Neutral Citation: [2025] UKFTT 00057 (TC)

Case Number: TC09409

FIRST-TIER TRIBUNAL
TAX CHAMBER

Heard at Taylor House, London

Appeal reference: TC/2020/03208

CORPORATION TAX – sections 119, 121 and 127 CTA 2010 – whether qualifying loss condition met in respect of claim for cross border group relief – relevant time for determination of qualifying loss condition – whether the existence of an intermediary holding company prevents the precedence condition being satisfied – was the main purpose or one of the main purposes of the arrangements to secure the amount (or part) of losses be surrendered for the purposes of cross border group relief – appeal dismissed

Heard on: 5-26 May 2023
Judgment date: 20 January 2025

Before

TRIBUNAL JUDGE GERAINT WILLIAMS
TRIBUNAL MEMBER JANE SHILLAKER

LLOYDS ASSET LEASING LIMITED

Appellant

and

THE COMMISSIONERS FOR HM REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: David Milne KC and Ronan Magee, of counsel and Yash Rupal, solicitor, instructed by Simpson Thacher & Bartlett LLP

For the Respondents: Akash Nawbatt KC, Brendan McGurk and Kate Balmer, of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. This appeal concerns whether Lloyds Asset Leasing Limited ("LAL") is entitled to claim cross-border group relief ("CBGR") for its accounting period ending 31 December 2010 in accordance with Chapter 3 of Part 5 and section 135 of Corporation Tax Act 2010 ("CTA"). On 14 January 2020, The Commissioners for HM Revenue and Customs ("HMRC") issued a closure notice ("the Closure Notice") which amended LAL's company return for the accounting period ending 31 December 2010. By the Closure Notice, HMRC disallowed LAL's claim for CBGR in the sum of £3,822,583 such that LAL became liable for an additional £1,070,323.24 of corporation tax. HMRC denied LAL's claim for CBGR on the basis that the qualifying loss conditions in s119 CTA were not satisfied and, in the alternative, s127 CTA should apply as the "main purpose or one of the main purposes" of the arrangements by which BOSI's losses were sought to be surrendered was to secure that the amount in question may be surrendered for the purposes of group relief. In their Statement of Case, HMRC additionally relied upon the precedence condition in s121 CTA.

2. LAL was one of 100 subsidiaries of the Lloyds Banking Group ("LBG") to whom Bank of Scotland Ireland Limited ("BOSI") sought to surrender losses it incurred in relation to its banking business in Ireland. Over 100 LBG subsidiaries made claims for CBGR and enquiries were opened. We have hereafter referred to the Appellant as "LBG".

ISSUES IN DISPUTE

3. Despite the Tribunal directing that the parties agree a list of agreed facts and issues no agreement was reached. Both parties were directed to file and serve a list of the legal issues in dispute. Having considered both parties' list of legal issues it is readily apparent to the Tribunal that, bar semantics, the only difference between the parties is applicability of Court of Justice of the European Union ("CJEU") case law post the judgment in *Marks & Spencer v Halsey* (C-446/03) ("*M&S*") and the no possibilities test in *Holmen AB* Case C-608/17 ("*Holmen*") and *Memira Holdings* Case C-607/17 ("*Memira*").

4. The issues to be determined are as follows:

   (1) Section 119 CTA 2010 (the "qualifying loss condition: relief for future periods")

   (a) Is the qualifying loss condition met in relation to LBG's claim for CBGR for its accounting period ended 31 December 2010?

   In particular:

   (b) Is s119 required to be interpreted or applied in a manner consistent with paragraph 55 of the judgment of the CJEU in *M&S*?

   (c) What is the relevant time for determining whether the losses to be surrendered by way of CBGR cannot be taken into account and/or otherwise relieved in accordance with s119(2) and s119(3) respectively? Is such determination to be made as at the time immediately after the end of the "EEA accounting period", as defined in s112 CTA 2010, (i.e. immediately after 31 December 2010) and as provided for in s119(4) or at some other time?

   (d) At the time of determination, must account also be taken of other legal possibilities that may have been available prior to the date of determination in accordance with the judgments of the CJEU in *Memira* and *Holmen?*

(e) If so, could the losses sought to be surrendered by way of CBGR have been so taken into account and/or otherwise relieved immediately after 31 December 2010 or such other time?

(2) Section 121 CTA (the "precedence condition")

(a) Is s121(2) met in circumstances where up until 17 September 2010 BOSI was owned by a Dutch intermediary company, Scotland International Finance BV ("SIF"), such that BOSI's losses could, in whole or in part, have been used by SIF or by a third party in the Netherlands?

(b) If not, does that fact bar any claim to CBGR?

(c) If so, does the precedence condition prevent all the losses of BOSI from being surrendered as CBGR or does it prevent those losses from being so surrendered only to the extent that relief can be given for the losses against the taxable profits of SIF?

(3) Section 127 CTA 2010 (amounts excluded because of certain arrangements)

(a) Was the main purpose, or one of the main purposes, of the arrangements to secure that the amount (or part) of losses may be surrendered for the purposes of CBGR?

(b) In determining the main purpose or one of the main purposes of the relevant arrangements, whose purposes are relevant?

(c) Is either s127 or the manner in which HMRC has applied s127 CTA to deny CBGR compliant with Article 49 (in conjunction with Article 54) of the TFEU?

5. In the discussion below, we have considered the issues in dispute in the following order: s127, s119 and s121.

EVIDENCE

6. We were provided with electronic hearing bundles in excess of 22,000 pages comprised of seven volumes, a core bundle and an additional bundle of documents relied upon by HMRC. Contained within the various hearing bundles were the appeal documents, correspondence, documents, witness statements and expert witness evidence. Not all of the relevant correspondence and documents were included and some e-mails/e-mail chains were incomplete, this is considered further at paragraph 438. The hearing was transcribed and the daily transcript was provided to the Tribunal. Transcript references are in the format: [Day/Page Number/Line Number]. The witness evidence (both factual and expert) are as follows:

On behalf of LBG:

Witness	Date of statement(s)	Position at the relevant time
Mr Eric Daniels	9 August 2022	LBG CEO
Mr Tim Tookey	9 August 2022	LBG Finance Director
Mr Truett Tate	27 July 2022	W&I Director
Mr Tom Godfrey	9 December 2022	M&A expert

Mr Paul Sharma	9 December 2022	Regulatory Expert
Mr Ciarán Rogers	9 December 2022	Irish Corporate Expert
Mr Paul Sleurink	19 December 2022	Dutch Law Expert
Mr Shane Hogan	9 December 2022	Irish Law Expert

All of LAL's witnesses gave oral evidence and were cross-examined during the hearing other than Mr Paul Sleurink whose statements was read as agreed

On behalf of HMRC:

Mr Arco Bobeldijk	23 December 2022	Dutch Law Expert
Mr Michael Ashe SC	19 January 2023	Irish Law Expert

Joint expert reports:

Mr Paul Sleurink and Mr Arco Bobeldijk	1 February 2023	Dutch Law Experts
Mr Shane Hogan and Mr Michael Ashe SC	10 February 2023	Irish Law Experts

7. Joint expert report of Mr Paul Sleurink and Mr Arco Bobeldijk dated 1 February 2023 Dutch Law Experts

Joint expert report of Mr Shane Hogan and Mr Michael Ashe SC 10 February 2023 Irish Law Experts

RELEVANT LAW

Applicable EU law at the time of the Closure Notice

8. Questions of direct tax are matters of retained competence. Articles 2-4 of the TFEU set out areas of exclusive EU competence and shared competence. It is therefore for each Member State to design their own system of taxation as they see fit. As the CJEU observed in paragraph 47 of its judgment in Case C-446/04 *Test Claimants in the FII Group Litigation v Inland Revenue Commissioners* [2012] 2 AC 436 ("*FII (No.1)*"): "*it is for each member state to organise, in compliance with Community law, its system for taxing distributed profits and, in particular, to define the tax base and the tax rate which apply to the company making the distribution and/or the shareholder receiving them, in so far as they are liable to tax in that member state*". Who is liable to direct forms of taxation, on what basis and in what amounts are therefore matters of retained Member State competence.

9. The CJEU has confirmed that "direct taxation does not as such fall within the purview of the Community", but further noted that "the powers retained by the Member States must nevertheless be exercised consistently with Community law": see case C-279/93 *Finanzamt Köln-Altstadt v Schumacker* [1996] QB 28 ("*Schumacker*"). The CJEU has moreover confirmed that Member States "*are not obliged to adapt their own tax systems to the different systems of tax of the other Member States*" in order to eliminate difficulties for claimants arising from "*the exercise in parallel by those Member States of their fiscal sovereignty*": C-

67/08 *Block v Finanzamt Kaufbeuren* [2009] ECR I-883. Thus the existence of tax law is a matter for Member State competence. However, how the Member State decides to exercise that competence remains subject to EU law and in particular the principle of equal treatment.

10. The right of establishment was set out in Article 43 of the Treaty establishing the European Community ("EC") (now Article 49 of the TFEU). Article 49 TFEU provides:

> "Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.
>
> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital."

11. Article 48 TEC (now Article 54 TFEU) confirmed that the right applies to companies.

12. Derogations from Article 49 TFEU are permitted under Article 52(1) TFEU which provides:

> "The provisions of this Chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health."

13. Article 54(1) TFEU further provides:

> "Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States."

<u>*M&S*</u>

14. C-446/03 *Marks & Spencer v Halsey [2006]* STC 237 ("*M&S*") concerned the case of a British company that had subsidiaries in a number of Member States. In 2001, it ceased trading in continental Europe owing to losses it had incurred there in the 1990s. It then claimed group relief in the UK from HMRC for the losses incurred, specifically by its Belgian, German and French subsidiaries. However, under English law applicable at the time, the resident companies in a group (i.e. UK-based subsidiaries) could set off their profits and losses among themselves but were not allowed to do so where the losses were incurred by subsidiaries which had no establishment in the UK and did not trade there.

15. The CJEU held that the UK rules on group relief breached Article 49 TFEU because they discouraged undertakings from setting up subsidiaries in other Member States and so constituted a restriction on freedom of establishment. However, having found a *prima facie* breach, the court did, however, recognise the necessary asymmetry between the treatment of profits and losses at the justification stage. The UK offered, and the Court accepted, three justifications:

(1) Protecting a balanced allocation of the power to impose taxation between the various Member States concerned so that profits and losses are treated symmetrically in the same tax system, [45] – [46];

(2) Avoiding the risk of the double use of losses which would exist if the losses were taken into account in the Member State of the parent company (i.e. in the UK) and in the Member States of the subsidiaries (i.e. Belgium, France and Germany), [47] – [48]; and

(3) Avoiding the risk of tax avoidance which would exist if the losses were not taken into account in the subsidiaries' Member States. In other words, preventing the situation that might occur within a group of companies, where losses might be transferred to the companies established in the Member States which apply the highest rates of taxation and in which the value of the losses is therefore the highest, [49] – [50].

16. However, the CJEU said that measures denying group relief in respect of loss from a non-resident subsidiary would be disproportionate only where:

> "the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods, if necessary by transferring those losses to a third party or by offsetting the losses against the profits made by the subsidiary in previous periods, and there is no possibility for the foreign subsidiary's losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party."
>
> ("para 55")

17. Para 55 embodies the "no possibilities" test that is referred to in subsequent case law. If the para 55 conditions are not both met by the taxpayer, then refusal of group relief will be permissible and proportionate where one of the three objective justifications set out in paragraph 15 above are available.

UK response to M&S

18. The treatment of Group relief claimed where the surrendering company is not resident in the UK was first introduced, to give effect to the *M&S* decision, by s27 of and Schedule 1 to the Finance Act 2006. The Explanatory Note to the Bill said as follows in relation to what was clause 27 and Schedule 1:

> "123 On 13 December 2005 the Court of Justice of the European Communities handed down its decision in the case of Marks & Spencer plc v Halsey. This case concerned the UK's group loss relief rules for companies.
>
> 124 In summary, the Court ruled that the UK's group loss relief rules are in principle compatible with European Law but go too far in denying loss relief to a parent company for the losses of a foreign subsidiary where the parent company has demonstrated that the non-resident subsidiary has exhausted all possibilities of relief in its state of residence.
>
> 125 Clause 27 and Schedule 1 provide for the extension to the group loss relief rules. The new relief applies only where a UK parent company has a foreign subsidiary (including an indirectly held subsidiary) which has incurred a foreign tax loss that is unrelievable in the home state (or elsewhere) and where that subsidiary is either resident in the EEA or has incurred the relevant losses in a permanent establishment in the EEA.

> 126 The foreign losses are 'relievable in the UK' only where all possibilities of relief have been exhausted and future relief is unavailable in the Country where incurred or in any other country. Where there is a foreign company in the ownership chain between the surrendering company and a UK parent, precedence rules apply to determine whether relief is available in the UK."

19. Group relief came to be governed by Part 5 of the CTA.

20. It is common ground that LAL's claim to CBGR is governed by Chapter 3 of Part 5. The Explanatory Notes to Chapter 3 of Part 5 of the CTA state, at paras 406-407, as follows:

> "406. This Chapter makes the United Kingdom group relief rules compatible with European Community law following the judgment in Marks and Spencer plc v Halsey, C446/03. That case decided that in some circumstances it is contrary to the provisions of the EC Treaty on freedom of establishment to deny group relief to a UK resident parent for the losses of a non-UK resident subsidiary.
>
> 407. So this Chapter allows relief for foreign losses. But there are two main restrictions:
>
> > the surrendering company must be resident in (or otherwise "related" to) an EEA territory; and
> >
> > the losses must not qualify for relief in the EEA territory."

21. Chapter 3 of Part 5 of the CTA begins at s.111 which provides an overview of the Chapter as follows:

> "(1) This Chapter allows a non-UK resident company that is resident or carrying on a trade in the European Economic Area to surrender losses and other amounts it has for a period.
>
> (2) Section 113 sets out the basic provisions about the surrendering of losses and other amounts.
>
> (3) Sections 114 to 121 set out conditions that must be met if losses and other amounts are to be surrendered (see Step 2 in section 113(2)).
>
> (4) Sections 122 to 128 set out other rules, assumptions and exclusions (see Steps 3 and 5 in section 113(2)).

22. The parties do not agree on how the UK legislation enacted to implement the *M&S* decision must be construed. The divergent positions are set out below in the parties' submissions.

Relevant UK legislation at the time of the Closure Notice

23. All references are to the CTA.

24. Section 119 provides as follows:

> "119 The qualifying loss condition: relief for future periods
>
> (1) This section applies to an EEA amount so far as subsections (2) and (3) apply to it.
>
> (2) This subsection applies to the EEA amount so far as, for the purposes of any relevant non-UK tax, the EEA amount cannot be taken into account in calculating any profits, income or gains that—
>
> > (a) might arise in any period after the EEA accounting period to the surrendering company or any other person, and

(b) (if there were any) would be chargeable to that tax for any period after the EEA accounting period.

(3) This subsection applies to the EEA amount so far as, for the purposes of any relevant non-UK tax, the EEA amount cannot be relieved in any period after the EEA accounting period—

(a) by the payment of a credit,

(b) by the elimination or reduction of a tax liability, or

(c) in any other way.

(4) The determination as to the extent to which the EEA amount—

(a) cannot be taken into account as mentioned in subsection (2), or

(b) cannot be relieved as mentioned in subsection (3),

is to be made as at the time immediately after the end of the EEA accounting period."

25. Section 121 provides as follows:

" The precedence condition

(1) An EEA amount meets the precedence condition so far as no relief can be given for it in any territory which—

(a) is outside the United Kingdom,

(b) is not the relevant EEA territory (as defined by section 117(2)), and

(c) is within subsection (2).

(2) A territory is within this subsection if—

(a) a company resident in the territory owns (directly or indirectly) ordinary share capital in the surrendering company,

(b) a UK resident company owns (directly or indirectly) ordinary share capital in the company resident in the territory,

(c) the surrendering company is a 75% subsidiary of the UK resident company, and

(d) the surrendering company is not such a subsidiary as a result of its being a 75% subsidiary of another UK resident company.

(3) In subsection (1) the reference to relief being given in any territory is a reference to relief being given—

(a) by taking the EEA amount (or a part of it) into account in calculating any profits, income or gains of any person chargeable to non-UK tax under the law of the territory,

(b) by the payment of a credit to any person under that law,

(c) by the elimination or reduction of a tax liability of any person under that law, or

(d) in any other way.

(4) Chapter 5 explains how to determine if a company is a 75% subsidiary of another company."

26. Section 127 provides as follows:

"Amounts excluded because of certain arrangements

(1) An amount (or part of an amount) resulting from Step 4 in section 113 is excluded

if—

(a) it is not attributable for corporation tax purposes to any permanent establishment through which the surrendering company carries on a trade in the United Kingdom, and

(b) the following condition is met.

(2) The condition is that the amount (or part)—

(a) would not have resulted from Step 4 but for any arrangements within subsection (3), or

(b) would not have arisen to the surrendering company but for any such arrangements.

(3) Arrangements are within this subsection if their main purpose, or one of their main purposes, is to secure that the amount (or part) may be surrendered for the purposes of group relief.

(4) "Arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)."

27. Applicable Irish Law

1. Section 33 of the Irish Central Bank Act 1971 provides:

"(1) Whenever the holder of a licence (in this Part referred to as the transferor) agrees to transfer, in whole or in part, to another holder of a licence (in this Part referred to as the transferee) the business to which the licence relates—

(a) the transferor and transferee may, not less than four months before the date on which the transfer is intended to take effect (in this Part referred to as the transfer date), submit to the Minister for his approval a scheme for the transfer,

(b) the transferor and transferee shall, not less than one month before the transfer date, publish notice of the transfer in at least one daily newspaper published in the State,

(c) the Minister, after consultation with the Bank, may, not less than two months before the transfer date, either approve of or decline to approve of the scheme by order,

(d) if the Minister approves of the scheme under this section, the provisions of sections 34 to 39 and 42 of this Act shall, if, and to the extent only that, the scheme so provides, have effect in relation to the transfer,

(e) the Minister may, at the request of the transferor and transferee, include in an order approving of the scheme under paragraph (c) of this subsection such incidental, consequential and supplemental provisions as he thinks appropriate for facilitating and implementing the transfer and securing that it shall be fully and effectively carried out, including provisions for substituting the name of the transferee for the transferor or otherwise adapting references to the transferor in any statute or instrument made under statute.

(2) An order under subsection (1) of this section or under this subsection may, after consultation with the Bank and with the consent of the transferor and the transferee to whom it relates, be amended by the Minister by order."

FACTS

28. The facts are taken from the documentary evidence that was in evidence before the Tribunal. The veracity of the documents was not challenged. What was disputed was the interpretation of and the meaning to be attributed to the documents. The Tribunal is at a loss to understand why a statement of agreed facts or a chronology of key facts could not be agreed. It has therefore been necessary to set out at length, in chronological order, the key facts to provide the factual context for the further findings of fact set out below at paragraph 466.

BACKGROUND

29. The Appellant is registered in England under companies' number GB02065463. It is a wholly owned subsidiary of Lloyd's Bank Leasing Limited which in turn is a subsidiary of LBG. During the 2008 financial crisis Lloyds TSB (as then known)("LTSB") agreed terms to purchase Halifax Bank of Scotland plc ("HBOS'') with formal completion in early 2009. Following the acquisition of HBOS the banking group changed its name to LBG. At all material times, LBG, Bank of Scotland ("BOS") and HBOS were resident in the UK for UK tax purposes

30. BOSI was incorporated in Ireland under companies' number IE288297. BOSI was a 100% subsidiary of HBOS and after the merger became a subsidiary of LBG. BOSI was a full service bank, providing commercial and retail banking services throughout the Republic of Ireland and commercial, corporate and asset finance in Northern Ireland. Services included corporate banking, business lending, property lending, commercial deposits, asset finance and treasury services. Retail banking, which was launched in 2006, provided a full range of personal banking products under the Halifax brand in the Republic of Ireland.

31. BOSI, as an Irish credit institution, was subject to regulation by the Irish Financial Regulator and it was required to maintain a prescribed level of regulatory capital and liquidity as a condition to maintaining its Irish banking licence. At the same time, the LBG group, as a UK based financial business, was subject to regulation by the UK financial regulator, which at the time was the Financial Services Authority ("FSA").

32. The global financial crisis that began in 2007 caused great turmoil in the global financial markets. Numerous financial institutions collapsed or were nationalised. Royal Bank of Scotland plc had to be bailed out by the UK Government. Several Irish banks and building societies that collapsed had to be nationalised by the Irish Government. In an attempt to restore confidence in the banking system the UK Government instituted measures that sought to maintain stability in the financial markets, including the provision of £200 billion in liquidity assistance via the special liquidity scheme and a recapitalisation scheme that allowed it to inject £50 billion of capital into eight eligible institutions including HBOS and LTSB.

33. HBOS was one of the institutions worst affected by the liquidity crisis caused by the global financial crisis. As part of a bank recapitalisation scheme, in October 2008, HM Treasury ("HMT") required HBOS to raise £11.5 billion in additional capital (separately, LTSB had to raise £5.5 billion).

34. In 2009, the BOSI property loan portfolio in Ireland was valued at approximately €32.6 billion, €20 billion of which related to corporate borrowing, impaired by €4 billion. Approximately 40% of BOSI's loan assets comprised loans made by it to the corporate real estate ("CRE") sector in Ireland. Of its remaining loan assets, approximately 30% comprised non-CRE commercial loans and the rest were retail mortgages and loans. BOSI's loans to the CRE sector had grown significantly and this growth had been facilitated by the provision of a guarantee from BOS (the "Guarantee"). By the Guarantee, BOS guaranteed certain amounts

owed to BOSI by its customers in the real estate sector. The Guarantee allowed BOSI to treat loans covered by it as not being real estate sector loans for regulatory purposes, thereby permitting BOSI to exceed the strict sectoral limits imposed by the Irish Financial Regulator ("FR") on lending to that sector and allowing BOSI to increase its lending to that sector without further regulatory capital. Historically, the Guarantee was not needed to meet minimum regulatory capital requirements (only sectoral limits), but due to the erosion of BOSI's regulatory capital base (due to the heavy losses it suffered), the Guarantee had to be relied upon from 2008 onwards to meet BOSI's Irish regulatory capital requirements. Due to the impairments in BOSI, in 2009, the limit in the Guarantee had to be increased from €5bn to €20bn. The CRE sector was a principal cause of the problems affecting the Irish economy. BOSI's impairment charge for 2009 was £2.949bn.

CHRONOLOGY OF KEY FACTS

35. The individuals referred to in the documents, their allocated abbreviation, and title/role are set out below.

NAME	ABBREVIATION	TITLE/ROLE
Eric Daniels	ED	Group CEO, Member of LBG Board and GEC
Truett Tate	TT	Group Executive Director, Wealth & International ("W&I") Member of LBG Board and GEC.
Tim Tookey	TTO	Group Finance Director, Member of LBG Board and GEC
LBG Tax		
Jon Breaks	JB	Senior Tax Manager
Ewen Gillespie	EG	Head of Performance
Grant Martin	GM	Senior Manager
Moira Sced	MS	Senior Tax Manager
Greig Sharratt	GS	Tax Advisory Director
Susan Walker	SW	Group Tax Director, Head of Group Tax
W&I		
Graham Allatt	GA	Divisional Risk Officer, Member Hermes Steering Committee ("MHSC")
Steve Colsell	SC	Finance Director, Group Strategy, MHSC
Jo Dawson	JD	Divisional Head of W&I until January 2010
Wilson Downs	WD	Hermes Programme Director, MHSC
Alan Kirkwood	AK	Director of Finance, MHSC
Anne E Lanc	AEL	Head of Balance Sheet Management
Jacqueleine White	JW	Head of Planning and Forecasting
Mike Wooderson	MW	Managing Director Intl Banking Europe & N America
LBG Group Finance		

Tony Ellingham	TE	Divisional Risk Officer
Sue Harris	SH	Finance Director, TTO's "Deputy"
Michael Holmes	MH	Head of Group Capital & Regulatory Reporting
BOSI		
Martin Akers	MA	Head of Risk
Jon Breaks	JB	BOSI Tax Director
Padraig Brosnan	PB	Head of Finance
Tom Fitzgerald	TF	Chief Finance Officer
Joe Higgins	JH	Chief Executive, MHSC
Siona Meghan	SM	Head of Strategy
Other individuals in LBG		
Marc Boston	MB	Senior Company Secretary
David Chalk	DC	Capital and Stress Testing Director, Risk
Steven Clark	SCK	Group Risk - Credit
Patrick Foley	PF	Chief Economist
Sandra Odell	SO	Head of Governance and Policy
Michael Oliver	MO	Director of Investor Relations
Alex Pietruska	AP	Group Corporate Development
Stephen Roughton-Smith	SRS	Group Credit, MHSC
Martyn Scrivens	MSS	Group Audit Director
Carol Sergeant	CS	Chief Risk Officer
Ed Thurman	ET	Group Corporate Development
External Advisers		
Mark Adam	MA	Partner, Reorganisation Services, Deloitte LLP
Mairead Foley	MF	KPMG
Nigel McCrea	NMC	Partner, Financial Services Tax, Deloitte LLP

January 2009

36. LTSB's internal Major Country Ratings downgraded Ireland's credit rating from 1 (AAA) to 1 (AAA) negative.

37. On 16 January 2009, the formal merger between LTSB and HBOS took place, the new group became LBG. BOSI joined W&I, other assets in W&I included Australia, corporate

Europe and Latin America. BOSI was a small part of LBG, as at 30 June 2010 it had about £27bn in loans outstanding, by comparison, LBG had in total £612bn in loans.

