[2013] UKFTT 322 (TC)

TC02725

Appeal number: TC/2011/01217

CORPORATION TAX – double taxation relief – dividends paid between related companies: relief for UK and underlying taxes – "rate-boosting" - Australian subsidiary of claimant company held all shares in UK unlimited company – Australian subsidiary subscribed for further shares in unlimited company – cancellation of those further shares and reduction of capital by unlimited company – subscription monies relating to cancelled shares credited to reserves – reserves represented by subscription monies released by way of "interim dividend" to Australian Company – no UK tax borne on reserves out of which "interim dividend" was paid – whether section 801(4B) of ICTA 1988 applied to increase underlying tax available for credit in hands of claimant company – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PENINSULAR & ORIENTAL STEAM NAVIGATION COMPANY **Appellant**

- and -

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

TRIBUNAL: SIR STEPHEN OLIVER QC
HELEN MYERSCOUGH FCA

Sitting in London in public on 21 to 23 and 25 March 2013

Jonathan Peacock QC and Philip Walford, counsel, for the Appellant

David Goldberg QC and Nicola Shaw QC, instructed by the General Counsel for HMRC, for the Respondents

DECISION

1. The Appellant ("P&O") appeals against an amendment made by HMRC (on 21 January 2011) to P&O's tax computation for the year ended 31 December 2004. The amendment reduced P&O's claim for double tax relief ("DTR") for the purposes of corporation tax from £20,841,750.30 to £6,768,343.19.

P&O's Claim

2. P&O claimed entitlement to a DTR credit of £21,103,383 in respect of certain payments made to it, directly or indirectly, by related companies. P&O says of those payments that they were all dividends. The claim was later reduced by other reliefs to £20,841,750. Of that amount the actual "underlying tax" paid by those related companies was £7,194,025. P&O's tax return was amended to reflect only the "capped" underlying tax actually paid (of £7,029,973) and to exclude the figure of £14,073,407 (that had been claimed by P&O on the basis that it represented "deemed" underlying tax for DTR purposes).

Preliminaries

3. In this Decision all statutory references are, unless otherwise stated, to Income and Corporation Tax 1988.

4. The expression "capped" in relation to underlying tax means the maximum amount permitted to be brought into account in claiming credit having regard to the so-called "mixer cap" in section 799(1A). The expression "underlying tax" means, "in relation to any dividend, tax which is not chargeable in respect of that dividend directly or by deduction": see section 792(1).

5. P&O's claim, in summary, is that it is entitled to credit in respect of amounts of underlying tax deemed as such by section 801(4B).

Background to the Claim

6. The background to P&O's claim can be briefly summarised. At the relevant time P&O was the publicly-quoted parent company of the P&O group, with a worldwide transport and logistics business. (It has since become part of the DP World group.) P&O Australia Limited ("POAL") was the principal holding company for the group's Asia-Pacific operations and was resident in Australia. Trading operations and property disposals in Australia had produced substantial cash surpluses. The majority of these had arisen from the sale of the P&O Australian resorts business to a third party and the liquidation of P&O Offshore services Pte Ltd (which was a company providing shipping products and services).

7. On 26 May 2004, POAL declared an interim dividend of $75,000,000 payable on 27 May from the profits of the year ended 31 December of POAL and its subsidiaries.

8. The rate of underlying tax in Australia was then just under 10%. P&O, in 2004, was aiming to "rebase" its dividend policy. To quote Lord Sterling of Plaistow (the then chair of P&O's board) - *"…the board believes that now is the appropriate time at which to rebase the dividend to a level consistent with the more focussed higher growth business that P&O is becoming* and *to provide the company with the maximum resources to take advantage of the attractive opportunities in the ports business"*. To achieve this, P&O had to bring A$155 million from POAL to P&O. But, were that amount to be paid up by way of dividend from POAL, it would be exposed to a Case V of Schedule D corporation tax charge at a 30% rate with credit for barely 10% of underlying tax. P&O needed to enhance the credit for underlying tax to enable it to satisfy the aspirations of its board.

9. Accountants told P&O that subsection (4B) of section 801, which had been enacted in 2001, made it possible to enhance the credit to 30% by giving a deemed amount of underlying tax thereby enabling overseas group profits to be brought to the UK in a "fiscally efficient way" (to use P&O's expression). A scheme to achieve this result was sketched out in a note made in September 2004. The aim of the scheme was to enable P&O to receive dividends of A$155,000,000 from POAL with sufficient credit for deemed underlying tax. The machinery involved the making of a dividend of some A$193 million by a UK resident subsidiary of POAL which did not need to be passed on, by way of dividend (additional to the A$155 million), from POAL to P&O.

10. The participants in the scheme will be explained in more detail later. The UK resident subsidiary, whose role is to make the A$193 million dividend, is Abbott & Goldman ("A&G") all of whose shares are owned beneficially by an Australian resident company called Liena Pty. Limited ("Liena"). Liena is owned as to 99% by POAL and indirectly as to 1% by P&O.

Witnesses

11. The only witness of fact presented by P&O was a Mr Peter Walker (Mr Walker). He had been group finance manager for the P&O group in 2004. As such he had reported to the group finance director. He had not been part of the tax team and had not been involved in the design and implementation of the scheme adopted to produce the deemed underlying tax that is in issue in the present appeal. He had been called, he explained, *"to assist the tribunal in its understanding of the transactions' commercial rationale"*.

