kingdom Continental Shelf." It expressed the desire of the parties to "novate the Illustrative Agreement to take account of the Sale and Purchase Agreement". The operative provisions were as follows:

> 1. With effect from the date hereof BP shall become a party to the Illustrative Agreement, Sulpetro shall cease to be a party and the Illustrative Agreement shall be read accordingly.
>
> 2. BP agrees that it will faithfully perform and discharge all obligations and liabilities under the Illustrative Agreement arising after the Effective Date (as defined in the Sale and Purchase Agreement).

> 3. The parties other than BP agree that in consideration of BP accepting the obligations and liabilities referred to in Clause 2 Sulpetro shall be released from the same.

The 1999 Novation Agreement

21. After the sale from BP to Talisman referred to at paragraph [12] of the statement of agreed facts took place, an "Assignment and Novation Agreement" was entered into on 5 May 1999. The parties to it were BP, Talisman and the Bank. After reciting (inter alia) that the Bank (defined as "the Third Party") "wishes to make the Assignee *[Talisman]* a party to the Said Agreement *[defined as the SPA "as supplemented, amended, assigned and novated from time to time"]* in the place of the Assignor *[BP]* in respect of the Assigned Interest" (defined as "all the Assignor's continuing rights, obligations, title, interest and estate in and under Article 5.4 of the Said Agreement"), this agreement provided as follows:

> 1. The Assignor hereby assigns, transfers and conveys the Assigned Interest unto the Assignee, effective as of and from 1 July 1996 the "Effective Date", to hold the same unto the Assignee for its sole use and benefit.
>
> 2. The Assignee hereby accepts the within assignment, transfer and conveyance of the Assigned Interest and covenants and agrees that, effective as of the Effective Date, it shall and will at all times be bound by, observe, perform and fulfil each and every covenant, agreement, term, condition and stipulation in the Said Agreement with respect to the Assigned Interest as if the Assignee had been originally named as a party to the Said Agreement.
>
> 3. The Assignee expressly acknowledges that, effective as of the Effective Date and thereafter until a fully executed copy of this Assignment and Novation Agreement is delivered to the Third Party, in all matters relating to the Assigned Interest, the Assignor has been acting as a trustee for and duly authorised agent for the Assignee, and the Assignee does hereby expressly ratify, adopt and confirm all acts and omissions of the Assignor in its capacity as trustee and agent, to the end that all such acts and omissions shall be construed as having been made or done by the Assignee.
>
> 4. The Third Party by its execution hereof does hereby consent to the within assignment, transfer and conveyance and accepts the Assignee as a party to the Said Agreement with respect to the Assigned Interest and does hereby covenant and agree that the Assignee shall be entitled, effective as of the Effective Date, to hold and enforce all the rights and privileges of the Assignor, and the Said Agreement shall continue in full force and effect with the Assignee substituted as a party thereto in the place and stead of the Assignor with respect to the Assigned Interest.
>
> 5. The Third Party by its execution hereof does hereby, effective as of the Effective Date, wholly release and discharge the Assignor from the observance and performance of its covenants and agreements in the Said Agreement with respect to the Assigned Interest to the same extent as if the Said Agreement had been wholly terminated with respect to the Assigned Interest by the mutual agreement of the Third Party and the Assignor; PROVIDED THAT nothing herein contained shall be construed as a release of the Assignor from any obligation or liability which accrued prior to the Effective Date under the Said Agreement.

ISSUE 1 – DOES THE UK/CANADA DTA AFFORD TAXING RIGHTS TO THE UK IN RESPECT OF THE PAYMENTS?

Introduction

22. Article 6 of the UK/Canada Double Taxation Convention of 8 September 1978 (which was implemented in UK law by the Double Taxation Relief (Taxes on Income) (Canada) Order 1980) and which came into force on 18 December 1980[10]) ("the Treaty") provided as follows:

> **ARTICLE 6**
>
> **Income from Immovable Property**
>
> 1. Income from immovable property, including income from agriculture or forestry, may be taxed in the Contracting State in which such property is situated.
>
> 2. For the purposes of this Convention, the term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.
>
> 3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property and to profits from the alienation of such property.
>
> 4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of professional services.

23. Articles 13(1) & (4) of the Treaty (under the heading "Capital Gains") provided as follows:

> 1. Gains derived by a resident of a Contracting State from the alienation of immovable property situated in the other Contracting State may be taxed in that other State.
>
> …
>
> 4. Gains from the alienation of:
>
> (a) any right, licence or privilege to explore for, drill for, or take petroleum, natural gas or other related hydrocarbons situated in a Contracting State, or
>
> (b) any right to assets to be produced in a Contracting State by the activities referred to in sub-paragraph (a) above or to interests in or to the benefit of such assets situated in a Contracting State,
>
> may be taxed in that State.

Arguments

Introduction

24. The parties are agreed that the central issue is whether the Payments received by the Bank amounted to income from "rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources" for the

[10] The Treaty has effect in respect of UK corporation tax for any financial year beginning on or after 1 April 1976.

purposes of Article 6(2) of the Treaty. Mr Peacock argued that they did not, broadly giving five reasons, as follows:

(1) properly construed, Article 6(2) is concerned with a grant, not a transfer of a right to work the relevant natural resources;

(2) to fall within Article 6(2), the Payments would have had to be made in consideration for that grant of the right to work;

(3) Article 6(2) contemplates a transaction in which a right to work natural resources is exchanged for a right to payments, and neither Sulpetro nor BP ever held the right to work the Buchan field;

(4) the royalty interest in the present case should properly be regarded as an earn-out right attributable to the sale of the whole of the business transferred rather than as a payment for the right to work the Buchan field; and

(5) even if that were wrong and the royalty interest were properly attributable to the right to work the Buchan field under the Illustrative Agreement and the transfer of that right was enough to come within Article 6(2), the royalty interest must be regarded not as being consideration for the right to work the oil, but as consideration for the novation of the Illustrative Agreement.

25. It is common ground that the Treaty was to be interpreted in accordance with Articles 31 and 32 of the 1969 Vienna Convention on the Law of Treaties ("the Vienna Convention"), which provide as follows:

> **Article 31. GENERAL RULE OF INTERPRETATION**
>
> 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
>
> 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
>
> (a) Any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
>
> (b) Any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
>
> 3. There shall be taken into account, together with the context:
>
> (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
>
> (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
>
> (c) Any relevant rules of international law applicable in the relations between the parties.
>
> 4. A special meaning shall be given to a term if it is established that the parties so intended.
>
> **Article 32. SUPPLEMENTARY MEANS OF INTERPRETATION**
>
> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) Leaves the meaning ambiguous or obscure; or

(b) Leads to a result which is manifestly absurd or unreasonable.

26. In *IRC v Commerzbank AG & Banco Do Brasil SA* [1990] STC 285 Mummery J summarised at 297-298 the approach to the interpretation of international treaties set out by the House of Lords in *Fothergill v Monarch Airlines Limited* [1981] AC 251 (HL) as follows:

> (1) It is necessary to look first for a clear meaning of the words used in the relevant article of the convention, bearing in mind that 'consideration of the purpose of an enactment is always a legitimate part of the process of interpretation': per Lord Wilberforce (at 272) and Lord Scarman (at 294). A strictly literal approach to interpretation is not appropriate in construing legislation which gives effect to or incorporates an international treaty: per Lord Fraser (at 285) and Lord Scarman (at 290). A literal interpretation may be obviously inconsistent with the purposes of the particular article or of the treaty as a whole. If the provisions of a particular article are ambiguous, it may be possible to resolve that ambiguity by giving a purposive construction to the convention looking at it as a whole by reference to its language as set out in the relevant United Kingdom legislative instrument: per Lord Diplock (at 279).
>
> (2) The process of interpretation should take account of the fact that—
>
> > 'The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament which deals with purely domestic law. It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co. Ltd v. Babco Forwarding & Shipping (UK) Limited*, [[1978] AC 141 at 152], "unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptation': per Lord Diplock (at 281–282) and Lord Scarman (at 293).
>
> (3) Among those principles is the general principle of international law, now embodied in art 31(1) of the Vienna Convention on the Law of Treaties, that 'a treaty should be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'. A similar principle is expressed in slightly different terms in McNair's *The Law of Treaties* (1961) p 365, where it is stated that the task of applying or construing or interpreting a treaty is 'the duty of giving effect to the expressed intention of the parties, that is, their intention as expressed in the words used by them in the light of the surrounding circumstances'. It is also stated in that work (p 366) that references to the primary necessity of giving effect to 'the plain terms' of a treaty or construing words according to their 'general and ordinary meaning' or their 'natural signification' are to be a starting point or prima facie guide and 'cannot be allowed to obstruct the essential quest in the application of treaties, namely the search for the real intention of the contracting parties in using the language employed by them'.
>
> (4) If the adoption of this approach to the article leaves the meaning of the relevant provision unclear or ambiguous or leads to a result which is manifestly absurd or unreasonable recourse may be had to 'supplementary means of interpretation' including travaux préparatoires: per Lord Diplock (at 282) referring to art 32 of the Vienna Convention, which came into force after the conclusion of this double taxation convention, but codified an already

existing principle of public international law. See also Lord Fraser (at 287) and Lord Scarman (at 294).

> (5) Subsequent commentaries on a convention or treaty have persuasive value only, depending on the cogency of their reasoning. Similarly, decisions of foreign courts on the interpretation of a convention or treaty text depend for their authority on the reputation and status of the court in question: per Lord Diplock (at 283–284) and per Lord Scarman (at 295).
>
> (6) Aids to the interpretation of a treaty such as travaux préparatoires, international case law and the writings of jurists are not a substitute for study of the terms of the convention. Their use is discretionary, not mandatory, depending, for example, on the relevance of such material and the weight to be attached to it: per Lord Scarman (at 294).

27. The effect of Articles 31 and 32 was also summarised by Lord Reed in *Anson v HMRC* [2015] STC 1777 at [56], as follows:

> Put shortly, the aim of interpretation of a treaty is therefore to establish, by objective and rational means, the common intention which can be ascribed to the parties. That intention is ascertained by considering the ordinary meaning of the terms of the treaty in their context and in the light of the treaty's object and purpose. Subsequent agreement as to the interpretation of the treaty, and subsequent practice which establishes agreement between the parties, are also to be taken into account, together with any relevant rules of international law which apply in the relations between the parties. Recourse may also be had to a broader range of references in order to confirm the meaning arrived at on that approach, or if that approach leaves the meaning ambiguous or obscure, or leads to a result which is manifestly absurd or unreasonable.

28. Also, it was not disputed that the Treaty was authenticated in both English and French, and accordingly Art 33 of Vienna Convention also applied to its interpretation. Article 33 reads as follows:

> **Article 33. INTERPRETATION OF TREATIES AUTHENTICATED IN TWO OR MORE LANGUAGES**
>
> 1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.
>
> 2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.
>
> 3. The terms of the treaty are presumed to have the same meaning in each authentic text.
>
> 4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

29. The French text of Article 6(2) of the Treaty reads as follows:

> Au sens de la présente Convention, l'expression "biens immobiliers" est définie conformément au droit de l'État contractant où les biens considérés sont situés. L'expression englobe en tous cas les accessoires, le cheptel mort ou vif des exploitations agricoles et forestières, les droits auxquels s'appliquent les dispositions du droit privé concernant la propriété foncière,

> l'usufruit des biens immobiliers et les droits à des redevances variables ou fixes pour l'exploitation ou la concession de l'exploitation de gisements minéraux, sources et autres richesses du sol; les navires, bateaux et aéronefs ne sont pas considérés comme biens immobiliers.