38. In early 2009, LBG reviewed HBOS's books in detail. At the same time, LBG's risk function unit advised that the economic position was far worse than LBG had predicted in 2008. As a result, LBG increased its forecasts of HBOS's impairments for 2008 and 2009, the total impairment figures for 2008 and 2009 were estimated at that time to be £23.9bn.

39. In 2009, the GEC of LBG sought to address the problem loans that were on the books of each of the groups.

26 February 2009

40. LBG's Annual Report and Accounts 2008 confirmed LBG's view that by 2010 there would be a gradual restoration of growth.

7 March 2009

41. LBG announced it intended to participate in the UK Government Asset Protection Scheme ("GAPS") to reduce its risks weighted assets and strengthen LBG's capital position.

23 March 2009

42. "Options for the retail business" paper prepared for the BOSI Board Meeting on 3 April 2009 at which JH recommended Option 5 – "Exit Retail - Close all branches, close to new business and dispose of the back book as quickly as possible to effect a complete exit."

18 May 2009

43. Draft paper "Tax Losses in BOSI and HBOSA Overview of Strategic Options" provided by Deloitte. The paper outlined strategic options to preserve the value of tax losses in Ireland and Australia. The paper did not provide a comprehensive tax analysis of each option but directional guidance on four options:

(1) Group relieve losses to LBG UK (BOSI only)

(2) Transfer Assets to UK Holdco (group bad bank).

(3) Risk transfer agreement between BOSI and UK group.

(4) Capitalise BOSI/HBOSA with non-deductible funding

June 2009

44. The strategic decision was taken that the LBG would, going forward, have a UK focussed business and that it would identify and manage down or dispose of £200bn of non-core assets over the next five years. A public announcement regarding this strategy was made in LBG's 2009 Interim Results for the half-year ended 30 June 2009.

15 June 2009

45. Paper titled "Future of the retail business" was prepared by JH for the BOSI Board Meeting to be held on 26 June 2009. The paper sought approval to close the retail operation in Ireland and explore disposal options.

19 June 2009

46. A draft LBG Forward Plan was prepared for submission to the EU Commission. The Strategy for W&I confirmed that non-core International Banking businesses would be managed-for-value ("MFV") in the near-term with a view to managing down when markets improve.

47. LBG Board Meeting. AP presented a paper on LBG's corporate strategy progress identifying key priorities and challenges faced following the acquisition of HBOS: deteriorating economy and rising impairment profile; funding constraints; recapitalisation and preference share conversion; potential state aid restructuring and behavioural remedies and participation in GAPS.

July 2009

48. W&I Integration Update confirmed that the retail business in Ireland was fundamentally unprofitable, there was now a need to accelerate the approach and announcement of the exit from Ireland.

21 July 2009

49. GEC meeting minutes record that the position in relation to Ireland was considered carefully and would be kept under review.

5 August 2009

50. LBG News Release of 2009 Interim Results announced that going forward, LBG, would have a UK focussed business and would identify, manage down or dispose of £200bn of non-core assets over the next five years. The intention was to manage these assets for value and, given the current economic climate, the primary focus would be on running these assets down over time. The PowerPoint presentation by ED confirmed that impairments were concentrated in CRE and that 80% of W&I impairments were from the HBOS book.

51. In the following months, various options as regards BOSI were considered by LBG. Consideration was given to the possibility of BOSI joining NAMA. NAMA was the Irish Government's scheme to purchase distressed assets from Irish banks. On 6 August 2009, SH e-mailed ED, TTO and confirmed that current thinking was that LBG did not want to join NAMA.

Autumn 2009

52. LBG established Project Memphis with Project Chicago running in parallel to retain optionality for LBG as it could be pursued pre or post Project Memphis. Project Memphis was the decision to withdraw from Retail Banking in Ireland with an announcement scheduled for early February 2010 with implementation by the end of May 2010. Project Chicago involved BOSI becoming part of a consolidated entity to form a "third force" in Irish banking. In the meantime, LBG continued with its medium term plan of Manage for Value ("MFV") with a view to managing down the BOSI portfolios in the future.

September 2009

53. A Business Support Unit ("BSU") based on the LBG operating model, was implemented in Ireland. RF, from LBG, was appointed as head of the Irish BSU.

10 September 2009

54. E-mail from JD to ED confirmed the approach was MFV whilst exploring options to reduce exposure. Confirmed that NAMA unlikely to be attractive to LBG.

13 September 2009

55. E-mail from JD to ED confirming the approach for JH to take at the meeting with Irish Finance Minister: "*looking at all options for our Irish Business*". ED approved the approach.

17 September 2009

56. Project Chicago paper for GEC sought approval for possible transfer of BOSI business to new Irish bank for minority shareholding. Following discussion with the FR it was considered that the option is "*potentially attractive ... both W&I and GCD believe that this is an option that should be investigated. The approval of GEC to proceed is requested*".

8 October 2009

57. Project Chicago GEC paper circulated which sought permission "to initiate [emphasis provided] discussions with Irish Govt/Finance Ministry to seek to get a large part of our Irish business included in a sector consolidation proposal. … to create a "3rd force" in Irish Banking". It stated that the need for such a response is being driven by the EU State Aid discussions the Irish Government is having with the EU. Confirmed that Plan A [to close down retail and manage down book and CRE book] was looking increasingly unlikely and unviable and identified a Plan C which would "hard close" the residual business and put in place a team (with UK support) who would be "incentivised solely on managing out the asset book at an acceptable price over the next 5 years (say)."

October 2009

Following the announcement of LBG decision to exit GAPS, Moody's placed BOSI's credit rating under review. Concern was expressed that any further downgrade would "remove our capacity to obtain funding".

13 October 2009

58. GEC Paper on Project Chicago presented by JD summarised the MFV strategy

18 November 2009

59. GEC approval sought to increase projected BOSI impairment provisions.

24 November 2009

60. The BOSI CFO, TF, prepared a memorandum for JD and TTO noting that BOSI's compliance with Irish regulatory capital requirements had historically been achieved through the use of the Guarantee provided by BOS however that position had been severely impacted by the downturn in the Irish economy and the increased impairment charges which had eroded BOSI's capital base. TF concluded that BOSI which require further capital in Q1 2010 to meet minimum Irish regulatory capital requirements and that the position would further deteriorate over the course of 2010 as BOSI continued to recognise further impairments. TF recommended an injection of up to €2bn of capital into BOSI in December 2009 to ensure ongoing compliance by BOSI with its Irish regulatory obligations up until the end of Q1 2010. BOSI would continue to work with W&I/GF to explore all options to mitigate BOSI's capital needs and to agree a medium term capital strategy following the completion of the BOSI strategic review by the end of Q1 2010. From a statutory perspective this would include consideration of transferring assets to a non-bank subsidiary or an LBG branch.

3 December 2009

61. Internal controls report rated BOSI control framework as Red. The report noted that a new executive team was in place which recognised the need to address managing risk effectively.

4 December 2009

62. BOSI Board Meeting. The minutes identified the BSU as pivotal to maximising income on distressed cases. An increase of €0.7bn in the projected impairment charge for 2009 to €3.2bn and an increase of €0.2bn in 2010 to €2.3bn was approved. The

Remuneration Committee recommended two short term and medium term incentive schemes be introduced in 2010 and that a higher level of bonuses be paid to BSU staff compared to other BOSI staff.

10 December 2009

63. LBG Audit Committee paper considered BOSI's poor risk management and increased impairment provisions and noted "Substantial progress has been made on the establishment of the Business Support Unit … the business is tracking towards an amber risk rating in early 2010."

January 2010

64. BOSI Business Review Briefing Pack for ED and TTO for the BOSI Board meeting on 6 January 2010. The Executive Summary stated: "New management team working to improve risk profile of the business, ensure control over tail risk on impairments and improve future options". The Key Achievements identified were: a new senior management team had been appointed who were focused on risk control and BSU established. The Future of the Business section re-stated MFV strategy and noted there was a team in place to deliver MFV or Project Chicago. The Briefing Pack confirmed: the Irish recovery would lag behind Europe in the short term; modest recovery from 2010 with CRE expected to see modest recovery in 2011-12, with strong growth in 2013; confirmed that Project Chicago preferable option but unlikely without Government support and was focused on asset reduction to reduce LBG funding.

5 January 2010

65. E-mail from TE to TTO with subject "Background reading for you [sic] visit to Dublin" attaching copy of Audit Committee paper on BOSI impairments and remediation of control issues. The e-mail stated: "The level of impairments have now been agreed between Group Credit Risk, Divisional Risk and Ireland, and the attached Appendix reflects the latest numbers … the level of coverage for the 2009-2014 plan period at 39% equates to that which is being used by NAMA and so holds up against local competitors."

11 January 2010

66. W&I Divisional Financial Control Committee Meeting confirmed BSU had been set-up and making progress and expected to be fully operational by end of Q1 2010. BOSI to remain at "*Amber*" until BSU fully operational.

67. Regulatory Contact Report – Meeting between BOSI (MA and CR) and FR. The summary recorded "The tone of the meeting was constructive and cooperative".

14 January 2010

68. Workshop held with key stakeholders summarised in briefing paper for TTO dated 26 January 2010:

> "Representation from BOSI, W&I, Group Finance and Group Tax
>
> Designed to consider all issues and agree structuring priorities
>
> Compare existing subsidiary structure vs. branch alternative
>
> Trade off between tax, capital and funding considerations
>
> Agreed conclusion to look to immediately extract value from tax losses through claim under BOS plc guarantee and then agree revised legal entity structure at a later stage as regulatory position becomes clearer"

18 January 2010

69. LBG's Audit Committee minutes record that Mr Ryan (a NED on the LBG Board) requested a paper considering alternative strategies for the BOSI portfolio. TTO agreed to raise the issue with ED for future consideration by the LBG Board.

19 January 2010

70. E-mail exchanges between SC and AK with the subject "Irish Entity Structuring". AK suggests agenda items for meeting, SC replies "Ok let's go with this plus the Irish capital and tax loss piece … can you send them the agenda plus tell them Neil and Padraig are coming". AK confirmed: "The meeting with [TTO] is Tuesday of next week". The distribution list at the end of the e-mail chain was GR, TF, MS, PB cc'd to MH and SM.

21 January 2010

71. E-mail from GR to MH and SC cc'd to TF, PB, AK and SM with the subject "Irish Entity Structuring" stating: "Working draft of doc from Tom and Padraig which highlights where the Group Tax, capital and group view; neeeds [sic] to dovetail."

22 January 2010

72. LBG Board Meeting attended by ED, TTO, TT and CS. The minutes record ED commenting:

> "after the turmoil of 2009, the management team was fully focused on delivering the goal of being the "Best Bank in the UK". The Board would discuss the strategy to achieve this – and the key drivers of the Group's performance – at the Strategy Session in April. The Board would also consider as part of its strategic debate how best to allocate scarce resources (including capital, funding and liquidity) and make difficult choices about strategic priorities. The Group was already heavily focused on funding and liquidity issues, which were clearly key. It was critical for the Group to begin to demonstrate in 2010 what could be achieved and delivered, although the economic, legal and regulatory environment was extremely challenging."

The minutes record that on or around, January 2010, ED met with John Fingleton (OFT) and Clive Adamson (FSA) to help build relationships and gain greater understanding of regulatory policy objectives and that:

> "[ED] and [TTO] had conducted a thorough review of the Irish business. There was a strong and motivated management team, but the Irish economy was clearly performing very badly. The historic strategy pursued by that business (particularly with respect to the Retail expansion) had done badly in the economic downturn."

26 January 2010

73. On 26 January 2010, a paper titled "Irish Entity Structuring" setting out structuring options for BOSI was prepared for TTO. The paper proposed that a claim be made under the sectoral €20bn Guarantee, the proposal was not pursued.

28 January 2010

74. JD prepared an Ireland specific paper titled "Group Executive Committee [BOSI] Proposed Strategy". The Executive Summary proposed that the MFV strategy be continued.

75. Project Memphis paper for GEC set out the proposed MFV strategy in Ireland. The paper confirmed the planning for the exit from Ireland would be announced on 10 February 2010.

Late January/early February

76. For reasons unknown, JD left BOSI in late January/early February. TT took on responsibility for W&I on an interim basis until a permanent replacement was recruited.

2 February 2010

77. GEC paper prepared by JD that had been previously circulated was noted by the GEC. ED commented that:

> "this was a move that would have material repercussions for the Irish business, and would be a serious development for the Irish economy. Nonetheless, this was the right course of action for the Group to take. Other possibilities had now been ruled out, or had fallen away. The programme was well planned, but execution would require close attention to detail by the W&I, and BOS management teams."

8 February 2010

78. Report to the W&I Divisional Financial Control Committee – y/e 31 December 2009. The Executive summary confirmed the most significant area of focus continued to be around impairments, focussed in particular on provisions in Australia and Ireland. An unsatisfactory control environment was identified in Ireland but progress was being made with a number of initiatives likely to improve the control environment including a focus on risk and control and establishment of a BSU.

9 February 2010

79. BOSI Press Release titled "[BOSI] *completes strategic review*" which confirmed retail business in Ireland to close. Corporate and Commercial banking to be main focus in the future with a strong presence with BSU role to be unaffected.

11 February 2010

80. W&I 2009 Full Year Divisional Results Paper which stated that impairments were forecast to have peaked in Half 2, 2009 in Ireland compared with Half 1, 2009 in Wholesale division. Data supplied by LBG's Group Chief Economists Office ("GCEO") predicted a growth in commercial property prices in Ireland from 2011.

14 February 2010

81. Irish Sunday Tribune article by Jon Ihle titled "After two false dawns, night falls on Halifax" which stated "Amid all the confusion, it emerged that a large US private equity firm, believed to be Blackstone, baulked at a deal to buy the bank's assets at a significant discount. The $93bn private equity giant, which had reportedly been on the hunt for distressed debt in Ireland last year, had completed six weeks of due diligence on Bank of Scotland Ireland's €35bn loan book before pulling out at the last minute. The collapse left Higgins strategically abandoned by Lloyds and with no concrete plan for dealing with BOSI's troubled retail franchise."

18 February 2010

82. TT e-mailed GA stating:

> "would like to visit Ireland once the current noise [Project Memphis announcement] subsides … craft a "fresh" view. … The "fresh" view might be particularly important as I am "smelling" that the Wholesale first half impairment numbers might be uncomfortably good….and "optics" might motivate "senior" management to do something that might not make sense. If Wholesales numbers were to be low…..it might provide some cover for us

> to be toughly realistic in Ireland, and get the impairments to an even more comfortable level than they are today (again, please forgive me if I don't express this well and it is misunderstood as either criticism of current impairments or processes. My point is that we might be "permitted" to be more conservative and give us more flexibility in what is an uncertain economy in Ireland!).

GA replied:

> "this is a great idea … Ireland is our one big risk. Given everything that has happened it would also be great for you to tell the troops how valued they are."

19 February 2010

83. E-mail from MO to ED and CS cc'd to TTO, SRS, SH, KC and OM with subject "Impairment guidance" which discussed a planned news release which indicated that the 2010 impairment charge will be significantly lower than 2009, with further substantial reductions in 2011 and beyond. It noted that the second half of 2009 impairment charge was lower than the first half charge.

21 February 2010

84. E-mail from CS to OM cc'd to TTO, SRS, SH and KC with subject "Impairment guidance". CS agreed was appropriate to reduce the range of market expectations even though it was early days, both Retail and Wholesale were looking good, the only concern was Ireland but "we need to this in perspective , both because of its overall size in the scheme of things and also it is very well flagged as an issue."

22 February 2010

85. W&I Credit Risk and Reporting Paper December 2009 Year End. Under Key Risks and Issues (1) it was stated:

> "current forecasts suggest that impairments levels have peaked in 2009";
>
> "The CRE portfolio has generated two thirds of the 2009 impairment charge in BOSI."
>
> "[GCEO] predict a further fall of 8.4% in 2010 (14% in the downside scenario) before signs of growth emerge from 2011 onwards."

In respect of Ireland it stated:

> "Impairments in Ireland moved in line with the weak economy and deterioration in the Irish property market. The BOSI portfolio is characterised by a high level of concentration in [CRE] … which have been severely impacted by the weak economic conditions and falls in asset values. The CRE portfolio has generated two thirds of the 2009 impairment charge in BOSI."

Under "Actions taken to mitigate risk (4)" the headline was the establishment of BSU in W&I during 2009 and to be implemented in 2010. It confirmed that:

> "Wave 3 BSU recruitment completed at the end of January 2010 with 98 out of the projected headcount of 110 appointed and operating from early February."

24 February 2010

86. Meeting of LBG Audit Committee attended by TTO, SH, TE, MS and CS. The Committee noted that alternative strategies for the BOSI portfolio would be considered by the

new Director of W&I following appointment and this item would be considered at the LBG Board strategy session in April, although "*the Group's options were considered to be limited.*"

25 February 2010

87. Memo "re Board Away Days" from ED to ET, AP and GEC setting out key points to cover including:

> "On the question of the participation choices that are available to us within Wholesale, we have made a lot of headway as part of last year's non-core approach. I would like us to have another look at this in time for the Board, specifically to assess whether we can be more rigorous in applying the non-core criteria, as well as to examine the potential benefits of accelerating the previously agreed actions on non-core assets and activities.
>
> …
>
> Internationally, I want us to think through how we can right size the balance sheet and reprice portfolios more quickly, as well as consider the full range of exit options that are available to us."

26 February 2010

88. LBG 2009 Results News Release. TTO stated "We continue to have ongoing concerns with regard to the outlook for the Irish economy although we expect 2009 to have been the peak for the International impairment charge." In the W&I section the MFV strategy was confirmed and it was stated:

> "We have spent a significant amount of time analysing and addressing the issues in the legacy HBOS portfolios, with the greatest attention paid to the over concentration in real estate related lending and those portfolios that fall outside the Lloyds TSB risk appetite."

89. LBG Preliminary Results 2009. ED's Key Messages headline was "A strong earnings outlook". The transcript of ED's address confirmed:

> "Impairments are the most significant number on the slide. At £24 billion, they are up 61% on 2008 and were the primary driver behind the management pre-tax loss. But as expected, they fell back in the second half of the year.
>
> In Wealth & International, we continue to have ongoing concerns with regard to the outlook for the Irish economy although we expect and believe that 2009 has been the peak for the International impairment charge.
>
> And so, in concluding, … We have an improved outlook for margins going forward, we are targeting substantial cost synergies and we expect impairments to reduce significantly.
>
> Question 15: Michael Helsby, Bank of America Merrill Lynch
>
> Firstly, I know you mentioned that Ireland clearly we all know Ireland is going through a difficult spot. But I think most people would have been surprised by the extent that bad debt jumped in the fourth quarter. So I was just wondering if you could give us some more colour.
>
> Answer: Eric Daniels
>
> In terms of Ireland, yes very clearly we gave you in August a cautionary note in terms of our guidance. We were concerned about the Irish portfolios, we remain concerned about them. Basically they are very, very heavily concentrated in real estate, both commercial and residential. Basically there

are therefore going to be a very high beta portfolio. The economy in Ireland is clearly not out of the woods yet. We have a rather bearish view of where the Irish economy is going, around a 2% drop in GDP and in our guidance we have said that we expect that in fact our impairments take that into effect. So we expect we will have peeked [sic] on the Irish impairments, but we are very cautious about them. There is less of a sense of confidence I think than we have in our other portfolios. Very fortunately they make up a pretty small part of our balance sheet. So I think that we feel very confident in the overall guidance that we have given."

90. Engagement Report W&I BOSI - Retail & Intermediary Collections and Recoveries issued by Kate Grant, Audit Manager to Bernard Kingston, Head of Retail and Intermediary, BOSI and copied to GA, JH, MW, MA and TT:

"RED Unsatisfactory - requires urgent attention"

March 2010

91. BOSI W&I DRO & GCRA Review of BOSI's 2010 Impairment Forecasts.

"The key conclusions are as follows:

- The 2010 revised forecast range is €2.5bn - €3.0bn and only slightly changed from Q1F.
- The Realistic Case has increased to €2.8bn, driven by deteriorating cure rates in all portfolios and a more cautious outlook for some of the largest cases.
- Although we have not forecast by half years, we believe the revised forecast range remains consistent with a declining trend in the Impairment Charge - with H1 2010 being lower than H2 2009 and H2 2010 being lower than H1 2010.
- In the last two weeks, 30% of the wholesale book by value has been reviewed by W&I Credit, GCRA and Group Risk with the findings factored into our assumptions.

The forecast decline in the MTP for 2011 is now looking a very large step down from 2010. Although we believe there will be a significant reduction, we intend to review the 2011 forecast as soon as possible."

2 March 2010

92. LBG Group Credit Portfolio Review – March 2010. The Executive Summary confirmed that LBG's impairments remain dominated by HBOS legacy Real Estate though the pace of deterioration has reduced.

12 March 2010

93. E-mail from RF to Karen James (Corporate Markets), subject "RE: DUBLIN TRIP" stating that he would "like to establish buddying relationships with colleagues in BSU in the UK."

19 March 2010

94. E-mail from AK to TF cc'd to PB, JW, MS, GS, EG and MH with subject "RE: Meeting today". The complete e-mail chain is not in the hearing bundle and does not include the e-mail timed at 13.27. The e-mail states:

"The purpose of the call this afternoon is to consider other options we sho [cut off] losses and to consider what work is required and when [cut off]

Moira has kindly prepared the attached and we can use this as the basis [cut off]"

24 March 2010

95. LBG presentation script at Morgan Stanley European Financials Conference which variously states:

> "Impairments are trending better than our guidance and, based on our current economic and regulatory expectations, we expect substantial further reductions for the rest of this year and into next year.
>
> We believe, given our current economic outlook, that the impairment charge in 2010 will be significantly lower than 2009.
>
> In Wealth & International, we continue to have ongoing concerns with regard to the outlook for the Irish economy although we believe that 2009 was the peak for the International impairment charge."

29 March 2010

96. Group Audit Engagement Report, Dublin Treasury BOSI sent to JH, TF, PB, MA, TT, MW, GA and SC. The report stated:

> "RED Unsatisfactory – requires urgent attention
>
> …
>
> This audit is rated Red because of a number of key control weaknesses identified in the governance structure, business processes and monitoring by the Risk and Compliance functions"

April 2010

97. W&I update provided to LBG Board by TT. The update variously stated:

> "Impairments
>
> - Sensitivity to economic environment, particularly in Ireland - impairments due to reduce by £1.3b in 2010, though Irish CRE/HPI values to be monitored*
> - Increasing impairments by £200m during our Q1 F exercise in recognition of continued downside in the Irish Economy.
>
> *Risks remain if CRE values continue to decline through assumed peak-trough level of -58%: a further c. 6% decrease in CRE prices along with some decline in HP/ values would adversely impact our impairments by £1.3bn, negating the decrease we have forecasted
>
> In 'International', outlook is on strengthening controls and actions to improve profitability .... and to create options for LBG
>
> <u>Ireland</u>
>
> Control
>
> - Embed robust risk management model
> - Strengthen BSU capabilities to manage impairments
> - Reduce overall balance sheet and RWAs
>
> Profit
>
> - Deliver asset re-pricing
> - Right-size the cost base and exit unprofitable retail business
> - Reposition the portfolio to reduce sectoral concentrations in property

Optionality

- Controlled run down of CRE book
- Explore targeted asset disposals when liquidity returns.
- Light focus on SME relationship business

Key External Risks

- Continued lack of liquidity in Irish commercial real estate markets."

98. Memo from TT to LBG Board Members with heading "[LBG W&I] STRATEGY -15 APRIL 2010" variously stating:

> "In our "International" business however, continued economic problems in Ireland … are resulting in a slower recovery. Whilst we forecast impairments to decline by £1.3bn in 2010, we continue to watch Irish CRE and HPI values with caution as even a 5% variance in these values would negate this favourable impairments decline.
>
> With impairment challenges over the short-term (which we believe have peaked in 2009), our focus will be on embedding a robust risk and control framework to manage impaired assets in both Ireland and Australia. … We are actively assessing radical options to re-size and re-shape our balance sheet. These include the recent closure of our Retail and Intermediary businesses in Ireland"

99. BOSI Briefing Material for Meetings with staff April 2010. Briefing confirmed:

> "Colleague Messaging Messages delivered on A-Day
>
> [key message] The Bank, and [LBG], are both committed to continuing a strong presence in the corporate and commercial banking sectors in Ireland. Corporate and commercial banking will be the focus of the Bank in the future."

100. BOSI Briefing Pack for TT's April 2010 visit to Ireland containing agenda and the following briefing:

"Executive Summary

New management team working to improve risk profile of the business, ensure control over tail risk on impairments and improve future options

Key Achievements

- New senior management team appointed and business refocussed on risk control rather than sales activity
- BSU formed to improve management of impairment cases – now fully operational.