12. Two expert witnesses came and gave evidence. A Mr Steve Parkinson ACA of Ernst & Young gave his opinion as to the appropriate accounting treatment of the transactions involved in the making of the A$193 million payment (described as a dividend) by A&G. He had been a member of ICAEW Company Law Committee since 1987 and a member of the ICAEW realised and distribution profits working party that had produced technical releases on realised profits and losses in the context of distributions under the Companies Acts since its inception. A Mr Stephen Lamb FCA, who had been employed by HMRC since 2000, gave evidence as to the accounting treatment of those transactions. He has been the "theme accountant" in

HMRC's so-called "Rate Booster" project since 2009. As such, his role has been to procure accountancy reviews and advice to assist individual case teams within HMRC involved with identified instances of Rate Boosters. He has had no involvement, in that capacity, in P&O's case.

Section 801(4B) and its function in the DTR code

13. The UK provides relief against UK tax for the foreign tax that is suffered by a UK resident company. Typically this is done by way of credit mechanisms which give credit against UK tax for the foreign tax that the taxpayer in question has suffered. The credit may be provided in a double tax agreement between the UK and the other taxing jurisdiction. That is recognised in the DTR code in section 788. The present circumstances are concerned with the other method by which credit is available, known as unilateral relief and provided for in section 790.

14. Section 801 is in Chapter II of Part XVIII. Chapter I includes sections 788 and 790 and grants "the Principal Reliefs" in the DTR code. Chapter II (sections 792 to 806M) contains the "Rules Governing Relief by way of Credit".

15. Section 790(1) grants the relief "from income tax and corporation tax in respect of income and chargeable gains" and directs that it be given "in respect of tax payable under the law of any territory outside the United Kingdom by allowing that tax as a credit against income tax or corporation tax". Section 790(4) provides that - "Credit for tax paid under the law of the territory outside the United Kingdom and computed by reference to income arising or chargeable gains accruing in that territory shall be allowed against any United Kingdom income tax or corporation tax computed by reference to that income or gain…".

16. Section 790(6) covers dividends and enables the UK company receiving them to obtain credit against its own corporation tax liability for the underlying tax suffered by the paying company. This is restricted to cases where there is a sufficient shareholding relationship (i.e. 10% of the voting power) between the payer and the recipient company.

17. Moving on to the Chapter containing the rules of the DTR code, section 797(1) limits the credit to an amount that shall not exceed the corporation tax attributable to the relevant income. Section 799 introduces the rules for identifying the amount of underlying tax for which credit may be available in the case of any dividend. Section 799(1) provides that – "…the tax to be taken into account … shall be so much of the foreign tax borne on the relevant profits of the company paying the dividend as (a) is properly attributable to the proportion of the relevant profits represented by the dividend, and (b) does not exceed the amount calculated by applying the formula set out in subsection (1A) below.

18. The expression "relevant profits" in paragraph (a) is defined in subsection (3) of section 799. Where a dividend is paid for a specified period, the relevant profits will be the profits of that period. By subsection (5) and (6) "Profits" are said to mean "profits available for distribution", being "profits as shown in the accounts of the

company, drawn up in accordance with the law of the company's home state, making no provision for reserves, bad debts or contingencies".

19. Subsection (1A) of section 799, referred to in paragraph (a), sets another ceiling on the double tax credit otherwise available to a UK company. This, the mixer cap, is based on the formula –"(D plus U) times M%", where D is the amount of the dividend, U is the amount of the underlying tax that would be taken into account and M is the maximum relievable rate (i.e. the rate of corporation tax). The mixer cap was introduced by FA 2001 to cover the situation where a non-UK company pays dividends up to its UK parent and where that non-UK company in turn has its own subsidiaries that may have suffered underlying tax at a rate higher than the UK corporation tax rate. It mixes the streams of dividends into a non-UK intermediate holding company which then pays a dividend up to the UK parent company; it has the effect of preventing advantage being taken by means of higher rates of foreign tax being set off against UK corporation tax.

20. Coming now to section 801, subsection (1) deals with the case of a non-UK subsidiary that pays a dividend to a UK parent company. It permits UK and creditable foreign taxes paid by the non-resident subsidiary to be treated as tax of the territory in which that company is resident for the purpose of allowing relief. For the purpose of calculating credit in that situation, it treats the UK tax and the tax of the third country as if both were tax suffered in the country of the paying company. It reads:

> "(1) Where a company resident outside the united kingdom ('the overseas company') pays a dividend to [*a UK resident company*] ('the relevant company') and the overseas company is related to the relevant company, then for the purpose of allowing credit under any arrangements against corporation tax in respect of the dividend, there shall be taken into account, as if it were tax payable under the law of the territory in which the overseas company is resident –
>
> any United kingdom tax or corporation tax payable by the overseas company in respect of its profits; and
>
> any tax which, under the law of any other territory, is payable by the overseas company in respect of its profits."

21. Subsection (2) of section 801, in conjunction with subsections (1) and (3), covers the situation where there is a chain of companies , each paying dividends upwards to its parent company and each paying local underlying tax on the profits out of which the dividends are paid. The provision operates by treating the underlying tax paid by a third tier company (or a fourth or fifth and so on) as if it were paid by the overseas company paying the dividend up to the UK company. It reads:

> "(2) Where the overseas company has received a dividend from a third company and the third company is related to the overseas company, then subject to subsections (4) to (4D) below, there shall be treated for the purposes of subsection (1) above as tax paid by the overseas company in respect of its profits any underlying tax payable by the third company, to the extent that it would be taken into account under this Part if the dividend had been paid by a company resident outside

> the United Kingdom and arrangements had provided for underlying tax to be taken into account."

