[2013] UKFTT 212 (TC)

TC02626

Appeal number: TC/2010/08369

CORPORATION TAX – loan relationships – debit under paragraph 19A, Schedule 9, Finance Act 1996 in respect of the difference in the accounting value of loan relationships on a change of accounting practice – appellant company changing accounting practice from UK GAAP to IFRS at the 2004 year-end – appellant claiming the debit in the 2005 accounting period – whether there was as a matter of fact the relevant difference in the accounting value – expert evidence as to UK GAAP and IFRS considered – found that there was the relevant difference in accounting value – whether in that case the debit was not to be brought into account, as being attributable to an unallowable purpose, under paragraph 13, Schedule 9, Finance Act 1996 – found that the appellant's tax avoidance purpose was achieved at the 2004 year-end – there were no times during the 2005 accounting period during which the appellant had an unallowable purpose such that on a just and reasonable apportionment any part of the debit was to be attributed to it – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

FIDEX LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN WALTERS QC
JOHN ROBINSON

Sitting in public at Bedford Square, London on 14, 15, 16, 17 and 18 May 2012 (The Tribunal received further written submissions dated 1, 13 and 18 June 2012)

Michael Flesch QC and Richard Boulton QC, instructed by Clifford Chance LLP, for the Appellant

John Tallon QC and Charles Bradley, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction – the Paragraph 19A Issue and the Paragraph 13 Issue

1. The Appellant, Fidex Limited ("Fidex") appeals against an amendment to its corporation tax return for the year ended 31 December 2005 ("the 2005 Year"). That amendment was made by the Respondents ("HMRC") by a closure notice dated 2 August 2010.

2. The amendment was to disallow a loan relationship debit of €83,849,399 claimed by Fidex.

3. The background to the dispute can be explained in general terms as follows, taking facts from a Statement of Agreed Facts supplied by the parties.

4. Fidex prepared its accounts for the year ended 31 December 2004 ("the 2004 Year") applying UK GAAP (UK Generally Accepted Accounting Practice). In those accounts Fidex showed, within shareholders' funds on its balance sheet, certain redeemable preference shares ("the Preference Shares") issued on 22 December 2004 to Swiss Re Financial Products Corporation ("Swiss Re") at a value corresponding to the net proceeds[1] of their issue. The Preference Shares were divided into four classes (A to D) and each class was referenced to a particular bond owned by Fidex (collectively, "the Relevant Assets"). The Relevant Assets were loan relationships and were recognised at their full value as assets in Fidex's balance sheet as at 31 December 2004.

5. At a meeting of the board of Fidex on 22 December 2004, the board resolved to adopt the use of International Financial Reporting Standards ("IFRS") in place of UK GAAP with effect from 1 January 2005.

6. Following the adoption of IFRS as from 1 January 2005, the Preference Shares were classified as liabilities of Fidex and derecognised. The Relevant Assets were, as to 95% of their value, also derecognised in Fidex's balance sheet (5% of their value continued to be recognised as the value to Fidex of the Relevant Assets adopting IFRS). These derecognitions reflected differences between the closing balances on the balance sheet as at 31 December 2004 and the opening balances as at 1 January 2005.

7. Fidex claims that in these circumstances the effect of paragraph 19A of Schedule 9 to the Finance Act 1996 (hereinafter "Paragraph 19A") is to allow a debit in the 2005 Year to reflect the difference between the carrying value of the Relevant Assets in the balance sheet as at 31 December 2004 (the end of the 2004 Year) and the carrying value of the Relevant Assets recognised as at 1 January 2005.

8. Paragraph 19A relevantly provides as follows:

> '(1) This paragraph applies where –
>
> > (a) There is a change of accounting policy in drawing up a company's accounts from one period of account ("the earlier period") to the next ("the later period"), and
> >
> > (b) The approach in each of those periods accorded with the law and practice applicable in relation to the period.

[1] 'Net proceeds' are relevantly defined in Financial Reporting Standard 4 as the 'fair value of the consideration received on the issue of a capital instrument after deduction of issue costs' (*ibid.* [11]) – as per Mr Martin's evidence. This is the meaning we have attributed to this agreed fact.

(2) This paragraph applies, in particular, where –

(a) The company prepares accounts for the earlier period in accordance with UK generally accepted accounting practice and the for the later period in accordance with international accounting standards ...

(3) If there is a difference between –

(a) the accounting value of an asset or liability representing a loan relationship of the company at the end of the earlier period, and

(b) the accounting value of that asset or liability at the beginning of the later period,

a corresponding debit or credit (as the case may be) shall be brought into account for the purposes of this Chapter [*viz:* Chapter 2, Finance Act 1996] in the later period.

(4) In sub-paragraph (3) "accounting value" means ... the carrying value of the asset or liability recognised for accounting purposes.'

9. Fidex claims to bring into account in the 2005 Year a debit of €83,849,399 pursuant to sub-paragraph (3) of Paragraph 19A.

10. HMRC resist the claim on two grounds. First, they submit that UK GAAP did not allow for the Preference Shares and the Relevant Assets (except as to 5% of their value) to be recognised in the accounts for the 2004 Year and that Fidex's accounts for that year did not give a true and fair view of its position or accord with the requirements of sub-paragraph (1)(b) of Paragraph 19A. We refer to this issue for the Tribunal's determination as "**the Paragraph 19A Issue**".

11. Secondly, HMRC submit that, even if we decide the Paragraph 19A Issue in favour of Fidex, the debit of €83,849,399 must not be brought into account for the purposes of Chapter 2, Finance Act 1996, that is, for corporation tax purposes, because the debit is in respect of loan relationships (the Relevant Assets) which are 'attributable to [an] unallowable purpose' within paragraph 13, Schedule 9, Finance Act 1996 (hereinafter "Paragraph 13"). We refer to this issue for the Tribunal's determination as "**the Paragraph 13 Issue**".

12. Paragraph 13 provides relevantly as follows:

'13 (1) Where in any accounting period a loan relationship of a company has an unallowable purpose –

(a) the debits, and

(b) the credits in respect of exchange gains,

which, for that period fall, in the case of that company, to be brought into account for the purposes of this Chapter shall not include so much of the debits or credits (as the case may be) as respects that relationship as, on a just and reasonable apportionment, is attributable to the unallowable purpose.

...

(2) For the purposes of this paragraph a loan relationship of a company shall be taken to have an unallowable purpose in an accounting period where the purposes for which, at times during that period, the company –

(a) is a party to the relationship, or

(b) enters into transactions which are related transactions by reference to that relationship, include a purpose ("the unallowable purpose") which is not amongst the business or other commercial purposes of the company.

(3) For the purposes of this paragraph the business and other commercial purposes of a company do not include the purposes of any part of its activities in respect of which it is not within the charge to corporation tax.

(4) For the purposes of this paragraph, where one of the purposes for which a company –

(a) is a party to as loan relationship at any time, or

(b) enters into a transaction which is a related transaction by reference to any loan relationship of the company,

is a tax avoidance purpose, that purpose shall be taken to be a business or other commercial purpose of the company only where it is not the main purpose, or one of the main purposes, for which the company is a party to the relationship at that time or, as the case may be, for which the company enters into that transaction.

(5) The reference in sub-paragraph (4) above to a tax avoidance purpose is a reference to any purpose that consists in securing a tax advantage (whether for the company or any other person).

(6) In this paragraph –

"tax advantage" has the same meaning as in Chapter 1 of Part XVII of the Taxes Act 1988 (tax avoidance).'

13. The term "related transaction" used in sub-paragraphs (2) and (4) of Paragraph 13 is defined in section 84(5) of the Finance Act 1996 as follows:

'In this Chapter "related transaction", in relation to a loan relationship, means any disposal or acquisition (in whole or in part) of rights or liabilities under that relationship.'

14. The relevant definition of "tax advantage" was, at the relevant time, in section 709(1) Income and Corporation Taxes Act 1988 ("ICTA") – referred to in sub-paragraph (6) of Paragraph 13 as "the Taxes Act". It provided as follows:

'... "tax advantage" means a relief or increased relief from, or repayment or increased repayment of, tax, or the avoidance or reduction of a charge to tax or an assessment to tax or the avoidance of a possible assessment thereto, whether the avoidance or reduction is effected by receipts accruing in such a way that the recipient does not pay or bear tax on them, or by a deduction in computing profits or gains.'

The Facts

15. We received a witness statement from Colin Gardner (proffered by HMRC). He was a director of Fidex from 17 December 2004 to 15 April 2005 and, as his main role, Treasury Manager of BNP Paribas SA ("BNPP") London Branch. He was not called to give oral evidence or be cross-examined by Fidex. We also received witness statements from the following expert witnesses: Anthony Clifford MA FCA, a partner in Ernst & Young LLP, Chartered Accountants, since 1991 and currently partner in charge of the Financial Reporting Group of Ernst & Young in the UK and a member of the firm's global IFRS policy committee and co-chair of its global network of IFRS financial instruments accounting experts; Colin Martin, B Eng (Hons), Chartered Accountant, a partner and the head of Financial Services Assurance Services, KPMG LLP, Chartered Accountants; David Chopping, a senior partner in Moore Stephens LLP, Chartered Accountants, and responsible for his firm's Technical Services Department; and Richard Simon Lawrence, FCA, Advisory Accountant in the Strategic Risk Unit of the LBS Directorate of HMRC and formerly an audit director at Ernst & Young. Each of these witnesses provided both an expert report and a

supplemental report and each of them gave oral evidence and was cross-examined. Mr Clifford and Mr Martin were instructed by Fidex. Mr Chopping and Mr Lawrence were instructed by HMRC.

16. We also had before us two bundles of documents and two bundles of accounting standards and related materials. Besides this, as indicated above, the parties had prepared a Statement of Agreed Facts.

17. From that Statement and the evidence we find the following facts.

18. The Fidex group of companies (composed of Fidex and its holding company Fidex Holdings Limited ("FHL")) was established in or about 1998 as an off-balance sheet group sponsored by BNPP with the aim of Fidex issuing commercial paper into the debt capital markets, collateralised by a diversified portfolio of highly rated bonds.

19. Following changes to BNPP's accounting policy in 2001, the portfolio of bonds held by Fidex was required to be consolidated in BNPP's 2001 Financial Statements and consequently Fidex's commercial paper issuance programme was terminated in 2002. Immediately prior to the Acquisition and Refinancing (a series of transactions which took place in December 2004 and to which we make further reference below), Fidex continued to hold 22 bonds (the "Bond Portfolio"). These bonds had various maturities to 2012 and Fidex was entirely debt financed by BNPP. The Bond Portfolio had been acquired in the period from 1999 to 2000. By the Acquisition and Refinancing, the Fidex group of companies was brought into the BNPP group structure.

20. Before the Acquisition and Refinancing, FHL's holding in Fidex had been 49,998 shares of £1 paid up as to 25p and one share of £1 fully paid up. SPV Management Limited ("SPVM") also held one share of £1 fully paid up in its capacity as trustee of the Fidex Charitable Trust ("FCT"). Further, FHL's issued share capital was held by SPVM as trustee of the FCT.

21. The Acquisition and Refinancing comprised the following transactions:

(a) An Agreement made on 17 December 2004 between SPVM (in its capacity as trustee of the FCT) and BNPP, whereby SPVM sold to BNPP its one share of £1 fully paid up in Fidex and the benefit of a loan of £12,500 made by it to FHL;

(b) A Subscription Agreement made on 22 December 2004, whereby BNPP subscribed for 300 million ordinary shares of €1 in FHL at €1.00 per share;

(c) An Agreement made on 22 December 2004, whereby FHL subscribed for 3 million ordinary shares of €1 in Fidex at €1.00 per share;

(d) An Agreement made on 22 December 2004 whereby BNPP in effect released approximately US$24 million of the indebtedness owed by Fidex to BNPP.

22. The Preference Shares issue by Fidex was implemented by the following steps:

(a) On 20 December 2004, Fidex was re-registered from a public company to a private company (in order to make a Court-approved capital reduction easier).

(b) By a Preference Shares Subscription Agreement ("PSSA") made on 22 December 2004, Swiss Re subscribed for the following redeemable Preference Shares in Fidex of €0.01 each:

19,953,967 Class A,
24,855,483 Class B,
19,881,760 Class C, and
19,801,987 Class D,

the total consideration being €84,493,197 in immediately available funds.

(c) On 22 December 2004, Fidex adopted new Articles of Association.

(d) By a Conditional Subscription Agreement made on 22 December 2004, FHL agreed to subscribe up to a maximum consideration of €85 million for €1.00 redeemable ordinary shares in Fidex, if Fidex served notice on FHL whilst the Preference Shares issued to Swiss Re under the PSSA were in issue, provided that Fidex required the subscription for the purpose of financing a redemption of such Preference Shares in accordance with company law requirements and the Articles of Association.