30. Paragraph 4 of the OECD Commentary on Article 6 of its Model Convention (which is in materially similar terms to the Treaty) reads as follows:

> It should be noted in this connection that the right to tax of the State of source has priority over the right to tax of the other State and applies also where, in the case of an enterprise, income is only indirectly derived from immovable property.

31. Against that background, Mr Peacock developed his five arguments mentioned at [24] above, and Mr Bremner responded to them as follows.

(1) Article 6(2) is concerned with a grant, not a transfer, of a right to work

32. Mr Peacock argued that this was the "natural reading" of Article 6(2), and also consistent with its purpose of linking any payments for the grant of a right to work resources to the state in which those resources were located. Further support to his argument was given, he argued, by three other sources.

33. First, he submitted that the word "*concession*" in the French text of Article 6(2) of the Treaty (equally authoritative as the English text) made it clear that the concept of "grant" was intended:

> "…les droits à des redevances variables ou fixes pour l'exploitation ou la concession de l'exploitation de gisements minéraux, sources et autre richesses du sol"

34. Mr Bremner responded by citing the guidance given by the FTT in *Volkswagen Financial Services (UK) Ltd v HMRC* [2011] UKFTT 556 (TC) at [60] (which was not disapproved of on appeal):

> Reliance on foreign language texts of decisions of the Court of Justice poses evidential problems for a UK tribunal. Even if the tribunal has knowledge of the language in question, such knowledge is unlikely to be sufficient to appreciate the nuances of language that are likely to be present. A straight word-by-word translation is not adequate. Where reliance is placed on a foreign language version in an attempt to elucidate, or even contradict, the ordinary meaning of the English language text, the tribunal must be given expert evidence to support any such submission. Absent such evidence, no reliance can be placed on the foreign language text.

35. In response, Mr Peacock referred to the observations of Lords Wilberforce, Fraser of Tullybelton, Scarman and Roskill in the House of Lords in *Fothergill v Monarch Airlines Limited* [1981] A.C 251 at 273-4, 286E, 293G and 300A, which clearly contradict any suggestion that there is an invariable rule that expert evidence is always required in support of an assertion that a foreign language text has a particular meaning by way of elucidation or contradiction of an English language text.

36. Mr Bremner also took issue with Mr Peacock's interpretation, arguing that the French word "*concession*" was equally apt to refer to a transfer rather than a grant of a right to work natural resources, citing various other (bilingual) Canadian legislation. In any event, he also pointed out that (as Mr Peacock had argued) the English and French texts of the Treaty were equally authoritative (see Article 33(1) of the Vienna Convention) and there was no basis for inferring a narrower meaning of the English wording by reference to a supposedly correct broader translation of the French wording. He also pointed out that Article 6(2) applied not

only where the payments were in exchange for "the right to work" natural resources, but also where they were consideration for the "working" of them. Mr Peacock's interpretation of the wording did not, he argued, sit easily with this point.

37. Mr Peacock's second argument under this head was by reference to Article 13(4) of the Treaty, dealing with capital gains. This Article is set out at [23] above.

38. Mr Peacock submitted that because Article 13(1) already provided that "gains derived by a resident of a Contracting State from the alienation of immovable property situated in the other Contracting State may be taxed in that other State", Article 13(4) would be "otiose" if the rights referred to in it were in fact already included in the scope of "immovable property" by reason of Article 6(2), as HMRC maintain. Mr Bremner argued that the specific rule in Article 13(4) merely made express provision for capital gains purposes of the rights referred to in it, removing any doubt as to their correct treatment, and made no attempt to override the definition of "immovable property" in Article 6(2), nor was there any principled basis upon which it could be said to do so.

39. Finally, Mr Peacock made reference to equivalent provisions in the UK/USA double tax treaty and certain comments made on it by way of commentary by the US Treasury Department in its Technical Explanation of it. This was admissible as an aid to interpretation, he said, by reference to comments made by the Federal Court of Australia in *Federal Commissioner of Taxation v Lamesa Holdings BV* (1997/98) 1 Offshore Financial Law Reports 380 at 389-90:

> "… where the construction of an international treaty arises, evidence as to the interpretation of that or subsequent treaties in one of the participating countries forms part of a matrix of material to which reference could properly be made in an appropriate case. As presently advised we would not wish it to be thought that a limited view of the material to which reference could be made in interpreting a double tax treaty should be taken. Had there been some decision of an appropriate Dutch court interpreting a treaty with identical or similar language then, in our view, evidence of such a decision might well have been admissible."

40. He argued that the US Treasury Explanation on the Article in the UK/US treaty equivalent to Article 13(4) in the Treaty made it clear that it was the US Treasury view that without the specific provision of that Article, exploration and exploitation licences would not be included within the term "immovable property", thereby confirming that rights of the type in issue in the present case do not fall to be treated as "immovable property" under the Treaty.

41. Mr Bremner argued that consideration of a non-judicial pronouncement on the effect of an entirely different treaty (which differed in some important respects from the Treaty) was simply irrelevant, but would not support Mr Peacock's argument even if it were taken into account.

(2) The payments themselves must be made in consideration of the grant of the right to work

42. Mr Peacock argued this was the "natural, and logical, interpretation of Article 6(2)". It was only when the "origin of the payments" was "in exchange for the right to work" that they became immovable property under Article 6(2). Subsequent dealings with the right to receive those payments were a separate matter. For payments to derive "from" a right to work natural resources, they must represent payment <u>for</u> the right to work them, not "payments that merely happen to be calculated by reference to" the resources. He sought to draw a distinction between the payments themselves and the right to the payments – if a right to a payment given in exchange for a right to work fell within Article 6(2), then "the purpose of the provision would be frustrated as the characterisation of the payments would become divorced from the reason that they are given". He gave an example of "A", a holder of "a music licence which gives rise

to payments made to A by those who play his music. B owns a quarry. A transfers his rights under the music licence (i.e. to receive the payments), and in return is granted a right to work the quarry. Under HMRC's analysis, those payments to B made under the music licence would be recharacterized as income from '*a right to… payments as consideration for… the right to work'* the quarry. This despite the fact that those making the payments do so without reference to the natural resources of the quarry." This he described as "an absurd conclusion".

43. In the present case, the Payments cannot have been made to the Bank for a right to work the Buchan field, as that right was never vested in Sulpetro or the Bank (the relevant licence was held by SUKL). Mr Peacock likened the royalty entitlement to the separate chose in action referred to in *Marren v Ingles* [1980] STC 600, effectively in his submission divorcing it from the "right to work" the Buchan field.

44. Mr Bremner responded by arguing that the Payments were in "origin" (a word used by Mr Peacock in his submissions) payments in exchange for the "right to work" the Buchan field, and the subsequent assignment of the right to receive those payments did not change that ultimate origin; there remained a "clear and direct reciprocal relationship between the Payments and the right to work the oil in Buchan" and this clearly fell within the intended scope of Article 6(2).

(3) Neither the Bank nor Sulpetro were ever in a position to transfer a right to work

45. On a close analysis of the contractual arrangements, Mr Peacock submitted that neither the Bank nor Sulpetro ever held an interest which amounted to a right to work the Buchan field; accordingly the required element of direct linkage between the transfer of the right and the obligation to make the variable payments "as consideration for" such right was absent.

46. Sulpetro never owned the UK licence to exploit the Buchan field, nor did it have the right to work it. Its entitlement was under the Illustrative Agreement with SUKL, whereby it provided the finance for the exploitation of the oilfield and was contractually entitled to the oil extracted. When the business was sold to BP (including the shares in SUKL), the Illustrative Agreement was novated to BP, SUKL remaining the holder of the licence. In short, Sulpetro never worked (or had any right to work) the Buchan field, nor did it own it. The Payments it received could not, therefore, be consideration for the right to work it; accordingly the right to the Payments could not have fallen within Article 6(2).

47. So far as the Bank was concerned, it was merely a lender realising its security. It had never exploited the Buchan field or held rights in or over it. Therefore any payments it received could not be treated as made for the right to work the Buchan field so again the right to receive such payments could not fall within Article 6(2).

48. Mr Peacock repeated the points he had made earlier about Article 13(4), and also referred to the content of (and US Treasury Guidance on) the UK/USA double tax treaty as providing material in support of his argument that Article 6(2) was simply not intended to cover situations such as the present.

49. Mr Bremner countered that the clear purpose of the SPA between Sulpetro and BP was to transfer to BP the right to work the Buchan field, and as part of the transaction BP agreed to make the Payments. It was wholly unrealistic to say that because the licence was legally vested in SUKL no right to work the field was passed to BP under the SPA.

(4) The royalty interest is an earn-out right attributable to the entirety of Sulpetro's interest in the business

50. Mr Peacock argued that the true character of the Payments set out in the SPA was as an "earn-out right attributable to the totality of Sulpetro's interest in the business of exploiting the Buchan oilfield." As such, in the absence of any specific attribution made in the SPA, it should

properly be attributed either to the other assets sold under that agreement or to the goodwill of the business so sold.

51. Mr Bremner argued that this missed the point. Whatever other description might be ascribed to the Payments, the fact remined that they fell within the description set out in Article 6(2). In any event, even if it were appropriate to attempt to allocate the Payments to a particular asset or assets under the SPA, the most obvious candidate for such allocation was Sulpetro's rights under the Illustrative Agreement, which effectively made it the beneficial owner of the licence interests – the only assets which had the capacity to prove more valuable in the future than could be demonstrated at the time of sale.

(5) Effect of the novation

52. Mr Peacock argued that the creation of the entitlement to the Payments ought properly to be regarded not as creation of a right to payment "as consideration for the right to work" the Buchan field, but quite simply as consideration for BP's agreement to enter into the Novation Agreement whereby the Illustrative Agreement between Sulpetro and SUKL was replaced by a new Illustrative Agreement in the same terms between BP and SUKL. Whilst he did not say so, presumably he could also be taken to be arguing that a similar analysis applied in relation to the 1999 novation (when Talisman assumed BP's obligation to make the Payments) under which the Payments the subject of this appeal actually arose.

53. Mr Bremner argued this approach was misconceived. It was clear, in his submission, that the right to the Payments was given by BP not only in return for Sulpetro entering into the Novation Agreement, but also for the transfer to it of the right to work the Buchan oil field (which was the very purpose of the SPA and the agreements entered into pursuant to it, including the Novation Agreement). He also pointed out that Mr Peacock's argument also effectively admitted that the entry into of the Novation Agreement amounted to the <u>grant</u> of a new "right to work" to BP, to the extent that the concept of a grant was relevant at all.

Discussion of Arguments

Argument (1)

54. Given that the purpose of the provision in the Treaty is clearly to focus on profit derived from the exploration for or exploitation of mineral resources, whether that profit is derived directly by working the resources or indirectly by letting out the right to do so, I see no reason for limiting the scope of Art 6(2) to cover only payments which are made directly to the owner of the rights in exchange for the grant of a right to exploit them. The apparent purpose of granting taxing rights on profits from natural resources to the state where the resources are situated would otherwise potentially be capable of avoidance by simply granting a licence to work those resources at a price equal to the cost of the works, then the grantee assigning that right to a third party in exchange for payment of substantial royalties. The focus must be on the ultimate source of the profit and it would be irrational and inconsistent with the apparent purpose of the provision if it were possible to avoid local taxation on that profit simply by interposing an assignment of the royalty rights (possibly even to an associated company resident in a low tax jurisdiction) after they had been granted.