22. The situation where the UK parent receives a dividend (referred to as a "Case V dividend") from a non-UK intermediate parent holding shares, directly or through one or more such intermediate companies, in a UK resident subsidiary was, at the time to which this appeal relates, covered by subsections (4A) and (4B). The effect of subsection (4A) is for subsection (4B) to operate where, in applying section 799(1)(b) to the UK resident parent , the amount given by the formula in section 799(1A) exceeds the value of U (the underlying tax). If so, subsection (4B) provides for an increase in the amount of the underlying tax that attaches to the Case V dividend. Subsection (4B) provides:

> "(4B) Where this subsection applies, in the application (otherwise than by subsection (2) or (3) above) of subsection (1) of section 799 in relation to the dividend mentioned in that subsection ('the Case V dividend'), the amount of foreign tax which by virtue of the provision made by the arrangements mentioned in that subsection would fall to be taken into account under this Part in respect of the Case V dividend –
>
> apart from this section, and
>
> after applying paragraphs (a) and (b) of that subsection,
>
> shall be increased by an amount of underlying tax equal to the appropriate proportion of the amount of the excess described in subsection (4A) above in relation to the dividend paid by the company resident in the United Kingdom."

23. Section 801(4C) provides that "the appropriate portion" is to be determined by the same formula as is found in section 806B (subject to some consequential changes). The relevant parts of Section 806B read as follows:

> "(6) … the 'appropriate portion' of any amount there mentioned in the case of a dividend is found by multiplying that amount by the product of the reducing fractions for each of the higher level dividends.
>
> (7) For the purposes of subsection (6) above, the "reducing fraction" for any dividend is the fraction –
>
> (a) whose numerator is the amount of the dividend; and
>
> (b) whose denominator is the amount of the relevant profits (within the meaning of section 799(1)) out of which the dividend is paid …
>
> (10) In this section –
>
> …'higher level dividend', in relation to another dividend, means any dividend –
>
> by which that other dividend is to any extent represented; and
>
> which either is the Case V dividend or is to any extent represented by the Case V dividend; …"

24. Section 801(4A)-(4D) had been inserted in DTR code by Finance Act 2000. They were repealed by Finance Act 2005 with effect for dividends paid on or after 2 December 2004.

Chronology of Events

25. On 26 May 2004 POAL paid a dividend of A$75 million to P&O.

26. On 16 September 2004, the Group Taxation Manager of P&O wrote to Accountants (in a letter that starts "Dear Simon") noting that P&O had accumulated significant cash in POAL. The writer observed that one of the issues on paying a dividend is "that the rate of underlying tax on the Australian profits is lower than might be expected". The letter continues with the words – "… in order to keep our options open, we propose to put in place now a structure which will enable POAL to receive a dividend from a UK company in the 2004 year thereby enhancing the rate of tax which would underlie a dividend paid or payable by POAL this year." The letter, referred to at the hearing as "the Dear Simon letter", was accompanied by a summary of proposed transactions ("the Dear Simon scheme") which, on inspection, were similar to the steps in the scheme with which this appeal is concerned.

27. By the start of October 2004 Liena was, as already noted, owned as to 99% of its shares, by POAL and, as to the remaining 1%, by P&O Dover Holdings Limited (UK), a 100% subsidiary of P&O. Liena was registered owner of 99 ordinary shares of £1 each in A&G; the remaining ordinary share was registered in the name of a nominee who held it for the benefit of Liena. Liena had purchased the shares in A&G for £100 on 27 September 2004 from another UK company in the P&O group. A&G, which had been incorporated as a limited liability company in 1969, had been reregistered as an unlimited company on 23 September 2004.

Events of the seven days starting on Tuesday 12 October 2004

28. In the morning of the Tuesday (12 October), a board meeting of A&G in London, attended by two directors, considered a proposal for the company to allot and issue to Liena 193 million B ordinary shares of A$1 each and to lend the cash received from Liena (save for A$50,000 which would be banked) to P&O at interest. The chairman (Mr Walker) explained that the existing ordinary shares were to be redesignated as A shares and that the necessary resolutions would be put to the shareholders. The board, according to the minutes, gave the proposals "due and careful consideration" and resolved that the issue of the 193 million B shares would be "in the best interests of the company".

29. At 2 pm (Sydney, Australia, time) the same day, a board meeting of Liena was held in Sydney. The chairman explained that Liena intended to subscribe for 193 million B shares in A&G. The subscription would, he explained, be funded by an interest free loan from POAL. The interest income which would be earned by A&G was expected to exceed the rate of return from depositing funds with a bank by 70 basis points. The investment by Liena was not, he said, expected to create exposure for Liena and it "may provide POAL with an opportunity to pay enhanced dividends

to the UK parent…". After "due and careful consideration" the Liena board resolved that the subscription was "in the best interests of the company".

30. On the Wednesday (13 October) at 9 am, Liena's board met and were informed that the proposals for the subscription for shares in A&G required shareholders' approval. A resolution was produced and "after due and careful consideration" the board members resolved that the shareholders' resolutions of A&G were- " in the best interests of" Liena and that they be approved. We understand from the Statement of Case produced for P&O that the resolutions were approved by the shareholders and that on the same day A&G issued the 193 million B ordinary shares to Liena. A&G's register of members (dated Monday 18 October) records the acquisition by Liena of the 193 million B ordinary shares.