Future of the Business

- MTP assumes closure of Retail activities (announced Feb 2010) with controlled rundown of CRE Book with further strategic review of residual business (sell; retain; close) in 2 years.
- Significant challenge to re-engage colleagues and customers in the continuing business
- Team in place with capability and commitment to deliver.

…

Despite this, international markets believe in Ireland's capacity to recover over the medium/long term, as confirmed by a number of successful/oversubscribed bond auctions undertaken throughout 2009 and early 2010

Economic Forecasts

Economic outlook as agreed with LBG economics – MTP Outlook: modest recovery from mid-2010

- In the medium term (2011-14) the Irish economy expected to outperform OECD
- Commercial property market expected to see modest recovery in 2011–12, with a strong growth in 2013.

…

Control/Profit/Optionality

Immediate focus is on improving the control environment and actions to improve current/future profitability … creating optionality for LBG.

Strategic Priorities were identified as creating optionality to dispose of some or all businesses and to determine the optimum legal structure, funding and capital model.

Initiatives underway included the asset shrinkage of 15.5bn euro over life of plan baked into MTP and a review of Subsidiary versus Branch model also underway.

Control over Key Risks confirmed that quick wins achieved; remaining actions underway and on track. The key risk on impairments analysed through full segmentation of book and now managed through the formation of BSU.

Key Risks and Mitigants

Very poor Q1 staff engagement results identified in survey, actions were underway to improve colleague engagement underway.

Regulatory

Confirmed strong relations with Financial Regulator and proactive approach to queries/requests for information and, from a Regulatory perspective, BOSI was in line with the Banking industry.

The BSU update confirmed that as at March/April all BSU staff were in place

Latest MTP would deliver lower costs and greater asset reduction over next two years at which point future strategy for business would be re-assessed. Commentary confirmed that MTP included property/mortgage portfolios adopting a run-off strategy with support functions right-sized accordingly and the strategy would be revisited as part of 2012 – 2017 planning phase."

6 April 2010

101. BOSI Capital Requirement paper for GEC presented by Harry Baines. The Executive summary requested the GEC note the proposed injection of a further €1bn of capital into BOSI to "facilitate the finalisation of a medium term capital structure for [BOSI]". It was confirmed that in "Q1LV the [BOSI] impairment forecast for 2010 was in line with the MTP reflecting broadly unchanged economic assumptions, although the forecast is currently being reviewed in conjunction with Divisional and Group Risk in the light of further emerging

experience data. Any increase in the impairment forecast would have a proportional adverse impact on BoS Ireland's capital position."

With regard to the MTP Capital Position, W&I/Group Finance, with support from BOSI were exploring all options to mitigate the medium term capital needs of BOSI. The work was stated to be "complex involving considerations of tax, regulatory and accounting issues, both in Ireland and the in UK and it will be Q2 before a definitive approach can be recommended. It is accepted that this timeframe will extend beyond the date which [BOSI] can remain within its regulatory limits."

102. GEC Meeting chaired by ED, attended by CS with apologies from TT and TTO. GEC approved the injection of €1bn into BOSI to secure its regulatory capital obligations until end Q3, 2010, pending the finalisation of its medium term capital structure.

8 April 2010

103. Memo from ED to LBG Board Members re Board Away Days, 15-16 April 2010 Briefing Materials. The memo enclosed a short briefing note for each of the sessions on the agenda. The W&I Strategy briefing note presented by TT confirmed that W&I were reshaping their International businesses stating "With impairment challenges over the short-term (which we believe have peaked in 2009), our focus will be on embedding a robust risk and control framework to manage impaired assets in both Ireland and Australia … We are actively assessing radical options to re-size and re-shape our balance sheet. These include the recent closure of our Retail and Intermediary businesses in Ireland, managing down our corporate real estate book in Australia and Ireland, as well as exploring exit options in Ecuador and Uruguay."

104. E-mail from JB to MF [the presence of an external e-mail address and KPMG footer at the bottom of the e-mail chain indicates she is from KPMG] with subject "Merger and EU Directive – Irish Legislation". E-mail states:

> "We discussed this briefly yesterday.
>
> The question has come through from Group Tax ie are there any advantages that could be gained through merging BoSI with LBG particularly in terms of getting value from the BoSI losses forward. I know we have looked at this before but could you send me a quick note on it.
>
> My understanding is that the Irish BoSI Case 1 losses forward will only be allowable against future taxable profits"

105. E-mail from JB to MF states:

> "In regard to the below, I understand from my colleagues in the UK that UK merger tax law seem to allow the transfer of assets at amortised value rather than impaired cost. If this was the case in Ireland, it could create a position where more of the impairments would be available against UK taxable profits."

106. The reply/replies from MF to JB are not in the hearing bundle. The e-mail text at the top of the e-mail chain suggests by reference to "she" and its position that JB summarised MF's reply/replies as follows:

> "it will be treated as a separate trade and profits taxable at 28%.
>
> - The NI trade should simply be absorbed into BOS's trade - if there are any losses they should transfer to BOS although how to treat the losses will need to be agreed with HMRC. Capital assets would go on a tax neutral basis as the NI branch is in a group with BOS.

- Finally there are discussions going on in the UK about an exemption for branch profits. These are only at a preliminary stage but worth mentioning.
- She doesn't think that the Irish losses could be c/f into the UK- there may be EU arguments but it would be a battle."

107. E-mail from Jeanette Craft (Secretary to CS) to GA and JH cc'd to SRS and Ras Krishneratne with subject "Visit by Matthew Elderfield, Head of Financial Supervision, Central Bank and Financial Services Authority of Ireland - 7 May 2010 at 10:30 - 11:30". E-mail confirms that CS "knows Matthew Elderfield very well from working with him at the FSA and he is also a good friend. Mr. Daniels knows him quite well also."

15 April 2010

108. Presentation by ED at April Board Away Days titled "Delivering LBG's strategic vision". The Agenda identified three phases:

> "Phase I: 2009 Managing through the crisis
>
> Phase II: 2010-2013 Driving outperformance (reference made to run down non-core assets)
>
> Phase III: Beyond 2013 Targeting growth opportunities"

It was confirmed that LBG had exited a number of higher risk activities. The 2009 results were ahead of expectations having outperformed internal and external forecasts demonstrating that the core business is in good shape with the momentum continuing to build in 2010. The 2014 objectives for International were: value protection, explore restructuring and exit options. New regulation was identified as an execution challenge: "Significant increase in RWA especially for trading activities; higher capital requirements; overall size limit on banking activities; restrictions on funding sources and quality of liquidity buffers".

109. At a meeting of the BOS Board Meeting attended by ED, TT and TTO, the proposed injection of a further €1bn of capital into BOSI was approved.

16 April 2010

110. E-mail from SC to DC with subject "Emailing: Group Credit – W&I impairments 11-2-1- final" with attached W&I impairments note following PwC's audit findings reported to DFCC 11 Feb'10 which stated:

> "Group credits in Feb 2010 – "Group Credit's view of view of BOSI impairments is unchanged and is in line with PwC. We continue to believe that the BOSI impairments are, assuming we are in the LBG base case, mid-range for 2009; aggressive by €300mn for 2010; slightly optimistic for 2011; and mid-range for 2012-14, although we have undertaken only limited work on the back years & there is inherently greater uncertainty."

Date prior to 20 April 2010

111. Agenda for TT visit to Ireland on 22-23 April. Objectives that TT should get from the visit were: "Understanding of the current issues faced by the business, in particular … impact of NAMA on the CRE market and the potential to dispose of assets in the future."

20 April 2010

112. Email from SM to Nick Beckwith cc'd MW and JH with subject "Briefing Materials in advance of GTT visit". The attachments included the agenda, background briefing pack, background information ahead of meetings and meeting papers for the Board and Board Audit Committee.

21 April 2010

113. E-mail from MS to AK cc'd to GR and GS with subject "Ireland - branch option". The e-mail dated 28 April confirmed that AK had embedded his comments in the text of MS's e-mail. The e-mail stated:

> "While you were away, I progressed the various points we discussed. … From what I have managed to gather from BOSI Legal and brief discussions with the tax guys, here's where we are at:
>
> Legally, there are 3 ways transferring the BOSI business to a branch:
>
> • transfer of assets using the Central Bank Act procedure (similar to our Part VII transfers here)
>
> • using an EU Directive to Implement a cross-border merger (there is precedent for a financial Institution in Ireland using this)
>
> • a scheme of arrangement (essentially and application for a Irish High Court ruling of your choice).
>
> For tax purposes, I see four ways of forming a branch - migration, EU cross-border merger, transfer of assets or commence trade of UK Co (whilst running down BOSI).
>
> I've done some deeper digging on the tax front In respect of the options on the table:
>
> 1. M&S Claim
>
> …
>
> The initial comments that I have been given on the Irish tax analysis are unhelpful when it comes to the M&S analysis. In the scenario of all assets being transferred to a UK company, the Irish tax losses will travel across with the trade. This will mean that we can't argue that there is 'no possibility' of the losses being used in Ireland in the full transfer scenario.
>
> I have also looked into the detail of the M&S case to see whether there is anything of use re circumstances in which we can make an M&S claim for BOSI … The facts of the case are not particularly helpful - at the time of the ECJ hearing, the subsidiaries were no longer trading (but not yet in liquidation). However, the ECJ Just rules on points of law and not on the facts. The case was sent back to the UK courts to apply the legal analysis to the facts of the case. …
>
> Despite the decision being in respect of companies in the course of liquidation, there are some comments made by the judges that give us some guidance. The main points to draw from the case are:
>
> • There being 'no real likelihood' of using the losses in the future is not enough - there has to be 'no possibility', broadly equivalent to there being no legal possibility.
>
> • For there to be 'no possibility', the indication is that a suggestion that the losses can be used must be 'fanciful'.
>
> …
>
> [AK Commented] This makes it much more difficult - almost back to the liquidation of BOSI situation. Just testing how far we would have to go, If we liquidated BOSI and as part of the liquidation transferred all the assets back to BOS plc to be managed out of the UK, retained some of the people on the Ground to manage collections would that work in terms of avoiding

the branch in Ireland. No Irish Branch of BOS plc, no opportunity to use losses ever and a M&S claim would become possible?

2. EU merger provisions

In respect of the EU merger directive (which states that essentially amortised cost can be used as tax basis in the UK), there are further provisions overwriting these where parties are not at arm's length. In such circumstances, the value of the loan relationship is the transfer value that would have been entered into between knowledgeable and willing parties at arm's length. This is a pity as it brings us back to the valuation issue that we have on the transfer to a branch.

[AK Commented] Pity - looks like this closes this one down

3. Group relief of PE/branch losses to wider UK group

As discussed, if the branch generates losses, it will only be able to surrender these losses to the wider UK group if none of the losses can be used elsewhere in Ireland. I have had discussions with KPMG re the Irish grouping rules for group relief, I've not received anything in writing, but I've been told that the group has to have all of the following 76% connections to being the same group:

• Ordinary share capital

• Entitlement to profits available for distribution

• Entitlement to assets on a winding up

The grouping rules only Include EU companies though, so a group can. be broken by a non-EU group company (e.g. Channel Islands) holding 26% ords of the Irish entities.

Given that I suspect the notion of holding some shares/rights through, say the Channel Islands, is likely to be unpalatable, I have not investigated further anti-avoidance provisions/problems it may cause with the UK grouping. This method of breaking the Irish tax group is the only one that KPMG Ireland had.

[AK Commented] Sounds like we need to get away from having an Irish branch. I think that HAIL (the Irish life assurance company) will always have some profits so will preclude us from surrendering the losses anyway

4. Tax projections for a branch scenario

I attach some projections of the branch scenario using the MTP and stressed MTP. As you can see, there is a considerable tax downside to a branch if the UK tax rules continue as present.

…

5. Migration

The migration of BOSI to the UK would result in a UK resident company with an Irish PE. In order to do this, BOSl's place of 'central management and control' must be moved to the UK. Where a company is dual resident, Its ultimate residence is determined by the provisions of the UK-Ireland tax treaty. … Please note that this area has been increasingly subject to scrutiny and challenge by HMRC In recent years and must be implemented carefully.

[AK Commented] Even if we got the migration right would we still need to satisfy the point at 3 above i.e. no ability to surrender losses of Irish branch to another Irish company? That would snooker us anyway?

> …
>
> 7. Next steps
>
> I suggest the following:
>
> • M&S claim - please can you consider whether there is any future possible actions re BOSI, short of liquidation, that may be taken to satisfy the no possibilities test (e.g. would there be any representations made to the regulator in a branch scenario that would make any decision on the future of BOSI Irreversible?)
>
> • Irish tax advice - I need the guys to review my attached calculations and I'm not comfortable until I have something in writing from them/KPMG. I'll pick up with them.
>
> • Market values - If we want to weigh up the various Implications of conversion to a branch, we probably need a discussion on the MVs at some point.
>
> • Discussion with Deloitte - I'll have a quick chat with Greig re the proposal to have a discussion with Nigel"

22 April 2010

114. TT arrived in Ireland for a two day visit accompanied by Hugh McKay (HR Director, W&I) and GA.

23 April 2010

115. BOSI Board Meeting attended by JH, H McKay, MW, RF and TT as a guest. The minutes record that a working group had been set up comprising W&I and Group Finance to determine the optimum medium term capital strategy for BOSI and the appropriate structure to deliver this. RF provided a progress update on the BSU: Dublin was up and running with 121 colleagues, c. 1,000 Customers, €9.6bn of exposure and badged Green. There were also six regional BSUs. Concerns, primarily about the availability of resources, meant four of the regional units were currently badged Red and the remainder badged Amber. TT advised that the BSU in the UK was also on a continuous learning curve and that BOSI was only 6 months behind from an experience point of view. RF outlined the current focus of the BSU and he was confident that a strong team had been put in place. However, some lacked experience and the continuous development of colleagues was vital to the success of the BSU.

116. TT provided a verbal update on LBG Strategy. LBG had recently released some good news in its 2010 Quarter 1 update to the City. While impairments did continue at a high level, it was noted that the Q1 Impairments were at a lower level than the last quarter of 2009. TT outlined that as part of this strategy, BOSI needed to show discipline, de-risk and realise available synergies over the next 18 months. Overall, TT had been comforted to see the excellent progress made in Ireland in reshaping its business. The progress being made had left him with the distinct impression that there was plenty to be positive about in Ireland and reinforced how success could often be defined by spectacular execution.

26 April 2010

117. E-mail from MO to ED, TTO, TT, SC and CS with subject "BOS Ireland – Moody's rating – CONFIDENTIAL". MO confirmed that BOSI would remain as BAA1 and "*taken off review for downgrade, albeit they kept the negative outlook on the rating which largely reflected their concerns about Ireland as a whole.*"

27 April 2010

118. E-mail from MS to NMC with subject "Deloitte" which stated:

> "I believe that my W&I Finance Colleague [AK] spoke to you a while back about Ireland. We have been doing some work on what the future structure/funding of Ireland will look like, the main driver being sorting out the capital position. [AK's] keen to do this in a tax efficient way and we also currently have several £bn in trapped losses in BOSI that we have no hope using. We'd like to have a discussion about the tax position and whether there is any planning that would be of benefit/any ideas that Deloitte can bring to the table.
>
> I can send you a brief note beforehand to give you an idea of the issues that we have discussed so far so that we're not starting from scratch."

119. In response to NMC confirming he would be out of the country, MS confirmed to AK that she was happy stating: "It will be a couple of weeks, but given that we are exploring the TRS option in the meantime, that may be no bad thing".

28 April 2010

120. E-mail from AK to MS with his thoughts embedded in the e-mail body (at para 113 above).

30 April 2010

121. E-mail from MS to NMC cc'd to GS with subject "LBG – [BOSI]":

> "In preparation for the meeting on Ireland:-
>
> The real driver for sorting out Ireland is the capital position. We injected €1.7bn In last year, €1.5bn to date this year and expect to need to inject more in Sept. The current status quo is unacceptable and we can't just carry on injecting capital into BOSI.
>
> Options currently on the table:
>
> • branch (email below will bring you up to speed with our branch thoughts, plus I have confirmation from the 5 year plan of the Shannon subs that group relief from an Irish PE will always be possible to other LBG co.s In Ireland)
>
> • branch (bad book) plus sub (good book)
>
> • new guarantee from BOS plc
>
> • total return swap idea from the STG guys
>
> Are you familiar with the current guarantee? We have decided not to make a claim under it and are in the process of agreeing the TP on the old guarantee. I am attaching a briefing note Grant sent to KPMG, which will give you some background info. If we carried on using a guarantee, it would be replaced with a new one."

May 2010

122. W&I Business Review by TT dated May 2010. The review variously confirmed:

> "International market and competitor outlook
>
> Ireland's negative outlook impacts performance through impairments
>
> Ireland
>
> - Irish economic situation remains challenging with a 2% GDP contraction expected in 2010 and modest recovery in the MTP

- Commercial property has fallen, recording capital values down 50% from their peak and a further decline of 8.4% is expected in 2010 followed by an upturn of 13% growth in 2011 [footnote confirms source "Group Economic Assumptions Apr 2010]

International summary

IB is delivering on optimising returns whilst preserving medium term strategic options and reducing draw on LBG capital and funding resources

Ireland

- BSU team now fully operational
- Asset reduction ahead of plan on a local currency basis

Ireland update

BoSI is focussed on reducing exposure, and right-sizing the cost base, in an uncertain market

- Given the risks and uncertainty associated with the Irish market, it is desirable to reduce exposure
- In the medium term, a disposal would require significant write-downs and discount to book value
- Therefore, the BoSI strategy is to reduce exposure through active run-off in the property sector
- This retains the optionality of disposing the business more favourably at a later date, outsourcing management of these books
- Project Memphis is the current focus, and is progressing well, but attention is also given to the residual book

Residual book update

- Impairments: In line with plan, however ~£13bn exposure is currently within BSU"

4 May 2010

123. Email from AK to EG cc'd to SC, GS MS with subject "FD papers to send out"". The e-mail stated:

> "Two paper for circulation. Grieg can you have a look at the tax one and make sure you are happy?"

The Ireland Update Paper produced by W&I/Group Tax was based upon MS's e-mail to AK dated 21 April 2010 and set out the possible routes to access tax relief for the losses. The paper concluded stating:

> "Future Structural considerations
>
> All of the analysis we have undertaken highlights the importance of ensuring that we have written business in the most appropriate jurisdiction for the underling [sic] risks. While a low tax rate is superficially very attractive for low risk business with a low chance of loss, it is not so attractive in a business, lending money to small corporates and SMEs, where the risks of loss are high. Given the nature of the business we will have in Ireland going forward, it does lead us to the conclusion that we should fully review the

structural option and consider whether a subsidiary is the most appropriate vehicle in the future.

> Given the need to need [sic] for an additional capital injection into Ireland by September and the need to find a permanent solution to the intra group guarantee, now does feel like the right time to look at the other options for operating our business in Ireland. A move away from our traditional banking subsidiary approach may be appropriate in the circumstances."

124. The note of TT's two hour interview with FSA records as follows: TT was responsible for W&I on interim basis; it was not his aim to redefine strategy or redefine what is being done. His role was primarily to support the teams and make sure that things are well run. In response it being pointed out that he now had two full-time jobs he confirmed that he tried to double up Wholesale and W&I as much as possible and that he was working harder but he appreciated it was not sustainable in the long run. He confirmed that if W&I was his only job he would spend more time visiting and would have visited all the key geographies in his first month but had so far only visited Ireland and Switzerland. This made him more dependent on his executives. He confirmed that the objective in Ireland was to "shrink well" and that with regard to ownership of strategy for W&I he was acting as custodian and guardian and that he had "a strong management team reporting into me."

5 May 2010

125. E-mail from TT to Angela Teke confirming TT's view of the meeting with the FSA:

> "My own feeling is that it was good."

May 2010

126. BOSI Briefing note for the meeting with the FR dated May 2010. The briefing note variously stated:

> "Note there are now two FR supervisory staff dedicated to BoSI (previously not the case).
>
> …
>
> The capital requirements of the foreign banks remain unchanged for now although the FR has flagged that it plans to place particular focus in the upcoming ICAAP review on:
>
> • stress test outcomes (including robustness of approach used and conservatism of assumptions); and
>
> • reliance on Group support (FR likely to look at Group's ability to provide capital possibly via discussions with FSA. They may also focus attention on the guarantee and any other support from Group).
>
> …
>
> BoSI Engagement with the FR
>
> Regular, constructive engagement with the Regulator - a no-surprises policy
>
> • The key focus of recent interaction with the FR has been around Project Memphis (closure of Retail and Intermediary businesses).
>
> …
>
> In particular, in Dec 09 the FR queried why BoSI had not made a claim under the BoS plc guarantee (which guarantees €20bn of assets, to be chosen by BoSI on a monthly basis). BoSI has the right to claim under the guarantee in respect of a particular asset once the customer defaults on his obligations.

No claim has yet been made under the guarantee as BoS plc has preferred to make capital injections into BoSI instead. If BoSI were to claim, it would trigger fair value accounting treatment of the guarantee in the accounts of both BoSI and BoS plc, which would introduce a degree of volatility for each which would raise some issues regarding the management of their respective solo capital positions. BoSI has committed to the FR that the ongoing use of the guarantee will be reviewed in 2010.

…

Other areas of recent/ongoing engagement include:

CEBS Guidelines on Liquidity Buffers - the Bank is required to confirm compliance with the guidelines to the FR by end June. Discussions ongoing with the FR regarding the methodology for maintaining a liquidity buffer under stress.

Dynamic Liquidity Line - our relationship officers in the FR were initially unhappy with the DLL proposed as it did not meet the liquidity requirements methodology. A revised DLL has been submitted and we await formal confirmation from the relevant FR officers that it is acceptable before implementation (note: we do not believe that this issue, or the issue above, has been escalated to Matthew Elderfield's office at this time).

…

Points that could be raised with the FR … LBG's ongoing commitment to support BoSI (from both a capital and funding perspective)."

6 May 2010

127. Papers for 7 May 2010 W&I FD meeting e-mailed by EG to TTO, SH, SC, AK and others. Attachments included Ireland Update Paper.

7 May 2010

128. Note for Record of meeting on 7 May 2010 between FR, Matthew Elderfield ("ME") and ED and CS. The note records:

"The conversation was very cordial and constructive building on the very good relationship we had with ME when he was at FSA and the contacts since. Most of the conversation was about general economic and regulatory issues. ME reported a very good relationship with Joe Higgins and the team in Ireland.

…

ME was clearly in favour of a slower introduction of the proposed liquidity and capital requirements, but said the international governance was now rather complex.

…

ME said the relationship with Joe Higgins and his team was very good and they had been impressed with the way the retail bank was wound down."

17 May 2010

129. Email from PB to MS with subject "RE: Meeting today" [E-mail chain not complete] stating:

"I am trying to pull together a list of the various options that have been considered from an Irish structuring perspective.

I came across the attached paper which lists some of the tax options. Is it fair to say that most if not all of these have been discounted at this stage for a variety of different reasons or are some of them still under consideration (and if so could you tell me which ones)?

Clearly the TRS is a new option that was not on this original list."

130. E-mail from AK to SRS cc'd to GS, MS and SC with subject "Ireland excl LTP – 17.05.10.xls" and attachment of same name stated:

"I wonder if you could help me with a query from [TTO] and [SH].

As you are well aware we are taking some significant Impairments in Ireland. One of the issues we are facing into is that we currently cannot get any tax relief for those losses so they are currently worthless to us.

There may be a way in which we can get UK relief for losses but that will probably require us to liquidate the BOS Ireland legal entity. Therefore a proposed route might be to put BOSI into members voluntary liquidation and them pass all the assets and liabilities up to BOS plc as part of the distributions in liquidation. The assets and impairments would then be managed out of the UK. I would envisage retaining BSUs in Ireland to manage the day to day customer relations but that all decision would be made in the UK.

Given this change in the operating model I have been told that there would be an impact on the absolute level and possible timing of impairments and I am trying to get a feel for what size the additional cost would be so I can measure the cost of additional impairments against the benefit of tax relief on losses (which are very significant).

Absolutely recognise there are a host of other issues with this proposal not least of which is managing the Irish regulator but we need to get a high level view of the cost/benefit trade off so we can decide whether to look at the idea any further. Is there someone at Group credit risk who could help me get a view on this. I have not discussed this point with the guys in Ireland given the potential impact on them so I would be grateful if you could keep this to yourselves while we investigate whether it could fly or not."

131. E-mail from MS to PB with subject "Meeting today" stating:

"The gtee claim has been dropped. Of the others, from reading through my emails, there has been no 'official' dropping of the others. Though the structured transaction being considered was something that has to be parked until we know what the future structure looks like, so is not currently being pursued."

132. E-mail from SRS to AK cc'd to GS, MS, SC, SC, DC, AH and NA with subject " Ireland excl LTP - 17.05.10.xls" stating:

"Very interesting idea. I agree the BSU needs to be maintained locally, but we are writing no new corporate business (retail, of course, is shut) except to build out existing, almost complete developments, if it make [sic] economic sense.