55. The obvious purpose of Article 6(2) would be so prejudiced if Mr Peacock's argument were correct that I must therefore reject it notwithstanding his various ingenious attempts to bolster it, all of which I consider must fail for the reasons argued by Mr Bremner. The only exception to this is the dispute about the necessity for expert evidence in support of any proposed interpretation of the French language text, where I agree with Mr Peacock; but this takes the matter no further as I do not consider the use of the French word "*concession*" in the French language version of the Treaty can, in the overall context, bear the weight which Mr Peacock seeks to place on it.

Argument (2)

56. This is very closely tied in with Mr Peacock's first argument, to the point where a rejection of his first argument necessitates a rejection of this argument also. If it is accepted (as I do) that the focus of Article 6(2) is not (as Mr Peacock argues) entirely on payments for the grant of the right to work the resources but may also extend to payments for subsequent dealings with that right, the assumption upon which this argument appears to be predicated falls away.

57. Even if this point is disregarded, I do not find Mr Peacock's exploration of the difference between "payments" and "rights to payments" helpful or informative. If one has an entitlement to a series of payments (as licensor of music rights or for any other reason) and one assigns that entitlement as consideration for the grant of quarry exploitation rights in the UK, I do not regard it as an "absurd" conclusion that the payments are regarded as "consideration for the right to work" the quarry, so that those payments would fall within the UK's taxing rights under Article 6(2); the fact that the person paying for the music rights might have no interest in the workings of the quarry, and indeed might not even be aware of its existence, is neither here nor there.

58. For these reasons, I reject Mr Peacock's second argument.

Argument (3)

59. The question under the Treaty is whether the rights vested in the Bank which gave rise to the Payments to it are "rights to variable… payments as consideration for… the right to work" the Buchan field. It is quite clear that on any realistic analysis, the royalty payment rights were originally created as part of the contractual arrangements under which the right to work the Buchan field (including the ownership of all oil won from it) was granted to BP by Sulpetro, and as part of the consideration for that right. Talisman then assumed the obligation to make the Payments as part of the contractual arrangements under which it obtained the right to work the Buchan field (and ownership of the oil won from it), but it is not possible in realistic terms to analyse the payments made by Talisman as being anything other than part payment for the assignment to it of the right to work the Buchan field, irrespective of how the original right to work the field arose.

60. I therefore reject Mr Peacock's third argument.

Argument (4)

61. The only relevant question before the Tribunal is whether the Payments (or the Bank's entitlement to them) fell within the wording of Article 6(2). In that context, I do not consider it assists to attempt to analyse and categorise them in a way which is simply not relevant to answering the question before the Tribunal. The assumption underlying Mr Peacock's argument is that if it is accepted that the Payments (or the Bank's entitlement to them) can be regarded as being in the nature of an earn-out attributable to the whole of the business transferred, then *a fortiori* they must fall outwith the scope of Article 6(2). I do not consider that assumption to be correct. Nor do I accept the premise of his argument: the fact that Sulpetro originally obtained a *chose in action* (the contingent entitlement to future royalty payments) as part of the consideration for the sale of its business and assets does not lead inescapably to the conclusion that there was some kind of earn-out arrangement; it can equally (or more) validly be regarded as a simple profit-sharing arrangement in respect of the future operations in the Buchan field, something which would on the face of it fall much more clearly within the apparent scope of Article 6(2). Be that as it may, in assessing the rights held by the Bank against the wording of Article 6(2), it is clear to me that those rights fall within the scope of that Article because the payments were made by BP and subsequently Talisman as part of the consideration given by them respectively for the right to work the Buchan field.

62. I therefore reject Mr Peacock's fourth argument.

Argument (5)

63. This is really nothing more than a variation of Mr Peacock's argument (4). He seeks to characterise the royalty interest as having been conferred by Sulpetro not as part of the consideration for the right conferred on BP to work the Buchan field, but as consideration for its agreement to terminate the existing Illustrative Agreement with SUKL, so enabling BP to enter into the novated Illustrative Agreement with it. This overly narrow focus on the legal mechanism by which the overall objective (of transferring the "right to work" the Buchan field to BP) was achieved ignores altogether the correct approach to interpreting Article 6(2), namely to discern the intention to be ascribed to the contracting parties by considering the ordinary meaning of that Article in context and in the light of the Treaty's object and purpose.

64. I therefore reject Mr Peacock's fifth argument.

Conclusion on Issue 1

65. The Payments fell due as part of the consideration given by BP (and subsequently Talisman) for the right to work the Buchan field. The oil actually won under the licence held by SUKL all became the property of BP (and subsequently Talisman) as a result of their agreeing to make the Payments. I do not consider the intricacies of the actual licensing arrangements affect this, or the natural conclusion that the royalty rights as originally created under the SPA between Sulpetro and BP (and subsequently novated so as to arise between Sulpetro and Talisman) were "rights to variable payments as consideration for the right to work mineral deposits" for the purposes of Article 6(2). The only question then is whether the assignment of the right to receive those payments from Sulpetro to the Bank, whether before or as a result of the assignment approved by the Court Order made in Sulpetro's receivership in October 1993, affects this analysis. I do not consider that it does, on the simple basis that the fundamental nature of the payment rights (as consideration for the right to work the Buchan field) remains unaffected by the identity of the holder of the rights or the history of how the rights came to be vested in it.

66. It follows that I consider the taxing rights over the Payments are allocated to the UK under Article 6(2) of the Treaty.

ISSUE 2 – ARE THE PAYMENTS SUBJECT TO TAX IN THE HANDS OF THE BANK UNDER DOMESTIC UK LEGISLATION?

Introduction

67. Having decided that the UK has taxing rights in respect of the Payments, the next question is whether it has exercised those rights by virtue of the relevant legislation.

68. S 1313 Corporation Tax Act 2009 ("CTA09") provides:

> (1) Any profits –
>
> (a) from exploration or exploitation activities carried on in the UK sector of the continental shelf, or
>
> (b) from exploration or exploitation rights,
>
> are treated for corporation tax purposes as profits from activities or property in the United Kingdom.
>
> (2) Any profits arising to a non-UK resident company –
>
> (a) from exploration or exploitation activities, or
>
> (b) from exploration or exploitation rights,

> are treated for corporation tax purposes as profits of a trade carried on by the company in the United Kingdom through a permanent establishment in the United Kingdom.
>
> (3) In this section –
>
> "exploration or exploitation activities" means activities carried on in connection with the exploration or exploitation of so much of the seabed and subsoil and their natural resources as is situated in the United Kingdom or the UK sector of the continental shelf,
>
> "exploration or exploitation rights" means rights to assets to be produced by exploration or exploitation activities or to interests in or to the benefit of such assets, and
>
> "the UK sector of the continental shelf" means the areas designated by Order in Council under section 1(7) of the Continental Shelf Act 1964 (c 29).

69. The parties are agreed that the predecessor wording (s 830 Income & Corporation Taxes Act 1988 and s 153(2) Finance Act 2003) (which applies in respect of the earlier years under dispute) are to the same effect.

70. As mentioned at paragraph [4] of the statement of agreed facts set out at [8] above, it is common ground that the Buchan Field forms part of the UK sector of the continental shelf.

Arguments in outline

71. In their statement of case, HMRC had argued that the payments received by the Bank were "profits arising from the exploitation by the Appellant (a non-UK resident company) of rights in the UK sector of the continental shelf". They accordingly submitted that liability arose under s 1313(2)(b) CTA09. In their skeleton argument submitted shortly before the hearing, they shifted their position, arguing that the payments fell primarily within s 1313(2)(a) as profits arising from exploration or exploitation activities, and only fell within s 1313(2)(b) ("profits arising from exploration or exploitation rights") in the alternative. Mr Peacock did not raise any objection to this late change of position and engaged without significant complaint with the new case put forward by HMRC. To the extent necessary, I therefore treated HMRC's statement of case as amended to plead the additional basis of liability.

72. Mr Bremner's argument for liability arising under s 1313(2)(a) CTA09 in respect of exploration or exploitation activities was that the Payments arose "because of the exploration or exploitation activities in the Buchan field. The Payments became due as a result of the exploitation (first by BP and now by Talisman) of the oil in the Buchan field. They are therefore '*profits arising to a non-UK resident company [i.e. RBC] from exploration or exploitation activities*'. There is no requirement… that it is RBC which carries on the exploration or exploitation activities which give rise to the profits."

73. In the alternative, he argued that the payments received by the Bank were from "rights to interests in or to the benefit of" the oil won from the Buchan field by BP/Talisman; the Bank had a "substantial commercial interest in that oil"; accordingly those payments amounted to profits from exploration or exploitation rights falling within s 1313(2)(b) CTA09.

74. As to s 1313(2)(a) CTA09, Mr Peacock's argument was that the payments do not represent profits *from* exploration or exploitation rights; instead they represented receipts of the Bank's banking trade. He likened HMRC's argument to saying that if a barrister paid a taxi driver to take him or her to court, the taxi driver was receiving a payment which represented a profit from the advocacy profession carried on by counsel. If Talisman failed to pay what was due to the Bank, there would be a contractual claim for the payment, based on the provisions of the SPA; this was very different in nature to the sort of profit contemplated in s

1313(2)(a), which clearly envisaged a situation in which the profits brought into charge were those of the person carrying on the exploration or exploitation activities – and here, it could not be said that the Bank was carrying on such activities, even indirectly.

75. As to s 1313(2)(b), Mr Peacock argued that the Bank clearly had no right to the oil produced by BP/Talisman, nor did it have any legal right to an interest in that oil or to the benefit of it; therefore it clearly had no "exploration or exploitation rights" as defined in s 1313(3). All it had was a contingent entitlement to payment of a sum of money computed by reference to the value of the oil actually won.

76. If he was wrong in relation to both 1313(2)(a) and (b), then he argued that the cost of acquiring the Payments ought to be taken into account in assessing them for tax. This effectively meant that the lost loan repayments should be deducted from the receipts, otherwise how could the "profit" from its exploration or exploitation activities or rights be properly assessed?

77. Here, Mr Peacock put forward two possible bases upon which credit should be allowed for the amount of the unrepaid loan from which the royalty stream derived.

78. First, he argued that the loan to Sulpetro had effectively created the ring fence trade which the Bank was now deemed to be carrying on; it was common ground that the assignment of the royalty interest to it was in partial repayment of the loan; the loan was the *sine qua non* of the ring fence trade and as such, the losses incurred on it (which predated the loan relationship legislation) should simply be treated as a trading loss under what is now s 304 Corporation Tax Act 2010 ("CTA10") which could be carried forward to set against royalty income in subsequent years.

79. Second, he referred to *Golden Horse Shoe (New) Limited v Thurgood* [1934] KB 548, which was concerned with whether the purchase (as part of an overall business purchase) of a large quantity of gold mine "tailings" bought by the taxpayer company with a view to extracting further gold from it should be regarded as giving rise to a (non-deductible) capital payment or a (deductible) revenue payment. The Court of Appeal held it was the latter and Mr Peacock argued the situation was analogous here, in that the Bank had, he submitted, acquired the royalty stream as stock in trade of its deemed oil exploitation business arising under s 1313(2); accordingly the price it had effectively paid for that stock in trade (the unpaid part of the loan) should be allowed as a deduction in computing the profits of its ring fence trade.