31. On the Thursday (14 October) money was introduced to enable Liena to pay the A$193,000,000 subscription monies for the B shares. We now describe the route that the money is said to have taken. The source of our information is a "Statement of Agreed Facts" signed by both sides. The Statement makes no reference to any preparatory arrangements or negotiations between the participants. We infer that the movements of the money (A$193 million) were dictated by the demands of the "proposed transactions" referred to in the Dear Simon letter (see paragraph 25 above).

32. The same day, POAL drew down A$174,664,486 under a "loan arrangement facility" made available to it on Tuesday 12 October by P&O. POAL obtained a further A$18,335,514 as repayment of an inter-company loan. Together those amounts provided POAL with A$193 million. Liena then drew down A$193 million under an arrangement set up on Wednesday 13 October. The subscription monies, save for the A$50,000 deposited with A&G's bank, were lent by A&G to P&O with interest at 0.625% above 3 month LIBOR.

33. The next day, (Friday 15 October), the board of A&G met. The chairman (Mr Walker again) is minuted as having explained to the only other person present (the deputy company secretary) that "it was proposed that the Company reduce its issued share capital by cancelling and extinguishing all its existing issued and paid-up 193 million B ordinary shares". It was also proposed, the chairman explained, that the issued share capital would be reduced to £100. The chairman further explained that "it was proposed that the amount arising on the reduction would be credited to reserves". He said that the members would need to authorise the reduction. After "due and careful consideration" the board resolved that the reduction and the redesignation of the A ordinary shares as ordinary shares were "in the best interests of the company". [Bearing in mind that A&G had received payment for the A$193 million B shares only the day before, this resolution (said to have been duly and carefully considered) call aloud for an explanation. The only sensible explanation that we can infer is that the chairman and the deputy company secretary were performing a planned step in the Dear Simon scheme in readiness for the A$193 million to go back to Liena dressed up as a dividend: see paragraphs 35 and 36 below.]

34. On the following Monday morning (18 October) at 9 am in Sydney, the board of Liena considered the proposal for the cancellation of the 193 million B shares in A&G

and for the amount arising on the reduction to be credited to A&G's reserves. After "due and careful consideration", according to the Minutes, it was resolved that that the proposals embodied in the written resolutions to be presented to the shareholders in A&G were "in the best interests of " Liena. A document headed "Written Members' Resolutions" of A&G (declaring the special resolutions to have effect as if passed at an EGM) referred to the cancellation of the B shares and the reduction of capital to £100. That document contains signatures, both dated as 18 October 2004, of a Sydney director and a Mr Luff of Purley, South London. [Here again, the only sensible explanation for what would otherwise appear an extraordinary course of conduct on the part of the Liena board and the shareholders in A&G is that they were all doing what they were told and acting out the Dear Simon scheme.]

November 16 to 30: the money goes back to P&O

35. On Tuesday 16 November 2004, A&G (according to the minutes of a board meeting held on Friday 19 November) had demanded repayment from P&O of the whole sum of A$193,766,877. This demand had, according to those minutes, been made to ensure that A&G had enough cash to pay the proposed dividend. The minutes of the meeting of 19 November are shown in the form of a draft of 17 November. That draft was signed by the chairman and attached to it were "Draft Accounts of A&G at 17 November". The Statement of Agreed Facts explains that, on 16 November, A&G had demanded repayment of the whole sum of A$192,950,000 that P&O had borrowed from it together with accrued interest. In total this amounted to A$194,106,253; however A&G agreed to offset against that amount the sum of A$339,376 as a payment for surrender of group relief from another member of the P&O group, resulting in a net payment due to A&G of A$193,766,877.

36. On Friday19 November 2004:

(1) (1) P&O, according to the Statement of Agreed Facts, paid to A&G the sum of A$193,766,877 by way of repayment of the loan plus interest.

(2) (2) According to the minutes of the 19 November meeting of the board of A&G (drafted on 17 November), the board proposed that an interim dividend in the aggregate of A$193,766,877 on its ordinary shares in respect of the year ended 31 December 2004 be declared. The attached Draft Accounts of A&G at 17 November showed a profit and loss account reserve of A$193,816,877. The proposal was, according to the minutes, approved "subject to the repayment of the debt being received by the company". (There is no record of when and how P&O repaid the A$193 million to A&G.)

(3) (3) A&G paid the dividend.

(4) (4) Liena paid POAL the sum of £192,950,000 by way of repayment of its interest-free loan.

(5) (5) POAL paid P&O the sum of A$174,664,486 by way of repayment of its interest-free loan.

37. On Monday 22 November, POAL made a short term loan of A$18,285,514 to P&O.

Liena pays a dividend

38. On Monday 22 November 2004, the board of Liena met and noted that Liena had received the dividend of A$193,766,877 from A&G on Friday 19 November. The board considered draft management accounts drawn up to 19 November (with a profit and loss account to 23 November showing the A&G dividend) and resolved to declare an interim dividend of A$820,000 on Tuesday 23 November. Of that amount, A$811,800 (99%) was payable to POAL and the rest to P&O Dover (Holdings) Ltd.

39. On 23 November, payment of the dividend was effected.

POAL pays dividend to P&O

40. On Tuesday 30 November 2004, POAL declared a dividend of A$80,000,000 for the year ended 31 December 2004. This was paid to P&O the same day.

P&O claims DTR

41. In its corporation tax computation for the year ended 31 December 2004, P&O claimed DTR of £20,841,750.30 in respect of the dividends of A$75,000,000 and A$80,000,000.