Therefore I'm not convinced a priori that impairments would increase or would even be accelerated. Borrowers might sense weakness/that we would cut them a deal, but we could soon put them straight - and even tighten the screws further by enforcing personal guarantees/bankrupting a few of them - that would send out a pretty clear message.

Steven Clark can lead this. He works in Group Wholesale Credit in Edinburgh, reporting to David Chalk (who works for me). Steven's team has been leading our BOSI impairments work in Group Credit. We will maintain strict secrecy.

I have copied in Alison Hewitt and Neeta Atkar from a reg & compliance and op risk perspectives to get their initial views."

18 May 2010

133. E-mail reply from AK to MS, GM, MH cc'd GS stating:

> "I would appreciate your thoughts on how much capacity there is to utilise losses from BOSI over the MTP. Assume the losses are equivalent to what you are see in our Q2F forecast above I assume no capacity in 2009 but after that can we assume full relief and what would be the timing of when that relief would crystallise at Group Level?
>
> Michael if we increase our forecast losses forward in 2010 and later years by the losses would we be able to recognise a deferred tax asset and improved capital position at end 2010?"

134. Incomplete e-mail reply from MH to AK, MS, GM cc'd GS which states "Alan" and nothing further.

135. E-mail reply from SC to AK cc'd to DC stating:

> "Following our conversation this afternoon, just wanted to capture the key elements with a focus on the credit side. Please let me know if anything obvious missing/inaccurate, or require more info on a particular point ahead of your next session with Tim & Sue.
>
> The proposal is in the very early stages
>
> • BOS Ireland would be liquidated and the assets transferred to BOS plc
>
> • The transfer would be at book value, i.e. no requirement to mtm
>
> …
>
> • All credit decisions to be made in the UK, although can retain (and would want to retain), the local BSUs
>
> • The BSU teams/RMs would remain as currently, albeit perhaps some rationalisation possible in the top tier of management. In practice, I think we would want to keep most/all of the senior people given scale of the task and shortage of experienced work-out specialists. Issue would be holding onto people given focus on winding up business in Ireland as I am sure we would not aim to take out headcount deliberately under the circumstances - just need to be wary of impact on attrition
>
> …
>
> • In theory, there should therefore be no material impact on the timing or quantum of impairments - the decision making and process through W&I (numbers per Q2F) would be taken over by Wholesale, i.e the same Group impairment policies (incorporating IFRS) & procedures apply.
>
> • In liquidating BOSI, the risk of losing colleagues would increase as the 'demise' of the business becomes more apparent, real or otherwise. This is mitigated in the short-medium term given the lack of alterative employment in Ireland but incentives may be required to help retain key staff.

• As discussed, the Wholesale BSU OD is expected to start to reduce later this year albeit likely to be 2011 before anything material. This freeing up of Wholesale BSU capacity could be available to backfill BOSI leavers, but equally Wholesale may have existing plans for 'repatriating' to other parts of the business with resource issues. An exco level decision."

136. E-mail reply from AK to SC cc'd to DC, SC, GS and MS stating:

> "Just a couple of thoughts below.
>
> Thanks for the help"

It is unclear from the e-mail at para 135 what comments were inserted by AK into the e-mail text.

137. E-mail reply from AK to MH, MS, GM cc'd GS stating:

> "I hope I am not talking rubbish!
>
> In 2010 we will make losses in Ireland (£2.5bn) which we could surrender to BOS plc if we manage to make group relief claim under EU law. This will increase the losses forward over and above what you have already baked into your capital plans by the quantum of the losses in Ireland (£2.5bn) and should benefit our deferred tax asset and therefore capital plans by 28% of that amount (£700m). The point is that we would be in a position to get relief for those losses and therefore recognise a DT asset on them whereas if we leave things as they are, we could not recognise a deferred tax asset in Ireland. Then as each additional year of losses is incurred we should see a capital benefit equal to the losses incurred (c£1.5bn in total of losses to 2014 and c£430m) over and above that baked into your capital plan currently.
>
> I hope this makes sense but no doubt you will tell me if it does not!"

138. E-mail from MH to AK, MS, GM and GS subject "FW: Ireland excl LTP":

> "If we can achieve a tax credit for the Irish losses then that would be an improvement over the current plan which assumes that we can not do this. Does Group Relief achieve this? i.e. what is the doubt entry that shows our reserves increasing? If it is debit DTA, Credit P&L then that's OK. If its anything else I'd need to understand what it is. This all assumes that our tax colleagues agree that they have enough support (5 year plan) to justify recovery. Subsequent years would be recognised as incurred assuming that we recognise the tax for accounting purposes."

139. E-mail from GM to AK, MS etc. – subject "RE: Ireland excl LTP – 17.05.10.xls"

> "Putting aside the technical arguments about if we can group relieve etc and when PWC would allow us to book the credit, it would seem that (based on the latest loss utilisation projections I have) only £2 billion of losses could be group relieved in 2010. In later years, the plans indicate sufficient UK tax capacity to absorb to future BoSI losses noted in the spreadsheet."

140. E-mail from AK to GM, MS, GS etc. - subject "RE: Ireland excl LTP – 17.05.10.xls"

> "Grant, If you have doubts on whether we can get ourselves in a position where we can group relieve the losses it would be useful to know because this will grow wings if I put it in front of Tim. Greig assume that if it did look like it could fly you would tell the Revenue we're going to do it"

19 May 2010

141. E-mail from GS to AK, GM MS etc - subject "RE: Ireland excl LTP – 17.05.10.xls"

[GS is replying to the cut off email from AK on 18 May]

"Given the numbers involved, discussions we've had and to get HMRC on board the answer is yes we'll need to cover with HMRC"

142. E-mail from AK to GS, GM, MS, etc - subject "RE: Ireland excl LTP – 17.05.10.xls"

"However provided we can show this is a commercial decision to liquidate you should be able to convince them"

143. E-mail from GS to AK, GS, MS etc - subject "RE: Ireland excl LTP – 17.05.10.xls"

"We have to get across our commercial object to HMRC – i.e. that we are doing this for reasons which are about managing things from the UK, that we are not seeking to import existing/forecast losses into to UK and that tax is not driving this.

It's possibly therefore a bit misleading if we emphasise the potential bad UK debt deductions, DTA etc too much if the loans perform and the position improves we would be bringing in additional profit to the UK which will be an important part of the story."

144. E-mail from AK to GS, GM , MS, etc - subject "RE: Ireland excl LTP – 17.05.10.xls"

"There are a hundred and one commercial reasons why we might want to liquidate BoSI.

Reduce costs by folding into the UK wholesale infrastructure Capital requirements driving us to having all capital in UK for optimum capital efficiency in the new world.

Enhance risk control and monitoring

Leverage the experience and resources in wholesale UK particularly as we might have spare resources in the UK going forward.

Issue is that there will be a big cost as well. I therefore need some upside to make it fly which is where the tax comes in? I need a realistic view from you guys on whether you believe we will access the Group relief under an M&S type claim and what that would require in terms of what we could leave in Ireland. I also need to make sure that when Sue asks you whether you support it you can say yes! Need a reply on these two points by the end of the week.

Just to be clear I do not think there is a cats chance in hell of BoSI making any profits for the foreseeable future and any business they do write will not be the kind we would want in a low tax jurisdiction as it is too high risk."

145. E-mail from MS to AK, GS, GM etc - subject "RE: Ireland excl LTP – 17.05.10.xls"

"Here's my initial thoughts, in addition to Greig's/Grant's comments:

A successful group relief claim would increase the amount of current year (UK) losses to be carried forward in the group (and hence potentially impact the amount of DTA recognised at y/e).

Certainty of loss – we've had discussions previously on the differences between the case law and the legislation enacted/HMRC practice in the UK

Anti-Avoidance rules need to considered i.e. a claim would not be successful if the main purpose, or one of the main purposes, of 'arrangements' were to secure group relief. There are 2 legs we can fail on here – that one of the main purposes of a liquidation is not to obtain group relief in the UK, or that a liquidations falls outside the statutory definition of 'arrangements'.

One point to note re negotiations with HMRC will be the possibility of a branch exemption being enacted next year. It depends on how this enacted re financial institutions whether they have an interest in taxation of future profits.

Are you thinking of putting BoSI into liquidation by the end of this year? Or should we base any analysis on the assumption that liquidation would commence in 2011?

Greig – we should discuss tomorrow."

21 May 2010

146. Email from AK to GS, Grant Martin, MS, etc - subject "RE: Ireland excl LTP – 17.05.10.xls"

[This e-mail is responding to earlier emails on 18 & 19 May 2010.]

"Moira, This is gaining real momentum. My starter for 10 would be that we commence liquidation prior to end of year. There will be a cast iron business case around this relating to the proper control of the risks, more effective use of BSU resources, capital benefits and cost reductions. Tax will be the icing on the cake but not the driver.

The assumption I am working with is that we would not want to have a taxable presence left. Therefore what we will have on the ground is some relationship managers but will all decision being made in the UK. Am I correct in thinking that a remaining PE in Ireland kills the claim?

Based on the losses included in Q2F what would be your best view as to when we would obtain relief for the extra losses carried forward? 2014/15?

I am not sure I follow the last point re: branch exemption?"

147. E-mail from GS to MS and GM - subject "FW: Ireland excl LTP – 17.05.10.xls"

"Moira – can you let me have a summary on Ireland for the update note today for Sue."

By 24 May 2010

148. BOSI Alternative Strategy Note prepared by AK

"Introduction

This is an update to the recent papers and discussions around the significant losses, which have been, and are being incurred in Ireland without obtaining any tax relief either in the UK or Ireland. By way of a reminder, the latest view of the losses being incurred in Ireland is predicted to be c.£2.2bn for 2010 on top of losses of £2.7bn incurred in 2009. Losses in subsequent years are predicted to be c.£700m at a minimum. Clearly this excludes a stressed position where the losses involved could be materially higher and the loss of value even greater. The amount of losses on which we are obtaining tax relief is minimal

Given the size and nature of the losses and the consequent erosion of value, we have undertaken an extensive review of the possible routes which we could utilise to improve the value proposition for shareholders by:

▪ Accessing tax relief for the losses

▪ Providing downside protection in the position where losses incurred in Ireland are worse than those indicated by the MTP driven by a worsening of the Irish Economy

> Details of the outcome of this review are contained in Appendix 1 to this paper. It was clear from the review that the only alternative strategy which allows us to materially improve value for shareholders is to put BOSI into member's voluntary liquidation to allow access to the losses incurred to date … Under this model, future business in Ireland, to the extent that it meets our risk criteria, would be written onto the UK balance sheet through an Irish branch of the UK bank
>
> Advantages of revised approach
>
> This more radical value driven strategy with respect to Ireland has some key advantages over the current strategy:
>
> ▪ Provided we are careful in our approach, access to UK Group Relief for 2010 onwards … This is equivalent to tax relief of c£800m. Even discounting this to reflect the fact that the losses cannot be utilised immediately, the benefit remains very significant"
>
> • Immediate incremental capital upside to MTP … this would be in the order of c£800m over the period of the MTP
>
> Disadvantages of revised strategy
>
> • Higher potential impairments but considered to be modest risk because will be keeping a BSU in Ireland for the foreseeable future
>
> ▪ Execution risk of winding up full service Bank is high given the complexity of BOSI
>
> ▪ Regulatory considerations [would require regulatory approval from both regulators]
>
> ▪ Further colleague attrition on the appointment of the liquidator … While this is a very real risk the current state of the Irish economy means that this should be less of a risk than it otherwise would normally be due to lack of alternative roles for colleagues.
>
> If you think that this proposal has merit, the next step in the process would be to do a full feasibility study of what would be required. This would involve setting up a project and bringing in subject matter experts from Group Finance, Group Tax, Group Risk and Group Legal. It would also involve bringing some of our senior colleagues in Ireland into 'the inside' so we could evaluate the risks and benefits more effectively."

24 May 2010

149. Email from AK's PA to MH, GS MS, SC subject "BOS Ireland – alternative strategy note"

> "Another update paper for Tim. Can you let me have any further thoughts tomorrow please?"

25 May 2010

150. E-mail from MS to Sian Hill, KPMG – Subject "M&S Group Relief" stating that the "latest plan that W&I are considering is a transfer of most of the BoSI operations to the UK and liquidating BoSI. There would be a branch of BOS plc, but it would look nothing like the current operations". Telephone call requested to discuss KPMG's experience of large M&S claims and likely HMRC response. MS confirmed that "although there are commercial drivers for reorganising the operations in this way, because of the size of the losses I am concerned that there is a danger that the tax benefits could influence the decision making

process and HMRC might try to argue that tax is one of the main purposes of reorganising BoSI in this way."

151. E-mail from MH to AK, GS, MS and SC – subject "RE: BOS-Ireland – alternative strategy note"

> "… next more detailed stage of process…will complete under the new code name of Hermes"
>
> I see that you have relegated the TRS to the detail at the end – I presume that this is on the basis that the proposal you set out is preferable as it gives us access to the 2010 losses. Not sure on what the lead time for the TRS is but I would guess if we could get that in fairly soon it would move the losses from Ireland to BOS from the date written? Would still caveat that we need to work through numbers etc. … All numbers will be caveated until we have done the more detailed piece of work!"

152. E-mail RMG to SCK and DC – subject "Project Hermes"

> "I have prepared an early draft. It may need to go out as a formal memo but we can address that later. … (not sure what is driving the timeline) …"
>
> Steve – SRS asked me to set up a meeting with Graham Allatt and Richard Dakin tomorrow to discuss UK BSU management of BOSI assets."

153. Draft Memo to CS, TT and TTO: Feasibility Review – Closure of BoSI (Project Joyce)

> "Proposal
>
> In view of the difficult trading conditions encountered, and an inability to offset trading losses against Group profits, the proposal is to withdraw entirely from the Ireland market. The Irish legal entity would be dissolved and the assets transferred to the BOS/Lloyds TSB Balance Sheet, subject to advice. This action would enable the Group to benefit from past losses to the extent of £xbn (Group Finance to quantify).
>
> A core BSU presence (c100 FTE) would be retained in Dublin. The Good Book and elements of the stressed book would be managed from the UK
>
> Potential issues to be considered:
>
>> Accounting treatment/Tax and Legal - proposed course of action to be investigated and confirmed.
>>
>> Regulatory Compliance - the proposal and the underlying TCF considerations would need to be discussed and approved by the Irish Regulator.
>>
>> …
>>
>> Impairments - the transfer of assets should not have a material impact upon the quantum or phasing of forecast Impairment charges."

26 May 2010

154. E-mail from GS to AK, MH, MS and SC – subject "BOS Ireland – alternative strategy note"

> "Alan, I only managed to look at this late last night. I have comments and would like to discuss these with you. I think Moira left you a voicemail last night."

155. E-mail reply from AK to GS saying MS has left AK a voicemail about comments on the alternative strategy note:

"I got the gist of it from Moira's message last night. If you or Moira want to tone it down that would be fine by me. I guess you guys are even more sensitive to tax related papers than Tax were in my day!"

156. E-mail from SCK to RMG – subject "Project Hermes"

"draft attached – made a few changes. Ready for your to fwd to Stephen & Davis with covering note"

157. E-mail from RMGG to SRS – subject "Project Hermes"

"As discussed, I have attached a first draft of the proposal … we are attempting to arrange a meeting for tomorrow."

27 May 2010

158. E-mail from GS to MS – subject "Ireland – How are we going?"

"Did you manage to speak to Alan today?"

159. E-mail reply from MS to GS – subject "Ireland – How are we going?"

"Yes. I sent a txt to you (maybe should give up on that form of comms hey!). He seems to understand things and will be doing another note. I made it clear that tax cannot be a main driver and I believe that he's got the message.

He's not in a hurry anymore and he'll send a new note for us to put a tax note in next week"

30 May 2010

160. E-mail DC to GS – subject "Project Hermes" without text forwarding the updated memo now headed "Feasibility Review – Closure of Bank of Scotland Ireland (Project Joyce)"

Late May/early June 2010

161. TT's handwritten undated note headed "Finance" in which Project Hermes was discussed. The note records

"b) Ireland – Biggest issue incurring losses – tax relief loss.

Project Hermes [illegible word].

Voluntary liquidation – to release this £1B

Execute Memphis, then…

Maybe an external solution - ? Alex P said

Bring Joe Higgins in."

June 2010

162. June 2010 – BoSI Executive Summary for W&I Division Risk Committee

"The implementation of the BSU is the key driver to improving asset quality.

…

Legal and Regulatory – Movement to "Green" will be facilitated by the following … fact that our business going forward is "lighter" relative to regulations, given exiting of Retail and Intermediary Business."

There are no significant pipeline regulations impacting on BoSI. The exiting of the Retail and Intermediary business reduces the impact of new regulations on the Bank."

3 June 2010

163. Email from Deloitte to AK – subject "LBG Ireland (Draft v1 2 June 2010) attaching an updated Deloitte paper

> "Alan, here is a draft of the tax position. In summary, based on current position of M&S, you should be able to get group relief following MVL. Couple of caveats, latest judgement in M&S due soon (though unlikely to affect analysis on the 'no possibilities' test) and secondly we would need to make sure that the losses didn't transfer to an Irish branch of BOS PLC. To a large extent this depends on what you intend to do in Ireland following the MVL. I have assumed it's a manageable risk, ie we could structure whats [sic] left to be an admin function only etc"

164. Deloitte – Draft Paper for Discussion Purposes – "BoSI Losses/Closure" dated 3 June 2010:

> "Background and scope:
>
> Further to [18 May 2009 Deloitte Note] …
>
> Update on potential for the surrender of BoSI tax losses to UK tax resident companies in LBG; and
>
> Possible Irish permanent establishment risk following the closure of BoSI;
>
> …
>
> Executive Summary
>
> Assuming that BoSI will be liquidated in 2010 it should be possible for LBG to submit a claim for group relief of the losses incurred by BoSI in 2010 to be surrendered to other (UK resident) entities in the group.
>
> …
>
> It is possible that LBG will have a PE following the closure of BoSI assuming that it has staff located in Ireland who are actively engaging with customers
>
> …
>
> If an Irish PE exists following the restructure, it will be necessary to review the Irish tax position for the historic BoSI losses. If these losses can be transferred to the new PE and utilised against the future profits of that PE then it may be difficult to make a group relief claim for these losses. … were BoSI to be put into liquidation by the end of 2010 then LBG should be able to claim group relief suffered by BoSI during 2010
>
> …
>
> Irish Permanent Establishment Risk
>
> … where the nature of the activities carried out in Ireland by the Bank go beyond marketing and the provision of information to existing/potential customers it is likely that a PE would exist … If an Irish PE exists then it will be necessary to review the Irish tax treatment of the BoSI losses on the transfer of the BoSI assets/business to the Irish PE of the UK Group. If under Irish tax principles part or all of the BoSI losses can be transferred to the Irish PE and utilised against future profits of that PE then the "no possibilities test" may not be satisfied and it may not be possible for BoSI to surrender those same losses to the UK group.

That said, it may be possible to structure the re-organisation of the BoSI business to either avoid the creation of a PE or have a PE that carried on a different business to that of BoSI such that the BoSI losses do not transfer to the new Irish PE"

165. Email from SC to SRS copied to MW and TTO – subject "Hermes"

"Mike and I discussed Hermes with Tim today and agreed we need to broaden the work out to be more strategic in nature."

At the moment we have started with Alan's great idea about how to capture Euro 1bn of value for the tax losses which are currently unrecognised… It seems to us though that we need to explore a number of different strategic options for the business simultaneously."

In view of this Tim agreed to widen the scope and include Joe Higgins in the project team."

We would suggest a steering group consisting of me, Mike and Joe with Alan (and any others?) in attendance as appropriate. We would like to have made material progress this month not least as we have our audit committee deep dive on July 1 and Q2F challenge just ahead of that."

4 June 2010

166. E-mail from TTO to ED copied to TT and MW – Subject: "Australia and Ireland"

"I met yesterday on Aus and Ireland with Alex and Mike Wooderson etc.

We agreed that full exit strategies should be prepared for both territories with the focus being on deliverables within one month."

June 2010

167. BOSI Business Review paper by Mike Wooderson dated June 2010

"We need to revisit strategy for Ireland: Whilst we intended to revisit the strategy in 2011/12, other external and internal factors will force us to revisit the issue sooner. … The intention was to revisit the options in 2012 but MTP plans shows we retain business in Ireland for longer term.

…

Recent concerns re PIIGS countries, means there will be ongoing pressures to re-assess the position; (2) Market pressure to clarify core and non-core business in line with approach RBS have adopted; (3) The scale of the impairments on the Irish book…mean that there will be pressure to make clear what is happening in Ireland…and when; (4) Sustained pressure for deposits in Irish market means local pricing is above Group appetite which has led to steady reduction in BoSI funding and increase in LBG funding

[Four options set out with advantages and disadvantages]

Announce plans to Exit – disadvantage is that "unable to utilise tax losses" because 2010 announcement not exit. Advantage is "Allows LBG to make intentions clear to market".

Full Sale/Exit – Not feasible given requirement for initial discount on sale. Very unlikely there are interested buyers.

Tax benefit enhances benefit but reduces timescale for an exit – The work on accessing the Irish tax losses has a very tight timescale for delivery with September announcement and December implementation.

Key questions that we need to get clarity on asap. (1) How important is it that we secure the tax benefit in 2010? (If important then we must implement this year. If less important, we could take risk on legislation and complete transaction in 2011). (2) If this is really important, can we agree that all work on BoSI sales/books disposals will be deferred until 2011? (3) Can we retain BoSI staff in an LBG subsidiary (option 2) without losing or reducing the tax benefit? (4) If this is possible, then what is our preferred option for servicing the book?

The tax work to date has identified that a MVL before year end is the clear preference. … The intention is to use the next 2 – 3 weeks to do the detailed planning work"

8 June 2010

168. E-mail from NMC to AK subject "Re: Meeting next week"

> "Alan, I expect one of the drivers on timing will be tax capacity in UK for 2010. Do you have this? Greig will I'm sure. Would be useful to see it, at meeting on thurs or even before better"

169. E-mail from MS to AK and NMC confirmed £2bn capacity in 2010 with MS confirming:

> "It will displace the losses that BOS is group-relieving to the rest of group, so will increase BOS losses c/f. Alan's aware of this impact and knows he needs to do a NPV calculation"

170. E-mail from AK to JH Subject "FW: MEJRG00l - LBG Ireland (Draft Vl 2 June 2010)" forwarding Deloitte paper:

> "This is the summary of the tax position. To be confident of claiming losses for 31/12/10 we need it to be in liquidation by end of the year"
>
> There is a bit of a debate whether UK rules allow claim if put into liquidation after that … We can certainly ask the question of Deloittes [sic] but for safety they will want us to plan for 31 December 2010."

9 June 2010

171. E-mail from JH to AK copied to NMC subject "LBG Ireland.."

> "LBG will need to use the services of some business with a material presence in Ireland (i.e. not just marketing) to service and collect these loans. The current plans show a much bigger operation managing the Corporate and Commercial customers than managing the retail customers.
>
> [Identifies options for structure: fully owned LBG subsidiary (BOSI or other); an Irish branch of LBG; a Irish company in which LBG has a majority but less than 75%); or an outsource company in which LBG has a small (10 – 15%) to no shareholding. It notes that the first two options create a problem as a PE in Ireland to which the BOSI losses could be transferred. Queries if the third option breaks the tax grouping and considers fourth option should be possible in timescale]"

172. NMC's reply confirms options 1 and 2 do potentially present problems and would require "much further consideration".

173. E-mail from JH to NMC asking to confirm that options 3 and 4 would be acceptable from a tax perspective and would "either be a "better" or safer option?"

174. E-mail from NMC to JH and AK – subject "LBG Ireland…"

> “Joe, one of my concerns, which i haven't bottomed out fully, is losing the ability to group relieve losses in the UK because you have actually structured the position Ireland to ensure that losses don't carry over. for this reason i'm a bit nervous about option 3, as its optics aren't great, ie it looks like you are trying to be clever and avoid a 75% group . therefore i think 4 looks better, however its clearly a commercial decision and the tax tail shouldn't wag the commercial dog.”

10 June 2010

175. Meeting between AK, MS and JH and Deloitte re BOSI and tax planning at which Deloitte presented their “BoSI: Tax Analysis and closure options” slide presentation. In advance of the meeting Deloitte sought information about LBG’s tax capacity.

Deloitte presentation – BoSI: Tax Analysis and closure options

> “This document has been prepared in order to facilitate a discussion with LBG on the potential for surrendering tax losses from BoSI to other LBG entities which are tax resident in the UK. The document also highlights issues to consider associated with managing and controlling the proposed close down of BoSI.”

