



Appeal numbers  
UT/2016/0176 & UT/2016/0177

*Corporation tax – purchase by traders of partnership interests and adherence to partnerships followed by realisation and distribution by partnerships of receivables – treatment of partnership profits distributed to traders so as to avoid double taxation*

UPPER TRIBUNAL  
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER  
MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and -

(1) INVESTEC ASSET FINANCE PLC  
(2) INVESTEC BANK PLC

Respondents

**Tribunal: The Hon Mr Justice Arnold and Judge Charles Hellier**

**Sitting in public at the Rolls Building, Fetter Lane, London EC4A 1NL on 5 November  
2018**

**John Tallon QC, instructed by the General Counsel and Solicitor to HM Revenue and  
Customs, for the Appellants**

**Jonathan Peacock QC and Michael Ripley, instructed by Allen & Overy LLP, for the  
Respondents**

## DECISION

### Introduction

1. This is the sequel to our first decision on this appeal released on 4 April 2018 ([2018] UKUT 0069 (TCC)). In our first decision we dismissed HMRC's appeal on issue 1, allowed HMRC's appeal on issue 2 in part and dismissed Investec's appeal on issue 3. For the reasons we explained at [91]-[94], we did not determine issue 4, but invited the parties to restore the appeal for further argument. The parties accepted that invitation, and we have had the benefit of further argument on the questions we raised at [92]-[93].
2. It may be helpful to recap the following points:
  - (1) The FTT found, and Investec no longer dispute, that Investec conducted two trades: (i) the solo financial trade carried on by each of IAF and IBP; and (ii) the trades carried on by each of IAF and IBP in partnership with the other partners in the Leasing Partnerships. It follows that there need to be tax computations for each of these trades.
  - (2) Section 42 FA 1998 requires the profits of a trade to be computed in accordance with generally accepted accounting practice ("GAAP") "subject to any adjustment required or authorised by law".
  - (3) Section 114 ICTA 1988 requires the profits and losses of a trade carried on by a partnership to be computed "as if the partnership were a company".
  - (4) We have already decided that, in principle, profits which had been taxed in the hands of the Leasing Partnerships did not fall to be taxed again in the hands of IAF and IBP.
3. Two further points should be noted before we proceed. First, as counsel for Investec pointed out, there is no challenge by HMRC to the basis upon which IAF and IBP prepared their accounts. Thus the accounts must be taken to be GAAP-compliant. Secondly, however, as we understand it, IAF and IBP prepared their accounts on the basis that they were engaging in one trade, not two, although for reasons that will appear this does not appear to matter in the case of Garrard.
4. The difficulty which confronts us is how (i) section 42 FA 1998, (ii) section 114 ICTA 1988 and (iii) the principle that there should be no double taxation of the same income apply in these circumstances.

### Repayments of capital contributions

5. Although the query we raised concerning repayments of capital contributions related to both LAGP and Garrard, it is common ground between the parties that the distinction we drew between returns of capital contributions and distributions of trading profits makes no difference in the case of LAGP because IAF and IBP accounted on the look through basis. By contrast, it potentially makes a difference in the case of Garrard because IAF and IBP accounted on the basis that Garrard was a separate entity.

6. HMRC accept that this point is academic in view of our conclusion in relation to issue 2 with respect to Garrard, but nevertheless ask us to decide it in case Investec successfully appeal on the latter point.

*HMRC's submissions*

7. HMRC point out that the accounting treatment (which is set out in paragraphs 73 to 77 of the Statement of Agreed Facts) for the solo trade of IBP (which was the only one of the two companies to which capital was returned) was as follows. First, IBP recognised the interest in Garrard it had acquired at cost. Next, there was an increase in the book value of IBP's interest in Garrard by the amount of the capital contributed. Next, IBP recognised returns of capital from Garrard by decreasing the book value of its interest by the amount of the capital returned. Finally, IBP accounted for the sale of its interest by showing the excess of its sale proceeds over the book value of the interest as a trading profit.
8. HMRC contend that the effect of this treatment was to calculate the true profit on the sale by IBP of its partnership interest, and that this did not result in double taxation of the same income because IBP's profit on the sale of its partnership interest is not reflected in the section 114 ICTA 1988 calculation for Garrard.