(e) By a further Conditional Subscription Agreement made on 22 December 2004, BNPP agreed to subscribe up to a maximum consideration of €85 million for €1.00 redeemable ordinary shares in FHL, if FHL served notice on BNPP at a time when FHL was under the obligation to subscribe for shares in Fidex, pursuant to the Agreement referred to in (d) above.

(f) BNPP undertook to Swiss Re, by an Agreement made on 22 December 2004, that Fidex would comply with the terms of the PSSA.

(g) BNPP agreed to pay to Swiss Re certain fees in certain circumstances relating to accounting and tax matters. This agreement was contained in four letters dated 22 December 2004 from BNPP to Swiss Re.

(h) On 22 December 2004, as indicated at [5] above, the Board of Fidex resolved to adopt the use of IFRS in place of UK GAAP for the period commencing 1 January 2005.

23. Classes A, B, C and D of redeemable Preference Shares issued to Swiss Re by Fidex pursuant to the PSSA were respectively referenced to four bonds, the Relevant Assets, owned by Fidex. That is to say, the rights attaching to each Class of Preference Shares were related to the corresponding receipts received by Fidex in relation to the referenced bond. The rights of the holders of the respective Preference Shares were restricted to 95% of the amounts received by Fidex from the respective Relevant Assets.

24. The Relevant Assets were:

Class A Assets – a bond for €20 million issued by Textron Inc., maturing on 14 March 2005;

Class B Assets – a bond for €25 million issued by IBM Corporation, maturing on 31 March 2005;

Class C Assets – a bond for €20 million issued by TCNZ Finance Limited, maturing on 19 April 2005; and

Class D Assets – a bond for €20 million issued by Coca Cola Erfrischungsgetraenke AG, maturing on 4 July 2005

25. Fidex had acquired the Class A Assets on 29 February and 24 March 2000, the Class B Assets on 29 March 2000, the Class C Assets on 6 April 2000 and the Class D Assets on 4 July 2000.

26. Fidex had undertaken to Swiss Re, under clause 4.1 of the PSSA that, whilst Swiss Re held the Preference Shares, Fidex would not:

(a) sell, pledge, transfer or otherwise dispose of or grant security over any of the Relevant Assets;

(b) take any action which might impair its rights to receive or recover payments in relation to the Relevant Assets; or

(c) save for the nominal "Preferred Sterling Ordinary Share Dividend" (as defined in article 18 of Fidex's Articles of Association), make any payment in respect of its ordinary share capital.

27. Upon Fidex's petition, the High Court confirmed on 23 February 2005 the reduction of the amount standing to the credit of Fidex's share premium account by €85 million which had been resolved on and effected by a Fidex's resolution in writing passed on 1 February 2005.

28. All amounts due and payable under the Class A Assets were received by Fidex on 14 March 2005 (the maturity date). On that day Fidex paid a dividend on and redeemed the Class A Preference Shares.

29. All amounts due and payable under the Class B Assets were received by Fidex on 31 March 2005 (the maturity date). On that day Fidex paid a dividend on and redeemed the Class B Preference Shares.

30. All amounts due and payable under the Class C Assets were received by Fidex on 19 April 2005 (the maturity date). On that day Fidex paid a dividend on and redeemed the Class C Preference Shares.

31. All amounts due and payable under the Class D Assets were received by Fidex on 4 July 2005 (the maturity date). On that day Fidex paid a dividend on and redeemed the Class D Preference Shares.

32. As indicated above (at [4]), Fidex prepared its accounts for the 2004 Year under UK GAAP and for the 2005 Year under IFRS.

33. Without prejudging the issue of whether such treatment was a proper application of UK GAAP, we find that in Fidex's accounts for the 2004 Year, the Preference Shares issued by Fidex to Swiss Re under the PSSA were shown, at the net proceeds of their issue, within

shareholders' funds on Fidex's Balance Sheet as at 31 December 2004. The Relevant Assets were also recognised in full on that Balance Sheet.

34. Again, without prejudging the issue of whether such treatment was a proper application of IFRS, as from 1 January 2005 the Preference Shares were classified as liabilities of Fidex and derecognised, and the Relevant Assets were, as to 95%, derecognised in Fidex's Balance Sheet, between the closing balances at 31 December 2004 (stated under UK GAAP) and the opening balances at 1 January 2005 (stated under IFRS). Fidex's accounts for the 2005 Year contained no prior period restatements.

35. Fidex's accounts for the 2004 Year and the 2005 Year received unqualified reports from its then auditors, PricewaterhouseCoopers ("PwC").

36. Fidex's accounts for the year ended 31 December 2006 (stated under IFRS) received an unqualified report from its auditors, Deloitte & Touche, who had replaced PwC as auditors in accordance with the BNPP group's auditor rotation policy. These accounts disclosed comparative information for the prior year, the 2005 Year.

37. The 18 bonds which formed part of the Bond Portfolio but were not Relevant Assets were disposed of or matured as follows:

> (a) 3 bonds were disposed of: one bond with a scheduled maturity date of June 2006 was disposed of in 2005, one bond with a scheduled maturity date of December 2007 was disposed of in 2006, and one bond with a scheduled maturity date of September 2012 was disposed of (as to part) in 2005, and (as to the remainder) in 2006.
>
> (b) 15 bonds were held to maturity. These bonds matured in the period from September 2005 to October 2010.

38. At all relevant times, Fidex was a company resident in the UK for UK tax purposes.

The evidence of the expert witnesses

39. The above facts, which are taken from the Statement of Agreed Facts, were understood to be the facts of the case by all the expert witnesses, Mr Clifford, Mr Martin, Mr Chopping and Mr Lawrence.

40. It was explained to Mr Clifford by Clifford Chance LLP (Fidex's solicitors) in their instructions to him that he was being asked to give expert evidence on the accounting aspects of the implementation of 'a preference share fund raising transaction known as Project Zephyr that took place in December 2004 (the "Project Zephyr Transaction")'.

41. The Project Zephyr Transaction was described in Mr Clifford's instructions as involving the issue by Fidex of preference shares to Swiss Re (a third party). He was told that the return on each class of preference shares was linked to the return of a specified bond held by Fidex, and that the aim was to transfer to Swiss Re the risk of approximately 95% of the repayment of principal and final coupons on the bonds.

42. Mr Clifford disclosed in his report that his firm, Ernst & Young, had advised Swiss Re in relation to the Project Zephyr Transaction, which had constituted 'notifiable arrangements' within the meaning of Part 7 of the Finance Act 2004, in respect of which Ernst & Young were the 'promoter'. Ernst & Young stood to earn a fee related to the tax saving resulting

from the implementation of the Project Zephyr Transaction, should the ultimate result of this litigation be in favour of Fidex. Mr Clifford accepted that this posed a conflict of interest for him, but said under cross-examination that the views he had come to in giving his expert evidence were exactly the same as the views he would have come to had he not been aware of the conflict.

43. Mr Clifford's instructions were to give his opinion on whether the approach adopted by Fidex's directors when accounting for the Project Zephyr Transaction was in accordance with UK GAAP for the 2004 Year, and generally accepted accounting practice under IFRSs as adopted by the EU for the 2005 Year.

44. Mr Clifford was asked to focus specifically

- in relation to Fidex's accounts for the 2004 Year on whether the non-derecognition of the Relevant Assets and the recognition of the linked Preference Shares which had been issued was in accordance with UK GAAP extant at that time;
- in relation to Fidex's accounts for the 2005 Year on whether the derecognition of the Relevant Assets and the non-recognition of the linked Preference Shares was in accordance with IFRS as adopted by the EU extant that that time; and
- on the extent to which the Project Zephyr Transaction represented a 'GAAP difference' between the 2004 UK GAAP and 2005 IFRS in so far as accounting derecognition of assets is concerned.

45. On the first of these issues, Mr Clifford's evidence was that the accounting provisions of the Companies Acts relevant to the accounts for the 2004 Year included Schedule 4, Companies Act 1985. This Schedule set out formats for the presentation of the balance sheet which included the requirement that all called up share capital should be included in 'capital and reserves'.

46. Further, he said that for accounting periods beginning before 1 January 2005, FRS 4 (Capital Instruments) was the relevant accounting standard for the treatment of capital instruments, i.e. 'all instruments that are issued by reporting entities as a means of raising finance, including shares …' – see: the definition of 'capital instruments' in FRS 4. Therefore FRS 4 was the relevant standard for the presentation of the Preference Shares in the accounts of Fidex for the 2004 Year.

47. Mr Clifford stated that, in Appendix III to FRS 4, the UK Accounting Standards Board ("ASB") had explained that, in developing FRS 4, it was unable to apply a single criterion for classifying all capital instruments, since it was constrained by the UK Companies Act 1985. As a result, FRS 4 was a mixed model: on the one hand, FRS 4 [24] set out a general principle that capital instruments should be classified as liabilities by the issuer if they contained an obligation to transfer economic benefits; on the other hand, the same paragraph (FRS 4 [24]) specifically excluded shares from this principle. Instead, FRS 4 [37] stated simply that '[s]hares and warrants should be reported as part of shareholders' funds'. He acknowledged that the application of FRS 4 to preference shares generally would frequently not have reflected economic reality.

48. He said that FRS 4 [83] explained that certain types of shares have features that make them economically similar to debt but that 'nonetheless, the requirement to classify capital

instruments as debt if they contain an obligation to transfer economic benefits does not apply to shares'. This distinction was grounded on the legal status of shares, the conditions which have to be satisfied if any payment is made in respect of them, and the requirement in the balance sheet formats prescribed by companies legislation to state called up share capital separately from liabilities.

49. Mr Clifford explained that the ASB had resolved this dilemma to the extent they could by distinguishing what they termed 'equity shares' and 'non-equity shares' and that FRS 4 [40] required that shareholders' funds should be analysed between the amount attributable to equity interests and the amount attributable to non-equity interests, so as to demonstrate clearly the distinction between the two types of shares.

50. Equity shares were defined as any shares that were not non-equity shares, and non-equity shares were defined as:

> 'Shares possessing any of the following characteristics:
>
> (a) any of the rights of the shares to receive payments (whether in respect of dividends, in respect of redemption or otherwise) are for a limited amount that is not calculated by reference to the company's assets or profits or the dividends on any class of share;
>
> (b) any of their rights to participate in a surplus in a winding up are limited to a specific amount that is not calculated by reference to the company's assets or profits and such limitation had a commercial effect in practice at the time the shares were issued, or if later, at the time the limitation was introduced;
>
> (c) the shares are redeemable either according to their terms, or because the holder, or any party other than the issuer, can require their redemption.'

51. Mr Clifford's conclusion was that, as a consequence of the Companies Act 1985 and FRS 4, the directors of Fidex were required to report the Preference Shares in the accounts for the 2004 Year in shareholders' funds, analysed as attributable to non-equity shares.

52. Turning to the treatment of the Relevant Assets in the accounts for the 2004 Year under UK GAAP, Mr Clifford's evidence was that the relevant standard was FRS 5 (Reporting the substance of transactions), which applied to all transactions unless specifically dealt with by another standard. The principle of FRS 5 was that an entity's financial statements should reflect the substance of the transactions into which it had entered (FRS 5 [14]).

53. He referred to FRS 5 [22], which is in the following terms:

> 'Where a transaction involving a previously recognised asset transfers to others –
>
> (a) all significant rights or other access to benefits relating to that asset, and
>
> (b) all significant exposure to risks inherent in those benefits,
>
> the entire asset should cease to be recognised.'

54. Mr Clifford commented that it was clear from the Statement of Agreed Facts that, as a result of the Project Zephyr Transaction, all significant rights or other access to benefits and significant exposures to risks relating to 95% of the Relevant Assets were transferred by Fidex to Swiss Re. Therefore, application of FRS 5 alone should have led the directors of

Fidex to derecognise 95% of the Relevant Assets, i.e. to remove 95% of the Relevant Assets from the balance sheet and show no liability in respect of the amounts received for the transfer from the transferee.

55. He made the point that FRS 5 – see *ibid* [11] – does not apply to individual assets or liabilities, but to 'transactions', and thus would dictate the accounting treatment of both the Relevant Assets and the issue of the Preference Shares, by which the risks and rewards of ownership of the Relevant Assets were transferred by Fidex to Swiss Re.

56. Therefore, Mr Clifford said, the requirements of FRS 4 and the Companies Act (on the one hand) and FRS 5 (on the other hand) were in conflict. If the directors of Fidex had derecognised 95% of the Relevant Assets in the balance sheet for the 2004 Year, in order for that balance sheet to balance either the Preference Shares would have had to be derecognised also, or an offsetting entry of an equivalent amount would have had to be inserted, either to create a new asset or to reduce shareholders' funds. This would not have been possible. A new asset would not have met the definition in FRS 5 of 'assets' ('Rights or other access to future economic benefits controlled by an entity as a result of past transactions or events'). The alternative of not recognising the Preference Shares or reducing shareholders' funds in any other way would have meant that shareholders' funds as stated in the balance sheet would not have represented the amounts attributable to equity and non-equity interests as required by FRS 4.