176. The presentation notes that when the Retail closure was announced: “A commitment to a continued presence in corporate and commercial business was indicated”:

> “In May 2010 Deloitte Tax were asked to consider the tax position of BoSI and, in particular, the potential for the surrender of Irish tax losses to the UK resident members of the LBG group and the possibility of a PE tax risk following the closure of BoSI by the end of 2010.
>
> We understand in addition to the tax considerations there may be commercial and strategic issues which will impact a closure by the end of 2010. In this respect timing and trading issues, such as the transfer of loan portfolios and management of the legacy business will need to be considered.
>
> …
>
> Tax objectives
>
> Tax issues
>
> A managed exit from Ireland involving the announced closure of the BoSI retail business and the run-off of commercial lending from BoSI could result in substantial Irish tax losses being lost [i.e. the previous/current strategy]
>
> The following slides outline a strawman exit strategy which may be capable of generating value from current year BoSI losses through utilisation against LBG’s UK taxable profits in 2010.
>
> …
>
> Cross border utilisation of tax losses is very limited under current UK law (see Deloitte draft tax paper of 3 June 2010) and will likely require an expedited members voluntary (solvent) liquidation of BoSI to have commenced before the 2010 year end in order to demonstrate “no possibility” of utilising the losses in Ireland in any period.”

Consideration is then given to issues to be considered and potentially implemented by the end of December 2010 in order to be able to surrender Irish losses to the UK group and identified two options: a Solvent Liquidation or a CBM. It noted that the CBM process is new and relatively untested. The Summary confirmed:

"Based on our high level understanding, a challenging though potentially achievable solution but one requiring substantial further analysis in key areas.

Key driver: (1) Exit Ireland by 31 December 2010; (2) Optimise LBG tax position; (3) Managed Irish exit to minimise value leakage.

Timing – Transfer of portfolios to LBG potentially achievable pre 31 December 2010 with external portfolio sales thereafter, or a managed run-off with a clean investor story.

…

Legacy business – Legal structure which avoids a permanent business; Management and control of run-off business (within or outside LBG)

Implementation: Solvent liquidation/EU merger option"

Next steps – Detailed option and tax feasibility analysis given time constraints and Legal input"

177. E-mail from SC to TTO – subject "Hermes – Quick Update"

"We've taken some advice from Deloittes [sic] on capturing the value of the tax losses through liquidation and are now reasonably confident it works. It's worth up to £1bn to us."

The issue will be implementation … as we have to implement by 31 Dec to capture the value from this year's losses. Implementation is of course very complex as we need to be able to run off the portfolio safely and without destroying capital.

We will have to push through governance at pace to deliver and plan to come with a GEC proposal note in 3 – 4 weeks time. We'll look to get you, Carol and I would think Mark onside to the proposals ahead of that but your support to help us push at pace would be appreciated.

We'll need to engage Deloittes [sic] and lawyers for the next 3 – 4 weeks to ensure we have all our facts straight. Given the huge time pressure I've ok'd that subject to a sensible price."

We have our Q2F review meeting on Monday and Alan and I can update you a bit more then."

178. E-mail from RMG to AK – subject "Hermes"

"I have attached the draft memo that I prepared a few weeks ago. As you will see, it essentially takes your concept to the next level, by proposing the complete closure of the Irish operation."

179. E-mail from NMC to MS and JB – no subject

"we should have a chat on Monday about this 2-3 week feasibility stage. It would be worth discussing what we would like to achieve and who does what."

I was only half-joking when I said "not if you're in tax' to Gerry's comment that it was good there was a 31/12 tax deadline!"

180. E-mail reply from AK to NMC subject "LBG Ireland (Draft V1 2 June 2010)"

"All joking aside I would put your people on standby for Monday if you can. I think I will get the nod tomorrow morning to do the three weeks intensive work!"

181. E-mail reply from NMC to AK

> "Will do alan. Good to see you today. Really good meeting"

182. AK prepared an updated version of the 'BOS Ireland – Alternative Strategy Note'. This version has a potential tax relief of "c£1bn", previously it was £800m. References to retaining a BSU in Ireland replaced with reference to an "outsourcing arrangement with the third party" and the need "to avoid creating a new permanent establishment which would limit our ability to access the losses". The reference to the risks of colleague attrition in BOSI was changed from "less of a risk… due to lack of alternative roles for colleagues" to "perhaps the biggest risk we face". Added were "the time line is very demanding" and "There would be no scope to miss this deadline if we are to hit the end December end date" – both statements are in bold and underlined.

11 June 2010

183. E-mail from SC to TT - subject: "Hermes – Quick Update"

> "Very quick update…wanted to keep you right in the loop as I have steered the team towards a "get on with it and stop if GEC tell us to" approach as the timescales are so so challenging.
>
> We've taken some advice from Deloittes [sic] on capturing the value of the tax losses through liquidation and are now reasonably confident it works. It's worth up to £1bn to us which goes straight to tier 1 (at least until Basel 3).
>
> The issue will be implementation…as we have to implement by 31 Dec to capture the value from this year's losses which is about 2/3rds of the total. Implementation [the e-mail in the hearing bundle is incomplete]"

184. E-mail from MS to GS – subject "Ireland MVL" stating:

> "Ireland is moving on at pace. It is clear that there is a move to change the current set-up for commercial reasons.
>
> The latest long term solution being developed is to essentially run off all of the books. Marketing, origination and sales, will move to the UK, along with the assets/deposits. BoSI would then be liquidated (timescale = by 31/12/10), but we expect to have to make an announcement on this in August.
>
> Outsourcing to third party would be preferred solution (over setting up new Co containing remaining operations) but has the danger of a forced deal, given the time pressure.
>
> 31/12/10 is obviously an extremely challenging timetable for all, but the team thought that it would probably be possible … If we do a MVL by then, this will obviously have the added benefit of falling within the HMRC guidance on group relief claims."

185. E-mail from TT to SC – subject: "Hermes – Quick Update"

> "Wow. Really appreciate the heads-up and, yes……you are taking the right course (with pace) and informing the right folks. If you keep Tim, Carol and me uptodate, the GEC, is, basically, "there"!.
>
> I will discuss shortly with Tim, but thank you for your leadership on this and let's keep current."

186. Project Hermes Conference Call notes. On the call: SC, SRS, AK and JH. [emphasis provided]:

“It was agreed that we should assume that the decision was to complete the MVL by 31 December as, even in the absence of the tax benefit, LBG would prefer to be able to announce that it was exiting the Irish market and this was the best (or most realistic) way to do it.

The tax advice is clear that **to be certain** of accessing the benefit of the 2010 losses in Ireland we need to have a MVL appointed by 31st December 2010. There is the possibility that a current tax case will extend the application rules but to avoid tax risk and to ensure inclusion in the 2010 results, the 31st December 2010 date is sacrosanct.

It was agreed that we would push Deloitte to give a firm tax opinion confirming that we "will" be able to utilise the tax losses rather than a "should" opinion.

…

Rather than wait for formal approval before commencing the detailed planning work, it was agreed that we would assume that the project was proceeding and engage with Deloitte and the Bank’s legal adviser’s immediately. (… spoke with Deloitte and also Arthur Cox … start-up meeting … agreed … Monday 14th June)

…

The straw man proposal was discussed and it was agreed that for the basis of the initial assessment we would use the indicative timeframe in the papers for the meeting (GEC initial approval early July, Announcement September, Implementation December).

…

The factors to be considered in assessing the options were minimising the execution risk (to ensure we secure the tax benefit).”

Consideration was given to four options on the possible approach to servicing and it was decided not to recommend servicing the portfolio entirely with UK because it would be extremely difficult to complete in the time available and would introduce additional risk on the collect out strategies. Servicing by BOSI staff working for a UK LGB subsidiary was rejected as the tax advice was that the losses would be linked to any PE in Ireland post MVL. Servicing by BOSI colleagues working for a new OpCo was the preferred option as:

“it avoided the PE tax risk and created the most positive story in the circumstances to maximise retention and minimise the collection risk. A suitable 5 – 7 year outsourcing agreement could be agreed with the new OpCo with flexibility to allow for subsequent asset disposals.

…

Given that timescales for completion were already tight, it was agreed that we should press ahead and abort if necessary rather than delay and potentially lose the option.

Assuming that there are no deal-breakers, and using the outputs from this work, we would then work over the following week to prepare a full project plan including financial assessment and risk assessment including mitigants. This could be socialised and incorporated into a GEC paper for circulation w/c 28th June consistent with the indicative timeline.”

187. E-mail from AK to MS – Subject: “Draft Note for Tim” with attachment “Ireland Alternative strategy (copy for MW GA and GR) (revised).doc. The document is a further revised version of the update and reference is made to it being “a more radical strategy that is

not without its risks" and that there were a number of "disadvantages of revised structure" including higher impairments, execution risk, reputation damage and further colleague attrition"

13 June 2010

188. E-mail from AK to NMC and MS subject "LBG Ireland (Draft VI 2 June 2010)"

> "I was speaking to Moira on Friday [11 June] and we may only have 2bn of capacity in 2010. This is the bare minimum we would need as I assume when we transfer assets out of BoSI to bos pre liquidation at market value we will crystalise more losses than we are currently showing.
>
> If we do is there a possibility of making a terminal loss relief claim in ireland. In the current circumstances how will we come to a view of market value? What about post cessation costs"

14 June 2010

189. E-mail from MS to NMC – subject "LBG Ireland (Draft V1 2 June 2010)

> "Another thing for the call agenda will be the anti-avoidance clauses. In particular, at what point does a tax figure that appears in a business case turn into a main purpose in the eyes of HMRC?"

190. E-mail from NMC to MS – subject "LBG Ireland (Draft V1 2 June 2010)

> "It is critical that this is a commercial decision as to the most effective way to extricate LBG from Ireland and that the tax analysis follows. This is true both of the liquidation and, critically, what is left behind. Speak at 1.30."

191. E-mail from MS to GS – subject "note for Sue re Ireland"

> "Draft note as discussed …
>
> Sue
>
> We have recently had a discussion with Deloitte in respect of the potential liquidation of BoSI. We are concerned about the anti-avoidance rules and how they may impact any claim for group relief in respect of the BoSI losses. It is important that we can show that the commercial decision to withdraw from Ireland completely was made before the decision to explore the current liquidation option. In order to claim group relief, we need to be comfortable that the ability to claim group relief is not one of the main purposes of the liquidation. To help substantiate this claim, access to the strategic documents relating to Ireland would be very useful. Please can you let me know whether you have been privy to any such documents, either exploring or recommending the option of a complete withdrawal from Ireland."

16 June 2010

192. Memo from Arthur Cox to Project Hermes Working Group – Subject IRLCO/UKCO

> "We refer to our recent discussions, in relation to the proposal to transfer the assets and liabilities IRLCO to UKCO; the revocation of the banking licence of IRLCO; and the establishment of a NewCO to service the relevant assets on behalf of UKCO ("OPCO")."

The paper set out observations in respect of both a s33 transfer and a CBM by reference to the advantages and disadvantages of each method, the timings of each method, including that a s33 transfer is likely to take at least 4 months or more. Appendix 4 set out "Issues to be

considered in determining whether an entity is providing the services through a permanent establishment in Ireland".

17 June 2010

193. E-mail from SM to MW, SC, AK, SRS, JH, MA (Deloitte) and others– subject "Hermes Steering Group Papers" for meeting on 18 June 2010. The draft GEC BOSI Project Hermes Draft paper dated 18 June 2010 is summarised as follows:

> "The purpose of the paper was to seek approval in principle to close BOSI and cease trading as a regulated banking entity in Ireland and to enter into an agreement with an independently-owned servicing entity to work out the remaining loan book and "to plan and execute to an accelerated timetable to achieve closure by year end"
>
> The paper set out in detail the commercial problems faced in the group's Irish operations. It noted that "Withdrawal options fall into two broad categories – change of ownership and wind-down. While options in the former category (sale of the BoSI business, sale of the assets, joint venture with a third party) would potentially deliver significant benefits, we do not believe that there are buyers/partners in the market who would engage at acceptable valuations." The footnote after "acceptable valuations" states there have been discussions with "a number of parties who expressed interest in buying asset portfolios but they were seeking significant discount".
>
> The paper considered that "wind-down" was the best option and suggested that the only way forward, under the "wind-down" option, was to exit the Irish banking market, which might be achieved in one of five ways, which were listed as being:
>
> Option 1: Wind down the business in the current structure. This was considered to have the lowest transaction risk but it was stated would need incentives to retain staff and was assessed as not sending a clear message to the market about exiting Ireland. It was also noted that under this option "Tax efficiencies unlikely to be realised."
>
> Option 2: Transfer the business to LBG and manage the wind-down from the UK. This was dependent on UK resources and it was considered that remote management of the Irish loan book posed a risk to the value of the assets. "Delivery of this option in the current year is unlikely"
>
> Option 3: Transfer the business to LBG by means of a cross-border merger (CBM) and manage wind-down via a LBG-owned Irish servicing entity staffed by current BOSI staff. This was considered to give rise to increased risks to tax efficiency as compared with Option 4. Concern was expressed that the Irish service entity, owned and controlled by LBG, might be treated as carrying on the same trade and its income deemed available to enable existing losses to be set against that further income.
>
> Option 4: Transfer the business to LBG as in option 3, but manage the wind-down via an independent entity staffed with ex-BOSI staff. This was considered to improve the probability of achieving tax efficiencies, would send the correct message to the market and meant that the entity could seek business elsewhere improving staff retention and motivation. This was the option that was chosen with a significant advantage identified as "Potential tax efficiency benefit of [£1.2bn]."
>
> Option 5: Transfer the business to LBG and manage the wind-down via a third-party provider. This was not considered desirable as it would require

using several different providers and could not be achieved by the end of the year.

The paper noted the two legal mechanisms by which Option 4 might be executed were (i) a s33 Transfer under Irish law (the 1971 Act) and (ii) a CBM by which the Irish entity could be absorbed into an existing LBG regulated entity in the UK. The paper recommended use of the CBM. Appendix 2 to the Paper recorded as a "Con" that even if a s33 Transfer were possible by the end of 2010 "it increases the risk around the delivery of tax efficiencies".

Under the heading "Tax Efficiencies" it was stated: "If the transfer of the business and the closure of BOSI can be achieved before 31 December 2010 it may be possible to obtain group relief benefit of up to £1 billion for LBG from the estimated 2010 and the forecast future tax losses associated with the BoSI business."

18 June 2010

194. E-mail from MA (Deloitte) to SM, MW, SC, AK and SRS – subject "Hermes Steering Group papers" setting out Deloitte's initial observations "based on an assumption that LBG do in principle want to exit Ireland rapidly":

> "This week the team has discounted the use of a Section 33 transfer followed by an MVL as this raises a significant number of legal and operational issues which we believe would make it very unlikely that the balance sheet would be clean enough by 31/12/10 to be able to claim that the business is no longer trading. Focus has therefore moved to the Cross Border option. This appears to be a more effective mechanism to provide for a closure/cessation of trade at BoSI by 31/12/10 … The provisional timeline prepared with Arthur Cox (Irish legal advisers) indicates that it is just possible to achieve a Cross Border Merger by the end of the year… Arthur Cox are progressing this with some urgency.
>
> Any timetable to deliver an exit from BoSI by the 31st December 2010 is extremely tight; however the benefits (although not fully validated) are potentially very significant.
>
> …
>
> Further work would include an assessment of 3rd parties able to provide services to the business in part or whole, and or the most effective ownership and staff incentivisation structure to meet the Group's overarching objectives (including effective management of the BoSI assets and tax efficiency)."

195. Call at 13.30 between Project Hermes Steering Committee team attended by Deloitte. No record or note of the call is in the hearing bundle.

196. E-mail from AK to NMC copied to MS – subject "Re Ireland"

> "I take it you have seen the paper prepared by Joe …We need to think about how much of a tax risk 3 is in comparison with 4. A great deal of nerves about outsourcing to an mbo in terms of how it would be perceived hence the work!"

20 June 2010

197. E-mail from NMC to AK cc'd to MS – subject "Re Ireland"

> "I saw a draft of Joe's paper. Asked for a couple of references to tax to be deleted. Will track down final version. Moria when are you around to discuss."

21 June 2010

198. Meeting between BOSI and the FR. Issues discussed included the Control Framework, impairments, Project Memphis, funding and liquidity and "the future direction of the Bank". In response to the FR's question about LBG's view of Ireland and "whether the commitment was there from Lloyds", JH "reiterated the capital was forthcoming and we were reviewing the structure of this". The meeting notes record:

> "ME queried whether BoSI was actually in wind down given limited appetite for new business. JH noted that the business strategy was always under review as part of the regular planning process, there had been no change in the strategy announced in February. This stated that we would focus on Commercial and Corporate business, close our retail and intermediary business and runoff our CRE book."

22 June 2010

199. E-mail from SM to the PHSC and Deloitte subject "Hermes – Updated Paper 1" attaching "Memo to Steering Group 22 June 2010" and "Hermes Draft GEC paper 22 June v2". The Hermes draft v2 dated 29 June 2010 contained the following changes:

> Sponsor/Presenter was now TT, previously it was "TBD".
>
> New content added to the "Executive Summary": "we believe that there are a number of key strategic and financial reasons which point to a withdrawal from Ireland as the optimum option for the group"
>
> Wording re tax efficiency points amended: changed the wording on Option 3 from "may have risks to the tax efficiency of this option" to "risks to the tax efficiency of this option (as compared with Option 4 below)". The same was done for Option 5.
>
> The section on "Tax Efficiencies" on page 6 was greatly expanded. Additions include: "If the strategic decision is taken to withdraw from the Irish market, we will look to plan the implementation of this strategy in the most tax efficient manner possible … However, the availability and benefit of this tax relief is dependent on: tax capacity in the UK business; the transfer value of assets from a tax perspective; the ability to recognise the deferred tax asset; and; the Irish business passing the "no possibilities test"… Based on current legal and tax advice, we believe that Option 4 presents lower tax risk than Option 3 ..."
>
> A new section titled "Key Transaction Risks" was added. This listed various risks not mentioned previously including:
>
> ▪ Legal and regulatory risk
>
> ▪ Credit
>
> ▪ Colleague – risk of staff industrial action and retention/motivation risks
>
> ▪ Operational delivery – "does not complete within the desire timeframe"
>
> ▪ Finance and benefits – "risk that the overall business case (including any potential tax efficiencies) is not realised"
>
> Addition of a new section titled "Recommendations"
>
> The paper concluded with TT's name and was dated 22 June 2010

23 June 2010

200. E-mail from MS to JH copied to AK & JB – subject "Hermes"

> "many thanks for the paper that you have sent …we have discussed the content, along with a brief update from Deloitte … We would prefer that the third bullet point in Section 5 [Tax Efficiencies] is removed, as it could be seen as giving more emphasis to the tax benefit than is the case"

201. Further GEC BOSI Project Hermes paper dated 29 June 2010. The key changes from the 22 June version are:

> Sponsor/Presenter is now SC and MW, previously was TT
>
> Changes made to the "Key Cost/Benefit Consideration" adding the section on "Tax capacity in the UK business and the ability to recognise the deferred tax asset" and "The Irish business passing the "no possibilities" test …" under "Tax Efficiencies".
>
> Paper signed off by SC and MW, previously TT

202. Further Updated GEC paper on BOSI – Project Hermes with the main change from previous version is TT is now the sponsor and SC the presenter.

203. E-mail from AK to MS and JH copied to JB cc'd to Jon Breaks – subject "Hermes"

> "Can you provide guidance for us on what would and would not constitute a pe. What the key indicators and pointers would be? We are working with a blank sheet of canvas so to a certain extent we can make it what it needs to be?
>
> I hear the point re market value … can we argue for a value that suits us and is tailored to the tax capacity that we can use?"

204. E-mail from JH to AK and MS (cc'd to JB) – subject "Hermes"

> "A lot of work ongoing with this with Coxs … believe we can recommend an approach that giv[e-mail cut off] change of solution"

24 June 2010

205. E-mail from AK to JB copied to MS, NM and SC – subject "FW: GEC paper 29th June – Project Hermes"

> "Jon. This seems to be the final paper. A few questions to ask. The way it is drafted does it give us a problem with the "one of the main reason" test [sic]. It is really difficult not to mention tax in the paper at all given the nature of decision we are looking at here but the size of the risk will depend on the way the courts interpret the legislation on the point? The key point to note is that we would withdraw from Ireland whether we got the benefit or not which I would have thought would be a [sic] strong evidence in our case with the Revenue. Would it be helpful to have this documented at the GEC meeting? Are you involved in getting further clarity on this PE point. There must be a way around this?"

206. E-mail from Hilary Scott (Group Tax) to MS – Subject "Losses"

> "Just got your message. Our transaction may generate up to £1bn of losses in bos legal entity … Therefore by crystallising the losses in bos in the current year we should not be adding to the deferred tax asset … Our transaction is being deferred to the second half of the year and is not certain to proceed"

207. E-mail from MS to JB – "FW: Losses" forwarding the email from Hilary Scott

> "FYI below. I've asked her to confirm my understanding (see attached)"
>
> "Group relief – confirmed that BoSI can only surrender as much as UK group can claim…. There is something else that we may need to be careful

> of when we are looking at tax capacity – we may need to make sure that the trade ceases on 31/12/10 and not before if we are to be able to surrender against the full year UK profits…. for the purposes of the memo, we could just say that we assume trade to cease on 31/12/10."

25 June 2010

208. E-mail from MS to JB copied to GS – subject "Hermes update for Sue" with suggested wording for an update to send to SH about Hermes:

> "Suggest the following … given things are likely to move further today, it may be best to delay a little before finalising:
>
> A GEC paper to present the various options for the future of BOS Ireland is currently being finalised…. Substantial work has been undertaken on non-tax aspects of the proposals and Group Tax has commented on the paper…. Potential tax efficiencies from the group relief of Irish losses can only be confirmed once the future operational model has been finalised. Group relief will be denied if one of the main purposes of arrangements is a group relief claim. ... Hence we have to ensure that the tax analysis is not a main driver in the decision making process. For this reason, Group Tax are currently holding off getting detailed Irish tax advice on the impact of the continuing activities. This should ensure that proposals are not deliberately structured in a way that guarantees a successful group relief claim."

209. E-mail from JB to AK and JH copied to MS & GS – subject "Hermes – GEC paper" (flagged high importance)

> " … My feeling is that we need to tone down the quantification of tax benefit in section 4 for the paper that is presented. Up to £1bn is optimistic and there are a number of transactions in place that may or may not proceed that could well impact on capacity in H2 2010. A verbal briefing during GEC would work … I've spoken with Deloitte also who feel it is too bullish and not enough consideration of downside. Can we have a call this pm to discuss please…"

210. E-mail from JB to MS copied to GS) – subject "Hermes update for Sue"

> "Looks good – subject to my nervousness around the quantification used in the paper. I suspect we'll move on this this afternoon. But I'd prefer to have a verbal discussion …"

211. E-mail from JH to JB and AK copied MS & GS – subject "Hermes – GEC paper"

> "The paper has issued [sic] at this stage. I can flag to Mike and Steve who are presenting the paper that, depending on our transactions, there may be an impact on 2010 capacity (although we should still be able to use the benefit over the longer term and would be able to recognize the deferred tax asset in the current year?)"

212. Draft Memo from Arthur Cox to Project Hermes Working Group – Subject "SERVCO/UKCO" [emphasis provided] stated:

> "Based on the structure discussed to date, we have considered below the risk from a regulatory perspective that UKCO will be deemed to be operating in Ireland through a permanent establishment and therefore be required to operate as a branch under the re-cast Banking Consolidation Directive.
>
> In order for UKCO to provide services in Ireland, it will be required to passport its banking license into Ireland… However, there is a risk that the operations of SERVCO in Ireland will result in UKCO being deemed to

have a permanent presence in Ireland… The ultimate determination of whether UKCO has a permanent establishment in Ireland will be made by the Financial Regulator and the FSA.

We have set out below possible steps to be taken to minimise the risk of SERCO constituting a permanent establishment of UKCO. None of these steps provide a guarantee of success but are designed to try to address issues which are likely to be raised…"

<u>SERVCO must not have a permanent mandate from UKCO</u>

<u>SERVCO cannot be subject to the management and control of UKCO</u>

To make the best possible case on this, the following steps would need to be taken [lists items like having its own management structure and not being subject to control from the UK]

<u>SERVCO cannot commit UKCO</u>

Conclusion

For the reasons outlined in sections 3 and 4 above both regulators are likely to have concerns on the issue and there are no guarantees that the case made for them will be successful… We have flagged in section 3 above some of the areas which could be addressed to enable the best case to be made …"

26 June 2010

213. E-mail from SH to SC subject "Hermes"

"Having enquired I understand that the Tax team did not sign off the paper on Hermes that went to GEC. They had seen an earlier version but the final version did not reflect their comments in total in the round.

The essence is that any decision re Hermes is strictly a commercial/strategic decision. Following the decision the tax consequence will flow subject to analysis. In respect to these and assuming the decision is in line with the commercial recommendation there will need to be a discussion with the UK and Irish tax authorities and its not clear that the potential benefits outlined in the paper will be realised. The Group tax team need to have sole 'jurisdiction' to opine on the tax analysis both from a corporate perspective and to ensure strong, transparent relationships with HMRC. We are contemplating whether to send Tim a mail [sic] drawing out the tax matters more distictly [sic] pre GEC and I wanted to give you the heads up. Given the strategic rational as I'd read the paper to take the action in line with the recommendation it seems a sensible route forward. If so tax analysis will follow."

27 June 2010

214. E-mail from SC to SH – subject "Hermes"

"Useful thanks – let's chat as I was under the impression they had signed off. Clearly must make sure we don't mess up."