80. In response to this, Mr Bremner argued that first the original loan had no connection with the Bank's actual (banking) permanent establishment in the UK and its deemed permanent establishment under the ring fence provisions was not a "permanent establishment" within the meaning of the Treaty, accordingly there was "no relevant UK permanent establishment to which any trading loss could be attributed". Second, he argued that the Bank's banking trade was clearly not part of any ring fence activities and therefore any loss incurred in that trade could not be set against its ring fence profits pursuant to s 304 CTA10.

Discussion and decision

81. S 1313(2)(a) brings into charge "any profits arising… from exploration or exploitation activities", and this is a separate charge from that arising under s 1313(2)(b), being on "profits arising… from exploration or exploitation rights". It is self-evident that the focus of s 1313(2)(a) is on the profit arising from the activities themselves, whereas the focus of s 1313(2)(b) is on the profit arising from a turning to account of the assets actually produced by the exploration or exploitation activities (or interests in them).

82. In the present case, it is clear that it was Talisman that was conducting the exploitation (and any associated exploration) activities referred to in s 1313(2)(a). Given that the legislation

specifically and separately addresses in s 1313(2)(b) the taxation of rights to (and interests in) the assets which are derived from the exploration and exploitation activities, it is in my view clear that s 1313(2)(a) is intended to apply only where there is some kind of direct link between the putative taxpayer and the exploration or exploitation activities themselves. The most obvious example would be where the putative taxpayer is itself actually carrying on the activities, but I accept that other arrangements might satisfy the test, for example where an agent or subcontractor is used in order to do so. I do not consider however that the connection between the Bank and the exploration and exploitation activities of Talisman in the present case is sufficiently proximate for it to be fairly said that profits from those exploration or exploitation activities have arisen to the Bank. I therefore consider (as HMRC did in their re-amended statement of case and right up to the submission of their skeleton argument shortly before the hearing) that s 1313(2)(a) can have no application to the Bank on the facts of this case.

83. Turning now to s 1313(2)(b), the statutory question to be answered is whether any profits have arisen to the Bank "from rights to assets to be produced by exploration or exploitation activities or to interests in or to the benefit of such assets". This divides up into a number of points:

(1) whether the payments in question, on their own, amount (as HMRC claim) to "profits";

(2) whether those payments arose from rights to "assets to be produced by exploration or exploitation activities", which can fairly be rephrased as "whether the payments arose from rights to the oil to be won from the Buchan field";

(3) whether those payments arose from rights to <u>interests in</u> the oil to be so won; and

(4) whether those payments arose from rights to <u>the benefit of</u> the oil to be so won.

84. With regard to the first point, this is considered further below at [97] et seq.

85. With regard to the second point, Mr Bremner did not argue that they did. I agree with him and consider the point no further.

86. The issue behind the third point is the nature of the Bank's interest, if any, in the oil won from the Buchan field. Clearly in the colloquial sense it had such an interest – if the sale price achieved for the oil exceeded a certain level, then it would expect to receive a share of the excess. Mr Bremner characterised this as a "commercial interest", and sufficient to fall within the legislation. I cannot agree. The statutory question is whether the Bank had "rights to interests in" the oil (contrasted, in the statute, with "rights to" the oil). This implies a more legalistic analysis than Mr Bremner's approach. A "right to an interest" in oil must ultimately refer to some underlying legal interest *in rem* in the oil itself (rather than a more general commercial interest). It is common ground that no such right existed.

87. The issue behind the fourth point is the meaning of the words "the benefit" in this context. Mr Peacock submitted that in requiring the putative taxpayer to have rights to "the benefit" of the oil (rather than "a benefit from, related to or calculated by reference to" the oil), the statute effectively required it to have a direct interest in all the oil produced, not just a right to some variable payment in respect of some of the oil when its price exceeded a certain value.

88. He argued that, in line with the principle enunciated by Megarry J in *Re Euro Hotel (Belgravia) Limited* [1975] STC 682, the nature of a payment is not determined by its method of computation (in that case the question was whether the payments in question really were "interest of money" and it was held that on a true analysis they were not, in spite of being described in the contractual documents as "interest" and being calculated as a percentage of

another sum of money (the bank's total investment in the relevant project)). Here, he submitted, the Bank was entitled to payments the size of which was calculated by reference to the production of oil from the Buchan field and certain other factors; this did not confer "the benefit of" the oil on the Bank. This was reinforced, in his submission, by a close analysis of the wording of the section, as to which he advanced the following three points:

(1) In referring to "the benefit of" the oil, the statute was requiring a right to a direct interest in the oil produced and rights over the profits produced from it. This did not extend to include "a benefit from", "a benefit related to" or a "benefit calculated by reference to" the oil.

(2) The "assets to be produced" which were under consideration (which the Bank must have "the benefit of" in order to trigger liability) must refer to the entirety of the oil, so that the "benefit" referred to could only trigger liability if it related to the whole of the oil produced and not if (as here) it was a sum computed by reference to "some share of the oil from time to time when the price exceeds a certain value".

(3) He also referred to Lord Hoffmann in *MacDonald (Inspector of Taxes) v Dextra Accessories Ltd and others* [2005] UKHL 47 at [18]: "If the terms of the definition are ambiguous, the choice of the term to be defined may throw some light on what they mean", arguing that "were it not for the definition [in s 1313(3)] it would not be suggested that a payment calculated by reference to the production and sale of oil at an oilfield was an 'exploration or exploitation right'. As a result, it would be wrong to stretch the meaning to cover the royalty interest."

89. Mr Bremner argued that *Euro Hotel* was entirely irrelevant, dealing as it did with an entirely different (and much less compendious) concept than "benefit" of the oil concerned. On any view, in his submission, the Bank, as holder of the right to the Payments, had "a substantial commercial interest" in the oil won from Buchan. Also, when the commercial context of the SPA was taken into account, it was clear that the effect of the royalty entitlement was to maintain for Sulpetro "a substantial part of the commercial benefit of the oil rights transferred": on any view a right to the benefit of the oil was (at least in part) retained by Sulpetro under the SPA and then assigned to the Bank.

90. I agree with Mr Bremner that any principle derived from *Euro Hotel* does not assist Mr Peacock; in my view it provides no assistance at all in dealing with the central issue around the interpretation of s 1313(3), simply confirming that the label placed on a transaction by the parties is not determinative of its nature when interpreting legislation that may or may not apply to it.

91. Nor do I accept that the reference to "assets to be produced" in the definition of "exploration or exploitation rights" must be read (as Mr Peacock argues) as referring to the entirety of those assets, so that any rights which extend to less than the totality of the assets under consideration necessarily fall outside the definition. Each and every part of the oil won from Buchan is an asset, and there is no reason, either based on the natural reading of the definition or on the legislative purpose underlying it, to limit its scope only to rights which extend to the totality of the oil won.

92. As to Mr Peacock's *Dextra Accessories* argument, I do not think that assists his case either. Lord Hoffman said (at [18]):

> It is true that, as Charles J pointed out, 'potential emoluments' is a defined expression and a definition may give the words a meaning different from their ordinary meaning. But that does not mean that the choice of words adopted by Parliament must be wholly ignored. If the terms of the definition are

ambiguous, the choice of the term to be defined may throw some light on what they mean.

The House of Lords was dealing with a short definition, "potential emoluments" (defined as meaning "amounts or benefits reserved in the accounts of an employer, or held by an intermediary, with a view to their becoming relevant emoluments"). The most that could be said was that "some light" might be thrown by considering the term defined. In the present case, it is clear that the draftsman intended, by the terms of the definition, to extend the scope of the defined term far beyond any normal meaning of "exploration or exploitation rights" and therefore the illumination provided by a consideration of the defined term itself is faint to the point of being invisible.

93. I also consider it clear that in addressing separately the situation where the putative taxpayer enjoys (i) "interests in" the relevant assets and (ii) "the benefit of" those assets, the draftsman was drawing a clear distinction between the two, and intended the "benefit" limb to cover situations where it could not fairly be said that an actual interest "in" the assets existed. The "benefit of" wording denotes an altogether broader and less legalistic approach to the question.

94. The real heart of the issue in my view is therefore whether the rights enjoyed by the Bank amounted to rights to "the benefit of" the oil to be won from Buchan, in a situation where it could fairly be said that the totality of the benefit of that oil was shared between the Bank and Talisman. The real question is whether, by referring to "the benefit", it was intended to limit the scope of the definition to situations in which the rights in question comprised the totality of the benefit, so that rights (as in the present case) in respect of only part of the benefit of the oil fall outside that scope.

95. When the context and purpose of s 1313 is considered, I do not consider that can have been the intention. It would effectively emasculate the effect of s 1313 in relation to almost any royalty arrangements providing an income stream to an offshore recipient. I do not accept Mr Peacock's brief suggestion that any such effect would be mitigated by other aspects of the tax code such as the updated rent factoring rules in Part 16 CTA10. In the present case, I consider the Bank does, by virtue of the royalty payments from Talisman, have rights to the benefit of the oil won from the Buchan field.

96. It follows that it is liable, through a deemed permanent establishment in the United Kingdom, to corporation tax on the "profits" arising to it from those rights. The question then arises: how should the "profits" be computed in this case?

97. Mr Peacock sought to argue that the losses the Bank had made on its loan to Sulpetro should be regarded as the "real cost" of its acquisition of the royalty interest formally assigned to it by Sulpetro in 1993. That loss was suffered before the loan relationship rules came into force and should therefore be simply accounted for as a trading loss of the new "ring fence royalty trade", available to be carried forward and offset against the royalty income profits of subsequent years. Alternatively, the cost of acquiring the royalty interest should be regarded as the purchase cost of the royalty stream, akin to the purchase of the gold mine "tailings" in *Golden Horse Shoe*; accordingly a deduction ought to be allowed in computing the Bank's profits of its deemed trade.

98. It is clear that the Bank's deemed trade through a UK permanent establishment would have commenced at the time it acquired the "exploitation rights" falling within s 1313(2), i.e. the contingent right to receive the Payments. According to the agreed statement of facts, it did so in the course of realisation by Sulpetro's receivers of its assets in the course of its receivership. Included in the bundle of documents was a legal assignment to the Bank by

Sulpetro dated 28 October 1993 of "all of [Sulpetro's] interest whatsoever in the Royalty[11] and in the Agreement[12] and of all its rights thereunder insofar as they relate to the Royalty." The stated consideration for this assignment was "the Bank crediting Sulpetro's indebtedness to it with the sum of one ($1.00) dollar." This was the formal assignment that was "approved" by the Court of Queen's Bench of Alberta on the same date (28 October 1993). The release of Sulpetro's outstanding debt owed to the Bank was not included as part of the consideration for the assignment, indeed the Payments have been applied towards the satisfaction of that debt in the Bank's books (even though Sulpetro itself has long since been dissolved and the debt has legally ceased to exist). I can see no proper basis for regarding any amount other than the stated figure of $1 as the consideration given by the Bank for the assignment of the royalty interest to it, accordingly if (as the parties have agreed) the Bank acquired its rights by virtue of the October 1993 assignment and not before, I consider the amounts of the Payments received by the Bank to represent pure income profit (except, possibly, to the extent of CAD $1).