Accounts of A&G

42. The draft accounts of A&G at 17 November contain a Balance Sheet that records its Assets as A$193,766,877 being "Represented by" £100 (share capital) and A$193,816,877 described as "Profit and loss account reserve". The Profit and Loss Account shows "interest" of A$1,156,253 and "Tax" of A$339,376. [It is not in dispute that A&G's tax liability was eliminated by losses surrendered by way of group relief from another group company.] The audited accounts of A&G for the period to 31 December 2004 contain Notes that explain its Reserves. These show A$193,000,000 in *Profit and Loss account" resulting from "Cancellation of share capital and conversion into distributable profit". That is followed by (A$193,766,877) referred to as "Dividends".

Accounts of Liena

43. Liena's draft accounts include a Profit and Loss account for the period 1 January to 23 November 2004. These record a "profit" of A$816,877 representing "Dividend from A&G" of A$193,766,877 "less amount accounted for as return of investment (A$192,950,000)".

P&O's explanation of its DTR claim

44. P&O's claim for DTR is founded on the premise, first, that the payment of A$193,766,877, made to Liena on 19 November 2004 was a dividend from A&G for the purposes of the DTR code: and, second, that that the dividend of 30 November 2004 paid by POAL to P&O represented the A&G dividend. Both premises are challenged by HMRC. However, at this stage of our decision we propose to treat those premises as sustainable in order to do justice to the full explanation provided to us of P&O's reasoning in support of its claim.

45. By way of introduction, P&O point out, non-controversially, that the dividends paid by POAL to P&O were taxable under Case V of Schedule D; and, as P&O owned more than 10% of POAL, it is entitled to credit for underlying tax in respect of those dividends ("the Case V dividends") on the strength of sections 799 and 801 with particular reference to section 801(4A) – (4C). It is relevant also that, in applying the various DTR provisions, POAL and Liena are to be taken together as a single taxable entity in accordance with the provisions of section 803A, since, for Australian tax purposes, they were part of a consolidated group for the year ended 31 December 2004. For the purposes of section 801, A&G, Liena, POAL and P&O are "related" to each other, so that A&G is related to the single taxable entity representing Liena and POAL, which, in turn, is related to P&O.

46. P&O observes that, leaving aside the effect of section 801(4A) and (4C), section 801, in conjunction with section 799, attaches underlying tax that represents tax that has been borne by related companies outside the Australian consolidated tax group (comprising Liena and POAL) if they have paid dividends into the consolidated tax group. On that basis, again non-controversially, actual corporation tax borne by A&G on its profits would be taken into account for DRT purposes. Section 801(4A) and (4B) contain deeming provisions. The former applies in the present circumstances as there has been a chain of dividends: the Case V dividends (paid by POAL) being at the top and the dividend paid by A&G to Liena being at the bottom. On that basis, section 801(2) requires the calculation, in accordance with sections 799 and 801(1), of what the underlying tax would be if A&G were a non-resident company paying its dividend into a UK resident company.

47. Bearing in mind that A&G's tax liability was eliminated by group relief, in applying the mixer cap formula in section 799, the value of "U" will have been zero. The formula then becomes D multiplied by M, i.e. 30% of the amount of the dividend. This exceeded the value of "U". Consequently section 801(4B) will have applied. On that basis, the underlying tax attributable to the Case V dividend paid by POAL will have been increased by the appropriate portion of that excess. The total amount of that excess, being the deemed underlying tax credit on A&G's dividend, is (on P&O's explanation) calculated as follows:

> A$193,766,877 (i.e. D) plus A$0 (i.e. U) = A$193,766,877 multiplied by 30% = A$58,130,063.

48. Section 801(4C) then provides for the appropriate portion (being the amount of the deemed credit that flows through to the UK) to be determined using the mechanism in section 806B(7)-(10). This involves comparing at each subsequent stage of the chain the amount of the dividend paid by the next company in the chain with its relevant profits. (For that purpose the dividend paid by the POAL "single entity" is compared with the relevant profits of the POAL single entity.) On that basis, the calculation that attaches to the POAL dividend paid to P&O is performed in the following manner and using the following figures.

> *Item 1.* Deemed underlying tax credit on A&G's dividend:
> *A$58,130,063*
> *Item 2.* Dividend paid by POAL on 27 May 2004:
> *A$75,000,000*
> *Item 3.* POAL/Liena single entity relevant profits:
> *A$213,437,020*
> CALCULATION
> Deemed underlying tax credit attaching to POAL dividend:
> A$58,130,063 multiplied by A$75,000,000/A$213,437,020 = A$20,426,422
> (Translated into £Sterling (at £1=A$2.456) this equals £8,316,947.
> A similar calculation is then carried out to arrive at the deemed credit attaching to the POAL dividend paid to P&O of A$80,000,000 on 30 November 2004. This produces a result of £8,882,260 (at an exchange rate of £1=A$2.453).

HMRC's Position

49. HMRC say that P&O's credit is limited to £7,029 976.19: that being the capped amount of the tax actually borne by POAL and Liena. To the extent that the claim is based on the "dividend" said to have been paid by A&G to Liena on 19 November 2004, it is excessive and wrong in law. £14,073,407.11 should, on that basis, be excluded from DTR.

50. They say that the so-called dividend of A&G has no relevance to the operation of the DTR code. While there might have been a dividend for company law purposes, it was not to be regarded as such for the purpose of the relevant (DTR) statutory provisions. The amount paid to Liena by A&G should properly be recognised as the repayment of a loan. Even if the "dividend" is to be taken into account for DTR purposes, the maximum amount of credit relief cannot exceed the amount of tax borne on the profits from which A&G paid the dividend; as A&G bore no tax , the maximum amount of credit relief is limited to zero. Moreover, in order to be able to claim credit under section 801(4B), there must be an "appropriate portion" as defined in section 806B; on the facts there was no appropriate portion.