28 June 2010

215. E-mail from GS to TTO copied to SC and SH subject "CONFIDENTIAL – PROJECT HERMES" attaching GEC paper – Project Hermes – 23 June.doc

"The attached Project Hermes paper is being presented to GEC tomorrow. We have been working with Steve's team on the proposal and I want to make sure that we are absolutely clear on the rationale for this and avoid any ambiguity over the significance of the tax consequences which will follow a

GEC decision to support the action proposed. There is a pressing need to take corrective action over Ireland which is intensifying as we progress through 2010. GEC is being asked to take the strategic decision to close the Irish business by liquidating BOSI. If that decision is taken and we are able to meet a challenging timetable for closure during the remainder of 2010 there would be a number of commercial advantages and there may also be an opportunity to optimise the tax position. However, the key point here is that it is only when the GEC decision is taken to withdraw from Ireland that the question of the timing of this and the possible tax impact of an accelerated timetable will be relevant.

We have carried out the preliminary tax evaluation possible within the time available and we have discussed this with Steve's team. However, this should not be confused with Group Tax having signed off on the figures quoted in paper. There are a number of factors which will need to be considered in greater detail before we are in a position to determine the tax outcome. We will engage on a transparent basis with the UK and Irish tax authorities on Hermes on a real time basis, in line with our current open relationship with both and I know that Susie has asked you to mention the Irish business situation in your update with Dave and Melanie this week.

We have flagged the following points to the Hermes project team and highlight these for your information also:

1. The figure quoted in the paper for the potential group benefit for the ability to utilise future losses on the Irish loan book is in our view very optimistic. It is not certain that we would have sufficient tax capacity in the UK to absorb additional losses and be able to recognise a deferred tax asset. We would therefore recommend caution in viewing the figure quoted.

2. There will be a significant tax valuation exercise required on the Irish assets and liabilities transferred to the UK. This will be an arm's length valuation and by its very nature will involve negotiation with the UK & Irish tax authorities. Valuations will be within a range and inevitably this will take a long period to agree so it is very difficult to predict where we will come out.

3. Any future upside upon a recovery in the Irish assets transferred to the UK will be subject to UK tax. This is not in our view adequately covered in the GEC paper.

4. The historic tax position relating the BOS guarantee arrangement in favour of BOSI is still to be agreed with HMRC. We have had an indication of HMRC's willingness to come to a reasonable agreement (Nil adjustment) in respect of the historic position on the condition that there is no attempt by LBG to gain an unreasonable tax outcome in terms of the long term solution put in place for Ireland."

216. E-mail reply from TTO to GS copied to SC and SH

"… I have seen the gec paper. What happens to the existing tax losses in Ireland – are they lost?... How does the tax benefit (whatever its size) arise at all? Please describe it…"

217. E-mail reply from GS to TTO copied to SC an SH

"… In answer to your first question, yes we could end up getting no relief for the losses in Ireland (if we discontinue the business there) and following the transfer of the Irish assets to the UK and a turn around the upside being taxed in the UK. We may also be able to get some relief in the UK for the

existing Irish losses (these relate to 2009) under the principles established in the EU courts by Marks & Spencer… However, the problems we have with a claim is the lack of certainty and the time it will take to pursue this… On your second question the potential benefit is being highlighted in the paper is in respect of the potential ability to offset 2010 tax losses on the Irish assets against UK taxable profits in 2010 and future years."

218. E-mail reply from SC to GS and TTO copied to SH and SW

"Though just to be clear the prospect of us getting value for the losses in Ireland is effectively zero too. And the likelihood of an upturn very unlikely – key is getting the assets transferred at sensible value"

219. E-mail reply from TTO to GS and SC copied to SH and SW

"Sounds important to get assets tfrd at high value!"

220. E-mail from SW to TTO, SC & GS copied to SH

"HMRC will be looking for low value, so we need to ensure that our valuation is robust …"

221. Email from TTO to SW, GS and SC copied to SH

"Obviously the main issue is that there is no third party buyer so if hmrc push for silly low valuations then Hermes may be unviable"

29 June 2010

222. LBG GEC attended by ED, TT, TTO, SC, MW & SH. [SC, MW & SH attended to present the GEC paper on Project Hermes]. The minutes record:

"Project Hermes

Steve Colsell presented a paper setting out a proposal that the Group should close down [BOSI], and should cease trading as a regulated banking entity in Ireland. The decision for BOSI to exit the retail and intermediary business in Ireland had been announced in February 2010. At that stage the intention had been that BOSI should continue in business, focussed on corporate and commercial banking. A number of factors now made it appropriate to revisit strategy for BOSI. In brief, withdrawal from Ireland was now considered the optimal option for the Group, which could bring significant organisational and financial benefits if completed in 2010.

Mike Wooderson commented on the background to the proposal, with respect to:

- the core strategic question of whether or not the Group was committed to BOSI. The non core nature of this business; the fact that it was projected to be loss making for the next several years; the fact that it would be a net consumer of funding from the rest of the Group; and the likelihood that this business would fail to meet return on capital and return on liquidity metrics, all supported the recommendation that the Group should seek to exit this business;
- timing where, given the strategic imperatives, an exit sooner rather than later was believed to be the best course of action. Closure by the end of the year could offer several advantages.
- The fine details of the approach, which did not need to be agreed at this stage, …

The proposed timetable was challenging. A detailed plan would be brought to the Committee on 28 July, covering cost-benefit analysis; legal and

regulatory issues; customer and colleague implications; and a project risk assessment. There were significant legal and regulatory hurdles that would need to be overcome, as well as not insignificant potential execution and reputational risks.

Whilst a sale of the business was a hypothetical possibility, it was not believed that there were any buyers likely to be interested in acquiring this business at a sensible valuation.

Following a review of various options, it was therefore now proposed that the best option was to transfer the existing BOSI books of business to a UK LBG subsidiary, and to enter into an arrangement with an arm's length independent service company who would be engaged to manage the run down of the portfolio. Involvement of current BOSI colleagues in the run off process would be critical. The possibility of appointing an arm's length service company owned by the BOSI management team was an option that was being considered. That approach could potentially improve motivation and retention of the management team, and optimise the eventual outturn.

The Committee agreed in principle to support the recommendations to:

▪ Close [BOSI] …

▪ Transfer BOSI's assets and liabilities to a Group UK subsidiary;

▪ Examine the best approach to the run down of the BOSI books of business; and

▪Seek to achieve closure by the year end.

…

A further report would come back to the Committee on 28 July."

223. Deloitte Memo – "Project Hermes – Summary Tax Analysis – Draft 29.6.10" to Group Tax is summarised as follows:

"Introduction - The proposed closure of BOSI via a cross border merger as outlined in the GEC paper of 23rd June is a complex transaction which will give rise to a myriad of UK and Irish tax considerations. This paper discusses the major tax considerations arising in order to assist management in understanding the tax profile of the transaction in terms of the potential risks, costs and value for tax attributes achievable. However, in a transaction of this scale and complexity there will be many points of detail in relation to the tax analysis that are bound to emerge in the course of implementation which could impact the overall tax benefits and costs arising.

Background - … The commercial and strategic background is discussed in the Group Executive Committee paper of 23rd June … As explained in the GEC paper, the legal mechanism currently favoured is a Cross Border Merger under which BOSI would be absorbed into an existing LBG banking entity in the UK …

Scope - … BOSI is 100% owned by Scotland International Finance BV ("SIF"), a Dutch holding company, which is 100% owned by BOS Plc. We consider the UK and Irish tax implications of a cross border merger of BOSI into BOS Plc. As a simplifying assumption it has been assumed that BOSI is moved under BOS plc prior to the merger. Legal and regulatory implications are outside the scope of this memo but the regulatory analysis in particular is likely to impact the tax analysis, as discussed further below. Our working assumption here is that post the merger LBG will have no regulated banking presence in Ireland to which the existing business transfers. The existence of

a continuing regulated branch would make a group relief claim impossible. A service company (OpCo) will be engaged to carry out certain administrative and operational activities in relation to the legacy portfolio…

Executive Summary – Cross Border Merger" – "The CBM mechanism for achieving the closure of BOSI by 2010 year end carries a level of tax uncertainty which will need to be addressed with UK and Irish tax authorities in advance. In particular, the CBM tax rules are premised on a taxable presence remaining in Ireland post merger … a merger and closure of the Irish business effectively happen at the same time…. The group would therefore be taking the position that the CBM is not tax neutral and that Irish tax losses do not survive. The tax authorities may be sceptical of this outcome…

The ability to group relieve Irish losses therefore depends upon whether the business and operational plan for the run-off is consistent with the following: (I) There should be no banking taxable presence in Ireland post merger…

(II) The CBM mechanism should not have a main purpose of securing a group relief benefit. This is a question of fact and LBG management will need to be comfortable that the sole main purpose of the CBM arrangements is to effect the closure as rapidly and as cost effectively as possible whilst optimising the value of BOSI assets.

If there is an ongoing regulated presence… then the opportunity to take the BOSI losses in the UK will not be available as there will be a transfer and ongoing use of the losses in Ireland.

Option 4 (independent service company) provides a better starting point for a discussion of the PE issue.

Transfer Pricing of Loan Portfolio

The transfer of the loan portfolio to BOS plc under the CBM should be at fair value for tax purposes, which we understand is likely to be [c€2bn] below current book value. This will result in greater tax losses in Ireland which it will not be possible to group relieve or obtain economic value for [reference to technical group relief provisions in footnote]. On the UK side, the loans will be treated as acquired at fair value (which depending on the accounting for the merger may be below the value recognised by BOS plc in its balance sheet). Recoveries on the portfolio above fair value will be fully taxable in the UK even where no income is recognised for GAAP."

224. BOSI – Project Hermes draft paper for GEC Sponsor/Presenter – SC and MW. The note states:

"This note represents an update on Project Hermes, together with a request for certain approvals which will enable us to make announcements alongside the Group's half year results on the 4th August …"

"At this stage we are seeking GEC and subsequently Board approval to proceed to 1. Close [BOSI] … 2. Effect the closure by … the Cross Border Merger (CBM) legislation, with a view to complete by 31st December 2010".

"We believe that there are a number of key strategic and financial reasons which point to a withdrawal from Ireland as the optimum option for the Group. Our overall aim would be to exit the Irish market as rapidly as possible in a cost effective way, whilst optimising the value of the existing BoSI assets and Group Tier 1 capital and minimising any reputational impact for the Group. The attached paper is drafted for onward submission to the

LBG Board. [The attached paper largely repeated the previous GEC paper but included a timetable for current year closure.]

30 June 2010

225. BOSI formally closed its Halifax Retail and Intermediary business.

July 2010

226. Undated and unaccredited documents titled "Draft and For Discussion – Hermes – TAX". The location of the document in the hearing bundle would indicate it was prepared in June/July 2010. The draft variously stated:

> "I've spoken with Deloitte (UK and Ireland) to join up the threads. There is a fundamental business decision it seems over whether this is do'able in 2010 vs deferring to 2011.
>
> Clearly, there are commercial factors around pushing to complete sooner, such as liquidity, staff attrition, retention of key personnel etc which should drive this. FSA also seem keen for a swift resolution.
>
> Reference was also made in this morning's call to a desire to announce to the market and analysts a course of action. If this is the commercial position, then the tax position should become secondary.
>
> The risk of pushing through in 2010 if all other areas push back and say unachievable are two fold from a tax perspective: - execution risk, p.e. structure is less than ideal … tax becomes the main purpose and anti-avoidance kick in - HMRC opener would be why the rush to get through in 2010 and could probably scratch through a few of the higher level commercial arguments to cut to the fact that it was done at pace for tax and deny any relief.
>
> 3 vs 4 vs 5 – In our call this morning Susie and I discussed the relevant percentages of risk of avoiding the p.e. Option 3… we put this around 25%... Option 4… moves this risk of avoiding to around 75%... Option 5… we positioned this around 90%.
>
> Other risks around realising tax benefit - … availability of capacity … challenge to MTP from Group Finance … Benefit in 201 1… Difference in valuation … separate trade argument"

1 July 2010

227. Email from Arthur Cox to "John and Lysanne" [The e-mail header is cut off] attaching Hermes.doc:

> "… I attach the initial paper we prepared on the structuring of the transaction … Because of certain shortcomings in the Irish statutory transfer scheme … the decision was taken not to proceed by way of a scheme, but rather a Cross Border Merger … We have asked Counsel to consider the feasibility of having the share transfer occur immediately prior to the merger becoming effective, but this may not be possible under the relevant regulations. We have been working on the draft merger terms …"

6 July 2010

228. Project Hermes briefing for meeting between LBG and the FSA:

> "Objectives of Meeting – "Brief the FSA and the FR on the intention to wind-down BOSI's business in Ireland and the mechanism identified to achieve that intention"

> “Why we have taken the decision to withdraw from Ireland – and why now” External Factors listed are: “market pressure to clarify the core/non core split”; “sustained pressure for deposits”; “heightened concerns regarding the PIGGS countries”; and “NAMA impact”. Internal factors listed are: “Scale of impairments”; “forecast to make a significant cumulative loss”; and reliance on “Group funding and capital” and “significant colleague concerns”.
>
> “A summary of the proposed transaction was provided.”

229. Note of Meeting between LBG and FR and the Irish Regulator (ME). Talked through slides that were confirmed to be same slides that had been “walked through” with FSA that morning.

9 July 2010

230. Meeting between BOSI and the Financial Regulator recorded in Business Overview Report dated 27 July 2010:

> “On the 9th July, the FR held a number of onsite update meetings with senior management from Risk, Finance and the BSU. These meetings were constructive and focussed on the processes within the BSU including our current credit processes.”

13 July 2010

231. E-mail from Nick Beckwith to TTO, CS, AP, RL copied to others subject “W&I QBR – 15 July” with attached PowerPoint deck:

> “2010 Profit & Loss Trading profitability has improved from QF1, however our Irish portfolio is showing further signs of deterioration”
>
> “Impairments – Stress-testing of Ireland portfolio has resulted in £(283)m increase in forecasted impairment charges signalling the need for continued de-risking.”
>
> “Project Hermes – Project Update
>
> ▪ Deloittes [sic] and A&O engaged as advisers.
>
> ▪ Initial briefings with FSA and Irish FR took place 7 July [Correct date as per above is 6 July];
>
> ▪ Detailed planning work underway to assess – relative benefits and risk associated with alternative Service Co options; structure of Service Co and UK Operating Co; financial impacts; implementation and communication plan;
>
> ▪ Go/no go decision at GEC 28 July”

15 July 2010

232. E-mail from AK to Craig Meldrum and others cc’d to JH, JB, SC and MW – subject “RE: OpCo Strawman”

> “… clearly as the result of the strategic decision we have made some activity will cease in Ireland… The second piece of work we need of what resources and therefore costs will be required in the UK to do the work that is transferred from Ireland…”

233. Deloitte Paper - LBG: Project Hermes – Tax Considerations for GEC:

> “Executive Summary – Cross Border group relief of BOSI losses should be achievable provided there is no [PE] in Ireland to which the losses transfer as

part of the [CBM]. An independent ServCo (Option 4 or 5) will provide the best opportunity of avoiding a P.E … with the right set of regulatory and commercial circumstances it may be possible to get the decision across the line. Based on current forecasts, the value obtained for Irish losses via group relief is higher if closure and CBM is achieved by the end of 2010. Losses potentially available are [€2.1bn/£1.7bn] in 2010 vs [€0.4bn/£0.3bn] in 2011 achieved by the end of 2010 … tax capacity available in 2010 is estimated to be c£2.1bn before priority off sets ... Significant tax uncertainty exists in relation to the CBM … discussion with HMRC should be instigated at an early stage following the GEC meeting at which the commercial arrangements are settled."

"Objectives/Scope – Our analysis of the tax implications is based on the paper presented to the GEC on 29 June 2010 and financial information prepared by LBG.…we have been asked to review the potential to surrender tax losses so the UK and the implications of various closure options set out in the GEC paper. We also highlight the tax risks and costs of these options…"

"Summary of Key Tax Considerations

Cross Border Group Relief – Benefits/Risks - Incremental value from BOSI losses of up to [£1.4bn] from closure in 2010 subject to UK capacity" - Comment – HMRC resistance to group relief claim – timing of CBM in 2010 should be consistent with the optimal commercial strategy for closure"

"Serveco ownership/P.E Analysis – Benefits/Risks - Independent Servco will provide the best opportunity of there being no P/E to which BOSI losses transfer."

"Cross Border Merger (CBM) – Benefits/Risks – Across border merger under which the merged business is closed so that there is no on going P.E. is unprecedented and tax implications are uncertain – Comment … tax rules are premised on a P.E remaining in Ireland which is not the case here…"

"Group Relief: Value Considerations – Assuming the onerous conditions for cross-border group relief can be satisfied… a claim to surrender closure period losses of BOSI should be possible … approximately €2.1bn of Irish losses would potentially be available for surrender in 2010. As a comparison, the most recent forecast for BOSI shows €0.4bn of losses for 2011 … The Irish losses which potentially falls away if BOSI is not closed in 2010 are therefore in the order of [€1.7bn] (£1.4bn). However value through group relief depends on whether UK tax capacity is available… based on current forecast numbers at Q2, there are UK taxable profits of £2.1bn against which eligible tax losses from LBG group entities can be offset during 2010."

"Loan Portfolio – Transfer at Fair Value

For UK tax purposes, the acquisition price of loan assets acquired through the CBM is likely to be arm's length fair value. The implication is that ultimate realisation of the loan portfolio at levels above the fair value determined for tax purposes (at the time of the CBM) will erode any group relief benefit. Conversely future losses deductible in the UK will increase the overall value obtained for Irish losses."

Group Relief Analysis – ["main purpose" test] – "This is a factual test which looks to the subjective intention of group management as evidenced by internal and external documentation and as such it is not possible to form a firm technical conclusion on whether the anti-avoidance rules will bite…".

"A strategic decision to exit the Irish market and cease trading as a regulated banking entity in Ireland has been taken. The strategic and financial rationale are set out in the GEC paper of 29 June 2010 - substantial on going losses, further capital required to be injected into BOSI and uncertain economic environment - all conspire to make BOSI's business non-core for the group. However group relief benefits will be a factor in the timing and manner of closure and thus there is a risk that HMRC will argue that additional losses available in 2010 vs 2011 are potentially unallowable because a CBM and closure by the end of 2010 is designed to achieve additional group relief benefits (with concomitant p&l and tier 1 capital benefits from the value of additional deferred tax asset recognition). The counter, if supported by the facts, is that as a matter of commercial reality, the overriding driver must be to maximise recoveries and minimise costs on a loan portfolio which - if not properly managed - could incur incremental losses many times any potential tax benefit. Any closure strategy therefore must first and foremost be consistent with this objective and whilst a group relief benefit is a "nice to have" it can only reasonably be viewed as subsidiary to the main commercial objective and is not itself a main purpose. The GEC paper also refers to a number of benefits of closing in 2010 - minimising employee uncertainty, contribution to group integration, clarity of strategy to the market, and the current trade union agreement."

Closure Options Comparison – [set out options] –

Option 1 will most likely give rise to an ongoing use of losses in Ireland. Option 2 is unlikely to be delivered in current year. Option 3 presents greater risk of a PE and a greater challenge to demonstrate that it can be avoided. As such "option 5 should present the strongest position", followed by Option 4". Option 5 is strongest because "ServCo would appear to be entirely independent".

"The determination of whether there is or is not a P.E is likely to be marginal in any consideration by the Irish Revenue of the issue, with Revenue initially likely saying that there is a possibility of a PE. Nonetheless, with the right set of commercial circumstances it may be possible to get the decision across the line."

Strawman CBM structure

"… CBM will be completed via the absorption of a wholly owned subsidiary … Prior to the merger, shares in BOSI will be transferred from [SIF] to BOS plc Scotland … the CBM mechanism for achieving the closure of BOSI carries a level of tax uncertainty that will need to be addressed with the UK and Irish tax authorities in advance. Timing is already very tight and the impact of this will need to be understood in terms of the legal and regulatory timetable … tax uncertainty here is enhanced by the fact that a cross border merger and closure of the Irish business are effectively happening at the same time…"

20 July 2010

234. E-mail from JB to SC, AK, MW, GS, MS and SW- subject "Hermes VAT"

"A wider challenge from the Deloitte tax team this morning. Is there an increasing risk that from an execution perspective, the risk of rushing through by 31.12.10 and getting an adverse tax position on p.e. arises? … Per Jacki White's numbers, the loss in 2011 is c£2.5bn in 2010. By we are constrained by capacity in 2010 (currently c£2.1bn) and priority loss claims

> in 2010 could reduce this further. We'll likely have a capacity constraint in 2011 also and the further out we go, the less certain we can be on veracity of numbers. Deloitte's view is that this potentially narrows the gap on benefit in doing in 2010 vs 2011. Their updated deck this pm will reflect this – what's your view on the realistic delivery of this in 2010? Will we need to cut corners to deliver with an associated impact on risk?"

235. Deloitte Paper – LBG: Project Hermes – Tax Considerations for GEC – Draft II. The paper set out in more detail the tax considerations of the proposed merger.

236. E-mail from AK to JB, SC & MW copied to MS and GS – subject "Re: Hermes VAT"

> "my thoughts would be. From a colleague point of view we must do it this year… From a regulatory point of view it feels like the regulator wants this sorted asap. Particularly the guarantee which is still out there and unresolved! From a tax point of view if we did it next year and completed early in the year our capacity in 2011 would be very limited due to the short accounting period so it does not get us out of the issue. Also there is a doomsday scenario where we miss this year end so missing the losses for this year and then find that the losses next year are not as large… My vote is for this year…"

23 July 2010

237. E-mail from David Taylor at Deloitte to SC, JB, AK – re "Draft GEC paper 32- Project Hermes – v5" requesting comments.

238. E-mail reply from JB to Deloitte copied to SC, AK

> "Re the tax section, can we go with: Efficiencies… If the strategic decision is taken to withdraw from the Irish market, we will look to plan the implementation of this strategy in the most tax efficient manner possible … According to the latest version of the MTP, this benefit could be to a maximum of £0.6bn … Finally, if the Tier 1 benefit is effectively just the tax can we change all references to "Tier 1 benefit" to "Potential Tier 1 benefit".

239. E-mail reply from SC:

> "thanks Jon. What about the relief on the 2011 losses… I thought that's where the original up to £1bn came from?"

240. E-mail reply from AK

> "… I think I would agree with Jon and tone down the tax benefit to "up to £0.6bn with the potential to be higher"… I would prefer if it was headed up tax consequences rather [than] efficiencies as well…"

241. E-mail reply from JB

> "I'd prefer to not have "with the potential to be higher but lets have that discussion on the phone"

26 July 2010

242. E-mail from GS to TT copied to SW – re "FW: CONFIDENTIAL PROJECT HERMES"

> "As you know the Hermes follow up paper is being presented by W&I to GEC this week. The W&I team have over the past few weeks provided an additional comfort on the fundamental commercial factors (regulatory, customer and employee considerations) which underpin the Hermes proposal and they understand that we will be required to demonstrate this to HMRC. Group Tax has been involved in drafting the paper … However, there are

> some remaining points… The W&I view on the possible tax benefit which might arise if we are able to utilise future losses on the Irish loan book remains optimistic. There are many moving parts including UK tax capacity, valuation of the book and transfer pricing adjustments, the ability to benefit from cross border merger legislation to enable a 2010 offset and the historic transfer pricing position. It is by no means certain that LBG would have sufficient UK tax capacity to utilise the potential Irish loan book losses in 2010 and in future years. We therefore continue to recommend caution in viewing these figures. … I understand that you will be seeing [SC] and [AK] at the W&I FD's meeting tomorrow morning … Overall our view is that the proposal should stand on its commercial merits excluding tax which Steve & his team understand."

243. E-mail from SC with meeting invite for "Hermes meeting: Steve/Mark Adams/Alan K/Jonathan L /Jon B" at 9.00am on 27 July 2010:

> "Further to Mark's email today [The e-mail was not in the hearing bundle], please note there will be a meeting at 9am tomorrow morning, 27 Jul, to prepare one-pager costs benefit analysis for Hermes".
>
> [The "one-pager" costs benefit analysis document was not in the hearing bundle.]