99. If there had in fact been an earlier valid assignment to the Bank in 1986 of the right to the royalty payments (see [113] below), the precise terms of that assignment and the consideration given for it are unclear; however there is no evidence of the Bank having given any significant consideration for the assignment and all the circumstances point the other way – to the extent there might have been a valid assignment in 1986, it was most probably required by the Bank by way of security in the context of a forced sale by Sulpetro (already in financial difficulties) of its interest in the Buchan field.

100. Clearly in either case it would be open to the Bank (as it has done) to apply the net proceeds it received from its royalty entitlement in reduction of the bad debt previously recognised in its accounts in respect of the loan to Sulpetro, but that does not mean that the amount of the bad debt should be treated as its cost of acquisition of the royalty rights, and it begs the question of whether there should be a deduction of UK corporation tax before it does so.

101. Even if the situation could be characterised as a purchase by the Bank of the royalty rights, I do not consider the situation here to be analogous to that in *Golden Horse Shoe*. There, the taxpayer had an existing trade of extracting gold from tailings and regarded the tailings as part of its stock in trade in doing so. Here, the Bank has acquired a right to a future contingent royalty, as part of a completely new deemed trade, in exchange for (at most) a nominal payment as part of an attempt to recover what it regarded to be a bad debt of its banking business. The situations could hardly be more different and even if the Bank could show it had given substantial consideration for the acquisition of the royalty rights, I would have regarded the expenditure as being capital rather than revenue in nature under the usual tests. Mr Peacock did not put his case on the basis of some amortised part of the capital cost of acquisition being available as a deduction and therefore I have not considered any such argument.

102. It follows that I consider the Payments to be taxable in full as ring fence profits of a deemed permanent establishment of the Bank in the UK.

103. Standing back and reviewing the situation in the round, it would appear somewhat unexpected at first sight that a bank that was simply doing its best to realise every asset of an insolvent debtor towards making good the loss it had suffered in its banking business with that debtor should find itself suffering corporation tax overseas on a deemed oil exploitation business. However, once one bears in mind the original purpose (both in the Treaty and the

[11] Defined in a Recital to the assignment by reference to the entitlement under clause 5.4 of the SPA, and recited as being "part of the consideration for" the sale of "certain of Sulpetro's assets" pursuant to the SPA.
[12] The SPA.

UK legislation) of subjecting profits derived from natural resources to tax in the state where those resources are situated, the picture appears more logical. The Bank would still be applying its net royalty receipts as income of its Canadian banking business, but those receipts would be reduced by the amount of UK tax properly payable on them.

104. That disposes of the appeal in respect of the years ended 31 October 2012 to 2015 inclusive, but I turn now to the question of the validity of the discovery assessments raised in respect of the years ended 31 October 2008 to 2011 inclusive.

ISSUE 3 – DISCOVERY

Introduction

105. Having decided in principle that the Payments are properly subject to UK corporation tax, the remaining question is whether any of the assessments for the years ended 31 October 2008 to 2011 inclusive ought to be discharged on the basis that HMRC were shut out from issuing them under the relevant provisions.

106. In very broad outline, Mr Bremner submitted that HMRC had made the relevant discovery at some point between August and October 2014 (as regards the 2008, 2009, and 2010 periods) and in October 2014 or 2015 (as regards the 2011 period); all the discoveries were acted on within a reasonable period; at the times the enquiry windows closed for all the periods, HMRC could not have been reasonably expected to be aware of the shortfalls on the basis of the relevant information made available before those times; the 2010 and 2011 assessments were both made within the normal 4 year time limit; and the 2008 and 2009 assessments related to losses of tax brought about carelessly by the Bank and were therefore made within the applicable six year time limit.

107. Mr Peacock, on the other hand, submitted that by reference to some much earlier correspondence (see below), HMRC either reached a conclusion many years previously as to the taxability of the Payments or were in a position to do so on the basis of the information made available to them. In the former eventuality, they could not say they had "newly" discovered an insufficiency of tax in 2014 or later and their assessments were therefore invalid for "staleness"; in the latter eventuality they would be debarred from raising the assessments anyway, because HMRC had sufficient information many years previously to arrive at a conclusion as to the taxability of the Payments. In any event, he argued, it could not be shown that the Bank had acted carelessly in not making a return of the Payments (as their proper tax treatment was so uncertain) and therefore the extended 6 year time limit for making the 2008 and 2009 assessments did not apply, so that those assessments were in any event out of time and therefore invalid. Finally, he argued that even if HMRC could only be said to have made their "discovery" in August to October 2014, that discovery was clearly "stale" by October 2015 so that the 2011 assessment (which was only issued then) was invalid.

108. Both parties agreed that the case law authorities on the equivalent discovery provisions for individual taxpayers in s 29 Taxes Management Act 1970 were generally applicable to the consideration of the companies legislation set out below, which is worded very similarly. Mr Bremner reserved the right to argue at a higher level that some of the authorities binding on this Tribunal (in particular as to the existence of a concept of "staleness") were wrong.

Legislation

109. Paragraphs 41 to 46 of Schedule 18, Finance Act 1998 ("FA98") provide, so far as relevant, as follows:

> **Assessment where loss of tax discovered or determination of amount discovered to be incorrect**
>
> **41 –**

(1) If an officer of Revenue and Customs discovers as regards an accounting period of a company that –

(a) an amount which ought to have been assessed to tax has not been assessed, or

(b) an assessment to tax is or has become insufficient, or

(c) ….

they may make an assessment (a 'discovery assessment') in the amount or further amount which ought in their opinion to be charged in order to make good to the Crown the loss of tax.

…

Restrictions on power to make discovery assessment or determination

42 –

(1) The power to make –

(a) a discovery assessment for an accounting period for which the company has delivered a company tax return, or

(b) …

is only exercisable in the circumstances specified in paragraph 43 or 44 and subject to paragraph 45 below.

…

Loss of tax brought about carelessly or deliberately

43 –

A discovery assessment for an accounting period for which the company has delivered a company tax return, or a discovery determination, may be made if the situation mentioned in paragraph 41(1) or (2) was brought about carelessly or deliberately by –

(a) the company, or

(b) a person acting on behalf of the company, or

(c) a person who was a partner of the company at the relevant time.

Situation not disclosed by return or related documents etc

44 –

(1) A discovery assessment for an accounting period for which the company has delivered a company tax return, or a discovery determination, may be made if at the time when an officer of Revenue and Customs –

(a) ceased to be entitled to give a notice of enquiry into the return, or

(b) in a case where a notice of enquiry into the return was given –

(i) issued a partial closure notice as regards a matter to which the situation mentioned in paragraph 41(1) or (2) relates, or

(ii) if no such partial closure notice was issued, issued a final closure notice,

they could not have been reasonably expected, on the basis of the information made available to them before that time, to be aware of the situation mentioned in paragraph 41(1) or (2).

(2) For this purpose information is regarded as made available to an officer of Revenue and Customs if –

(a) it is contained in a relevant return by the company or in documents accompanying any such return, or

(b) it is contained in a relevant claim made by the company or in any accounts, statements or documents accompanying any such claim, or

(c) it is contained in any documents, accounts or information produced or provided by the company to an officer of Revenue and Customs for the purposes of an enquiry into any such return or claim, or

(d) it is information the existence of which, and the relevance of which as regards the situation mentioned in paragraph 41(1) or (2) –

(i) could reasonably be expected to be inferred by an officer of Revenue and Customs from information falling within paragraphs (a) to (c) above, or

(ii) are notified in writing to an officer of Revenue and Customs by the company or a person acting on its behalf.

(3) In sub-paragraph (2) –

"relevant return" means the company's company tax return for the period in question or either of the two immediately preceding accounting periods, and

"relevant claim" means a claim made by or on behalf of the company as regards the period in question or a application under section 751A of the Taxes Act 1988 made by or on behalf of the company which affects the company's tax return for the period in question.

…

General time limits for assessments

46 –

(1) Subject to any provision of the Taxes Acts allowing a longer period in any particular class of case no assessment may be made more than 4 years after the end of the accounting period to which it relates.

(2) An assessment in a case involving a loss of tax brought about carelessly by the company (or a related person) may be made at any time not more than 6 years after the end of the accounting period to which it relates (subject to sub-paragraph (2A) and to any other provision of the Taxes Acts allowing a longer period).

Facts in relation to Discovery

110. The early history of Sulpetro's involvement in the Buchan field is sketchy. It is not clear precisely when the exploration licence was actually granted to SUKL, and there are indications in the documents that there were initially no formal arrangements in place between SUKL and Sulpetro governing the exploitation of the licence vested in SUKL (the position only being "formalised" by the entry into of the Illustrative Agreement at a later date, probably 1982).

111. By September 1986, however, it is clear that negotiations were already under way for the sale of the Sulpetro group's interests in the Buchan field to BP, Sulpetro already being in financial difficulties by that time. In the context of those discussions, BP wrote to HMRC's Oil Taxation Office on 19 November 1986 seeking guidance on certain aspects of the proposed transaction. In particular, they referred to the proposed royalty payments in favour of Sulpetro,

and observed that "they will, when received, be chargeable to corporation tax in the hands of Sulpetro by virtue of section 38 of the Finance Act 1973[13]. It would be helpful if you could confirm that BP Pet Dev would not be obliged to deduct income tax from any payments made which would arguably represent income taxable under Case VI of Schedule D in the hands of Sulpetro…".

112. HMRC responded to this letter by letter dated 28 November 1986. They confirmed that the royalty payments would be accepted as a deduction in computing BP's Schedule D Case 1 profit, and went on to say this:

> "subject to the proviso (and to the extent) that the question of deduction of tax is a matter for resolution between the parties, the royalty payments in question are not within the provisions of section 53 ICTA 1970 and are thus not payable under deduction of tax by virtue of the current provisions of the Taxes Acts.
>
> It is agreed, following conversations with Mr Thompson of Messrs Freshfields, that the question of Sulpetro's future liability to UK tax on royalties received under clause 5.4 is to be the subject of further discussions in due course."

The letter therefore allayed BP's concerns on the two particular points it had raised, but left open the future tax treatment of the royalties in Sulpetro's hands. Addressing the issue of capital gains, the letter went on to say this:

> It is also agreed that there will be further discussions with Sulpetro and Messrs Freshfields as to the treatment of the value of the right to future royalty payments in the computation on Sulpetro of the chargeable gains arising on the occasion of these disposals. It is the Revenue's view that the value of the right constitutes part of the total disposal proceeds and, in the event of this being the determined manner of computation, I can confirm that the value of the right will be treated as consideration to be allocated to the Buchan and Humbly Grove licence interests.