57. He noted that the ASB had recognised the potential for conflict and had provided in FRS 5 [13]:

> 'Where the substance of a transaction or the treatment of any resulting asset or liability falls not only within the scope of this FRS but also directly within the scope of another FRS, a [SSAP], or a specific statutory requirement governing the recognition of assets or liabilities, the standard or statute that contains the more specific provision(s) should be applied.'

58. Mr Clifford concluded on the first issue that since the Companies Act 1985 and FRS 4 had established specific requirements for accounting for preference shares, it was clear that the treatment required by FRS 4 should prevail over that suggested by FRS 5 alone. Therefore, he said, the directors of Fidex would have had no choice but to record the Preference Shares and to continue to recognise the 95% of the Relevant Assets in the accounts for the 2004 Year, representing the Preference Shares as shareholders' funds attributable to non-equity interests in order to account consistently and properly for the Project Zephyr Transaction. Mr Clifford stated (having considered the reports of Mr Chopping and Mr Lawrence) that he would not expect a reasonable accountant to arrive at any other conclusion.

59. Under cross-examination, Mr Clifford was invited to consider a number of extreme hypothetical situations, such as the insolvency of an issuer of one of the Relevant Assets days before 31 December 2004. He accepted that in such a situation the Relevant Assets and the Preference Shares would have been written down and the write-down of the Relevant Assets would have been taken to profit and loss account which would (without having regard to any explanatory note) have accounted for a loss accruing in reality to Swiss Re as if it had been a loss accruing to Fidex. The write-back of the reduced obligation inherent in the Preference Shares would be credited either to distributable reserves (equity shareholders' funds) or to profit and loss account and thence to equity shareholders' funds. (Mr Martin's opinion was that the necessary adjustment in this hypothetical scenario would be through reserves.) It was put to Mr Clifford that such accounting treatment could not have been included in accounts

that showed a true and fair view, but Mr Clifford responded that redeemable preference shares were not accounted for under FRS 4 according to their substance and asked rhetorically: how may extra features do you add before you decide that somehow this is no longer tenable and you have to override FRS 4? He answered his own question by saying he would not know where to draw the line and that he did not think anybody in practice would have drawn that line. This was also the substance of his answer when it was put to him by Mr Tallon QC, with reference to a 2008 Opinion of Martin Moore QC instructed by the Financial Reporting Council, that the 'true and fair view or fair presentation concept' is of an overarching nature and could justify departure from accounting standards in exceptional or extremely rare cases in which such departure is permitted.

60. Turning to the second issue on which he had been asked to focus (see: paragraph 44 above – the presentation in Fidex's accounts for the 2005 Year), Mr Clifford noted changes to the Companies Act to allow private companies incorporated in England and Wales to use IFRS for accounting periods beginning on or after 1 January 2005 (for details of which, see [139] below). He said that a consequence of a private company choosing to report in accordance with IFRS was that it was no longer required to report in accordance with the Companies Act formats. He noted that the directors of Fidex had made this election for the accounts for the 2005 Year.

61. He commented that, in implementing IFRS, the directors of Fidex would have had to determine the accounting treatment for the Project Zephyr Transaction and, in particular, the accounting treatment of the Preference Shares and of the Relevant Assets, on transition to IFRS. The relevant IFRS standards were: IFRS 1 (First-time adoption of IFRS); IAS 32 (Financial Instruments: Disclosure and Presentation); and IAS 39 (Financial Instruments: Recognition and Measurement). He said that the accounting treatment would be based on the circumstances at year end (by which he meant the end of the 2004 Year and the beginning of the 2005 Year) and that this would not have been affected if, for example, there had been an unexpected sale of the Relevant Assets in January or February 2005.

62. IFRS 1 [36A] allowed entities not to restate their comparative balance sheet or income statement to comply with IAS 32 and IAS 39 but instead, Mr Clifford said, they were required to provide disclosures in the notes to the accounts showing the necessary adjustments between the balance sheet at the comparative date as previously reported under the previous GAAP and a balance sheet as at the start of the first IFRS reporting period prepared under IFRS. For Fidex, he commented, this note would have had to show the adjustments between the UK GAAP balance sheet as at 31 December 2004 and a balance sheet prepared under IFRS as at the same date.

63. Mr Clifford said that one of the major differences between UK GAAP in 2004 (as set out in FRS 4) and IFRS (as set out in IAS 32) was that, under IAS 32, the assessment of whether a financial instrument should be treated as debt or equity by its issuer is intended to reflect the substance of the contractual arrangement, rather than its legal form. The overarching requirement is set out in IAS 32 at [15]:

> "The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument, in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.'

64. He said that a financial liability was defined to include any ‘contractual obligation to deliver cash or another financial asset to another entity’, whereas an equity instrument was any ‘contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities’. Hence, Mr Clifford observed, a preference share that requires payments to be made to the holder is treated as a liability. If a preference share was to be classified as equity, the issuing entity would have to retain discretion over whether to redeem it or pay dividends. As a consequence, he noted, under IFRS there is no such category as ‘non-equity shares’.

65. Mr Clifford commented that classification of a preference share as a liability under IFRS is not affected by whether the payments on the preference share are conditional on the receipt of payments on an asset, or whether there must be available distributable profits in order for it to be redeemed. He cited IAS 32 [25] which requires a financial instrument to be treated as a liability if it:

> ‘may require the [issuing] entity to deliver cash … in the event of the occurrence or non-occurrence of uncertain future events [such as the issuer’s future revenues or net income] … that are beyond the control of both the issuer and the holder of the instrument …’

66. He said that this was illustrated by paragraph [AG25] of the Application Guidance (“AG”) to IAS 32, which addresses the application of IAS 32 to preference shares. Paragraph [AG25] states:

> ‘Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristics of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient profits or reserves, does not negate the obligation.’

67. Turning to IAS 39 (Financial Instruments: Recognition and Measurement), Mr Clifford observed that the derecognition rules contained in IAS 39 are much more detailed than those in FRS 5. Three steps are required to determine if a financial asset should be derecognised. They are:

> (a) whether to apply the derecognition rules to an entire asset or part of the asset;
>
> (b) whether the contractual rights to receive the cash flows of the financial asset have been transferred; and
>
> (c) whether the transferor has transferred substantially all the risks and rewards of ownership of the financial asset.

68. Dealing with the first step (a), Mr Clifford said that as only 95% of the cash flows of each Bond comprised in the Relevant Assets were to be paid to holders of the Preference Shares, it was necessary to determine whether to apply the derecognition requirements to 95% of each Bond or to each Bond in its entirety. He observed that IAS 39 [16(a)] sets out three conditions, in order to apply the requirements to only part of a financial asset. One of these conditions must be met by the part being considered for derecognition. He pointed to the second of these conditions (IAS 39 [16(a)(ii)]) which is that ‘the part comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset ..’ and observed that, as the Articles of Association of Fidex require that 95% of the cash flows on each Bond had to

be paid to the holders of the Preference Shares, this condition was met and the derecognition rules should have been applied to 95% of the cash flows on each Bond.

69. Dealing with the second step (b), he pointed out that, as Fidex did not transfer the contractual rights to receive the cash flows from the Bonds to Swiss Re, it was necessary to determine whether, by issuing the Preference Shares, Fidex was deemed to have transferred 95% of the cash flows on each Bond, applying what is known as the "pass through test". Fidex would be deemed to have done this if the Project Zephyr Transaction satisfied the three conditions set out in IAS 39 [19], which are:

> (a) that the entity [Fidex] has no obligation to pay amounts to the eventual recipients [Swiss Re] unless it collects equivalent amounts from the original asset [a Bond comprised in the Relevant Assets] …
>
> (b) that the entity [Fidex] is prohibited by the terms of the transfer contract from selling or pledging the original asset …; [and]
>
> (c) that the entity [Fidex] has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay …

70. Mr Clifford said that in his opinion the first of these conditions (a) was satisfied as articles 13 to 16 of Fidex's Articles of Association stated that the dividends and redemption amounts on the Preference Shares were to be 95% of the interest and principal actually received on the maturity of the respective Relevant Assets. The second condition (b) was satisfied by Fidex's undertakings to Swiss Re, set out in paragraph 4 of the PSSA.

71. His evidence was, however, that there were a number of difficulties with the third condition (c), mainly concerning the meanings of the words 'obligation' and, more significantly, 'without material delay' in context, for neither of which a definition is provided in IAS 39.

72. Mr Clifford commented that, on the one hand, there is a requirement, set out in Fidex's Articles of Association, to pay dividends and redeem the Preference Shares within one business day of receipt of interest and principal on the maturity of the respective Relevant Assets. But, on the other hand, the main feature of the Preference Shares which distinguished them from ordinary liabilities, is that they could only be redeemed out of distributable reserves, or the proceeds of a new issue of shares.

73. Taking account of this feature of the Preference Shares, Mr Clifford observed that as at 31 December 2004 Fidex had only €16.1 million of distributable profits, which was not enough to effect the redemption. Without further action, Fidex would not have been in a position to redeem the Preference Shares without material delay and Swiss Re would not have been entitled to take action against Fidex for a failure to redeem. He added that IAS 39 [19(c)] requires that the entity *has* an obligation to remit any cash flows it collects, without material delay, which, in his view, implied that the assessment of whether the condition was satisfied must be based as at the date of such assessment.

74. For this reason, Mr Clifford said that he did not believe that it would have been wrong if Fidex's directors had concluded that, as at 31 December 2004, Fidex did not satisfy the third of the 'pass through' conditions set out in IAS 39 [19(c)] in relation to the Project Zephyr

Transaction and, as a consequence, they had decided to continue to recognise the Relevant Assets under IFRS.

75. But, as against that, he pointed out that the term ‘obligation’ is used not only in IAS 39 as part of the derecognition test, but also in IAS 32 for determining the classification of preference shares. Based on the passage from paragraph [AG25] of the Application Guidance (“AG”) to IAS 32 (cited above at paragraph [66]) he had formed the view that the same interpretation of the word ‘obligation’ should be used in applying both IAS 32 and IAS 39, which would mean that the directors of Fidex were entitled to consider that Fidex did have a relevant obligation as at 31 December 2004. Mr Clifford’s reasoning was that he thought it inappropriate to ascribe different meanings to the word ‘obligation’ when determining the correct accounting treatment of a single transaction, especially having regard to the fact that the two standards were revised together and were issued in their revised form as a package.

76. He added, in support of this conclusion, that the directors of Fidex would have been confident as at 31 December 2004 that, by the date of redemption of the Preference Shares, Fidex would not only have an obligation to redeem them but also would be able to meet that obligation without material delay. This was for two reasons: First, BNPP had undertaken on 22 December 2004 to subscribe for new shares in FHL, which in turn had agreed to subscribe for new shares in Fidex, if that was required in order to enable the Preference Shares to be redeemed. Secondly, the directors of Fidex would be able to apply to the Court to reduce the share premium account in order to create sufficient distributable reserves to effect the redemption. Such an application, while not quite a formality, in Mr Clifford’s opinion, would – he had been advised by Fidex’s legal advisors – have been straightforward and very likely to be successful, given that Fidex had few creditors.

77. Mr Clifford commented that while it was possible that Fidex could have generated losses before the redemption date(s) of the Preference Shares, it had sufficient in the share premium account (a) to absorb losses that could have arisen under any conceivable future scenario, given its activities, and (b) to leave sufficient to enable the Preference Shares to be redeemed. He added that his confidence on this point had been confirmed by what subsequently took place: by the time the accounts for the 2005 Year were prepared and the directors of Fidex made their assessment, the Court had long since approved the reduction of the share premium account and the Preference Shares had been redeemed on their due dates.

78. In the result, Mr Clifford believed that it was appropriate for the directors of Fidex to conclude that 95% of the Relevant Assets had been transferred as described in IAS 39 [19].

79. Dealing with the third step (c), set out in paragraph [67] above, Mr Clifford pointed out that IAS 39 [20(a)] required an assessment of whether Fidex had transferred substantially all the risks and rewards of ownership of the Relevant Assets. He said that since 95% of all the cash flows received on the Relevant Assets were to be paid to Swiss Re, this requirement was met. All interest rate- credit- and liquidity-risk was, in effect, transferred to Swiss Re. His view was that, as a result, according to IAS 39 [20(a)], 95% of each Bond was required to be derecognised and the remaining 5% to continue to be recognised as a separate asset.

80. Mr Clifford added that derecognising 95% of the Relevant Assets required that the Preference Shares should not be recognised as liabilities.