244. Email from MA (Deloitte) to SC, AK, JB – subject "Hermes meeting: Steve/Mark Adams/Alan K/Jonathan L /Jon B"

> "Please find attached a pro forma analysis, table, and graph which could be used … to illustrate the tax efficiencies v costs of Options 3, 4 & 5 in Hermes paper…For discussion on 9am call"
>
> [The documents referred to are not in the bundle]

245. E-mail reply from AK

> "The tax guys best estimate of capacity is £2.1bn. This is unlikely to change. I would therefore use this as the base case …"

27 July 2010

246. Project Hermes meeting between LBG and Deloitte to discuss one-pager costs benefits analysis for Project Hermes. [No note of the meeting is in the bundle]

247. E-mail from GS to AK, Mark Adams, JB, MS & SW – subject "Hermes meeting: Steve/Mark Adams/Alan K/Jonathan L /Jon B"

> "I've been unable to speak to Susie this morning but when I did catch up with her briefly yesterday … she indicated to me that she had made it clear last week that the Group Tax view remains that £2m [sic] of capacity is very optimistic. The tax capacity remains fluid…"

248. E-mail reply from SW

> "…yes – the 2.1 is highly optimistic and you'll recall that I said on the call that at most I'd say there's 1bn. The 2.1 is before capital allowance claims…"

249. E-mail reply from AK

> "Not sure I understand. We could do a call on this attended by all parties … as we are getting confused on the position at the moment. We are trying to create a decision tree on this but it is really difficult with only half the information"

250. E-mail reply from SW

> "The figure of £2bn assumes no capital allowance claims for 2010 … As I said on the call, I'd assume £1bn of tax capacity in 2010 given the level of judgment in putting the number together…"

251. BOSI – Business Overview Paper – for International Banking Ex Co Presenter JH:

> "Principal Issues & Key Messages – including "Project Memphis – this project continues on-track following successful implementation of T-Day on the 18th of June … "Media coverage was limited with no significant adverse reporting…"
>
> BSU – "c50 colleagues have now been selected to staff the 3 Regional BSUs being established. Cases are expected to migrate through July and August to these new teams"
>
> Operational & Regulatory "The control environment continues to show improvement…"

28 July 2010

252. E-mail from SC to SH re "Project Hermes - pensions"

> "Just a couple of thoughts on tax - they are swinging around a lot on the capacity point and really need to come off the fence; after our meeting yesterday we did a quick calc – if we got the maximum benefit in 2010 and transferred the assets at 3bn below book… the future taxable gains wipe it out; however, if it looked to be ongoing that way wouldn't we either argue "we'll drop the 2010 claim if you drop the market argument" or in extremis pull the cross-border merger?"

253. E-mail from AK to SW, MA Deloitte, JB, MS & others – subject "Hermes meeting: Steve/Mark Adams/Alan K/Jonathan L /Jon B"

> "… As discussed this is a no regrets move because we have already made the decision to exit Ireland. Just confirmed it with Steve again!"

254. BOSI – Project Hermes Paper for GEC dated 28 July 2010:

> The Executive Summary stated "This note represents an update on Project Hermes … We believe that there are a number of key strategic and financial reasons which point to a withdrawal from Ireland as the optimum option for the Group. Our overall aim would be to exit the Irish market as rapidly as possible in a cost effective way, whilst optimising the value of the existing BoSI assets and Group Tier 1 capital and minimising any reputational impact for the Group."
>
> A number of external factors that had changed were cited which made it appropriate to revisit the strategy: concerns re PIIGS, pressure to reduce non-core assets, scale of impairments, pressure for deposits, pressure from FR to replace Guarantee with direct capital injection. Internal factors listed were that BOSI will be unable to generate liquidity and cross-sales, colleague concerns re long term future as evidenced by over-subscription of voluntary redundancy programme and low employee engagement scores.
>
> "In revisiting the strategy for Ireland, we believe that there are a number of key strategic and financial reasons which point to a withdrawal from Ireland as the optimum option for the Group:
>
> • Under the existing Q2F Base Plan, the business is forecast to make a cumulative loss before tax of €4.7bn over the next five years.

• Against this financial performance, BoSI will require average Group funding of €18bn and a further capital injection of €1.7bn; and

• Given the economic outlook and the shape and performance of the business in Ireland, it is challenging to describe the business as anything other than non-core and, as set out above; there is merit in clarifying that position for external and internal stakeholders as quickly as possible.

Assessment of Options

We believe that neither a sale of BoSI as a whole nor the same of asset portfolios is the optimal form of rapid withdrawal from Ireland. Following discussions with a number of parties who expressed interest in buying the asset portfolios, we do not believe there are buyers ... who would engage at acceptable valuations in the short term. A managed wind-down is therefore believed to be the preferred form of withdrawal and it was agreed by the GEC on 29 June 2010 that we would review the viability and implications of three selected wind-down options in further detail. …

Recommended withdrawal option

While more complex to implement, the independent nature of options 4 and 5 have potentially very material strategic, commercial and market message benefits relative to Option 3. We will therefore continue to work on these options over the next few weeks with an expectation to confirm our choice during August. Our current expectation is that it is most likely that we move forward with Option 4 as this is more likely to retain the senior management team, and be achieved by 31st December. In parallel to this, we propose to continue to engage with a third party (codenamed "Mercury") to provide: (a) a benchmark for the operational efficiency and commercial terms proposed by existing BoSi management; and (b) provide a contingency if Option 4 becomes unviable… We are in detailed discussions with BoSI management… and have achieved broad agreement and understanding around key commercial terms. We have held initial discussions with Mercury… to discuss the viability of Option 5 in the timeframe… but we remain concerned about the achievability of this.

…

Legal Position and Process

The Legal Appendix B prepared jointly by Arthur Cox … and Allen & Overy sets out the steps and timetable to give effect to the [CBM] in 2010." [These documents are not in the bundle]

255. GEC Meeting attended by ED, TT, TTO, SC, CS, HW and MW Item 2010/311 "Project Hermes – Update "

"[SC] and [MW] explained the background to the key recommendation, namely that the Group should seek to exit from the Irish market, in a cost effective way, as rapidly as possible.

[SC] commented that the Irish market was already substantially in "run off", with very limited new lending taking place. In the longer term, full exit from the Irish market was believed to be the right strategic move. Formally recognising this - alongside a structured approach to managing the run off - could assist with satisfactory resolution of the Group's exposure, as well as staff retention and motivation (particularly with a "colleague owned" ServCo). Discussions were taking place both with the management team and independent third parties with respect to the appointment of the most appropriate ServCo … Achieving this by the end of the year would require

> the appropriate Court process to be commenced by no later than the end of August."
>
> The Committee agreed to recommend to the Board that LBG close BOSI and effect the closure through the CBM "with a view to completion by 31st December 2010".

July 2010

256. LBG hired EY to programme manage the BOSI Irish exit. A Full Business Case document was completed with the "Programme/Project Description - To plan and execute the exit from the Irish market as rapidly as possible…" and lists "must do" items completed by 31/12/2010 to include disposing of property, IT solution for ServCo; Operating model development and implementation; and Service Contract between OpCo and ServCo.

August 2010

257. Undated document [Located at the beginning of the August section of the bundle] detailing the primary and secondary messages for the rationale for BOSI exiting Ireland for use with colleagues and customers.

> "Rationale – [LBG] is planning to withdraw from Ireland due to significant continuing loans losses and the poor economic environment … the Group could not see a return on investment in the foreseeable future … The Group believes that Ireland does not present scalable growth opportunities …"
>
> "Colleagues – … It is planned that 90% of colleague will transfer, via TUPE, from BoSI to the new managed services company… most colleagues will continue in their existing roles…We plan to put in place a pay and reward structure that will incentivise colleagues to remain with the business in the years to come"

2 August 2010

258. LBG Group Impairment Adequacy Review – H1 2010 presented by SRS variously stated:

> "Current expectations, based on our latest base case economic forecasts, are that the Group impairment charges have peaked in H1 2009 and that they will be significantly lower in 2010 compared to 2009. However, further economic deterioration remains a downside risk to the Group and could lead to material increases in our impairment charges."
>
> It noted that the economic conditions remained challenging, particularly in Ireland and BOSI Impairment charge "has reduced by 21% from its H2 2009 peak (£2bn) to £1.6bn as at June 2010" and "Wholesale is reporting that there are some early warning signals that in parts of the portfolio performance is deteriorating, however, this has not yet impacted impairment levels."
>
> "The positive trend in Group impairment charges since the peak of H1 2009 is reflective of the Group's accelerated review of high risk portfolios and early failure of poorly structured heritage HBOS corporate transactions, rather than more recent economic recovery. The H1 2010 position confirms our previous forecast that the impairment charges would reduce, however, we expect that the level of impaired assets will continue to increase across certain portfolios."
>
> "Current impairment allowances are considered adequate, but downside risks remain particularly for BoS Ireland mortgages portfolio, given the on-going economic uncertainty."

> The Impairment Allowance Overview (2) stated: "Having risen significantly during 2009 across virtually all material books, impairment allowance growth has slowed during H1 2010, with increases in Real Estate BSU and Ireland offset by decreases in Retail."
>
> " Impaired Assets - £62.9bn (c. 10%) of the Group's assets are impaired as at June 2010 (Dec 2009: 9.1%). The increase in H1 2010 (up £3.0bn, 5.0%) is driven by Ireland, Real Estate BSU and Wholesale Markets books."
>
> "W&I impairment charge for H1 2010 is £2.2bn, representing a decrease of 16% from the H2 2009 charge of £2.7bn. … BOSI charge has reduced by 21% from its H2 2009 peak (£2bn) to £1.6bn as at June 2010, accounting for 70% of the divisional H1 2010 charge. … BOSI Commercial Real Estate portfolios remain the primary source of impairment losses (56% of H1 2010)."
>
> "Despite strong Q1 growth, the outlook for Ireland remains challenging … Ireland - After eight consecutive quarters of contraction, the Irish economy made a surprisingly strong start to 2010, with GDP expanding by 2.7% quarter-on-quarter during Q1. The increase was attributable to a robust export performance, mainly supported by a softer euro. However, annual growth remains negative, as does the outlook, with ongoing Eurozone concerns leading to weak Euro-Area growth prospects, and prospects for growth in the UK and US (Ireland's main trading partners) also looking fragile. Indeed, domestic demand remains weak, with private consumption, government spending and fixed investment all continuing to contract in Q1."

3 August 2010

259. BOSI – Project Hermes Paper for LBG Board Meeting on 3 August 2010 with attached draft "External Announcement", draft CBM terms and draft "Colleague Message":

> The paper requests approval "for the delegation of a sub-committee consisting of Truett Tate and Tim Tookey for the financial decision to initiate (or not) the process during August. This deadline is essential for us to achieve implementation prior to 31st December 2010, which could generate very material incremental tax benefits for the Group"
>
> "We are recommending an implementation in 2010, including ceasing regulated banking activity in Ireland, as this has the potential to generate material benefits to the Group."
>
> "We believe that there are a number of key strategic and financial reasons which point to a withdrawal from Ireland as the optimum option for the Group. Our overall aim would be to exit the Irish market as rapidly as possible in a cost effective way, whilst optimising the value of the existing BoSI assets and Group Tier 1 capital and minimising any reputational impact for the Group."
>
> A "Draft External Announcement" is attached to the paper stating that LBG are exiting Ireland "principally due to the ongoing loan losses at [BOSI] and the continuing difficult economic circumstances in Ireland".
>
> The Draft "BOSI Colleague Message" stated:
>
>> "Following the closure of Retail … it was always our intention to develop this business and focus on Corporate and Commercial Banking in the future. Since then, however, … the Group has announced its intention today. The Group has cited two main reasons. The losses we have made, and will continue to make over the next few years… Also the last six months has demonstrated that the economy here, and around the

World, will not improve quickly enough to make an impact on the fortunes of our customers or the Bank."

260. BOSI – Project Hermes Tax Considerations – by Group Tax dated 3 August 2010

> "Executive Summary This note sets out the Group Tax initial conclusions following review of the closure proposals under Project Hermes … The decision by LBG to exit the remaining Irish business is driven by strong commercial imperatives set out in the paper submitted to the GEC on 28 July by [SC] and [MW], including the Group's desire to cease having a locally regulated presence in Ireland … Further detailed consideration is required on the UK and Irish position as there remains uncertainty with regard to the final structure itself, the accounting treatment of the CBM and also the application of the Irish and UK tax rules to this. … A substantial valuation exercise will also be required to facilitate agreement with the tax authorities regarding the tax basis of the assets transferred to the BOS."
>
> "Tax Consequences of the Claim – … we are working through these with Deloitte, Allen & Overy and leading tax counsel in the UK and with Arthur Cox in Ireland … BOSI is currently a subsidiary of SIF … and Dutch advice will also be required, although we do not anticipate any significant Dutch tax issues."
>
> "Group Relief Claim – We do not expect to have a continuing regulatory (or taxable) presence in Ireland beyond 31/12/2010 … Subject to satisfying a number of conditions it should be possible under EU cross border group relief provisions for BOSI to surrender its Irish losses against LBG UK profits … There is a specific anti-avoidance provision … We are satisfied based on the information provided by the W&I business and the Hermes project team that the proposal to close [BOSI] permanently is driven by strong commercial imperatives (regulatory, market, investor, customer and colleague) and understand that the desire to eliminate a locally regulated presence in Ireland is the key consideration here. We are advised that it is intended to proceed with the exit in the way contemplated (closure of the business and CBM by 31/12/2010 with a third party Irish service company administering the loans locally) regardless of the position regarding the availability of any group relief. … [CBGR] is also subject to the availability of 2010 UK taxable profits ("tax capacity") … there is possible capacity of around £1bn in 2010 … Indicative losses for Ireland for 2020 are in the order of £2.1bn."
>
> "Additional High Level Tax Comments … EU Group Relief Claim - … we expect HMRC to strongly resist a claim made in respect of BOSI losses, given the quantum …" and on the main purpose test "As there is more tax capacity in 2010 than in 2011, HMRC may argue that, whilst the CBM is executed for purely commercial reasons, accelerating it into 2010 to obtain more group relief, causes a claim to be denied."

261. LBG Board Meeting attended by ED, TT and TTO. The minutes record:

> "Project Hermes
>
> Mr Tate introduced the paper. It was proposed that the Group should exit totally from its Irish businesses, which were likely to suffer additional impairments and require further capital and liquidity from "Group" … Strategically this was believed to be the correct decision, and there were strong reasons to favour an exit sooner than later. The potential tax implications of this were complex and required further work. … The sensitivity of not being seen to reward members of the management team

> who were part of creating "the problem" was well understood. Mr Tate would confirm to the Board in due course that appropriate safeguards were in place in this regard.
>
> The Board: supported the decision to exit from Ireland in principle; agreed that an ad hoc Committee of the Board comprising of Mr Tookey and Mr Tate should continue the analysis of the implications of this proposal and should have the authority on behalf of the Board to proceed with the proposed transaction, with timing to be agreed by the Committee …"

TT's handwritten speaking notes for the meeting state "Our recommendation is to truly exit Ireland, leverage our London credit and risk expertise and do both in a way and at a time which is tax and capital efficient … and doing it before year end. The timing is a tax issue and I'll turn over to Tim to walk you though the tax implications. Importantly for the Board this is first and foremost a good thing, the right thing to do for commercial reasons but there are meaningful tax implications which drive timing."

4 August 2010

262. 2010 Interim Results – News Release. The interim results confirmed "… a significant reduction in impairment… Group has returned to profitability… Impairment levels significantly lower than originally envisaged… all divisions (and importantly within the Wealth and International division, our Irish business) are showing improving trends in 2010."

263. 2010 Interim Results presentation by ED and TT:

> "W&I Impairments up 52% … continued to reduce the size of our balance sheet … [W&I] reported a loss of £1.6 billion, reflecting the increased impairment charges in the International units. Impairments rose by 52 per cent in comparison to the same period in prior year, but were down by 15 per cent on the second half of 2009. … There will be more stringent regulatory requirements, particularly affecting both capital and liquidity … [W&I] delivered a better performance for the first half overall, and pleasingly a reduction in Irish losses compared to the second half of last year. … In W&I, impairment charges were down 15 per cent on the charge in the second half of last year and the level of losses continues to be dominated by the economic environment in Ireland. We continue to believe that the impairment charge for the Division peaked in the second half of last year, although economic conditions continue to be monitored closely.
>
> In response to a question from a Goldman Sachs analyst – "shouldn't we expect a relatively dramatic fall of in impairments in Ireland. You seem very cautious in your guidance." , ED answered: "We have been cautious about Ireland ever since we started to report on the acquisition. The country continues to have a difficult economy. There is no activity as such in terms of buying and selling and we have basically seen the latest tranches going into NAMA coming in at very considerable discounts. So all of that needs to continue with caution. But we believe we have taken a very prudent stance and we will see how it develops over the next several periods."

264. Email from SC to TT – subject "Hermes etc":

> "We are still planning to get you the Hermes tax note for in-flight entertainment it's with Sue at the moment. As far as I can see only one tricky issue around the Irish withholding tax which wouldn't prevent us implementing the operational solution but might make us pull the cross border merger if we couldn't fix it. …"

12 August 2010

265. E-mail from SC to SH (cc'd to AK) – subject "Hermes Approval":

> "… I understand that the discussions on tax, accounting and capital have taken place … I understand there is nothing that should stop us proceeding… we are planning for an announcement next Thursday (the 19th). That would suggest a board sub-committee meeting of the two TTs at the start of next week … When I spoke to Tim before he left he was happy to give that remote approval once Group Finance had been through the tax and capital points."

266. E-mail from SH to SC (cc'd to AK) – subject "Re: Hermes Approval":

> "The tax position is per my email to you and others of last week" [the e-mail is not in the bundle] … I haven't seen the accounting and reg view yet … There is growing concern that CBM is indifferent with the total return swap and structuring that STG have designed. And I hear Tom is going to see/talk to Truett about that option. As the 2 seem not dissimilar in financial terms and given Risk's concerns re CBM soln I've asked Greig to find out if we can withdraw from CBM if we find in a few weeks when the full analysis has been completed that for risk, accounting or tax reasons that STG's soln is preferable."

267. E-mail from SC to SH (cc'd to AK) – subject "Re: Hermes Approval":

> "Thanks Sue – there have been discussions between Alan and Tom's team about the swap which I thought highlighted the disadvantages with it vs the CBM … The legal advice is that we can withdraw the CBM application at any point up to 31 December. Wasn't aware of any concern from Risk re the CBM".

268. E-mail from AK to SC and SH– subject "Re: Hermes Approval":

> "… I know from my limited involvement to date that the TRS had immediately run into issues because we need to do a detailed valuation on the book before implementation and that it only works for prospective losses so does not gain access to the bigger historic losses position including those in the current year (2.1 bn euros). The other disadvantage… is the need to keep BOSI for the foreseeable future as the regulated bank in Ireland. I thought we had decided that for capital and regulatory purposes we did not want this going forward. I know the MH [Head of Group Capital & Regulatory Reporting] liked the CBM idea because it solves a headache with regard to the up coming large exposures rules re Ireland. … we are unfortunately running out of time."

269. E-mail from SH to SC (cc'd to AK) – subject "Re: Hermes Approval":

> "As I said in my email last week its important to look at options side by side [MH]'s e-mail to me last week was not the same as you suggest below. The end to end analysis for the project needs pulling together urgently – do you have an end to end paper please?"

270. E-mail from AK to SC – subject "Re: Hermes Approval" :

> "Can you have a word with Sue. She needs one of her team to pull together an end to end paper. That is a Group Finance role is it not? We lay out the commercial transaction and they lay out the tax, accounting and regulatory treatment of what is proposed? Sorry to ask you but she does not listen to me!"

271. E-mail from AK to Jonathan Winstanley (Treasury) – subject "Enhanced TRS proposal"

> "I understand from [SH]'s office that you now have a fully worked up enhanced TRS proposal complete with accounting, tax and regulatory analysis. Steve has asked if you were available to take him through it on Monday at 1pm … we are up against it in terms of time because we are aiming to announce Hermes next Thursday!"

The reply agrees to set up a meeting on Monday.

13 August 2010

272. E-mail from SC to MA (Deloitte) – subject "Re: Hermes Approval" forwarding the email chain of his discussion with AK about an end-to-end paper analysing the project:

> " … could you guys give Alan some support to put together this definitive note on tax, capital, accounting and pensions in the next day if poss."

273. E-mail from MA (Deloitte) to SC (cc'd to AK) – subject "Re: Hermes Approval"

> "I had a call with Alan this morning. It appears to me that the Hermes GEC and Board papers, and background analysis have sought to address a number of strategic and commercial issues. I believe that the Hermes/CBM solution was driven by two key strategic/commercial factors: - the discontinuance of all new lending in Ireland, in a way that is public and sends a strong message to LBG investors…a solution to a potential need to replace the LBG guarantee, with direct capital injection into BOSI … In addition the Hermes paper/analysis prepared by W&I/LBG considered a number of further matters, including regulatory position, the customer proposition, the colleague proposition, the tier 1/regulatory capital position, the potential tax consequences, the accounting treatment, and the cost benefit analysis of implementing the solution. … in order to be provide a reasonable side by side comparison, it would be necessary to see a paper which at some level demonstrates how the TRS proposition clearly addresses [the above points] … As noted by [AK], neither he nor we, are close to the TRS proposition … As a preliminary comment, (and not having seen any paper on the TRS proposition!), it is not yet clear to me how the TRS solution meets the strategic/commercial objective of demonstrating to all that LBG has exited Ireland."

274. E-mail from MA (Deloitte) to AK – subject "Re: Hermes Approval"

> "We have tried to pull together a document which compares the CBM solution to the TRS solution in a matrix, which reflects the LBG key drivers as we understand them. We clearly have been provided with very little information on the TRS solution, and its structure and impact on many of these key drivers. Consequently, the attached requires considerable input from those that have analysed the TRS solution (i.e. STG)."
>
> [No document is shown as attached to the e-mail and the document was not in the bundle.]

275. E-mail timed at 18.59 from SH to SC "Hermes and other solutions". No other information is shown as the e-mail continues over the page and a complete version is not in the bundle.

276. E-mail from SC to SH – subject "Hermes and other solutions" replying to truncated 18.59 e-mail.

> " … clearly we are moving at a much faster pace on this than is ideal… It is probably worth reiterating for everyone exactly what the Board approved as it was deliberately separated into two parts … 1. To withdraw from the Irish market (ceasing all business) … 2. To execute a [CBM] so that we no longer had a banking entity in Ireland and could potentially access value from a tax point of view but also avoid future capital injections and importantly unwind the sectoral guarantee provided by BOS ...... [sic] and also reinforce the external message that we were out of Ireland. … The key outstanding questions related to (2) – in particular were there any financial showstoppers or indeed better alternatives. And critically was there anything which could make us rethink (1). I think from where we are it's clear we can proceed with (1) even if (2) gets executed in a different form. It's also clear we can stop the CBM at any time albeit with egg on our faces … we have that clear legal advice. So I'm firmly in the camp of the first option at the end of your email as that's what we asked the Board to approve and I don't believe we've found anything at all which questions (1). My understanding gleaned from holiday is that: - Tom M's team have an interesting alternative to the CBM which we should definitely discuss though it's not at all clear to me it meets the wider strategic imperatives that the CBM does around capital and regulatory concerns. … Tax, Capital, Accounting no show stopping issues… Risk - I agree with SRS's concerns about Op Risk as we are looking to implement the operational solution (1 above) at breakneck speed ..... [sic] for me we simply delay the implementation if we are not ready we cannot put a tax opportunity ahead of running a material op risk given the size of this book."

16 August 2010

277. E-mail from SC to SH, AK & MW – subject "RE: Hermes – Update and Request for Board Sub-Committee Meeting to Approve"

> "Here is a draft of the email I would propose sending to [TTO] and [TT] tonight to enable us to proceed to the next stage. I will update the section on the [TM] ideas when [AK] and I have met them … I'm sceptical that the new ideas solve the wider strategic issues (including capital and regulatory) as well as the CBM but let's see … regardless we need to file the CBM papers very quickly to stand any chance of that working so I don't think we can let that opportunity slip between our fingers."

278. E-mail from SH to SC, AK & MW – subject "RE: Hermes – Update and Request for Board Sub-Committee Meeting to Approve"

> "… My immediate reaction … why do we have to commit to a servco that could source external business … Risk have tabled serious concerns with the current proposal … tax while there is lots of analysis to do there are no showstoppers that suggest an adverse situations however its equally not clear this is the optimal solution. Further we should assume that whatever route we choose that HMRC will be very interested in the details. The decision should be made assuming no tax benefit … Capital … This if [sic] the first time that further capital injections have been raised with me .. Do they unwind if the CBM is successful".

279. SC responds to SH's questions by typing answers (in capitals) into SH's email. His answers include:

> "In answer to why they need to commit to a ServCo that could source external business – This was the clear preference at GEC and Board (including Carol) in terms of best value overall. As I understand Stephen's

concerns they do not relate to the principle but to executing effectively particularly given the timing. Our agreed fallback position was a group owned ServCo if we couldn't get there in time."

In answer to the point that the decision should be made without regard to the tax benefit – "Agree – and actually that was the reason for splitting it into (1) and (2)".

In answer to the point about capital - "Yes they do … The other issue is the sectoral guarantee is not liked by FSA or [FR] and we will have to unwind at some stage – this would require another 1.6bn. The CBM removes the need for this but I don't beleive [sic] the other options do"

280. E-mail from MA (Deloitte) to AK – subject "Re: Hermes Approval" following up on the matrix he sent re CBM and TRS

281. E-mail from AK to MA (Deloitte) – subject "Re: Hermes Approval"

"I think where we have got to is that there is a recognition that the enhanced TRS does not deliver a holistic solution and neither does the CBM. So we are going to lodge the CBM papers on Thursday and work up the enhanced TRS solution over the next few months and if it is significantly better then we might pull the CBM before implementation. This means better from a tax and regulatory perspective."

282. E-mail from SC to TT and TTO (cc SH & MW) – subject "Hermes – Update and Request for Board Sub-Committee Meeting to Approve":

"The purpose of this email is to give a brief update on Hermes, and in particular the financial items where more work was needed at the time of the Board meeting (Tax, capital, Pensions, Accounting) to ensure there were no material downsides to proceeding. If you are happy with the status we would then propose the Board committee convenes on Wednesday to approve and we announce and file the papers for the [CBM] on Thursday.