113. Clearly the Bank was seeking to protect its position in connection with the prospective sale to BP. In a letter dated 19 December 1986 addressed to BP, the Bank gave notice that Sulpetro had executed an Assignment on 28 November 1986 whereby it assigned to the Bank "all monies due under an Assignment of Proceeds Accruing Due, a copy of which is attached". The letter (which was countersigned by way of acknowledgment "for receipt only" by BP on 22 December 1986) stated that the Bank was authorised by the Assignment "to receive certain monies payable to the assignor under clause 5.0 of the Agreement set forth and described in the Assignment", however BP was informed that Sulpetro had been appointed to act as the Bank's "agent and trustee" for the receipt of such payments, so BP was instructed to "continue to send funds directly to [Sulpetro] until further notice is received from the Bank". In my bundle, this letter had none of the stated annexures, however I infer that it would have referred to the draft SPA and I also infer that it had attached to it a document (of which an incomplete one-page copy was separately contained in the bundle) headed "Assignment of Accounts due from Specified Debtors and/or Debts growing due under Specified Contracts" (clearly a standard form of the Bank) which provided that the intended assignor "hereby grants, assigns, transfers and makes over unto THE ROYAL BANK OF CANADA (hereinafter called the "Bank")…all the debts growing due under specified contracts set forth particularly in Schedule "B" appended hereto…"[14]. Thus it would appear that the Bank attempted to secure a direct entitlement to, amongst other things, any royalty payments falling due from BP under the SPA which was subsequently entered into (though whether the documents were successful in

[13] A predecessor provision to s 1313 CTA09.

[14] Schedule B was missing from the copy of the document in the bundle.

achieving this result is not clear, not least because the document, being between a Canadian bank and its Canadian customer, in Canada, was presumably governed by Canadian law. In any event, this uncertainty does not affect this decision).

114. By letter dated 2 December 1986 from Sulpetro to the Bank, its consent was sought for the proposed sale by Sulpetro notwithstanding the Bank's security over the relevant assets. The letter was formally countersigned on behalf of the Bank on 3 December 1986 and a manuscript note on it states that it was "delivered by RBC London to BP at closing Dec 21/86. Executed copy returned to Sulpetro Dec 24/86". I infer that the SPA was signed on 2 December 1986 and formally completed on 22 December 1986 (one of the numerous copies of the SPA in my bundle included marginal notes to the effect that "Closing Date" was 22 December 1986, as did the later letter dated 16 June 1987 from KPMG referred to at [117] below).

115. In March 1987, however, there was a meeting between BP and Sulpetro, following which BP wrote a letter dated 23 March 1987 setting out additional details that had been discussed between them as to the precise method of calculating any royalty payments falling due under the SPA.

116. Sulpetro's financial position was clearly no better, and included in the bundle was a note dated 9 June 1987 by Freshfields setting out their opinion on whether HMRC would have preferential rights to recover Sulpetro's outstanding tax liabilities in the UK and whether any officers of Sulpetro might be personally exposed if those liabilities were not settled. It is not clear to whom this note was addressed, and it does not contain anything specific which casts light on the issues before me, save to show that Sulpetro had outstanding UK tax liabilities at the time.

117. On 16 June 1987, KPMG (acting for Sulpetro) wrote to their client about a number of matters, chiefly what was clearly an outstanding enquiry by HMRC in relation to earlier years. That letter refers to a draft corporation tax computation they had prepared, in which they treated the sale by Sulpetro on 22 December 1986 as a part disposal for chargeable gains purposes, with Sulpetro retaining a residual interest by reason of its prospective royalty entitlement. It noted however that this entitlement had been valued at nil by external consultants based on the market oil price at the time. KPMG noted that in prior correspondence HMRC had "indicated that they did not concur with this treatment. Therefore they will probably argue that there is a full disposal on 22 December, 1986".

118. Clearly the sale by Sulpetro had been something of a forced sale, and Sulpetro was placed into receivership in Canada by order of the Canadian courts made on 17 June 1987.

119. Notwithstanding the receivership, Sulpetro responded by letter dated 6 July 1987 to BP's letter dated 23 March 1987, disagreeing with some of the points set out in BP's earlier letter about the calculation of the royalty payments and inviting them to confirm their agreement. There does not appear to have been any substantive response to this letter.

120. Sulpetro's receivers and managers then stepped into the picture, seeking to maximise the Bank's dividend in the insolvency. Through Canadian lawyers they sought advice from Freshfields on two main areas of concern:

(1) whether the UK authorities could assert claims against Sulpetro ahead of the Bank; and

(2) whether BP would be entitled to recoup itself out of amounts it was liable to pay Sulpetro if BP was required to pay Sulpetro's unpaid liabilities.

121. There were two main potential assets with which they were concerned. First, there was the credit of some £1.8 million of Advance Petroleum Revenue Tax ("APRT") due to Sulpetro

from BP (which would be receiving that credit from HMRC) on 1 March 1988 and second there was the contingent royalty entitlement.

122. Freshfields gave their advice by fax dated 24 September 1987, responding to an approach from the receivers' Canadian lawyers dated 26 August 1987. This advice was generally reassuring about the possibility of HMRC being able to set off the APRT credit against Sulpetro's other tax liabilities, but did not address any of the issues involved in this appeal.

123. In response to Freshfields' advice, on 2 October 1987 the Bank wrote to BP, notifying it of the rescission of Sulpetro's appointment as its agent, and asking for all future payments to be made direct to itself.

124. HMRC ultimately issued a notice of assessment on 22 January 1988 to Sulpetro for outstanding corporation tax of £2,957,000 in respect of the 1986 financial year and clearly turned their attention to means of enforcement of that debt. On 17 March 1988 Sulpetro's inspector at the Oil Taxation Office wrote to the Enforcement Office, requesting advice about the enforcement of the debt. His attention focused on the royalty, which he knew was potentially payable by BP to the Bank, having been assigned to it. Whilst the oil price at the time ($14 per barrel) meant there was no immediate prospect of any royalty payments, projections as to the life of the Buchan field indicated there was a prospect of substantial royalty payments, well in excess of the outstanding corporation tax liability, at some point. It was suggested that the Enforcement Office "may therefore wish to consider the possibility of a lien of some kind on royalty payments." There was no mention of any possibility that the royalty payments themselves might be taxable.

125. On 20 May 1988 the Enforcement Officer responded to the Oil Taxation Office at HMRC. Their considered view was that "there is no way the Revenue can put any kind of lien on the royalties since any payments being made by BP Petroleum Development Ltd are to the Bank rather than Sulpetro Ltd." They went on to say this:

> There is therefore no realistic way of collecting the UK Tax [content redacted] and our interests are best served by ensuring that any further royalty payments are taxed (by whatever Oil Taxation Legislation is appropriate) when sums are remitted to Canada for the Bank's benefit.

126. Sulpetro's inspector then wrote to BP's inspector on 6 October 1988, saying he was now going to put his file away, and that "the only action we can now take to limit the damage is to ensure that any royalty payments made in due course by [BP] are subjected to tax in the hands of the recipients."

127. BP's inspector at the Oil Taxation Office then wrote to BP on 24 November 1988, including the following:

> … I understand there is a potential liability on BP to pay production royalties to Sulpetro – a liability now assigned to the Royal Bank of Canada – if the oil sales proceeds, net of Department of Energy royalty and PRT, should exceed $20 a barrel. Although it seems somewhat unlikely by reference to present oil prices that any royalty will be payable, it is not inconceivable that within the lifetime of these two fields royalties will be due.
>
> In the event that royalties are paid, the Inland Revenue would want to consider carefully any withholding tax provisions that may be applicable at that time. May I ask you therefore to note that should any royalties be due, it would be prudent for BP to seek Revenue approval before making any payments gross. Otherwise tax may be assessable on BP, that might prove difficult for the company to recover from the recipient, if gross payment is made in error.

> As it may be quite a few years – if ever – before this becomes a live issue will you please acknowledge that this letter has been received and the potential need for action noted.

128. BP acknowledged this letter by a letter in reply dated 29 November 1988, stating that "the potential need for action has been noted."

129. Nothing further then happened until the Bank wrote to BP on 11 January 1991, referring to the royalty which was payable to it under the SPA and the assignment from Sulpetro to it dated 28 November 1986; it noted that no statement of account from BP had been received since 23 November 1988, covering the first three quarters of 1988. It went on to observe that since "oil prices in the latter half of 1990 have been considerably in excess of $20.00 US per barrel, it may be that a royalty payment is due under the terms of the Agreement. We would therefore appreciate you providing us with the appropriate statements for 1990 together with a remittance, as required."

130. BP carried out the calculations and established that royalty payments were indeed due. However, mindful of the earlier correspondence with the Oil Taxation Office, they wrote again to them on 15 April 1991, as follows:

> I refer to previous correspondence and in particular to your letter of November 24, 1988 regarding BP's acquisition of the UK licence interests of Sulpetro Limited. As you are aware clause 5.4 of the agreement provides for a royalty to be paid to Sulpetro Limited (subsequently assigned to the Royal Bank of Canada) should the oil sale proceeds, net of the Department of Energy royalty and PRT exceed $20 a barrel.
>
> I would advise you that due to the recent "high" oil prices a production royalty in the region of £860,000 now falls due to be paid to the Royal Bank of Canada, in respect of production for 3Q and 4Q 1990.
>
> As requested, I am now writing to seek your confirmation that no withholding Tax need be deducted before this payment is made and I look forward to hearing from you in this respect.

A "post it" note dated 16 April 1991 appears added to this letter, with the inspector at the Oil Taxation Office sending the letter to a colleague, saying this:

> The point is that if we can get BP to withhold tax we can set it against the arrears at enforcement office.
>
> Would you organise a search for the old papers please.

131. Obviously the inspector obtained the old papers and wrote to BP on 22 April 1991 in response to BP's 15 April 1991 letter. The text of that letter, in full, was as follows:

> Mr MacIver wrote to me on 15 April about a royalty now payable to the Royal Bank of Canada as the result of an assignment of the right to a royalty originally held by Sulpetro.
>
> When I wrote to you on 24 November 1988 I did not have Mr Jasper's letter of 28 November 1986 to hand. I have now found that earlier correspondence and enclose a copy of his letter for ease of reference. You will see that although Mr Jasper said that the question of deduction of tax is a matter for resolution between the parties he did say that the payments were not within Section 53 ICTA 1970.
>
> It seems to me that it may be possible to argue that these payments, when made, are mineral royalties within Section 119 ICTA 1988 and thus payable subject to deduction of tax. If this is a correct view of the payments it would be necessary for me to consider whether the clearance given by Mr Jasper, in

> respect of the payments to Sulpetro, would now apply if the payments are made to the Royal Bank of Canada. It would also be necessary to consider the application of the UK/Canada Double Taxation Agreement.
>
> Mr Jasper's letter left as an open issue the possibility that Sulpetro might be liable to corporation tax on the royalties. The papers make it clear that it was Section 830 ICTA 1988[15] (as it now is) that the parties had in mind. This issue was never resolved. You might like to bear in mind therefore that if BP were to make gross payments there would be a possibility that Paragraph 4 Schedule 15 FA 1973 might apply in the event that the Royal Bank of Canada was liable under section 830 but the tax was not paid. I accept of course that this is an extremely unlikely situation with a body of the Bank's standing.
>
> It might be helpful if you discuss the issue with the Royal Bank of Canada. I would be quite happy to consider any proposal that you or the Bank may make to settle how CT on the royalties should be brought into account.

132. On 3 May 1991 BP wrote to the Bank, confirming that a royalty payment of $1,676,524 was due for 1990 in respect of Buchan. The letter informed the Bank that BP had recently disposed of its interest in Humbly Grove (the other field subject to the SPA) and suggested that the Bank deal direct with the new owners in relation to the royalty payments due on that field. The letter went on to say this:

> One further complication arises. I think you may already have seen a copy of a letter from the UK Oil Taxation Office which, in effect, prevents both we and Treredo *[the new owners of the Humbly Grove field]* from making over any payments to yourselves given the existence of outstanding undetermined claims by the UK Inland Revenue against Sulpetro. I enclose for your information a copy of the Revenue's letter dated 24 November 1988 which confirms that the Revenue may wish to consider any withholding tax provisions which may be applicable. I can confirm that we have written to the Oil Taxation Office asking for guidance in relation to this matter in so far as Buchan is concerned and shall let you know as soon as we receive a reply.
>
> Until we hear further from the Oil Taxation Office, I believe we have taken matters as far as we can. However, if there are any points you wish to raise in connection with this letter, please do not hesitate to be in touch with me.