*Investec's submissions*

9. Investec contend that the mechanism by which sums are returned to partners – whether this is a distribution of trading profits or a return of capital – is immaterial and that what matters is whether the sums received and taxable in the hands of the recipients are amounts that have been taxed already. In the case of Garrard, Investec contend that the sum returned as capital to IBP was funded by the consideration from the sale of the receivables to Lombard, which was included in the section 114 calculation, and hence was taxed in the hands of Garrard. Investec say that under the section 114 calculation it was not the accounting profit which was taxed, but, in effect, the gross receipts from the trade.

*Assessment*

10. Garrard's corporation tax computation is based on a profit and loss account which includes as turnover the sum of £63,501,142 for "consideration for sale of receivables" (see also paragraph 79 of the Statement of Agreed Facts) and as an expense the sums of £59,894,779 for "impairment of Leases – Operating Lease" and £5,059,099 for "impairment of Leases – Finance Lease". A loss of £304,680 on ordinary activities is recorded. In calculating the profit for Schedule D Case I, the figures of £59,894,779 and £5,059,099 are added back. Together with certain other adjustments, this produces a total profit of

£48,276,222. There is also a Schedule D Case III profit of £81,212 yielding a total profit of £48,357,434. Of that sum, £45,934,557 is allocated to IBP and £1,933,749 to IAF.

11. Turning to IBP's tax computation, this recognises proceeds from the sale of IBP's partnership interest in the sum of £15,241,321 and a "capital distribution" in the sum of £62,760,000, from which are deducted the cost of partnership investment in the sum of £74,835,067 and the partnership loss of £304,681, giving a net taxable profit of £2,861,573. IAF's tax computation shows proceeds from the sale of its partnership interest in the sum of £3,224,319 less cost of partnership interest in the sum of £3,144,319, giving a net taxable profit of £80,000.
12. In those circumstances, Investec's argument is that the sum of £63,501,142 received from the sale of the lease receivables was included in the profits of the partnership which were taxed and that it would amount to double taxation if the return of capital of £62,760,000 which derived from that source was taxed in IBP's hands without deduction.
13. While we see the force of that argument, we are unable to accept it. Our reasons, which are not quite the same as those advanced by HMRC, are as follows. The question, as we see it, is whether the receipt by IBP of the capital repayment constitutes the same income as the income of Garrard from the receivables sale so as to attract the double taxation principle. In our view it does not. It may help to illustrate the point by two examples. First, suppose Garrard had used the £62.7 million to buy assets from IBP which cost IBP £60 million. IBP's accounts would show a profit of £2.7 million. But on Investec's argument IBP would be treated as making a loss of £60 million for tax purposes because its receipt of £62.7 million would be disregarded. Secondly, suppose that IBP had previously lent Garrard £62.7 million and Garrard used the £62.7 million in question to repay that loan to IBP. On Investec's argument IBP's receipt of £62.7 million would again have to be disregarded. What these examples show, we think, is that it is not sufficient that the money received by IBP derived from money received by Garrard which contributed to Garrard's taxable profits.
14. We would add that this point was not considered by the FTT in its decision, which focusses on LAGP and HKP.

Look through accounting

15. As previously noted, IAF and IBP accounted on the look through basis in respect of LAGP and HKP. The question which exercised us at [93] of our first decision was how section 114 ICTA 1988 and section 42 FA 1998 were to be applied in those cases.
16. Prima facie, two tax computations are required: (i) IAF's and IBP's shares of the profits of the partnership trades computed in accordance with section 114

ICTA 1988 and (ii) IAF's and IBP's own profits from their respective solo trades computed in accordance with section 42 FA 1998. The computations must be done in a way which avoids double taxation of the same income. How is this to be done given the adoption of look through accounting?

*HMRC's submissions*

17. HMRC point out that, in relation to the accounting treatment for the LAGP transaction, paragraph 29 of the Statement of Agreed Facts records:

“Each of IAF and IBP ‘looked through’ the partnership, and the Leases were accounted for directly in each company’s accounts. The profit earned by each company being the excess of the fair value of its share of the lease receivables over the aggregate of the cost of its partnership interest and the cost of its capital contributions, was shown in its profit and loss account.”

18. Similarly, in relation to the accounting treatment for the HKP transaction, paragraph 108 of the Statement of Agreed Facts records:

“Each of IAF and IBP ‘looked through’ the partnership, and the Leases were accounted for directly in each company’s accounts. The profit earned by each company, being the excess of the fair value of its share of the lease receivables over the aggregate of the cost of its partnership interest and the cost of the put options, was shown in its profit and loss account.”