81. He noted that IAS 39 [26] requires that on derecognition of a financial asset, the difference between the carrying amount and the consideration received (plus any cumulative fair gain or loss recognised in equity) must be recognised in profit or loss. The cash received by Fidex on the issue of the Preference Shares was treated as the consideration for the deemed transfer of 95% of the Relevant Assets. In accounting terms, the liabilities arising from the Preference Shares had, in effect and substance, been immediately discharged by the deemed transfer of 95% of the Relevant Assets.

82. Turning to consider Fidex's balance sheet as at 31 December 2004, Mr Clifford commented that the directors of Fidex had chosen to apply the exemption in IFRS 1 and so not to restate that balance sheet for the effects of IAS 32 and IAS 39. As a result, they had just showed the effect of the transition from UK GAAP to IFRS in notes 22 and 23 to the accounts. In note 23, 95% of the Relevant Assets, to the value of €83,849,399 were derecognised, together with €62,358 of accrued interest payable on the Preference Shares, while in note 22, Preference Shares to the value of €84,493,197 were deducted from non-equity shareholders' funds.

83. On the third of the issues on which Mr Clifford was asked to focus – the extent to which the Project Zephyr Transaction represented a 'GAAP difference' between 2004 UK GAAP and 2005 IFRS in so far as accounting derecognition of assets was concerned – he acknowledged that there was a very significant difference. The different requirements of 2004 UK GAAP and 2005 IFRS regarding the recording of Preference Shares had such a significant effect as to warrant the conclusion that there was a difference in the required accounting treatment of the Project Zephyr Transaction under UK GAAP in 2004 and under IFRS in 2005.

84. Mr Clifford commented that had the directors of Fidex not decided to adopt IFRS for the accounts for the 2005 Year, the treatment of the Preference Shares would have changed in that year even if the accounts had continued to be prepared under UK GAAP. This was because a new paragraph (5A) in Part 1 of Schedule 4 to the Companies Act 1985 (see further at [141] below) had required the directors to have regard to 'the substance of the reported transaction or arrangement in accordance with generally accepted accounting principles or practice' in determining how amounts were to be presented in the accounts.

85. This change in the Companies Act permitted the ASB to replace those parts of FRS 4 that addressed the classification of financial instruments by the issuer as debt or equity. FRS 25 (Financial instruments: presentation and disclosure), which imported the equivalent provisions of IAS 32, was issued in December 2004 with effect for periods beginning on or after 1 January 2005. In the Notes on the application of FRS 25, the ASB explained that 'as a result, preference shares that contain obligations to transfer economic benefits will be classified as liabilities rather than shareholders' funds'.

86. Mr Clifford stated that although FRS 25 [97] required retrospective application, FRS 25 [97B] allowed an entity not to restate its comparative figures in the first year of application (as in the similar provision in IFRS 1), but instead to show the change in presentation as at the beginning of the year in a note to the accounts. Thus, the Preference Shares would have been treated as a liability if 2005 UK GAAP had applied but the directors of company had a choice whether or not to restate the 2004 balance sheet.

87. The superseding of FRS 4 by FRS 25 in 2005 would, together with FRS 5, have required the derecognition of 95% of the Relevant Assets in the accounts of Fidex for the 2005 Year if

those accounts had been prepared under 2005 UK GAAP. If the directors of Fidex had applied 2005 UK GAAP to the accounts of Fidex for the 2005 Year and had decided to restate the balance sheet for the 2004 Year to reflect the introduction of FRS 25, they would also have had to derecognise 95% of the Relevant Assets, together with the Preference Shares. However, if they had opted not to restate the comparative balance sheet, they would have shown the effect of moving to FRS 25 and the derecognition of 95% of the Relevant Assets and the Preference Shares, as at 1 January 2005 in a note to the accounts. In this way the accounting treatment under 2005 UK GAAP would have been consistent with that actually applied by the directors of Fidex under IFRS.

88. Mr Martin's instructions were to give his opinion on the same issues as those addressed by Mr Clifford – see above, paragraph [44].

89. He made the usual expert's declaration in his report as to his objectivity in giving his evidence and that he was aware of no conflict of interest of any kind, other than that he was aware that his firm, KPMG, had provided *ad hoc* verbal advice in 2004 to BNPP in relation to the Project Zephyr Transaction. He stated that he was not involved in the provision of that advice.

90. In relation to his analysis of the Project Zephyr Transaction under UK GAAP applicable to the 2004 Year, Mr Martin stated that the accounting standards of particular relevance would have been FRS 4, FRS 5 and UITF Abstract 33 (Obligations in capital instruments).

91. Mr Martin's opinion was the same as Mr Clifford's as regards the requirement on Fidex to report the Preference Shares in the accounts for the 2004 Year in shareholders' funds, analysed as attributable to non-equity shares, under UK GAAP, pursuant to FRS 4. He reinforced this opinion by reference to UITF Abstract 33. He said that he was not aware of any instances of a reporting entity applying a "true and fair override" or concluding that FRS 5 should override the provisions of FRS 4 so as to account for preference shares as liabilities in the reporting entity's individual accounts and his view was that it would have been inappropriate to do so, given the specific consideration of the ASB on this point. He made the point that Fidex's accounts had already accounted for the cash received (the net proceeds) on the issue of the Preference Shares as required by FRS 4. It would therefore, in his view, have been inappropriate to account for those proceeds a second time as the proceeds of a bond sale. The general provisions of FRS 5 would not in his view have applied to the Project Zephyr Transaction having regard to paragraph [13] of FRS 5 – the view expressed by Mr Clifford.

92. Mr Martin also agreed with Mr Clifford that the recognition (or non-derecognition) of the Relevant Assets in Fidex's accounts for the 2004 Year was correct. He reiterated the point that the accounts had already accounted for the cash received as consideration for a share issue and that it would have been inappropriate for the cash to be accounted for a second time as proceeds of a bond sale, which would have been the consequence of de-recognising the Relevant Assets.

93. In relation to his analysis of the Project Zephyr Transaction under IFRS in Fidex's accounts for the 2005 Year, Mr Martin referred (as had Mr Clifford) to IFRS 1, IAS 32 and IAS 39. His opinion was in agreement with Mr Clifford's in all material respects. He said that, having regard to the facts and circumstances of the particular case (i.e. the Project Zephyr Transaction), he would have accepted the accounting treatment used by Fidex and therefore would not have recommended the qualification of the auditor's opinion with respect

to that matter. This conclusion was subject to adequate disclosure being made in the accounts to alert the reader that off balance sheet assets exist to satisfy creditors with a prior claim upon them and his view was that the disclosures made by Fidex in the accounts for the 2005 Year were adequate.

94. Mr Martin also agreed with Mr Clifford's conclusion that there was a significant 'GAAP difference' – that is, that the primary reason for the difference in treatment of the Project Zephyr Transaction between the accounts for the 2004 Year and the accounts for the 2005 Year was the use of different accounting frameworks in 2004 and 2005.

95. Mr Chopping, the first expert instructed by HMRC, considered the relevant accounting requirements of UK GAAP, in particular the interaction between FRS 4 and FRS 5. He accepted that 'in 2004 the treatment of preference shares was normally covered by FRS 4' and that 'as a general rule, preference shares were treated as non-equity shares and initially stated at the amount of the net proceeds'. He stated in cross-examination that this case was the only exception to the proper application of FRS 4 to the treatment of preference shares which he had ever encountered. His view was that a 'normal' redeemable preference share, although in substance a liability, but 'without any unusual elements', was also in substance a preference share that needed to be recorded, and would properly have been accounted for in non-equity shareholders' funds under FRS 4. He also accepted that FRS 4 was an exception to the substance over form principle.

96. With regard to the Preference Shares in this case, his view was not that they should have been treated as debt in the accounts for the 2004 Year prepared under UK GAAP, but that they should have been derecognised (or not recognised). This was because the Preference Shares were issued as part of a much larger arrangement and FRS 5 required that recognition be given to the substance of the larger arrangement when deciding how to account for the Preference Shares. FRS 4 did not apply because the Preference Shares had to be derecognised: the threshold for consideration of the application of FRS 4 was that there were preference shares which had to be recognised. But the larger arrangement had included 'steps that meant the substance was [that] the normal limitations on shares [i.e. that they were subject to more restrictions on redemption than debentures or other debt] should not be relevant in [the] accounting treatment [adopted]'.

97. However he made reference to FRS 5 [13] (which Mr Clifford had noted – see above [57]) and to FRS 5 [43], part of the explanation given of the scope of FRS 5 and specifically its relationship to other standards, which states as follows:

> 'The FRS [FRS 5] sets out general principles relevant to reporting the substance of all transactions. Other accounting standards, the Application Notes of the FRS and companies legislation apply general principles to particular transactions or events. It follows that where a transaction falls within the scope of both the FRS and another accounting standard, whichever contains the more specific provisions should be applied. Nevertheless, the specific provisions of any standard or statute should be applied to the substance of the transaction and not merely to its legal form and, for this purpose, the general principles set out in FRS 5 will be relevant.'

98. With reference to the last sentence of FRS 5 [43], Mr Chopping stated:

> 'I can only interpret this paragraph, and in particular the final sentence, to mean that where a transaction has been structured in such a way that it appears to fall within the scope of another standard, but that this does not reflect the substance of the transaction, then the general principles of FRS 5 are applied first. The specific standard is then applied, if it remains relevant, only once that substance has been determined and reflected.'

99. He made reference to FRS 5 [45], which addresses the interaction between FRS 5 and SSAP 21 (Accounting for leases and hire purchase contracts), which notes that SSAP 21 governs accounting for leases that fall wholly within its parameters, but that FRS 5 is relevant in determining the nature of a lease, and therefore which parts of SSAP 21 will then be applied.

100. He also made reference to Application Note E to FRS 5, which deals with loan transfers and commented that the arrangement entered into by Fidex, on the face of it, falls within the scope of that Application Note. He accepted, however, that the legal nature of shares and debt (debentures) was different and this needed to be recognised when both UK GAAP and IFRS were being applied.

101. His opinion was that FRS 5 takes precedence in cases where an arrangement has elements which appear to fall within the scope of both it (or an Application Note to it) and another standard, and that the other standard is then applied only once the substance of the transaction has been determined.

102. He also noted FRS 5 [47] which sets out the features of more complex transactions which require 'particularly careful analysis' and commented that the paragraph appeared directly relevant to the treatment of the Relevant Assets and the Preference Shares.

103. Mr Chopping's conclusion was that the Relevant Assets and the Preference Shares should have been derecognised in the balance sheet of Fidex, prepared under UK GAAP as at 31 December 2004 (or, in the case of the Preference Shares, never recognised). His opinion was that the accounts of Fidex for the 2004 Year did not give a true and fair view.

104. When asked where he 'would draw the line' between accounting for preference shares under FRS 4 and derecognising them by reference to FRS 5, he said the 'the hurdle there is extremely high' and 'the situation would have to be quite extreme' and he did not describe (or apparently conceive of) a case other than the present case which he thought would have been over the line. In cross-examination he accepted that he could not be certain what he would have decided in relation to the present case at the time when the question of how the accounts of Fidex for the 2004 Year should be drawn up fell to be considered. In a publication for which he had been responsible at the time (2004-05) he had made the point that FRS 4 takes a form over substance approach and he accepted under cross-examination that at that time he had not considered any circumstances where shares would not (under FRS 4) be accounted for as shares.

105. In relation to IFRS, Mr Chopping considered (as did Mr Clifford and Mr Martin) that IAS 32 and IAS 39 were the relevant accounting standards for consideration.

106. Mr Chopping stated that he agreed with the analysis of the relevant paragraphs of the 'Project Zephyr Accounting Opinion' provided by PwC on 17 December 2004, as to how the relevant paragraphs of IAS 39 ([17] to [23]) should be applied to the Relevant Assets and associated Preference Shares. He also agreed with PwC's conclusion, expressed in that Opinion, that (95% of) the Relevant Assets and the Preference Shares should be derecognised under IFRS.

107. We note that this was the conclusion of Mr Clifford (see [79] and [80] above) with which Mr Martin agreed. Mr Chopping expressly accepted that he was in agreement with Mr

Martin that it was acceptable to derecognise the Relevant Assets (or 95% thereof) and the Preference Shares under IFRS.

108. Mr Lawrence agreed with Mr Chopping that FRS 5 [43] ‘makes it clear that the substance of a transaction, recognition and derecognition override the classification requirements of FRS 4’. His view was that, for accounting purposes and having regard to FRS 5 [14], ‘Fidex never actually had any obligations under the [P]reference [S]hares and, in substance, their non-recognition [for the purposes of the application of UK GAAP to the accounts for the 2004 Year] is appropriate’. He also considered that those accounts did not give a true and fair view. In saying that, he meant that the treatment adopted in Fidex’s accounts, which were audited by PwC without relevant qualification, (which treatment was supported by the evidence of Mr Clifford and Mr Martin) was based on an unreasonable interpretation of the relevant accounting standards (FRS 4 and FRS 5). He accepted that if he had considered that the treatment adopted in Fidex’s accounts had been based on a reasonable interpretation of those standards, even though he himself did not agree that the interpretation was correct, or was the better view, he would still have regarded the accounts as having given a true and fair view.