133. It is not clear whether BP had in fact already received HMRC's letter dated 22 April 1991 (see [131] above) before sending this letter but were simply not saying so. As there is no indication that BP wrote to the Bank again until 29 August 1991, I consider it more likely than not that this was the case and BP were simply seeking to protect their own position by being economical with the information they provided to the Bank. Be that as it may, on 25 June 1991 BP wrote to HMRC again, referring to their 22 April letter, as follows:

> Sulpetro Limited (In Receivership)
>
> I refer to our recent telephone conversation and to your letter of April 22, 1991 regarding the above.
>
> I would advise you that I have suggested that the Royal Bank of Canada should contact you directly with regard to their UK tax exposure on the royalties from the Buchan Field.
>
> I have also proposed that payment of these royalties be deferred meantime until the tax treatment has been agreed.

---

[15] This provision was the immediate predecessor to s 1313 CTA09.

134. On the same day (25 June 1991) a file note was prepared by KPMG Peat Marwick Thorne (who I infer were acting on behalf of the Bank) recording a telephone conversation with Mr Thompson of Freshfields the previous day, who had obviously been contacted by them to discuss the tax position surrounding the royalty payments, following his original involvement on behalf of Sulpetro in the November 1986 discussions on the topic with HMRC. Noting that HMRC had advised the royalties would not be subject to UK withholding tax (subject to any agreement between the parties), Mr Thompson was reported to have commented that "this was an odd position for Inland Revenue to take given that, in the same letter, they confirmed that the payments would be deductible as a trade expense in computing Case 1 income of BP". The conclusion of the note (which had presumably been the purpose of the conversation with Freshfields the previous day) was that "there would appear to be no down side to requesting payment of the royalty from BP, such request to be made without reference to withholding tax. It is fully expected that BP will assess their tax position with Inland Revenue prior to any payment."

135. After a little more reflection, the Bank wrote to BP on 29 July 1991, referring back to the previous letter dated 3 May 1991 from BP. In this letter, it said this:

> We understand your concern that a U.K. withholding tax may (possibly) apply with respect to the royalty payment and that BP may become liable for taxes not withheld. In light of this, we request you to determine the maximum level of withholding tax for which BP could ultimately become liable and remit to us the net amount immediately together with interest thereon. Thereafter, we will assess our position respecting the right to withhold and the quantum of withholding tax, if any, assessed by OTO."

136. BP replied by letter dated 29 August 1991. The text of this letter was as follows:

> Dear Sir,
>
> Thank you for your letter of 29 July 1991. We have spoken again to the Offshore *[sic]* Taxation Office (OTO) in an attempt to accelerate resolution of the withholding tax issue. It was concluded that the Royal Bank of Canada should contact Mr Howard of the OTO directly to determine your tax liability on the Royalty receipts as:
>
> 1. If BP made the royalty payments gross, we could be exposed to a tax charge if any tax thereon was not paid by the bank,
>
> 2. If BP made the royalty payment under deduction of tax, then presumably the Bank would make a claim to the UK Inland Revenue to have part or all of this tax charge repaid and in doing so you would need to agree your tax position before any repayment could be made.
>
> 3. BP are not the Bank's tax agents, nor would we want to be, and therefore cannot negotiate the Bank's UK tax position with the Inland Revenue.
>
> In my letter of 3 May 1991, I attached a copy of a letter from Mr Howard of the OTO. He can be contacted at the address contained in this letter.
>
> Should you have any queries, please do not hesitate to contact the undersigned.

137. On 3 September 1991, the OTO wrote to BP, noting that BP had deferred payment of the royalties "and that I can expect to be contacted directly by the Royal Bank of Canada presumably with their views as to whether the royalties should be paid gross or under deduction of tax. I will therefore write to you again once I have heard from the Royal Bank of Canada."

138. It seems no such contact occurred. On 30 March 1992 the OTO wrote again to BP in response to a telephone call a few days earlier. It seems that the Bank was pressuring BP to

pay the royalties but had not approached HMRC to agree the tax position on them. BP had clearly not paid anything to the Bank in respect of the royalties in the meantime. This letter contained the following text:

> Although the matter is not entirely free from doubt I do consider the appropriate course of action is for me to authorise BP to make the payment of these overriding royalties in full. I am taking this course of action because I think the likelihood is that this would have been the result had discussions with the Royal Bank of Canada taken place. I thank you for your forbearance in this matter and would ask that you do not regard this letter as a precedent in deciding the taxation status of other overriding royalty payments.

139. I infer that BP thereafter made payment as there were no further documents before me until the Court Order of the Court of Queen's Bench of Alberta dated 28 October 1993 which formally discharged the Receiver/Managers of Sulpetro from their obligations and approved the assignment of the royalty interest to the Bank for nominal consideration.

140. It appears that BP disposed of its interest in the Buchan field to Talisman with an effective date of 1 July 1996, though the formal novation of the SPA and obligation to pay the royalties was only executed on 5 May 1999.

141. 14 years later in 2013, HMRC started making enquiries into the tax returns of Talisman (whose name had now changed to Talisman Sinopec Energy UK Limited) and in a letter dated 28 June 2013 they asked for a great deal of information, including the question "There is a royalty payment of [redacted]. Who is this paid to and what for?" Talisman's reply dated 8 October 2013 included reference to a royalty payment of $10,085,000 identified as "Buchan Sulpetro royalty payment", and stated that Talisman had been liable for it since acquiring the relevant interest from BP. It was stated that "In 1988, Sulpetro went into liquidation and The Royal Bank of Canada (RBC) was assigned to manage the debts. Talisman pays the royalty to the Royal Bank of Canada on a quarterly basis. The method for the calculation, provision of a quarterly statement and payment of the Sulpetro Royalty are covered in the original Sale and Purchase Agreement."

142. Clearly a meeting then took place between HMRC and Talisman, followed by a further letter from HMRC to Talisman dated 23 January 2014, which sought confirmation of how and why the royalty payment arose, and why Talisman was treating it as a royalty payment. On 18 April 2014, Talisman wrote back to HMRC, providing a more detailed explanation and copies of the original SPA and the Court Order dated 28 October 1983.

143. The officer dealing with the Talisman enquiry then referred the matter internally with a view to investigating the Bank's position. This was done by email dated 27 June 2014. The referral was given to officer Sophia Thompson, who at that time was the newly-appointed corporation tax specialist assigned to the affairs of the Bank in HMRC's Large Business Banking sector. On 4 July 2014, she was provided by the officer for Talisman with copies of the SPA and the Court Order, together with a note of the information he had gleaned about the royalties from Talisman. This showed that royalties of $10,085,000 had been paid during the period covered by Talisman's 2011 return; no specific corresponding entries could be found in the papers held by HMRC in respect of earlier periods. He sought further information from Talisman and on 6 August 2014 he passed on to officer Thompson a copy of a schedule he had received at some point in the previous two weeks from Talisman, setting out the quarterly payments of royalties that had been made to the Bank from 2010 up to that time.

144. At some point between 6 August 2014 and 28 October 2014, further information was obtained from Talisman by HMRC as to the royalty payments that had been made in earlier years back to 2004, and passed to officer Thompson.

145. Officer Thompson met with the Tax Manager at the Bank's London branch on 28 October 2014 and gave her the rough calculations that had been carried out by a colleague specialising in oil taxation dating back to 2004, including calculations right up to 2013. She followed this up by emailing the information to her the same evening. She then issued notices of assessment dated 31 October 2014 (which she hand-delivered to the Bank's London branch on that same day) in respect of the tax supposedly chargeable for the years ended 31 October 2008, 2009 and 2010. At the same time, she delivered a notice of enquiry into the Bank's return for the year ended 31 October 2012 (which was still within the enquiry window).

146. She did not at that time issue any notice of assessment in respect of the year ended 31 October 2011. That was only done on 29 October 2015, when notice of assessment was sent to the Bank at the same address. The figures included in it were the ones which had been calculated and provided to the Bank no later than October 2014, and Ms Thompson, in response to the question as to why this notice of assessment had not been issued at the same time as the others, said this:

> It was not issued because it was not necessary for it to be issued because that accounting period would not go out of time for discovery assessment until later and we hoped that this might be a simple issue that would be cleared up by that time and it wouldn't be necessary.

147. There was no suggestion that any new information had come to Ms Thompson's attention between October 2014 and October 2015 in relation to the 2011 liabilities that HMRC sought to impose.

Discussion and decision

Staleness

Introduction

148. On the current state of the authorities, the Court of Appeal in *HMRC v Raymond Tooth* [2019] EWCA Civ 826 has confirmed the approach to "staleness" set out in *Charlton & others v HMRC* [2012] UKUT 770 (TCC); [2013] STC 866, Floyd LJ (agreed, on this issue, by the other members of the Court) endorsing relevant passages from *Charlton* as follows at [60] – [61]:

> 60. Both parties accepted that the legal approach to whether there is a "discovery" is correctly set out in this first passage from the decision of the UT in *Charlton & others v RCC* [2012] UKUT 770 (TCC); [2013] STC 866 at [37], where the tribunal said:
>
> > "37. In our judgment, no new information, of fact or law, is required for there to be a discovery. All that is required is that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment. That can be for any reason, including a change of view, change of opinion, or correction of an oversight."
>
> The UT continued in a second passage:
>
> > "The requirement for newness does not relate to the reason for the conclusion reached by the officer but to the conclusion itself. If an officer has concluded that a discovery assessment should be issued, but for some reason the assessment is not made within a reasonable period after that conclusion is reached, it might, depending on the circumstances, be the case that the conclusion would lose its essential newness by the time of the actual assessment."
>
> 61. I agree with the UT's approach in both passages. The requirement for the conclusion to have "newly appeared" is implicit in the statutory language

> "discover". The discovery must be of one of the matters set out in (a) to (c) of section 29(1). In the present case the officer must have newly discovered that an assessment to tax is insufficient. It is his or her new conclusion that the assessment is insufficient which can trigger a discovery assessment. A discovery assessment is not validly triggered because the officer has found a new reason for contending that an assessment is insufficient, or because he or she has decided to invoke a different mechanism for addressing an insufficiency in an assessment which he or she has previously concluded is present.

Staleness - Were all the discoveries stale due to the earlier knowledge of HMRC?

149. Mr Peacock suggested that HMRC might have made their "discovery" no later than 1992, rendering stale any assessment based on the events of 2013-2015, or meaning that those events were simply unable to form the basis of a "discovery" in 2014 in view of HMRC's earlier knowledge. I reject any such suggestion. The "discovery" under consideration is a discovery by an individual officer falling within paragraph 41(1) of Schedule 18 FA98. That paragraph clearly requires the discovery to relate to the accounting period of the company in question, and a particular shortfall <u>in relation to that period</u> of a type falling within paragraphs 41(1)(a) to (c). Clearly it is not possible to "discover" in 1992 any of the things listed in paragraphs 41(1)(a) to (c) as regards an accounting period ending in 2008, 2009, 2010 or 2011, nor is it possible to say that knowledge many years earlier by someone other than officer Thompson within HMRC of some pieces of the ultimate jigsaw acts in some way to preclude officer Thompson herself from making the discovery that she did in 2014.