51. Further, say HMRC, P&O can only claim credit relief in respect of the so-called dividend from A&G if, making the statutory assumption that Liena been a UK

resident company, Liena could have claimed relief in respect of that dividend. As A&G had paid no tax in the relevant period, Liena could not have maintained any claim for relief in respect of a dividend paid to it. The claim in this case is consequently precluded by the express terms of section 801(2).

Conclusions (part 1)

52. We start our conclusions by asking whether, on the assumption that A&G paid a dividend of A$193,816,877 to Liena on 19 November 2004, P&O can make good its claim for DTR having regard to the proper interpretation and application of the wording of the DTR code.

53. For this purpose, we proceed on the basis that A&G's "relevant profits" (within section 799(3)-(6)) were A$816,920 and its pre-tax profits were A$1,156,296 (converted to £472,150 in its tax computation). Those profits, according to the draft accounts as at 17 November 2004, came from "interest earned". The tax on those profits was, we understand, discharged by operation of the UK group relieving provisions. So far as is relevant, therefore, we think that those profits should be regarded as having borne tax.

54. P&O's claim is based on the operation of section 801(4B). Subsection (4B) applies in the circumstances defined by subsection (4A) the opening words of which relate it to "section 799(1)(b) by subsection (2) or (3) above in relation to a dividend paid by a company resident in the United Kingdom". How then does section 801(2) apply to the present circumstances? Section 801(2) operates where the overseas company (in this case Liena/POAL taken, in accordance with section 803A(2)(a), as a single company) "has received a dividend from a third company and the third company is related to the overseas company". A&G is the third company and it is related to Liena/POAL in the statutory sense. Section 801(2) goes on to say that there is to be treated (for subsection (1) purposes) as tax paid by Liena/POAL in respect of "its" profits "any underlying tax payable by the third company" (i.e. by A&G). The latter words are qualified by the concluding part of subsection (2) which read " … to the extent that it would be taken into account under this Part if the dividend had been paid by a company resident outside the United Kingdom to a company resident in the United Kingdom and arrangements had provided for underlying tax to be taken into account".

55. It follows that, in finding out whether (and, if so, to what extent) section 801(4B) is engaged by subsection (4A), the exercise requires the determination of the underlying tax payable by A&G (which is to be treated as tax paid by Liena/POAL). This calls for three assumptions. First, A&G is assumed to be an overseas company. Second, Liena/POAL is assumed to be a resident of the UK. Third, DTR arrangements that provide for A&G's "underlying tax" (which refers, ordinarily, to overseas tax) are assumed to exist. This leads to the inquiry as to what would A&G's underlying tax have been. Read in the light of those assumptions, the answer (found in section 799(1)) is "so much of the foreign tax borne on the relevant profits by the body corporate paying the dividend … as is properly attributable to the

proportion of the relevant profits represented by the dividend, …". The company paying the dividend will, for this purpose, be A&G.

56. Taking the entire amount of the "dividend" (A$193,766,877 said to have been paid by A&G on 19 November 2004) as A&G's "relevant profits" within section 799(3) and assuming (see paragraph 52 above) that A$339,376 of tax had been underlying tax of A&G, the question then is how much of that "foreign tax borne" is "properly attributable" to the dividend. The answer must be that none of that tax can be attributed to the A$193,000,000. That amount will, on no basis, have been "struck" with tax, whether foreign or United Kingdom tax. P&O has shown no reason why, even if A&G is assumed to be an overseas company, the principal amount of A$193 million could have been taxed. That leaves the interest element which, on our construction, has borne tax. The result, in our view, is that section 801(4B) is engaged but only so far as it applies to the tax on the interest element.

57. Suppose, however, that section 801(4B) applied to the whole of A&G's dividend, we know that the interest element, as shown in Liena's accounts, was A$816,899 and we know that the rest of the payment received from A&G was not taken into Liena's profit and loss account The rest was applied against the cost of its investment in A&G as a return of capital. Turning to section 801(4B), the question is what "portion of the amount of the excess" qualifies as the "appropriate portion". Before there can be an appropriate proportion, there must be a "higher level dividend" in relation to the dividend paid by A&G: see section 806B(6), (7) and (10). A higher level dividend is one by which the A&G dividend is "to any extent represented". Here, the facts record that Liena, on receipt of the dividend on 19 November 2004, spent A$192,950,000 by way of repayment to POAL of its interest-free loan: and POAL paid to P&O the sum of A$172,664,486 in respect of its interest-free loan. Those amounts should, therefore, be ignored in determining what part of the relevant profits of POAL featured as component parts of the higher level dividend. The dividends actually paid by POAL to P&O (A$75 million and A$80 million) were, even ignoring the contribution made by the A&G dividend, well within POAL's distributable profits. (in any event the A$75 million dividend, paid on 26 May 2004, happened long before the Dear Simon scheme was even mooted.)