109. In cross-examination Mr Lawrence said that until he met this case he had never seen a case where a company would issue preference shares and not recognise them.

110. His view on the relevance of the balance sheet formats laid down by the Companies Act was that they apply to the presentation of shares ‘if they [such shares] are recognised’. He went on: ‘if a balance sheet item is not recognised it is irrelevant that company law dictates where it would be recognised. CA85 does not override accounting standards’. But under cross-examination he accepted that it was implicit in the fact that an item was presented in the balance sheet that it was recognised and that he could not point to anyone ever having considered it possible that issued preference shares might not be recognised.

111. He agreed with the other experts that IAS 39 was properly applied as at 1 January 2005 in providing for derecognition of 95% of the Relevant Assets and derecognition of the Preference Shares (subject to his view that a proper application of UK GAAP in the 2004 Year would already have provided for such derecognition).

112. Mr Clifford and Mr Martin disagreed with Mr Chopping (and Mr Lawrence) in their interpretation of FRS 5 [43]. They made the point that if the argument were valid, it would apply equally to most preference shares, the substance of which is that they are liabilities, even if they are not ‘structured’ so as to be linked to specific assets.

113. Mr Clifford and Mr Martin also disagreed with Mr Lawrence’s view that accounting standards are not overridden by Companies Acts, explaining that the ASB had expressly developed FRS 4 so as to be consistent with the Companies Act 1985. Mr Clifford agreed that FRS 4 (which he thought was the applicable accounting standard) would have prevailed if it had conflicted with the Companies Act, but said that there was no conflict, because FRS 4 was designed to be consistent with the Companies Act. He said that in his view FRS 4 gave no choice to a reporting entity but to report preference shares as part of shareholders’ funds, while acknowledging that if there had been a choice of applicable accounting standards, an entity ought to select the most appropriate standard for its particular circumstances with the object of giving a true and fair view.

114. Mr Clifford and Mr Martin disagreed with Mr Lawrence's view that FRS 4 only deals with classification once a capital instrument is recognised, but not with the issue of whether it should be recognised. Mr Clifford said that FRS 4 nowhere cross-refers to FRS 5 to assist determination of whether a capital instrument should be recognised in the first place, but assumes that shares are always classified as part of shareholders' funds, then dealing with their sub-classification into equity interests and non-equity interests.

115. Mr Clifford and Mr Martin disagreed with Mr Lawrence's view that the changes in company law and accounting standards between 2004 and 2005 were not directly relevant to this case and merely provided 'recognition in statute of the extant situation'. They pointed out that FRS 25 substantially amended FRS 4 to remove the concept of non-equity shares with the result that capital instruments had to be classified either as equity (shareholders' funds) or liabilities.

Submissions on the Paragraph 19A Issue and our comments thereon

116. At the Tribunal's request counsel for both parties (after the hearing) produced written submissions on the evidence of the expert witnesses. We summarise those submissions and the oral submissions on the Paragraph 19A Issue as follows.

117. Fidex places some emphasis on the 'fire power' of their expert evidence – two senior practitioners from Big 4 firms who had taken the trouble to consult widely. And they reminded us that Mr Chopping had admitted that it was difficult to be sure what he would have thought about the issue at the time.

118. Mr Tallon challenged Mr Clifford's objectivity by reference, first, to the fact that his firm, Ernst & Young, were registered as the promoters of the scheme manifested in the Project Zephyr Transaction under the disclosure of tax avoidance scheme rules, and, secondly, by reference to his observation that he would not expect a reasonable accountant to disagree with his view on the central issue of the application of FRS 4 to the accounts of Fidex for the 2004 Year.

119. We reject these challenges. Mr Clifford referred to the fact that his firm was the promoter of the scheme at an early stage. We were entirely satisfied that his evidence was quite unaffected by this connection, which, in terms personal to him, was of very minor significance. We bear the connection in mind when considering the weight of his evidence, but we do not think it appropriate to discount the validity of his opinion by any significant amount. Mr Clifford impressed us as a conscientious and professional expert witness. As to his saying that he would not expect a reasonable accountant to disagree with him, we regarded that as an expression appropriately used to underline the confidence he felt in his opinion. We disagree with Mr Tallon's description of it as 'intemperate' and 'unbecoming'.

120. Mr Flesch QC and Mr Boulton QC challenged Mr Lawrence's objectivity because he was employed by HMRC. They also submitted that Mr Lawrence did not have the experience to assist us, having never been an audit partner and never having had authority to sign the audit reports for listed companies. We consider that there is some force in these criticisms, but on the whole we found Mr Lawrence to have been a straightforward expert witness who was as helpful as he could be.

121. Turning from the quality of the expert witnesses, HMRC asked that we should make certain specific findings of fact, which we do. The facts referred to are as follows:

(1) The purpose of the forgiveness by BNPP of the release by BNPP of approximately US$24 million of indebtedness owed to it by Fidex, on 20 December 2004 – see [22(d)] above – was to create distributable reserves in Fidex, in order that Fidex could pay a dividend on the Preference Shares. This is evident from a confidential internal BNPP memorandum dated 15 December 2004, with our papers.

(2) Fidex paid BNPP an unspecified amount for giving the undertaking to Swiss Re to guarantee Fidex's obligations under the Preference Shares. This is evident from two BNPP internal documents commenting on the deductibility of the fee.

(3) None of the 4 expert witnesses had experience before 1 January 2005 of an issue of redeemable preference shares whose terms could be described as similar to those of the Preference Shares.

(4) All of the 4 expert witnesses agreed that it was unlikely that the framers of FRS 4 (or indeed the authors of contemporaneous books on UK GAAP) would have had in mind an issue of preference shares on terms similar to those of the Preference Shares.

(5) Both Mr Clifford and Mr Martin accepted that, while there was not as a matter of fact any reason for there to be an impairment issue arising in respect of any of the Relevant Assets (i.e. some material effect on the bond issuer's ability to pay in full) any impairment loss arising in the 2004 Year would have had to have been reflected in the profit and loss account (or reserves) of Fidex.

(6) The economic effect of the issue of the Preference Shares on 22 December 2004 was that Fidex sold 95% of the Relevant Assets to Swiss Re.

(7) Both Mr Clifford and Mr Martin agreed that accounts of companies audited by the 'Big 4' firms of chartered accountants had in the past been required to be restated by the Financial Reporting Review Panel.

122. HMRC submits that there was no relevant 'practice' of accountants to which we should have regard in determining whether Fidex's accounts for the 2004 Year were stated in accordance with UK GAAP. This was on the basis that the terms of the Project Zephyr Transaction, and the terms of the Preference Shares which were integral to Project Zephyr Transaction, were to all intents and purposes unheard of before 17 December 2004 (the date of the PWC 'Project "Zephyr" accounting opinion').

123. While we accept that the terms of the Project Zephyr Transaction and the terms of the Preference Shares were to all intents and purposes unheard of before 17 December 2004, it does not follow in our view that there was no relevant 'practice' of accountants to which we should have regard. That depends on whether the terms of the transaction and of the Preference Shares are of such significance in interpreting and applying the relevant accounting standards that they effectively eclipse the fact that the issue is how preference shares ought to have been accounted for and the consequences of the answer to that question in relation to the accepted way of accounting for the Relevant Assets. These are the main issues for our decision in relation to the application of UK GAAP to Fidex's accounts for the 2004 Year and we do not prejudge them. We note, however, that Mr Chopping admitted in cross-examination that it was difficult for him to be sure what he would have thought at the time was the correct accounting treatment. He recognised that in giving his opinion on the Project Zephyr Transaction – that shares had been issued which did not fall to be recognised – he was in a position that he had never been in before in his professional career, in that he

was giving an opinion and interpretation of accounting standards which was unsupported by any accounting authority apart from Mr Lawrence's opinion. We consider this is an important point for us to bear in mind in considering in terms of Paragraph 19A whether Fidex's accounts for the 2004 Year were prepared in accordance with 'UK generally accepted accounting practice'. It tells against Mr Chopping's opinion that they were not.

124. The evidence of Mr Chopping and Mr Lawrence was that the application of UK GAAP (specifically FRS 5 [13] and [43]) as at 31 December 2004 required consideration of whether the Preference Shares fell to be recorded on Fidex's balance sheet (that is, whether they ought to have been recognised at all), and, if so, whether they took the form of shares. If both questions were answered in the affirmative (which they would be in the case of a 'normal' redeemable preference share), then FRS 4 was the correct standard to apply. Their opinion was that the Preference Shares did not fall to be recognised at all, because the requirement to apply an accounting treatment, which reflected the substance of the entire Project Zephyr Transaction, would result in the transaction being treated as the sale of 95% of the Relevant Assets. The consequence in accounting terms was that no credit entry would fall to be recorded in respect of the Preference Shares because there was, in substance, no issue of a 'capital instrument' as defined by FRS 4 – that is, no 'means of raising finance' – because the Project Zephyr Transaction had not in substance been a transaction aimed at raising finance.

125. HMRC submitted on this basis that FRS 4 [37], which required that shares should be reported as part of shareholders' funds, was not a "recognition principle" but instead a direction of how anything called a 'share' had to be presented if it had been recognised as such.

126. On the point raised by Fidex's experts that if this was the correct approach it would be difficult to know where to draw the line between recognising and not recognising shares, HMRC's submission was that it was a matter of professional accounting judgment to distinguish between cases where shares had been issued which should be accounted for under FRS 4 as shares, and cases where shares had been issued where the substance of those shares was such that they should not be recognised as shares at all. HMRC went on in their written submissions to assert that this was not a borderline case, since applying FRS 4 resulted in an overstatement of Fidex's assets by some 25%.

127. Mr Flesch and Mr Boulton, for Fidex, took us back to the text of FRS 5 [13] and [43], reminding us that both paragraphs made reference to the need (in the case of conflict between FRS 5 and another FRS or SSAP, or a specific statutory requirement) to apply the standard or statute which contains the more specific provision(s). They make the point that FRS 4 contains the more specific provisions when it comes to accounting for preference shares. FRS 4 (in particular Appendix III thereto) specifically excludes shares from recognition *as liabilities* because 'shares have a distinct legal status reflected (*inter alia*) in the limitations imposed by companies legislation on the circumstances in which payments may be made in respect of them'. The point is also made that it is impossible to classify shares as liabilities within the constraints of the (pre-2005) statutory formats for the balance sheet. FRS 4 (as we have noted) deals with this problem by proposing the distinction of accounting for equity and non-equity shares.

128. The authors of FRS 4 therefore gave explicit consideration to the potential conflict between FRS 4 and the substance of transactions involving shares. Accounting for the substance of transactions (later dealt with in FRS 5) had been the subject of the predecessor to FRS 5, FRED 4. FRED 4 had been in issue when FRS 4 was being prepared and

Appendix III to FRS 4 deals with potential inconsistencies between FRS 4 and FRED 4. However while, as stated above, there is an exposition of why a share cannot be accounted for as a liability, there is no explicit (or even implicit) suggestion that in some cases a share, instead of being accounted for as a share, should not be recognised at all.

129. HMRC submitted that the explanation for this was that (as Mr Chopping had said) it was fruitless to look for a "non-recognition" principle in FRS 4 (or to draw any inferences from its absence) because FRS 4, like any other accounting standard dealing with a specific category of asset or liability, implicitly assumed that something had fallen to be recognised in the first place. This was also the explanation given for the fact that the authors of the chapters on FRS 4 in UK GAAP textbooks had failed to mention the point.

130. We are not convinced by this argument. It seems to us that FRS 4 and FRS 5 (and its predecessor FRED 4) were carefully considered documents and were intended to set down comprehensive standards. That is how they were approached by Mr Clifford and Mr Martin – both very experienced accountants in this field – and that is how, in our view, they should have been approached. The purpose of the publication of accounting standards is, it seems to us, that they should be regarded as comprehensive according to their terms. It is not a satisfactory way of construing FRS 4 to say that it does not apply to certain specific shares which are not in their substance shares at all, when FRS 4 (and FRS 5) are entirely silent on the point.

131. We also do not regard HMRC's argument that it is acceptable to make an exception from accounting on the basis of substance for 'normal' redeemable preference shares, which are in substance liabilities, but are nonetheless to be accounted for as part of shareholders' funds, but not to make a similar exception for the Preference Shares whose net proceeds, we accept, were in substance the proceeds of sale of 95% of the Relevant Assets. In terms of the logic which we discern to have been adopted in the promulgation of FRS 4 and FRS 5, we do not see any reason for assuming any accounting treatment on the basis of substance for any shares, once it is recognised that normal redeemable preference shares are to be accounted for on the basis of their form, not their substance.