19. HMRC contend that this accounting treatment reflected the reality of the situation, namely that, whilst the solo financial trades of IAF and IBP were separate trades from those carried on by the Leasing Partnerships, the generation of trading profits in LAGP and HKP was the only business activity represented by their participation in the trades of those partnerships. HMRC further contend that the section 114 ICTA 1988 computation dealt with the taxable profits arising in the trades of the partnerships and that the profits disclosed by the accounts of IAF and IBP for that activity, which reflect their participation in LAGP and HKP, are displaced by the section 114 computation because the latter is an “adjustment required ... by law” within section 42 FA 1998.

*Investec's submissions*

20. Investec contend as follows:
- i) given the findings of the FTT, it is not correct to say that there was only one business activity: there were two separate trades;
  - ii) section 114 ICTA 1988 sets out how the profits of the leasing trades carried on by the Leasing Partnerships must be computed;
  - iii) section 42 FA 1998 sets out how the profits of the solo financial trades carried on by IAF and IBP must be computed, namely in accordance with GAAP, subject to any adjustment required or authorised by law;
  - iv) the only relevant adjustment to the section 42 calculation is that required by the rule against double taxation, which entitled IAF and IBP to exclude the taxable partnership income computed under section 114 when computing the taxable profits of their solo trades;
  - v) the look through basis of accounting adopted by IAF and IBP in respect of LAGP and HKP is consistent with this; and
  - vi) none of the Disputed Expenditure was included in the section 114 calculation, and therefore section 114 provides no basis for disallowing any of the Disputed Expenditure from the computations for the solo trades.

*Assessment*

21. The problem as we see it is that, as noted above, IAF and IBP prepared their accounts on the basis that they were engaging in one trade, not two. In the case of Garrard, the accounting treatment nevertheless distinguished between the two trades. In the case of LAGP and HKP, the look through method adopted did not distinguish between them. It appears to us that the effect of Investec's argument is to treat IAF's and IBP's accounts as showing the profits of the solo trades, rather than (as one might expect) the profits of the partnership trades.
22. The FTT said at [144] that, in the case of LAGP and HKP, Investec calculated their "sole trading profits by looking through to their share of the partnership profits i.e. the very profits that we have already concluded are plainly to be brought in to account under section 114", giving the impression that the two were the same. But the description of the accounting in the Statement of Agreed Facts which we set out above shows that they were not the same: the deduction taken in the accounts was not the partnership's cost of the receivables, but Investec's cost of the partnership interest. The FTT made no findings as to which trade(s) the accounts reflected, no doubt because the issue was not raised

before the FTT. Nor did the FTT make any specific findings as to what (if any) adjustments were required by the double taxation principle.

23. We do not consider that we are in a position to resolve this conundrum, because it requires a factual determination, which the FTT did not make. Accordingly, to the extent that it is necessary to determine this issue, we must remit the matter to the FTT for it make the necessary findings of fact.

Disposition of HMRC's appeal on issue 4

24. As Investec point out, HMRC only raised issue 4 *in the alternative to* issues 1 and 2 if they were unsuccessful on the latter issues (see paragraph 75 of our first decision). In our first decision, we decided that HMRC succeeded in part on issue 2. In those circumstances, we agree with Investec that it is not open to HMRC to pursue their case on issue 4 *in addition to* their case on issue 2. This is a question of basic procedural fairness. As we understand it, that is why HMRC accept that the question as to return of capital contributions is currently academic. Nevertheless, we have come to an alternative conclusion in case we are wrong on issue 2 in relation to Garrard.
25. So far as look through accounting is concerned, HRMC point out that they have been unsuccessful with respect to both issues 1 and 2 in relation to HKP. In relation to LAGP, however, they were partially successful on issue 2. Accordingly, we consider that, as matters stand, it is open to HMRC to pursue their case on issue 4 in relation to HKP, but not in relation to LAGP.
26. Accordingly, HMRC's appeal on issue 4 is dismissed save that issue 4 is remitted to the FTT so far as it concerns HKP. If, contrary to our previous decision, HMRC were wholly unsuccessful on issue 2, then we would also (a) allow HMRC's appeal on issue 4 in relation to Garrard and (b) remit issue 4 to the FTT in relation to LAGP.

**MR JUSTICE ARNOLD**

**JUDGE HELLIER**

**Release date: 19 December 2018**