58. For those reasons we have concluded that P&O's claim for DTR is unsound in law having regard to the strict wording of the computational rules in Chapter 2 of Part XVIII. Section 801 (4A) -(C) were introduced into the code by Finance Act 2001 to correct the perceived anomaly that existed where a UK resident company, whose shares were owned by a related intermediate overseas holding company. The profits of the UK company at the bottom might have been fully subjected to UK tax; but the rate of the underlying tax (representing the corporation tax on those profits) might have been abated by the effect of reliefs from and allowances against the corporation tax. The mechanism of Section 801(4B) topped up the amount of underlying tax in relation to the DTR claim made by the UK claimant company receiving dividends representing the taxed profits of the bottom company. It had the effect of preserving the benefit of the reliefs and allowances given to the bottom UK company. Moreover, the present claim for relief, based as it is on tax that has never been payable, is

completely at odds with the terms of Chapter 1 which grants the relief in respect of tax payable.

59. Our view so far, based on the construction and application of section 801, means that P&O has not established its claim for DTR (to the extent that the claim is disputed by HMRC). Before leaving this part of our conclusions, we mention that both parties provided us with calculations based on various permutations. These were designed to illustrate the presentation of their respective contentions as to workings of the relevant statutory provisions. We acknowledge that we were greatly assisted by these; we have taken them into account in reaching and testing our conclusions on the wording of the relevant provisions of the DTR code. But, as explained above, the question for us is whether P&O have made good their claim having regard to the wording of the DTR code.

Conclusions: Part 2

60. We now address the question, raised in HMRC's challenge to P&O's DRT claim, as to whether as to whether A&G had "relevantly" paid a dividend to Liena. As the DTR claim is based on the operation of the sections (799 to 806) dealing with "Tax underlying dividends" (to quote the words of the rubric), P&O has to satisfy us that the payment of A$193,766,877 made, according to Statement of Agreed Facts, by A&G to Liena on 19 November, should be recognised as a dividend for the purposes of sections 799(1) and 801.

61. HMRC say, in reliance on the evidence of Mr Lamb, that it should be characterised as the repayment of a loan. Mr Lamb's opinion had been based on the fact that the reserve that had arisen from A&G's cancellation of the B shares had arisen from a circular transaction. The result was that the amount described as a dividend must have been paid out of unrealised profits. The only conclusion that made any "commercial sense" to him was that Liena "would get the money back the following month". Mr Lamb had disagreed with the manner in which the accounts of A&G for the period ended 31December 2004 had been presented. The accounts should, in his view, have recorded the substance of what had happened. The "commercial effect" of the transactions in question had been that A&G had borrowed group funds and then returned them a month later together with A$0.8 million interest cost.

62. P&O relied on the evidence of Mr Steve Parkinson, the partner in Ernst & Young who had been a member of the ICAEW Company Law Committee and of its Distributable Profits Working Party. It was his opinion that Liena's investment had in substance been £100 plus A$193 million on which the return by way of a dividend had been just under A$0.8. The position had been "faithfully represented" in the accounts of A&G "by showing the injection of capital, the cancellation of the B shares, the income received from operations and the payment of the subsequent dividend. The disclosures in the notes to the accounts make clear to the reader both the sequence of events that took place in October and November 2004 and the extent to which the events were linked." He considered that nothing in FRS 4 and FRS 5 called for a different presentation in the accounts to be reported.

63. The dividend had, it was argued for P&O, been created by means of the mechanism recognised as appropriate by the Upper Tribunal in *First Nationwide v HMRC* [2011] STC 1540 at paragraphs 23 to 38. In *Rae v Lazard* [1963] 1 WLR 555 and in *HMRC v First Nationwide* [2012] STC 1261 the House of Lords and the Court of Appeal respectively accepted that the form by which the distribution is made rather than the substance that determines whether it is of capital or of income. The reserve out of which the dividend had been paid could not, in the light of the cancellation of the B shares in A&G, be assimilated to share capital. Nothing in law, therefore, prevented the A$193 million payment from Liena from being properly characterised as a dividend. That was the case for P&O; and it was, P&O said, in line with the expert opinion of Mr Steve Parkinson. Mr Parkinson's opinion had been that the cancellation of the A$193,000,000 B shares and consequent reduction in share capital represented a "realised profit for A&G at the time of the capital reduction".

64. Our view of the transactions with which this appeal is concerned is that they were all part of an elaborate trick designed to exploit section 801(4A) and (4B). P&O had, as we have already concluded, misunderstood the law; but that is not the point here. P&O and its subsidiaries played out a scripted game of charades designed to produce, as an illusion, the requirements for the application of section 801(4B).

65. The script was based on the steps set out in the Dear Simon letter of 16 September 2004. Mr Peter Walker, who had been a director of A&G in September to December 2004, acknowledged that every step in the Dear Simon letter had been carried out. He said that he personally had not been aware of the Dear Simon letter when he had attended the board meetings of A&G. The steps involved in the scheme had, he acknowledged, been part of an exercise to create distributable reserves in order to generate credit for underlying tax. He had not, he said, been involved in the tax considerations. The tax affairs, he told us, had been handled "by a completely separate group". Nor had he known why it had been necessary, in order to achieve its objective, to have issued and cancelled A$193 million shares in A&G. He admitted that he had been concerned to make sure that A&G would not come to any harm by partaking in the scheme. He said – "I think it is fair to say that I did not know what was going on in Australia". Specifically, he acknowledged that, within a week of the Dear Simon letter, A&G, then a dormant company, had been made "unlimited" and bought in by Liena for £100 from another company in the P&O group. He was unable to trace the movements of cash. He said - "We had a cash pool, so it's quite difficult to identify precisely where particular elements of cash went".