132. We accept that there is no logical basis for 'drawing a line' between redeemable preference shares which are to be recognised as such (although in substance they are not shareholders' funds – because they are liabilities) and redeemable preference shares (such as the Preference Shares in issue in this case) which are not to be recognised as such (although, again, they are in substance not shareholders' funds – but for another reason). If there is no logical basis for drawing such a line, it cannot be a question of judgment where it is to be drawn. On the contrary, drawing such a line would be an arbitrary exercise.

133. With respect to Mr Chopping and Mr Lawrence, we have concluded that their opinions have been developed to deal with the specific case of the Preference Shares, not giving sufficient emphasis to the fact that accounting standards are intended to be of general application and not directed to specific cases.

134. We have concluded for these reasons that we prefer the evidence of Mr Clifford and Mr Martin as to the correct accounting treatment of the Preference Shares. In so doing, we believe we have, as we have been urged to do by Mr Tallon, put much more weight on the reasons given in the expert opinions and the oral evidence, than on the experience and status of the witnesses. We have nevertheless been fortified by the fact that the opinions we prefer on the accounting issues are those offered by the witnesses with the more appropriate high

level practical experience. We also accept the evidence of Mr Clifford and Mr Martin, which was not seriously disputed, that if the Preference Shares were accounted for in Fidex's accounts for the 2004 Year as part of shareholders' funds, then it followed that the 95% of the Relevant Assets (the subject of the Project Zephyr Transaction) had also to be included in the balance sheet as a balancing item. We find that Fidex's accounts for the 2004 Year showed a true and fair view.

135. All the experts were agreed that Fidex had accounted correctly in the 2005 Year under IFRS, and we so find.

136. We asked Mr Boulton for a document which conveniently, concisely and completely described the changes in accounting standards and in company law that were brought into effect from 1 January 2005. Such a document was provided, as an Appendix to the written closing submissions of Mr Flesch and Mr Boulton, and we are grateful for it. In the following paragraphs we set out the main points.

137. Following the adoption of Regulation 1606/2002/EC (the IAS Regulation) by the European Parliament and the Council of the European Union on 19 July 2002, publicly traded companies were required to prepare their consolidated accounts under EU-indorsed IFRS, while Member States were given power to permit or require publicly traded companies to prepare their annual accounts and other companies to prepare their consolidated and/or annual accounts in accordance with EU-indorsed IFRS.

138. The UK Government announced on 17 July 2003 that it would permit (but not require) non-publicly traded companies to use IAS in their consolidated and individual accounts (and publicly traded companies to use IAS in their individual accounts). This would allow Fidex to report under IFRS in its accounts.

139. In order to implement the Government's policy, however, it was necessary to amend the Companies Act 1985. This was done by the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 ("the Regulations"), which amended section 226 of the Companies Act 1985. The amendment was effective for financial years beginning on or after 1 January 2005. Early adoption of IFRS was not permitted, so Fidex would not have been able to report under IFRS for any financial period before that commencing on 1 January 2005. Fidex applied IFRS in its financial statements for the 2005 Year and used UK GAAP as applied in the 2004 Year to give the comparative information to financial instruments within the scope of IAS 32 and IAS 39 (as allowed by IFRS 1 [36A]).

140. A company preparing IAS accounts was not required to comply with the requirements of Schedule 4 to the Companies Act 1985. Therefore, any restrictions in company law regarding the presentation of preference shares did not apply to Fidex's accounts for the 2005 Year.

141. However the Regulations also introduced a new paragraph 5A into Schedule 4 to the Companies Act 1985 (with effect for financial years beginning on or after 1 January 2005), which required directors to have regard to the substance of a reported transaction or arrangement in accordance with generally accepted accounting principles, in determining how amounts are presented in the accounts. FRS 25 was issued in December 2004 and applied to accounting periods beginning on or after 1 January 2005.

142. Following the adoption of IFRS in Fidex's accounts for the 2005 Year, in the opening balances as at 1 January 2005, 95% of the Relevant Assets were derecognised and the linked Preference Shares ceased to be recognised. The consequence was a 'GAAP difference' of €83,849,399 between 2004 UK GAAP and 2005 IFRS in so far as accounting derecognition of assets is concerned.

Decision on the Paragraph 19A Issue

143. We hold accordingly that the conditions in Paragraph 19A apply and that the identified 'GAAP difference' requires to be brought into account for the purposes of Chapter 2, Finance Act 1996 in the 2005 Year in accordance with Paragraph 19A(3). This is subject to our decision on the Paragraph 13 Issue to which we now turn.

The Paragraph 13 Issue - Introduction

144. As indicated above, the essence of the Paragraph 13 Issue is whether or not in the 2005 Year the Relevant Assets (being loan relationships of Fidex) had an 'unallowable purpose'. This focuses the attention (in broad terms) on whether the purposes for which 'at times during' the 2005 Year, Fidex was a party to such loan relationships or entered into related transactions by reference to them (which would include disposals – in whole or in part – of rights under them) was a tax avoidance purpose, which was the main purpose, or one of the main purposes, for which Fidex was a party to the loan relationships at a time during the 2005 Year when it held them, or for which it entered into related transactions by reference to them.

145. It is common ground that Fidex acquired the Relevant Assets in 2000 as collateral for its business of issuing commercial paper – that is, for a commercial business purpose. Fidex ceased to issue any commercial paper in 2002, but after that time the Relevant Assets continued to be held for commercial purposes. There is no suggestion that any tax avoidance purpose existed before December 2004.

146. An 'Approval Document' prepared by BNPP Structured Finance and dated 10 December 2004 was entitled 'Project Zephyr – Acquisition of the Fidex group and structured risk transfer of selected bond assets held by Fidex Plc' was with our papers. The Executive Summary in this document is in the following terms:

> '2.1 This transaction results in [BNPP] purchasing the legal ownership of a presently orphaned, BNPP sponsored, failed collateralised commercial paper issuance vehicle (Fidex Plc) and the corresponding risk transfer of *circa*. €84 million of the US$488 million book value of collateral (being a diversified portfolio of highly rated bonds) remaining within that vehicle. The risk transfer of €84 million of bonds is structured such that it results in the BNPP UK group being able to claim a UK tax deduction for €84 million under current UK tax law as a result of the application of the transitional rules for UK taxpayers moving accounting basis from UK GAAP to IFRS on 1 January 2005.
>
> 2.2 Organisation Finance have been working with Swiss Re Capital Markets (who are advised by Ernst & Young) in structuring this transaction.
>
> 2.3 The commercial purpose and net effect of the transaction is for the BNPP group to transfer the economic risks and reward of ownership of a €84 million portfolio of bonds in a tax efficient way to the Swiss Re group.

Counterparty risk	Mitigant: The BNPP group is not taking any additional counterparty risk as a result of this transaction and removes €84 million of counterparty exposure and 100% risk weighted assets as a consequence.
Market risk	Mitigant: No additional risk of any consequence.

Reputational risk	Mitigant: The transaction was presented to leading tax counsel … who, while conceding that the proposal might be regarded as aggressive, did confirm that the anticipated tax results were in accordance with UK tax law (as currently drafted).
Legal risk	Mitigant: The documentation is relatively simple and is being prepared by Clifford Chance on BNPP's behalf.
Tax risk	Mitigant: A change in tax law by the UK authorities prior to 31 December 2005 could render this transaction without the anticipated tax result. As the fee paid to Swiss Re is refundable in these circumstances, economic losses are confined to fixed costs of implementation (estimated at €500,000 at the date of this paper, the majority of which have already been incurred), additional hedging costs and opportunity costs associated with liquidating the whole bond portfolio of Fidex as [*sic*] current market levels.
Operational risk	Mitigant: None in addition to those already present in the management of Fidex and its portfolio.'

147. As indicated above, the Project Zephyr Transaction took place over the period between 17 December 2004 and 22 December 2004 and answered to the description in the document dated 10 December 2004 which has just been cited. The PwC 'Project "Zephyr" accounting opinion' was also dated 17 December 2004 and, as one would expect, outline the proposed transaction in more detail.

148. We have no hesitation in finding that the main purpose, or one of the main purposes, of Fidex in entering into:

> (1) the acceptance of the release of approximately US$24 million of indebtedness owed to it (Fidex) by BNPP on 22 December 2004 to create distributable reserves in Fidex, in order that Fidex could pay a dividend on the Preference Shares (see: [121] above),
>
> (2) the PSSA on 22 December 2004,
>
> (3) the adoption of new Articles of Association on 22 December 2004,
>
> (4) the Conditional Subscription Agreement with FHL on 22 December 2004, and
>
> (5) the adoption, on 22 December 2004, of the use of IFRS in place of UK GAAP for the period commencing 1 January 2005,

was a tax avoidance purpose, as that expression is to be construed for the purposes of Paragraph 13. It was the main purpose, or one of the main purposes of these actions for Fidex to secure a tax advantage, being a relief from tax represented by the loan relationship debit of €83,849,399 in issue in this appeal.

149. However, Paragraph 13 does not direct attention to the purposes for which these actions were carried out – it directs attention to the purposes for which Fidex was a party in the 2005 Year to the loan relationships represented by the Relevant Assets or for which in the 2005 Year it entered into a related transaction by reference to any of those loan relationships.

150. If those purposes included a tax avoidance purpose as defined (a species of 'unallowable purpose'), then the further question arises (pursuant to sub-paragraph (1) of Paragraph 13) as to how much of the debits falling for the 2005 Year to be brought into

account for the purposes of Chapter 2, Finance Act 1996 is, on a just and reasonable apportionment, attributable to the tax avoidance purpose.

The parties' submissions on the Paragraph 13 Issue

151. Mr Flesch (for Fidex) submits that consideration of whether Paragraph 13 applies in this case requires one to consider precisely how and when the debit under subparagraph (3) of Paragraph 19A crystallised.

152. The debit, he submits (rightly), results from the fact that there was a difference between the accounting values of the Relevant Assets as shown in the closing balance sheet for the 2004 Year and the opening balance sheet for the 2005 Year, 'the beginning of' the 2005 Year in the language of sub-paragraph (3)(b) of Paragraph 19A. He also makes the point that those accounting values had to be determined by reference to the same facts, namely the facts existing at the end of the 2004 Year.

153. The time at which the 2004 Year ended was chronologically immediately before the time at which the 2005 Year commenced. Mr Flesch's point is that nothing happened in the 2005 Year (i.e. in the calendar year 2005) which did affect, or could have affected, the accounting value of the Relevant Assets in the closing balance sheet for the 2004 Year or the opening balance sheet for the 2005 Year. Therefore, nothing happened in 2005 which did affect, or could have affected, the Paragraph 19A 'difference'.

154. Mr Flesch goes on to submit that Fidex's purpose in being party to the 4 loan relationships represented by the Relevant Assets at any time after midnight on 31 December 2004 cannot have affected the facts and matters giving rise to the Paragraph 19A 'difference'. In particular, the debit to be brought into account pursuant to sub-paragraph (3) of Paragraph 19A cannot be said to be attributable to any unallowable purpose of Fidex in the 2005 Year.

155. Mr Flesch submits that the crystallisation of the debit at the end of the 2004 Year is further demonstrated by Note 11 to Fidex's financial statements for the 2005 Year, which showed the derecognition of the Relevant Assets (a credit of €83,849,399) as an adjustment made at 31 December 2004.

156. He further submits that this conclusion is reinforced by the wording of sub-paragraph (2) of Paragraph 13 which describes purposes which may include an unallowable purpose as purposes for which 'at times during [the accounting period in issue] the company (a) is a party to the [loan] relationship, or (b) enters into [related transactions] by reference to that relationship'. He focuses on the draftsman's use of the plural '*at times during*' the accounting period, rather than the expression 'at any time in' the accounting period. He submits that the reference to 'at times during' the accounting period indicates that the draftsman had in mind a continuing and ongoing unallowable purpose for being party to a loan relationship in an accounting period. Mr Flesch submits that since the Paragraph 19A debit crystallised at midnight on 31 December 2004, there cannot have been even a single time during the 2005 Year at which Fidex had an unallowable purpose for being party to the 4 loan relationships constituted by the Relevant Assets – but on any view there cannot have been 'times' during the 2005 Year when Fidex had an unallowable purpose.

157. Mr Flesch submitted that at the start of the 2005 Year, any alleged unallowable purpose had been achieved, because by then the debit had already crystallised. He made reference to and relied on Mr Clifford's evidence that it was correct for the accounting treatment for the 2005 Year opening balances to be based on the circumstances as the 2004 Year end (see [61]

above). An unexpected sale of the Relevant Assets in, say, January or February 2005 would not have made any difference to the accounting treatment of them in the opening balance sheet for the 2005 Year.