Staleness - Was the discovery stale before the 2011 assessment was issued?

150. The question of staleness also arises in an alternative way in respect of the 2011 assessment.

151. In the present case, it is clear that there was absolutely no new information or change of circumstances from (at the very latest) 28 October 2014 up to 29 October 2015 when the 2011 assessment was issued. In effect, what HMRC did was simply wait until the statutory time limit was about to expire before issuing the assessment. This sort of situation was considered by Lord Glennie in *Pattullo v HMRC* [2016] UKUT 270 (TCC) at [52], where he observed:

> It would, to my mind, be absurd to contemplate that, having made a discovery… HMRC could in effect just sit on it and do nothing for a number of years before making an assessment just before the end of the limitation period…

152. He did however go on to say this at [53]:

> However, the word "if", as used in this way in the sub-section, does not mean "immediately". Mr Gordon was right, in my view, to accept that the discovery could be kept fresh for the purposes of being acted upon later. As he accepted, each case would turn on its particular facts. He gave the example of notification being given to the taxpayer of the discovery in the expectation that matters could be resolved without the need for a formal assessment to be made. No doubt there are many other examples which could be given. The UT in Charlton at para 37 recognise that the decision in each case will be fact sensitive. I do not think it would be helpful to try to define the possible circumstances in which a discovery would lose its freshness and be incapable of being used to justify making an assessment. But I consider that Mr Gordon was right to accept that it would only be in the most exceptional of cases that inaction on the part of HMRC would result in the discovery losing its required newness by the time that an assessment was made.

153. In the present case, HMRC did provide details of their discovery in relation to the 2011 accounting period to the Bank in October 2014. On Ms Thompson's evidence (which I accept), the reason for the delay in issuing the 2011 assessment was because "it was not necessary for it to be issued because that accounting period would not go out of time for discovery assessment until later and we hoped that this might be a simple issue that would be cleared up by that time and it wouldn't be necessary".

154. The only action apparent in the correspondence following the issue of the 2008, 2009 and 2010 assessments in October 2014 was a formal letter of appeal from the Bank dated 25 November 2014 and a response from officer Thompson dated 19 December 2014 confirming receipt of the appeal and postponement of the disputed tax. An indication of the likely timetable for HMRC to reach a decision on the appeal was promised in the new year, but no further correspondence was sent until the 2011 assessment was notified in October 2015. In the meantime, officer Thompson had involved officer Holloway, an international tax specialist, who took over as lead officer on the case team. During the period from January 2015 (when officer Holloway became involved) and the issue of the 2011 assessment in October 2015 there was no further correspondence with the Bank but seemingly a great deal of discussion within HMRC as to the correct approach to the matter.

155. Thus, in Mr Peacock's submission, there was a period of "some 15-16 months" from the time when officer Thompson made her discovery upon receipt of the royalty figures provided by Talisman until the time when the 2011 assessment was raised. In *Pattullo* at [57], it was said that "in the circumstances of this case" an 18 month delay after the discovery would make the assessment stale, and Mr Peacock invited me to reach the same conclusion in respect of the delay in this case.

156. As was made clear in *Pattullo*, however, there is no single period of delay that can simply be mapped across from one case to another to establish staleness – Lord Glennie was keen to make it clear that his 18 month statement was specific to the circumstances of that case. Counsel for the taxpayer in that case had (as mentioned at [152] above) acknowledged that a discovery could be prevented from going stale by "notification being given to the taxpayer of the discovery in the expectation that matters could be resolved without the need for a formal assessment to be made". I consider that acknowledgment to have been correct and that this is just such a case. Accordingly, even if the views of the Court of Appeal in *Tooth* as to the existence of a doctrine of "staleness" are confirmed on appeal by the Supreme Court, then I find that officer Thompson's discovery in 2014 of the 2011 insufficiency had not become stale by the time she issued the assessment in October 2015.

Paragraph 44 Schedule 18 FA98 – awareness prior to closure of enquiry window

157. Even if the assessments were not "stale", they could only validly be issued "in the circumstances specified in paragraph 43 or 44" of Schedule 18 FA98 (see [109] above). The argument before me focused on paragraph 44.

158. Mr Bremner pointed out that the last of the enquiry windows for the years ended 31 October 2008 to 2011 closed on 31 October 2013. By that time, he submitted, it was quite clearly true that no hypothetical HMRC officer could, on the basis of the information listed in paragraph 44(2) notionally "on their desk", have been reasonably expected to be aware of the insufficiency. The Payments formed no part of the returns submitted by the Bank's UK branch and had not been disclosed to HMRC in any relevant sense.

159. Mr Peacock sought to argue that there should be attributed to the hypothetical HMRC officer, for the purposes of paragraph 44, knowledge of the 1986-1992 correspondence (accepting that if it were not included, HMRC were bound to make out their case under paragraph 44).

160. It is clear that the list of information "on the desk" of the hypothetical officer which is set out in paragraph 44(2) Schedule 18 FA98 is an exhaustive list – a matter that is so well established by authority that it hardly needs repeating (though Mr Peacock reserved the right to challenge the point in the Court of Appeal if the matter goes that far). However, he sought to argue that HMRC's actual knowledge gleaned in 1986-1992 ought to be included on the desk of the hypothetical officer on the basis that HMRC actually had that knowledge and it would "upset the prescribed balance" of the discovery assessment provisions if this were not done.

161. I reject any such argument. It is quite clear that the list in paragraph 44(2) is an exhaustive list and any attempt to include other information, however ingeniously the argument is repackaged, must be rejected. This has been made completely clear in *Langham v Veltema* [2004] EWCA Civ 193 at [36], as endorsed in *Sanderson v HMRC* [2016] EWCA Civ 19; [2016] STC 638 at [17(5)]:

> The key to the scheme is that the Inspector is to be shut out from making a discovery assessment under the section only when the taxpayer or his representatives, in making an honest and accurate return or in responding to a s 9A enquiry, have clearly alerted him to the insufficiency of the assessment, not where the Inspector may have some other information, not normally part of his checks, that may put the sufficiency of the assessment in question.

162. This disposes of the appeal in respect of the years ended 31 October 2010 and 2011. However, it leaves outstanding the issue of whether the applicable time limit under paragraph 46 of Schedule 18 FA98 for issuing the assessments for the years ended 31 October 2008 and 2009 had expired by October 2014. This depends on whether the loss of tax involved in those years had been "brought about carelessly" by the Bank, the question to which I now turn.

Paragraph 46 Schedule 18 FA98 – Carelessness

163. Mr Peacock submitted that the history of uncertainty about the correct tax treatment of the Payments in the hands of the Bank made it perfectly clear that it had not been careless in failing to include them in its returns. In 1992 HMRC had either formed the view that the Payments were definitely taxable (in which case they could not fairly claim to have made a "discovery" of such taxability in 2014) or they were uncertain on the point (in which case it could hardly be careless of the Bank not to consider them taxable itself). A review of the history of the correspondence on the point showed, in his submission, that although various possibilities had been raised, the Bank was effectively entitled to assume that HMRC's agreement for BP to pay the gross royalties without deduction of tax meant that it was reasonable for the Bank to assume HMRC now accepted it had no liability to UK tax on the Payments.

164. Mr Bremner accepted that the burden lay on HMRC to establish carelessness on the part of the Bank. He sought to discharge that burden by essentially pointing to the fact that the Bank had been told by BP in their letter dated 29 August 1991 that they (BP) had spoken to HMRC again to resolve the withholding tax issue, as a result of which "it was concluded that the Royal Bank of Canada should contact Mr Howard of the OTO directly to determine your tax liability on the Royalty receipts". He submitted that this clearly put the Bank on enquiry that there was a potential argument with HMRC about the taxability of the Payments, which then effectively shifted the burden back onto the Bank to demonstrate that it had taken steps to consider and act on the matter. No evidence had been produced by the Bank that it had taken any such steps, whether by way of making an approach to HMRC direct or by seeking external professional advice. In Mr Bremner's submission, the result was that the Bank had clearly been careless in failing to include the Payments in its returns for the relevant years.

165. In terms of the test to be applied, the statutory question is whether this case involves "a loss of tax brought about carelessly by" the Bank. Mr Peacock, by reference to *Atherton v HMRC* [2019] UKUT 41 (TCC); [2019] STC 575 at [54] and [56] rephrased the test as a question of "whether a reasonably diligent taxpayer, mindful of the need to make a complete and accurate tax return" would have failed to include the Payments in the Bank's returns for 2008 and 2009. In his submission, given the complexities of the issues involved (as demonstrated by the history of HMRC's consideration of them) there were reasonable grounds for concluding that the Payments were not taxable in the UK in the hands of the Bank and that was a reasonable position for the Bank to take.

166. Mr Bremner's response to this was that if *Atherton* was considered carefully, the test applicable to this case was whether "a reasonably diligent taxpayer, mindful of the need to make a complete and accurate tax return, would not have made a return of the Payments <u>without explanation</u>". In his submission, the nature and quality of any explanation given was vital to the analysis of whether the insufficiency had been brought about carelessly. Simply failing to include the Payments without any explanation for the omission was not good enough. He acknowledged the issues were complex, but that only emphasised the need for the Bank to have addressed them properly, taken advice and so on instead of simply omitting any mention of the Payments from its returns altogether. The Bank had been notified by BP that HMRC expected it to contact them to resolve the point, and had simply ignored it. That was not the approach of a reasonably diligent taxpayer, mindful of the need to make a complete and accurate return.

167. I prefer Mr Bremner's argument, essentially for the reasons he gave. It was clear from the terms of BP's letter to the Bank on 29 August 1991 that HMRC still regarded the correct tax treatment of any royalty payments in the Bank's hands as a matter that was unresolved. The Bank was informed that it should contact HMRC to progress such resolution. It made no attempt to do so. The fact that the Bank subsequently started to receive gross royalty payments might fairly have led it to infer that HMRC had accepted no withholding tax was applicable, but could not be interpreted as HMRC's acceptance that the Bank itself had no liability to tax. As a reasonably diligent taxpayer, mindful of the need to make a complete and accurate tax return, I consider it ought either to have included the Payments themselves in its returns or at the very least it ought to have appended a statement of the royalties received to its returns when submitted and brought the matter to HMRC's attention (which would also have satisfied the requirements of paragraph 44(2)(c) of Schedule 18 FA98). Its failure to do so means that I consider that the 2008 and 2009 years both involve a loss of tax brought about carelessly by the Bank and the extended time limit in paragraph 45 Schedule 18 FA98 applies.

168. I therefore uphold the assessments for the years ended 31 October 2008 and 2009.

SUMMARY AND CONCLUSION

169. I consider the UK/Canada double tax treaty confers taxing rights on the UK in respect of the Payments (see [66] above).

170. I consider the UK legislation applies so as to charge the Payments to corporation tax (see [102] above).

171. I consider HMRC are not precluded from raising discovery assessments in respect of each year (see [162] and [168] above).

172. It follows that the appeal is DISMISSED.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

173. 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.

KEVIN POOLE
TRIBUNAL JUDGE

Release date: 23 JUNE 2020