66. It is clear that the scheme would only work so long as every participant in it was either a captive company or a stooge employee of a company within the P&O group. Everything that happened during the seven days starting on Tuesday 12 October 2004 was directed at achieving the alchemy of turning the £100 share capital of A&G into at least A$193 million of distributable reserves. To avoid leakage of any real money, A&G had to be owned beneficially, as to 100%, within the P&O group. By that means, the cancellation of the B shares simply caused the A$193 million to accrue to the remaining 100 ordinary shares in same ownership. Liena had to be another captive within the P&O group. It had to play the part of subscribing for the A$193 million B shares which were, to use HMRC's advocate's words, to "exist for the lifespan of a

mayfly”. The minutes of the board meeting of Liena on 12 October 2004 record that Liena’s “investment” was not expected to create exposure for the company and that it knew the scheme had been designed to benefit P&O.

67. The paperwork appears to have been prepared in advance. The same clichés appear in both UK and Australian versions of the minutes. Take, as an example, the meeting of the board of A&G on Friday 15 October. Mr Walker is recorded as having been the chairman; the other person present was the deputy company secretary. The previous day, A$193 million had been received by A&G as subscription monies for the issue of 193 million B shares. The “purpose” of the meeting was minuted as having been to deal with a proposal that all those B shares be cancelled and that a reduction of capital of A$193 million was to be made. Apparently (so the minutes record) Mr Walker had explained the proposal at the board meeting and a “due and careful consideration” had taken place. The board, again according to the minutes, had concluded its deliberations by resolving that the proposals were “in the best interests of the company”. But when he came to give evidence at the hearing, Mr Walker professed ignorance of the workings and tax implications of what had been going on. Either Mr Walker knew what had been going on and was not telling us or, more likely, he was being used as a stooge. We have already commented that the only sensible explanation for the conduct of the boards of A&G and of Liena (and the shareholders in A&G) is that they were acting out the scripted steps of the Dear Simon charade so as to facilitate the return of the A$193 million, dressed up as a dividend, to Liena. The A&G board minute of the meeting held on Friday 19 November to declare the A$193,766,877 dividend, also signed by Mr Walker, is another example of pre-drafted paperwork: see paragraphs 35 and 36(2) above.

68. The scheme needed an injection of funds. The amount required had been calculated as A$193 million on the basis set out in paragraph 8 above. It was, moreover, important that the A$193 million did not flow back to P&O as a dividend; that would have caused a large unwanted tax liability on P&O. The funds were routed through safe hands down to A&G and back instantly to P&O by way of loan on 14 October from A&G. Then on 16 November, for no apparent reason other than the furtherance of the Dear Simon scheme, A&G (an otherwise insignificant company in the P&O group) demands repayment in full from P&O. A&G was then ready to pay the “dividend”, which it purported to do on 19 November. Liena used the money to repay POAL and POAL repaid P&O. As all the funds had been in a group “pool”, the Dear Simon scheme moved in a trouble-free manner to a conclusion. It ceased to be of interest to anyone except P&O’s tax people. To quote from Evelyn Waugh’s Brideshead Revisited, “The Charity matinee was over…; the impresario had buttoned his astrakhan coat and taken his fee and the disconsolate ladies of the company were without a leader”. Within a few days, an announcement was made in Parliament that section 801(4B) was to cease to operate with immediate effect.

69. The Dear Simon scheme was designed and implemented for no reason other than tax avoidance. It depended on the alchemy of turning share capital into distributable reserves almost overnight. The trick was written into the script of the charade. To achieve the tax advantage and to get the money back to its rightful owner, i.e. P&O, without exposing P&O to any unwanted tax liability, a “dividend” from

A&G was an essential part of the machinery; and P&O had get its money back when the scheme was over by way of discharge of a debt through POAL rather than as a dividend.

70. Neither the words of a statute nor principles of proper accounting are designed to cope with tricks, unless the statutory words are targeted anti-avoidance provisions.

71. The only conclusion that we can reach is that the A$193 million was introduced for the purposes of the Dear Simon scheme and for no other purpose. When the scheme was "done" the money was to be restored to P&O by the preordained route. It was absolutely alien to the scheme that A&G should benefit from its participation, save for £50,034 left in the company. There was no risk that any of the participants, companies or directors, would step out of line. On that basis our conclusion is that A&G held the "subscription monies" for the sole purpose of the Dear Simon scheme and to restore it to where it came from. None of the A$193,000,000 ever became distributable reserves in any real sense of A&G. By making the payment on 19 November 2004 that purported to be a dividend, A&G was returning money that was no longer required. There was, in reality, no dividend for the purposes of P&O's claim for DTR.

72. If authority were needed to support that conclusion, it could be found in the words of Ribeiro PJ in *Collector of Stamp Revenue v. Arrowtown Assets Limited [2003] HKCFA 46 at [35]*:

> "The ultimate question is whether the statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

The statutory purpose of Part XVIII is to give credits for tax paid on the profits out of which the relevant dividend is paid: see section 799(1). As the provisions of section 801(4A) and (4B) make plain, the central objective in section 799(1) applies just as much to credits claimed in respect of dividends from UK companies. For the DTR claim to be effective, there has to be a payment that can properly and realistically be characterised as a dividend; and the claim must relate to foreign or UK tax borne on the relevant profits represented by the dividend. There were, in the course of the implementation of the Dear Simon scheme, neither profits on which tax was borne nor any payment that could realistically be classed as a dividend for the purposes of section 799(1).

Outcome

73. We dismiss P&O's appeal.

74. 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.

SIR STEPHEN OLIVER QC
TRIBUNAL JUDGE

RELEASE DATE: 29 May 2013

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