158. Mr Flesch contended that this demonstrated that Paragraph 13 is not apt to apply to this type of case, where a taxpayer's creditor loan relationship is derecognised as a result of a change of accounting policy. He submitted that Parliament had appreciated that such was the case when, by paragraph 5, Schedule 4, Finance Act 2011, it had enacted a new section 455A, to be inserted into Part 5 of the Corporation Tax Act 2009 (which re-enacted the loan relationships provisions of Chapter 2, Finance Act 1996) as follows:

> '(1) This section applies where –
>
> (a) A company is at any time a party to tax avoidance arrangements,
>
> (b) As a result of those arrangements, a creditor relationship to which the company is party, or any part of such a relationship, is (in accordance with generally accepted accounting practice) derecognised by the company, and
>
> (c) The company continues to be a party to the creditor relationship immediately after the transaction or other event giving rise to the derecognition.
>
> (2) No debit that would apart from this section be brought into account by the company for the purposes of this Part as a result of the derecognition is to be brought into account
>
> …
>
> (5) For the purposes of this section, arrangements are "tax avoidance arrangements" if the main purpose, or one of the main purposes, of any party to the arrangements, on entering into them, is to obtain a tax advantage.
>
> (6) In subsection (5) "arrangements" includes any arrangements, scheme or understanding of any kind, whether or not legally enforceable, involving a single transaction or two or more transactions.'

159. Mr Flesch's main submission was that it was not necessary to consider Fidex's purpose in being a party in 2005 to the 4 loan relationships constituted by the Relevant Assets, because any tax avoidance purpose, which Fidex may have had, had been achieved by the start of the 2005 Year.

160. However, as a first alternative submission, should the Tribunal not accept his main submission, he contended that in the 2005 Year, until the Relevant Assets' several maturity dates, Fidex remained the full legal and beneficial owner of the Relevant Assets, as it would have done if the Project Zephyr Transaction with Swiss Re had never taken place, and for as long as it would have done if the Project Zephyr Transaction with Swiss Re had never taken place. The issue of the Preference Shares did not change this – all it did was bring Swiss Re in as a shareholder of Fidex (albeit one whose rights to dividends and redemption proceeds were, subject to company law, linked to the Relevant Assets). Mr Flesch made this submission on the basis that, given the agreed fact that Fidex held 15 of the other 18 bonds (i.e. the bonds which were not Relevant Assets) to maturity, it is more likely than not that the Relevant Assets would also have been held to maturity if the Project Zephyr Transaction had not occurred. Also, the Relevant Assets were bonds very close to maturity, which made them suitable for the purposes of a short term transaction with Swiss Re but, had that transaction not been entered into, Mr Flesch submitted that it was highly improbable that Fidex would have chosen to sell the Relevant Assets ahead of other bonds with longer periods to maturity.

161. For these reasons, Mr Flesch submitted that the Tribunal could reasonably infer that, irrespective of the transaction with Swiss Re, Fidex would have continued to be a party to the Relevant Assets until their respective maturity dates. Thus, during the 2005 Year, Fidex was not a party to the Relevant Assets, nor did it dispose of them, for any tax avoidance purpose, but as part of the 'running off' of its portfolio of bonds acquired and held for commercial purposes unconnected with tax avoidance.

162. Mr Flesch submitted that there was no evidence to suggest that Fidex was seeking to sell the Relevant Assets prior to the approach from Swiss Re in November 2004, and no evidence that a 'straightforward' sale of the Relevant Assets to Swiss Re was ever contemplated. Mr Colin Gardner's evidence was that his memory of the transaction was extremely vague but that he believed that the reasons behind the transaction was that it was a tax efficient way to dispose of certain assets held by Fidex, which was an objective of the treasury management in BNPP Paris.

163. If his first alternative submission is not accepted, Mr Flesch makes a further alternative submission on the basis that that Tribunal finds that Fidex's reasons (purposes) for holding the Relevant Assets did change as a result of the transaction with Swiss Re.

164. The transactions entered into on 22 December 2004 passed the risks and rewards of ownership of 95% of the Relevant Assets from Fidex to Swiss Re. Furthermore, under the terms of the PSSA of that date, Fidex was obliged to pay over to Swiss Re – in broad terms – 95% of the amounts it received in respect of the Relevant Assets when they matured. A sale of the Relevant Assets before their respective maturity dates would accordingly have been inadvisable and unlikely because Fidex would then not have been the person to receive the redemption proceeds on maturity. Additionally, under the terms of the PSSA, Fidex expressly undertook to Swiss Re that it would not sell, or otherwise dispose of, the Relevant Assets while the Preference Shares remained in issue. This was an undertaking given for wholly commercial (and not tax avoidance) reasons (purposes) and it would have been uncommercial for Fidex to have acted in breach of the undertaking. In summary, Fidex's continuing in the 2005 Year to be a party to the loan relationships constituted by the Relevant Assets, and its disposal of them on their respective maturity dates, was motivated by the commercial purpose of complying with its obligations assumed when the transactions with Swiss Re were entered into on 22 December 2004, and not by a tax avoidance purpose.

165. Mr Tallon (for HMRC) submitted that, by December 2004 at the latest, BNPP had decided to dispose of the Relevant Assets and the other corporate bonds held by Fidex. Referring to the Approval Document dated 10 December 2004 (see [146] above), Mr Tallon drew our attention to clause 3.5 which stated that 'Project Zephyr represents a precursor to the disposal of bond assets' and referring to the proposed issue of Preference Shares as 'the transfer of the risk and rewards of the selected bond assets (and therefore their synthetic disposal) to the Swiss Re group'. Clause 3.3 of the same document indicated that the Treasury and Group Finance function within BNPP favoured 'an orderly disposal of Fidex's remaining assets' and would make such a proposal ('market conditions permitting') to the board of Fidex.

166. He submitted that the fact that the bonds were 'as a result (presumably) of some subsequent change of mind, ultimately held to maturity does not negative the intention to dispose of them evident at the material time' – which we take to be December 2004.

167. Mr Tallon disputed Mr Flesch's submission that, following the Project Zephyr Transaction, Fidex remained (as to 95% of the Relevant Assets) their beneficial owner. Fidex was not free to transfer them and Swiss Re was entitled to 95% of all payments made under them. He cited *Wood Preservation Ltd v Prior* 45 TC 112 at 133 and *J Sainsbury Plc v O'Connor* [1991] STC 318 at 329e-g.

168. He submitted that throughout the 2005Year until the respective maturity dates of the Relevant Assets, Fidex continued to be a party to the loan relationships constituted by them after they had outlived any commercial purpose, and had both formed an intention to dispose of them and had parted with the economic benefits of ownership of them – and had indeed effected a 'synthetic disposal' of them, as belatedly recognised in its financial statements for the 2005 Year. The reason for this, Mr Tallon submitted, was that it was necessary to be able to derecognise the Relevant Assets in the accounts for the 2005 Year and obtain the claimed debit under Paragraph 19A.

169. Mr Tallon submitted that the retention of the Relevant Assets in the 2005 Year was necessitated by the obligations Fidex undertook to Swiss Re to ensure that the 'pass through' requirements of IAS 39 [19] were satisfied. Fidex had, he submitted, to remain in a position so that it could pay on the cash flows arising from the Relevant Assets to Swiss Re without material delay – and this meant that Fidex (in order to ensure that it could derecognise the Preference Shares under IAS 39) had in practice to remain a party to the loan relationships constituted by the Relevant Assets in the 2005 Year. Thus the retention of the Relevant Assets in the 2005 Year was for the purpose of obtaining a tax advantage and not for Fidex's other business and commercial purposes.

170. Additionally, as evidenced by the BNPP confidential memorandum dated 15 December 2004, referred to above at [121(1)], retention by Fidex of the full ownership of 5% of the Relevant Assets into the 2005 Year was:

> 'due to the fact that when computing the tax debit, Fidex [would] need to compare two carrying values (the carrying value of the bonds as of 31/12/2004 UK GAAP version and the carrying value as of 1/1/2005 IAS version), If 100% of the rights under the bonds were transferred, the bonds would totally disappear from IAS 2005 opening balance, and there would be a technical argument from a tax perspective that there would not be anything anymore to compare with the carrying value as of 31/12/2004.'

171. In response to Mr Flesch's argument that any tax avoidance purpose on Fidex's part had been achieved before the 2005 Year began, Mr Tallon submitted that Paragraph 13 focuses attention on Fidex's purposes in holding the Relevant Assets in the 2005 Year. The scheme would not have worked – that is, the debit on change of accounting practice would not have been achieved – if the legal title to the Relevant Assets had been disposed of before 1 January 2005. It followed that Fidex's purpose in retaining legal title to the Relevant Assets in the 2005 Year was a tax avoidance purpose.

172. Mr Tallon submitted that Mr Flesch's argument based on there not being '*times*' in the 2005 Year in which Fidex had an unallowable purpose was completely unsustainable. He referred to section 6(c) of the Interpretation Act 1978 providing that words in the plural are to be taken to include words in the singular unless the contrary intention appears. He submitted that Parliament's use of the plural 'times' was not 'intended as an invitation to engage in the abstruse philosophical exercises now urged on the Tribunal by Fidex', adding that, even if it was, it is impossible to say as a matter of fact that the unallowable purpose only existed for a single moment in time.

173. While accepting that Fidex's retention of the Relevant Assets in the 2005 Year enabled it to perform the commercial obligation undertaken to Swiss Re, Mr Tallon pointed out that those obligations had been incurred purely for the purpose of being in a position to comply with the requirements of its Articles of Association in respect of the Preference Shares and to ensure that the tax avoidance scheme based on IAS 39 was properly implemented.

174. Mr Tallon submitted that Paragraph 13 on its face applied to both creditor and debtor loan relationships. Reference to the new section 455A of the Corporation Tax Act 2009 is impermissible as an aid to the construction of Paragraph 13, absent strict ambiguity. He cited *Kirkness v John Hudson & Co Ltd* [1955] AC 696 at 735-739 and *Cadbury Schweppes plc v Williams* [2006] EWCA Civ 657; [2007] STC 106 at [64] in support of this proposition. He also cited *Walker v Centaur Clothes Group Ltd* [2000] UKHL 23; [2000] STC 324 at 331 in support of the proposition that an argument from redundancy seldom has persuasive effect.

Discussion and Decision on the Paragraph 13 Issue

175. We approach this issue as one in respect of which we must apply orthodox methods of statutory construction to a realistic view of the facts. By this we mean that we must discern and apply to the facts of this case, viewed realistically, Parliament's purpose in enacting Paragraph 13. We note that such was the approach adopted by Ribeiro PJ in the 2003 Hong Kong case of *Collector of Stamp Revenues v Arrowtown Assets Limited* [2003] HKFCA 46 and approved by the House of Lords in *Barclays Mercantile Business Finance Limited v Mawson* [2005] STC 1 at [36], in relation to the application of the *Ramsay* principle and, although the *Ramsay* principle has not been invoked in this appeal, in our view the general guidance given in those cases is relevant and binding on us.

176. As regards the construction of Paragraph 13, we note, first of all, that the examination of any unallowable purpose is confined to a consideration of the purposes for which a company is a party to a loan relationship or enters into a related transaction during the accounting period for which debits and credits in respect of exchange gains fall to be brought into account. The only relevant purposes are those 'had' by the company during that accounting period. So we are confined to looking at Fidex's purposes during the 2005 Year. So much is common ground.

177. The next point to notice is that sub-paragraph (1) of Paragraph 13 expressly envisages an exclusion, from debits or credits brought into account, of so much of them, as respects the loan relationship in question, as, on a just and reasonable apportionment, is attributable to the unallowable purpose.

178. This is an indication that, in Paragraph 13, Parliament is addressing loan relationships held for mixed purposes during an accounting period, one or more of such purposes being unallowable and one or more of them not unallowable.

179. Mr Tallon gave an example – a manufacturing concern based in Yorkshire, which exports to South America, borrows money to buy a property in London in which to house visiting buyers from South America and to hold meetings with them. The debits arising in an accounting period as respects the loan relationship – most obviously in respect of interest – are allowable (that is, not unallowable). When the property is used from time to time by the managing director's son, who is going to university in London, the debits arising in the accounting period concerned include amounts which, by virtue of Paragraph 13 cannot be brought into account, and a just and reasonable attribution of the debits arising in the accounting period has to be made.

180. It is in this context that the structure of sub-paragraphs (2) and (4) of Paragraph 13 – the sub-paragraphs most relevant to the Paragraph 13 Issue – is to be understood.

181. Sub-paragraph (2) sets out *when* a loan relationship is to be treated as having an unallowable purpose, and sub-paragraph (4) sets out, so far as is relevant to this appeal, *what* an unallowable purpose is.

182. It is noteworthy that sub-paragraph (2), dealing with *when* 'in any accounting period' – cf sub-paragraph (1) – a loan relationship has an unallowable purpose, uses the expression '*at times*' during the accounting period when the company's purposes include an unallowable purpose.

183. In contrast, sub-paragraph (4) – dealing specifically with *what* an unallowable purpose, in relation to tax avoidance, is – speaks of one of the purposes for which the company is a party to a loan relationship *at any time* (or enters into a related transaction) being a tax avoidance purpose, if it is the main purpose, or one of the main purposes for which the company is a party to the relationship *at that time* or for which it enters into the related transaction.

184. We consider that the difference in language between the use of the expression 'at times' in sub-paragraph (2) and the use of the expressions 'at any time' and 'at that time' in sub-paragraph (4) cannot be ignored in the purposive construction of Paragraph 13 and, in particular, the context militates against reading 'at times' in sub-paragraph (2) as including 'at any time', in accordance with the Interpretation Act.

185. The significance of sub-paragraph (2) – the identification of *when* in an accounting period a loan relationship is to be treated as having an unallowable purpose – is that the period of time during which the loan relationship has an unallowable purpose is highly relevant in carrying out the just and reasonable apportionment required by sub-paragraph (1).

186. On the other hand, whether a loan relationship has an unallowable tax avoidance purpose, prompting an answer to the question of *what* such an unallowable purpose is, is a matter which (obviously) can be, and is required to be, tested as of a single moment in time. This is why, in our view, sub-paragraph (4) speaks of 'at any time' and 'at that time'.

187. We therefore consider that Paragraph 13 requires us to examine the loan relationships which Fidex had in the 2005 Year and decide whether at any time the main purpose or one of the main purposes for which it was a party to those loan relationships was a tax avoidance purpose.

188. If we conclude that the main purpose or one of the main purposes for which Fidex was a party to those loan relationships (or any of them) at any time during the 2005 Year was a tax avoidance purpose, we must then examine at what times during the 2005 Year Fidex's purpose for being party to those loan relationships included such a tax avoidance purpose.

189. If we find that there were times during the 2005 Year that Fidex's purpose for being a party to those loan relationships included such a tax avoidance purpose, then we need to make the apportionment of the debits falling to be brought into account for the 2005 Year required by sub-paragraph (1) of Paragraph 13.

190. The relevant loan relationships which Fidex had in the 2005 Year were, of course, the Relevant Assets. In considering whether, at any time at all, the main purpose or one of the main purposes for which Fidex was a party to the Relevant Assets was a tax avoidance purpose, we find, on the basis of the findings of fact made at [148] above, that one of the main purposes for which Fidex was a party to the Relevant Assets from 22 December 2004 (the date of the PSSA pursuant to which Swiss Re subscribed for the Preference Shares in Fidex) until such time as the tax avoidance purpose inherent in the Project Zephyr Transaction was achieved, was a tax avoidance purpose within the meaning of Paragraph 13. We do not find that the tax avoidance purpose was Fidex's *main* purpose in being party to the Relevant Assets at any time, because the main purpose, or one of the main purposes, of Fidex being party to the Relevant Assets at all times when it was a party to them was the commercial purpose of being entitled to the cash flows inherent in the Relevant Assets – even if (at any time) it was contemplated that those cash flows would be accounted for to the holders of the Preference Shares.

191. When, then, was the tax avoidance purpose inherent in the Project Zephyr Transaction achieved? In a sense it can only be regarded as having been achieved if Fidex is successful in this appeal and/or on any final appeal from our decision. However, that sense is not the sense in which we mean to be understood when we refer to the tax avoidance purpose being achieved. We refer to the establishment of such facts as would be necessary to support Fidex's claim to the tax advantage which it seeks to secure. This takes us back to sub-paragraph (3) of Paragraph 19A and the establishing of the accounting value of the Relevant Assets (in accordance with IFRS) 'at the beginning of the later period', that is, at the beginning of the 2005 Year.

192. On this point we accept Mr Flesch's main submission that the debit under sub-paragraph (3) of Paragraph 19A crystallised at the end of the 2004 Year. This is because the Relevant Assets were held by Fidex at the end of the 2004 Year and, on 22 December 2004, Fidex had adopted the use of IFRS in place of UK GAAP for the period commencing 1 January 2005. The accounting value of the Relevant Assets had to be determined by reference to the facts existing at the end of the 2004 Year.

193. Mr Tallon made the point that the retention of the Relevant Assets in the 2005 Year was necessitated by the obligations Fidex undertook to Swiss Re to ensure that the 'pass through' requirements of IAS 39 [19] were satisfied, and thus that the fact that the accounting value of the Relevant Assets at the beginning of the 2005 Year could properly be stated as they were, in accordance with IFRS, and giving rise to the claimed difference under sub-paragraph (3) of Paragraph 19A, depended on the retention of the Relevant Assets in the 2005 Year. This point was, we consider, answered by the unchallenged evidence of Mr Clifford that the accounting was based on the circumstances at the year-end (i.e. the end of the 2004 Year) and would have been unaffected by an unexpected sale of the Relevant Assets in January or February 2005. Mr Clifford said that he did not think that such an event would normally be viewed as an event calling for a post balance sheet adjustment.

194. The same answer, we consider, can be made to Mr Tallon's point (see [170] above) that full ownership of 5% of the Relevant Assets was retained into the 2005 Year in order to avoid the total disappearance of the Relevant Assets from the opening balance of the 2005 Year as stated under IFRS. Although that may well have been so, it does not affect the point that the opening balances were fixed by the circumstances prevailing at the end of the 2004 Year and that, consequently, the tax avoidance purpose was achieved at that time.

195. We accept Mr Tallon's submission that the scheme would not have worked if the legal title to the Relevant Assets had been disposed of before 1 January 2005, but it does not in our view follow that Fidex's purpose in retaining legal title to the Relevant Assets in the 2005 Year was a tax avoidance purpose. The tax avoidance purpose was achieved, for the reasons we have given, by Fidex's retention of the legal title to the Relevant Assets to the end of the 2004 Year.

196. We turn to examine Fidex's purposes in being party to the Relevant Assets in the 2005 Year in order to form a realistic view of the relevant facts. There is not much direct evidence before the Tribunal on this issue. There is evidence from a contemporaneous email (one dated 1 December 2004 from Sarah Roussel to Nick Williams, which we take to be an internal BNPP email) that (one, or some, or all of) the bonds which are not 'synthetically sold through the issuance of the prefs' (i.e. Fidex's portfolio of bonds other than the Relevant Assets) should be retained by Fidex until at least 1 January 2006. It appears that the thinking behind this was that Fidex's losses in the 2005 Year (which would include the debit in respect of the difference on the change of accounting basis) should be available for group relief in the 2005 Year.

197. The Approval Document dated 10 December 2004 (see [146] above, and referred to by Mr Tallon, see [165] above) was a document by which Nick Williams and Oke Uwakwe sought internal BNPP approval for the Project Zephyr Transaction. It evidences the fact that BNPP had decided by that date, in general terms 'market conditions permitting, to propose to the board of Fidex an orderly disposal of Fidex's remaining assets' and that the Project Zephyr Transaction '[represented] a precursor to the disposal of bond assets', being 'the transfer of the risk and rewards of the selected bond assets [the Relevant Assets] (and therefore their synthetic disposal to the Swiss Re group'. The commercial purpose and net effect of the Project Zephyr Transaction was described in that Document as the transfer by the BNPP group of 'the economic risks and reward of ownership of a €84 million portfolio of bonds in a tax efficient way to the Swiss Re group' (see [146] above). Colin Gardner's evidence is that he believed 'it was a tax efficient way to dispose of certain assets held by [Fidex], which was an objective of [BNPP Paris]'.

198. We find on the basis of this evidence that Fidex embarked on a programme of disposal of its portfolio of bonds, including the Relevant Assets. It is an agreed fact that of the 18 bonds (apart from the Relevant Assets), 3 bonds were disposed of (by sale, we assume) in 2005 and 2006, while the remaining 15 bonds were held to maturity, maturing between September 2005 and October 2010.

199. We find that it was one of Fidex's purposes in entering into and carrying out the Project Zephyr Transaction that Fidex would thereby dispose of the Relevant Assets as part of a general policy of conducting an orderly disposal of its remaining assets. Once the tax avoidance purpose inherent in the Project Zephyr Transaction had been achieved – that is, after the end of the 2004 Year – that was the only 'main purpose' of Fidex's retention of the legal title to the Relevant Assets. At no time during the 2005 Year (except perhaps, in an abstract sense, the *scintilla temporis* at which the 2005 Year began (cf. sub-paragraph (3)(b) of Paragraph 19A)) did Fidex have a tax avoidance purpose as a purpose for being party to the loan relationships constituted by the Relevant Assets (or the other bonds in its portfolio).

200. In particular, we find that Fidex's purpose in being party to the following actions did not include a tax avoidance purpose, *viz*:

(1) the resolution on 1 February 2005 to petition the High Court for the reduction of the amount standing to the credit of its share premium account by €85 million,

(2) the payment of a dividend and redemption of the Class A Preference Shares on 14 March 2005,

(3) the payment of a dividend and redemption of the Class B Preference Shares on 31 March 2005,

(4) the payment of a dividend and redemption of the Class C Preference Shares on 19 April 2005, and

(5) The payment of a dividend and redemption of the Class D Preference Shares on 4 July 2005.

201. In relation to the *scintilla temporis* at which the 2005 Year began, if (which we doubt) it is right to take any account of it at all, because the statutory language of 'times' is not applicable to it, we go on *de bene esse* to consider whether it constituted 'a time' during the 2005 Year that Fidex's purposes for being a party to the Relevant Assets included a tax avoidance purpose which was the main purpose or one of the main purposes for which Fidex was a party to the Relevant Assets at that time. Although rejecting the proposition that a tax avoidance purpose was Fidex's *main* purpose for being a party to the Relevant Assets at the time of the *scintilla temporis* (there was no evidence of any intention to make anything but a 'synthetic disposal' of the Relevant Assets to Swiss Re in 2004), we accept that a tax avoidance purpose was *one of* Fidex's main purposes for being a party to the Relevant Assets at that time.

202. The next step would be to seek to make the apportionment of the debits falling to be brought into account for the 2005 Year required by sub-paragraph (1) of Paragraph 13.

203. Although it might be said that the whole of the debit claimed by Fidex under Paragraph 19A should on any just and reasonable apportionment be attributed to the tax avoidance purpose under sub-paragraph (1) of Paragraph 13, this would ignore the effect of sub-paragraph (2), which must be taken into account in any purposive construction of Paragraph 13 as a whole.

204. As we have stated above (at [185]), the 'times' during the 2005 Year when Fidex's purposes for being a party to the Relevant Assets included a tax avoidance purpose (as the main or one of the main purposes for being a party to the Relevant Assets) – and, by the same token, the 'times' during the 2005 Year when Fidex's said purposes did not include such a tax avoidance purpose – must be considered and are highly relevant in carrying out the just and reasonable apportionment required by sub-paragraph (1).

205. Carrying out this exercise we conclude that, at all 'times' during the 2005 Year, Fidex's purposes for being a party to the Relevant Assets did not include a tax avoidance purpose as the main or one of the main purposes for its being a party to the Relevant Assets, except at the *scintilla temporis* at which the 2005 Year began. On this basis we consider that, even if (which we doubt) we can interpret 'times' and meaning 'any time', on any just and reasonable apportionment no part of the Paragraph 19A debit would be attributed to that *scintilla temporis* (on account of its having no realistic length at all) and that therefore no part of the Paragraph 19A debit falls to be excluded from the debits falling to be brought into account by Fidex under Chapter 2, Finance Act 1996 for the 2005 Year.

206. For the reasons given above, our decision on the Paragraph 13 Issue is in favour of Fidex and we allow the appeal.

207. By way of a postscript, we would add that, as we have indicated above, there was no evidence of any intention on the part of Fidex to make anything but a ‘synthetic disposal’ of the Relevant Assets to Swiss Re in 2004. The evidence is that the Project Zephyr Transaction represented a precursor to the disposal by Fidex of its portfolio of bond assets, which, in fact, was carried out in the years 2005 to 2010. We do not therefore attribute a main tax avoidance purpose to Fidex’s holding the Relevant Assets in the 2005 Year by reference to the argument that, but for the Project Zephyr Transaction, Fidex would have disposed of the Relevant Assets in 2004, and that therefore its holding of the legal title in them in 2005 demonstrated a main tax avoidance purpose.

Right to apply for permission to appeal

208. 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.

JOHN WALTERS QC
TRIBUNAL JUDGE

RELEASE DATE: 2 April 2013