If you recall the proposal to the Board was split into two elements: 1. To exit through splitting into an OpCo and ServCo … 2. To optimise tax and capital, and strengthen the market message on exit, by executing a CBM prior to the end of this year… The further work completed since the Board meeting has consisted of advancing the commercial discussions around (1) and testing for any potential show-stoppers or alternatives around (2), particularly if they compromised the structure in (1). We have consulted with colleagues across Group and reflected their feedback - and Sue is happy with the position from a Group Finance point of view.

Commercial discussions – Continuing at a pace…we still have work to do to make sure any agreement is absolutely watertight… Summary position – no showstoppers and we can announce the intention to exit and establish the new model.

Tax – We have a comprehensive paper from the Group Tax team … As previously discussed we can withdraw the CBM at any time up to 31 December and we have included a specific clause in the papers relating to unfavourable tax outcomes ... Summary position - lots of work to do but no showstoppers identified… and a "get out" option by withdrawing the CBM in adverse circumstances. However, the CBM may not be the optimum tax solution – see "Other Option" – below".

Other Options – Tom Murphy's team have come up with an alternative to the CBM involving a Total Return Swap and a series of structured transactions which transfer income from the UK to Ireland. Though not

> viewed as more or less likely to be successful from a tax point of view it could gain access to 2009 losses (which the CBM would not). However, we would require an ongoing banking presence in Ireland, which is less attractive from a strategic and messaging point of view and potentially compromises the OpCo/ServCo model … The view of myself and Tom is that we should proceed with the CBM. … as otherwise we will miss the opportunity to achieve end 2010 implementation …
>
> There is a chance that one of Tom's options is more attractive than the CBM, or our conversations with the tax authorities are unfavourable, in which case we can withdraw from the CBM. We recognise the embarrassment factor here and this was flagged at GEC and Board … I therefore recommend we convene the Board sub-committee on Wednesday to approve an announcement of both (1) and (2) …"

283. E-mail from MW to SC – subject "RE: Hermes – Update and Request for Board Sub-Committee Meeting to Approve":

> "As you probably gathered on the call with Steve I have real concerns around the risks of puling the CBM down the line to accommodate the TRS … To pull the CBM at a later date and go down the TRS route would be a complete reversal of our position both internationally and externally and brings added and significant operational risk, reputational and commercial risks. I think we need to discuss this further with Truett… I am around if you want a chat."

284. E-mail from SC to MW – subject "RE: Hermes – Update and Request for Board Sub-Committee Meeting to Approve"

> "I agree … I think the TRS is, overall, suboptimal and we have no choice but to crack on with the CBM. I think it's worth catching Truett if we can."

285. E-mail from TT to SC and TTO (cc SH & MW) – subject "Hermes – Update and Request for Board Sub-Committee Meeting to Approve"

> "Will take a closer look … but … on the surface I would support the planned meeting on Wednesday; not certain if we can arrange to have Tim piped in, but let's try to arrange around what he can do!
>
> Also, thanks for running it past Tom and his deal! Always with good alternatives… tho [sic] the first thing that I mentioned to him is that the commercial considerations have to come first!
>
> Let's keep running everything down but… could be good that we have the optimal."

286. E-mail from AK to SC and Deloitte and others – subject "Hermes – Update and Request for Board Sub-Committee Meeting to Approve"

> "I had a conversation with greig tonight. I asked him why he was not so worried about the relative aggressiveness of the stg process. Answer was that most of the structuring was in Ireland and they are not as worried about upsetting the Irish revenue. We agreed that we should put a time limit on tom and his team in terms of coming back to us with concrete proposals … by end of September … We should also ask Susie for capacity projection at the same date so we can make a final decision."

17 August 2010

287. E-mail from SC to AK and Deloitte and others – subject "Hermes – Update and Request for Board Sub-Committee Meeting to Approve":

> "I think that's fine … but if showstoppers emerge in the meantime we should not wait. The bit I can't get my head around is the UK revenue being less concerned about shipping 500m a year out of the UK tax net."

288. E-mail from AK to SC and Deloitte and others – subject "Hermes – Update and Request for Board Sub-Committee Meeting to Approve"

> "I do not get that as well … I do not understand why we are comparing the CBM saving tax at the UK rate of 28% now [with] a 12.5% rate [in Ireland] over say 10 years. If I discount that cash flow back the CBM must be the better approach. We did think originally about more income into Ireland to utilise the losses… but we dismissed it… The deciding factor was that it did not fit in with our commercial aims for Ireland. The commercial rationale for doing this has been lost in this discussion which I find really worrying!"

289. E-mail from SC to TTO and TT (cc'd to others) – subject "Hermes – Update and Request for Board Sub-Committee Meeting to Approve"

> "We have reviewed the papers to make them as non-committal as possible.. So they won't prevent other options, but it would be a very public change of direction."

290. E-mail from TTO to SC and TT (cc SH, MW, Tom Murphy & others) – subject "Hermes – Update and Request for Board Sub-Committee Meeting to Approve"

> "I have had a brief review with Sue this morning. On the basis of that, I delegate my position on the LBG Board Committee to [SH]. … I believe there is more work to be done to confirm that we have the optimal route but that work is sufficiently advanced for Hermes to proceed to the stage of filing court papers … [they] should not be filed in a way that narrows other options that we may wish to pursue. Sue will represent my views at the Committee and has my full delagted [sic] authority on Hermes until Monday 23 August."

291. E-mail from AK to GS and JB (cc'd to SC) – subject "Tax capacity"

> "As discussed we would like Group tax to give us their best view of tax capacity in 2010 by end September so we can make an informed decision between the enhanced TRS and CBM at that point in time."

18 August 2010

292. E-mail from AK to JB (cc'd to GS & SC) – subject "STG ideas"

> "The more I look at these the more I really do not understand them. In the first of the two ideas. Are we not getting relief for our losses at the Irish tax rate? ... In the second one… why is the benefit not at 12.5%. Even if you say 500m … a year it takes 10 years to recover the losses from 2009 and 2010. If I discount this back it will be a worse outcome than the CBM? ... We look at this and dismissed it as being unacceptable from a capital perspective and most importantly it was not in line of what we wanted to do commercially? I must be missing something."

293. BOS Sub-Committee Board Meeting attended by TT, SH, SC, Hugh Pugsley (General Counsel at HBOS) and others (company secretaries)

> "Cross Border Merger" – the committee discussed the proposed merger of the company with BOSI by way of a CRM and reviewed draft merger terms – "The Committee Members discussed the strategic, commercial and economic grounds for the Merger. The Chairman emphasised that the transfer of BOSI's business … would allow the Company to take advantage

> of its operational and management capability in the UK in relation to the Irish portfolio …
>
> It was resolved to ratify and approve the proposed actions."

19 August 2010

294. Press Release - "LBG Banking Group announces results of a Strategic Review of its Irish Business":

> "[LBG] has announced the results of a strategic review of [BOSI]. The review concluded that there was little opportunity for scalable growth in the future and it is therefore now intended that the business currently carried on by BoSI will transfer, pursuant to [a CBM] to [BOS]
>
> The transfer of the BoSI business , including all of the strategic management and decision making activities relating to BoSI, will allow Bank of Scotland plc to utilise its extensive operational and management capability (including general and credit management, oversight and control) within the UK in relation to the Irish portfolio. This will aid the efficient rundown of the existing lending portfolio.
>
> … it is proposed that [BOS] would enter into an agreement with an independent service company which would perform various administrative functions relating to the BOSI banking business."

23 August 2010

295. E-mail from Joanne Smith to TT, CS, JH and PWC – Subject "FW: Final Group Audit on BOSI CRM". The audit report rated BOSI as "Red – unsatisfactory - requires urgent attention". A separate email from Gary Henshaw (W&I Audit Director) to TT states in respect of the report: "they are making progress and subject to implementing agreed plans, should move to Amber with the right leadership and direction in a reasonably short timeframe. Clearly recent changes may impact progress."

26 August 2010

296. Post Announcement Day FSA Meeting. LBG provided the FSA with an update on IB Businesses, including Project Hermes.

31 August 2010

297. E-mail from TTO to TT & SC – subject "Capita – Ireland – Hermes interest" advising that following a conversation at Lords cricket ground, Capita are "clearly interested in Hermes" as they were looking to grow their loans servicing agreement with NAMA. TTO suggest that they contact TT initially.

September 2010

298. BOSI – Project Hermes Paper – by Group Corporate Treasury/STG - September 2010. The paper set out the alternative option of a TRS in detail described as an "alternative structure … which could be used to implement the Group's strategic objectives for BOSI". It stated that the alternative structure "was developed by GCT and STG in conjunction with Group Tax Group Finance and W&I" and sets out the cost rationale for this structure and the summary financial analysis including "Irish Losses Utilised under Alternative Proposal". Under "Comparative Analysis: Advantages" tax is listed as one of the key advantages to this transaction and compares the TRS and CBM: "TRS - Potential to fully utilise BOSI 2009 and 2010 losses (GBP4.5bn); timing of capital recognition subject to capacity constraints. CBM - claim group relief for BOSI 2010 losses (GBP2bn)…BOSI prior year losses of GBP2.5bn will be lost…"

3 September 2010

299. Hermes Outsourcing ServCo Commercial Briefing Paper. The Executive Summary confirmed that a "Management led ServCo is recommended as the best option, and the deal "agreed" on 26/27 August is recommended for approval".

8 September 2010

300. BOSI – Capital Requirement Paper. Sponsors are TT & TTO . The paper states that a further capital injection is required pending completion of the merger with BOS which is consistent with "the Q2 capital plan and the Hermes paper recently presented to GEC."

10 September 2010

301. E-mail from He Shen [Group Corporate Treasury/Structured Transactions] to AK, SC, TM, GC and others subject "BOSI Alternative Proposal.ppt":

> "Following our call with you in mid-August, we have been further developing our alternative proposal for Project Hermes together with our internal and external advisors. Please find attached a presentation that summarises the initial feedback from our advisers."

16 September 2010

302. E-mail from AK to He Shen & SC (cc'd to others) – subject "RE: BOSI Alternative Proposal"

> "could you send me your supporting opinions … [and] the supporting spreadsheets which lay out how you get to the numbers in the presentation …"

303. E-mail from He Shen to AK (cc'd to others) – subject "RE: BOSI Alternative Proposal"

> "… we look forward to working with you to provide the appropriate comparative analysis for Tim and Truett over the next few days …
>
> As requested please find attached –
>
> Note from Arthur Cox on availability of trading losses for Irish tax purposes;
>
> Note from Arthur Cox on the tax analysis of the alternative proposal;
>
> Note from Linklaters on the UK tax analysis of the alternative proposal
>
> …
>
> We will circulate the revised UK and Irish regulatory analysis from KMPG when we receive it later today."

17 September 2010

304. SIF removed as intermediate parent between BOS and BOSI.

20 September 2010

305. E-mail from AK to SH, SC, GS and others – subject "Alternative proposal" attaching documents in advance of the meeting the next day.

306. CBM/TRS Options paper comparing the two options. Under the heading "Strategic Drivers" it was noted in respect of the CBM: "BOSI ceases to exist. Banking licence ceases to exist in Ireland. Regulation by FR cease. All assets and liabilities clearly transferred to the UK. Sends a clear message to the market that BoS has exited the Irish market." TRS – "BoSI would retain a banking presence and its banking licence in Ireland, assets and liabilities remain on BoSI balance sheet although credit risk transferred to BoS PLC. Less clear

message to the market that BoS has exited the Irish market". Under the heading "Mitigate any requirement to convert guarantee into capital objection into BoSI" in respect of the CBM it notes that no capital injection would be required, the TRS section states "[To be set out]". The "Core Requirement" for both the CBM and TRS is stated to be "minimise or eliminate asset value leakage as a result of the transaction". The TRS is said to be "Potentially less operational restructuring required, with less associated risk".

The "Tax consequences" considered –

> For the CBM: "LBG Tax have suggested that there could be a €700m benefit from group tax loss relief in 2010 if the CMB[sic] is successfully implemented by 31.12.2010 and have assigned a 40% to 75% probably of this relief being obtained … In subsequent years, LBG tax have suggested €280 €80m, €60m, and €60m tax benefits."
>
> For the TRS: "[Bos would retain a permanent establishment for tax purposes in Ireland. [Tax consequences/benefits of TRS solution to be set out further] [The TRS proposal will result in the utilisation of Irish losses…deferred tax asset…]" [the text and square brackets are as set out in the document]

Other considerations:

"If the CBM solution is not instigated within the next week, it is almost certain that the CBM cannot be completed in 2010, and the strategic benefits and tax benefits not realised for 2010 (potential 2010 tax losses of BOSI becoming trapped). If the CBM is instigated within this week, it is possible withdraw the application and process over the coming months, if the TRS (or another solution) were to prove more consistent with LBG strategy or be more beneficial from a tax or regulatory capital perspective."

21 September 2010

307. E-mail from CS to SC subject "FW Alternative Proposal"

> "I am aware that a plan B for Ireland is under discussion. I am emailing to bring to your attention an additional regulatory factor. The FSA was greatly relieved (an understatement) to hear that the BOS guarantee which they regulate would fall away. They would give us a much, much tougher time on Ireland were that not to be the case."

22 September 2010

308. E-mail from SH to TTO – Subject "Re: Hermes"

> "I think Tom's scheme [the TRS option] has a lot of offer and economically it seems the best. It doesn't tick the we are leaving Ireland box however in practical terms I think the effect is the same. We didn't agree a common preference yesterday … More substantively it was suggested that Risk don't think we can control/minimise losses without the opco/servco. We have asked that this be tested with them in the context of the TSR…
>
> Reputational – much concern about a volt face… This is so complex that SHs should be persuadable re best economic outcome and press may not fully get the detail. Steve's concern is that the I mangt team [Irish management team] will leak and brief against us (Why they would want to do that – because financially this is not as good a financial outcome for them seemed to be the answer).
>
> Reg risk - it does require FSA and FR clearance and they may not be forth coming. Again mixed views on the· level of risk here. We may need to get a view from Carol.
>
> …

So in summary – pending further views re above – TSR [sic] is the best economic outcome on balance assuming this is not completely outweighed by higher losses than otherwise would be incurred… It we could square these off I would do the TSR and am prepared to work to get it ie the prize is worth it."

27 September 2010

309. E-mail from GA to TT, TTO and CS cc'd to SC, MW AC, SH and TM with no subject. Embedded in the e-mail is the Word document titled "Hermes pros and cons.doc"

"Carol asked me to prepare a note of pros and cons for tomorrows meeting. You will note the tax advantages of the swap are now a multiple of those under plan A (£1.3bn vs £320m) whereas in earlier discussions the numbers were the other way round and £400m vs £1bn. The latest numbers are from Tom Murphy's team and I am advised they have been confirmed by Group Tax.

I believe the four issues we need to discuss are:

1. The differential tax benefits

2. The project implementation risks, noting that the current project has red status. Plan B is more complex but does not have such tight deadlines

3. The impact on our ability to staff the various entities

4. The attitude of the regulator, noting that letters to all customers describing plan A have already gone out"

310. Hermes Plan B- Pros and Cons Document:

"Pros and mitigants

Additional tax savings worth £1.3bn (per Tom Murphy – previously £1bn)

No longer a deadline for implementation of new structure of 31 December 2010

Risks

Additional complexity and regulatory risk endangers plan A savings worth £320m.

…

TRS is a greater financial prize but a greater reputational, tax, credit and regulatory risk. We won't know until its too late to go back to Plan A whether the regulators will approve

TRS suffers adverse risk of legislative change as benefit comes over a number of years. CBM presents legislative opportunity as there is a chance 2009 losses become available

Risk that the regulator will not accept the TRS as an adequate and better alternative to the sector guarantee Also the Irish FR has directed resources to Plan A and put BAU issues to one side to focus on the CBM. We are also in the midst of the court process for the CBM. All of that brings potential reputational risk under Plan B.

TRS gives greater risk of reputational risk as more aggressive from tax point of view with no business story to back up

Uncertainty over published strategy. We have said we are coming out of Ireland now if we implement Plan B we are not. There is no clear message to put forward in terms of shareholders/regulators/customers or colleagues. What is the reason for the about turn and how might that impact us at all these levels going forward? Creates uncertainty around the tax structure for example."

28 September 2010

311. Meeting of the Project Hermes Steering committee. A vote was held on the two options, Plan A versus Plan B. The votes were as recorded in an e-mail from TTO to CS, GA, TT, SC and Simon Hill (cc'd MW and others) – subject "RE: Hermes plan B":

"Tom B perhaps unsurprisingly

Sue B driven by financial and scale of upside if it can be achieved

Steve A (I think) marginally

Graham B marginally

Truett A reputational issues with regulators and shareholders and strategic goal of exit achieved

Me A reputational issues with regulators and shareholders and strategic goal of exit achieved

… I have a 1-1 with Eric this afternoon at 2.45 and you could see if part of that time could be hijacked to get us together F2F or by phone.

…

So no decision"

312. E-mail from TT to Tom Murphy cc'd to TTO and Andrew Géczy Subject "Hermes"

"I wanted to drop you a quick note, even if only from my bberry.

You have been terrific in the work that you have done on Hermes and I wanted to let you know the outcome of today's meetings.

As you might have projected based on Tim's round-the-horn "count", the die was finally cast in favor of Plan A and the team is proceeding with speed.

Importantly, we invited Eric to hear the summary thoughts (Sue was a very articulate spokes-person in favor of B) and the final decision was unanimous between/amongst all the GEC members present.

While I won't do the debate justice pounding it all out with thumbs, let me summarize the critical drivers behind the vote and then open myself (or you can go to Tim; or each of us!) for a richer, personal debrief:

A) We assumed that Plan A generates no tax benefits whatsoever. All operating complexities associated with "preserving/proving status" fall away. All financial comparisons are against a "zero" from Plan A.

B) We are concerned that we will lose or diminish the "we-have-gotten-out-of-Ireland" confidence that we have worked so hard to achieve ... and that we feel at least partially supports the price.

C) We are concerned about the "front page story" factor: 40% tax-payer owned Bank parks loans in Ireland to reduce taxes paid to UK.

D) The very scale of the savings works against us. The assets required to be moved would be large ... broken out in sector announcements/analysis .....

> and would have to be justified against a backdrop of "we are exiting Ireland"!?!?
>
> E) We worry about reputation risk with the regulators.
>
> F) We are worried about further delays and the impact on staff, the threatened industrial action, etc."

October 2010

313. Certus created. Directors listed on Form B1 include three former BOSI employees MA, TF and JH. The shareholders were listed as Certus and Aspira both with the same Isle of Man registered address.

314. Unsigned and undated Project Hermes – Services Agreement between LGB and current BOSI management who will run ServiceCo.

4 October 2010

315. Document headed "FINAL – Certus Contract Compliance dos and don'ts" setting out the key rules which must be followed by all Certus staff.

8 October 2010

316. E-mail from SC to TT subject "Hermes – Signing of HoT/Announcement" attaching Heads of Term that had been reviewed and are now ready to be signed subject to TT's "ok".

12 October 2010

317. E-mail from SC to AC, GA, BT and DW subject "Hermes HoT"

> " … Truett has given the all clear to sign Heads of Terms and I will be putting pen to paper this afternoon. There will be a short internal announcement in Ireland tomorrow and a local press statement which Group Comms have approved."

15 October 2010

318. E-mail from Stephen Carter (Group Credit Risk) to MW, JH and MA cc'd to TT, SRS, DC, SC, GA subject "Confidential GCRA Impairment review – BOSI wholesale" stating:

> "You will be aware that the GCRA view is that the 2010 Impairment charge (for the wholesale BOSI book) should be in the range of €3.4 bn. to €4.0 bn."

18 October 2010

319. Document titled Hermes - FSA Briefing 18 October 2010 providing an explanation of the scheme, the planned stages and regulatory requirements. The meeting objectives were stated to be: Provide FSA with Update on Project Hermes; Explain strategy and progress on Customer Propositions; Explain impact on BOSI Colleagues; Understand Future requirements of FSA (including meeting frequency and content. The respective roles of BoS and ServCo were confirmed:

> "All decision-making in respect of the transferred business conducted by BoS, with ServCo's role being the provision of administration support to BoS. ServCo will not be able to take decisions on behalf of BoS, commit BoS or execute documents on behalf of BoS."

It was agreed that, going forwards, there would be "daily phone calls and weekly formal meetings with FR on a range of specific questions/issues, primarily customer proposition matters" and "Awaiting FR Feedback/Confirmation of PE matter"

320. E-mail from GA to SC cc'd to TT, AH, MW subject "Hermes"

> "I hardly dare say this, but I think we had a very good meeting with the FSA. Their questioning was relaxed and focussed around technical areas such as passporting and subsidiary companies. They don't want to see us again till early Dec, which has to be good news."

25 October 2010

321. E-mail from Anne Lanc (Head of Balance Sheet Management W&I) to many people including AK and PB cc'd to SC subject "Re Hermes – Treasury Workstream (Treasury Steering Committee)- URGENT ADDITIONAL PAPER FOR TOMORROW …"

> "Unfortunately we have not succeeded in securing plans from all product owners for the migration of Treasury products from the BOSI balance sheet.
>
> As you are aware the migration of Treasury products from BOS Ireland to BOS by 31st December 2010 is a key deliverable to ensure that no permanent establishment remains in Ireland for BOS post year end. Without this Hermes will fail.
>
> …
>
> Could you please bring plans for these to the Steering Committee tomorrow morning as a matter of extreme urgency as I wish to resolve this as a matter of extreme urgency?"

5 November 2010

322. E-mail from Richard Monaghan (Group Procurement) to TT Subject "Project Hermes: Briefing Papers on advance of contract signing" confirming that in advance of the meeting at 11.30am on Tuesday to sign the outsourcing contract briefing papers were enclosed to provide background to the contracts.

8 November 2010

323. Emails between Anne Lanc (Head of Balance Sheet Management W&I) and JB (Group Tax) – subject "RE BOSIF" seeking confirmation that none of the other products in the treasury product workstreams caused him any concerns from a PE perspective.

By early December 2010

324. Document headed "Project Hermes – Accounting Treatment of Cross Border Merger". Background confirmed that post merger BOS will manage the BOSI assets and liabilities with the support of Certus, Certus will be owned and manged by a number of the existing BOSI management team. All credit sanctioning activity and decisions on workout strategies will transfer to BOS and to the extent that LBG has any appetite to write new business in the Ireland it will be written in BOS by the new executive team.

3 December 2010

325. Note of telephone conference between LBG (SW, GS, MS & JB, all from Group Tax) and HMRC

> "[GS] explained that at the half year stage some £2bn of losses had been identified in relation to [BOSI]. External analysts and commentators had been looking for LBG to "do something" about the group's Irish exposure. At that stage LBG had recognised the need to consider termination of the operations in Ireland and manage the wind-down of the assets ... from the UK. Since then matters had deteriorated significantly and at the end of Quarter 3 it had been recognised that BOSI had incurred further losses …

LBG had therefore decided to merge the business of BOSI with LBG's business in the UK.

The purpose of the meeting was to provide additional background to this in real time but [GS] emphasised that LBG were not seeking any tax clearances in relation to the reorganisation. He considered that statutory claims would follow in relation to group relief and he believed these to be justified. Consequently they were not seeking clarification on the operation of the law but would be very happy to engage with HMRC in relation to all matters arising on a pre-filing basis.

…

HMRC asked if LBG could have set up a non regulated subsidiary in Ireland to carry out the same function as Certus. [GS] acknowledged that this was possible but it was not the decision which had been taken.

…

[HMRC] asked who the decision-makers had been and [GS] explained that there would have been decisions at various levels involving the Boards of LBG, HBOS, BOSI and Wealth & International. [GS] confirmed that there would be various supporting papers that had been prepared to help inform Boards' decisions and he confirmed that these would be forwarded to HMRC."

9 December 2010

326. LBG Audit Committee Accounting Matters Paper.

"Executive Summary

The cross border merger between [BOSI] and [BOS], which will complete on 31 December 2010, is expected to enable the Group to claim a current tax credit of approximately £1 billion from the utilisation of BOSI 2010 trading losses against taxable profits in the UK. While this claim is supported by EU case law, it remains uncertain as to whether HMRC will accept its validity. We will await the outcome of ongoing discussions with HMRC before reaching a conclusion as to the recognition of any current year tax credit."

10 December 2010

327. Court of Session Court Order approving the CBM.

15 December 2010

328. Group Relief Surrender consented to by BOSI under Chapter 3 Part 5 of the CTA.

17 December 2010

329. LBG announces update on Irish Portfolio.

"Since the release of its Interim Management Statement on 2 November 2010, the Group has seen a further significant deterioration in market conditions in the Republic of Ireland, with concerns over the country's fiscal position leading ultimately to the approval of its application for EU-IMF financial support on 21 November. Market sentiment has continued to be negatively affected by uncertainty about the political situation and about the economic impact of the austerity measures introduced in the Irish Budget of 7 December.

…

> Therefore, the Board anticipates that, compared to 30 June 2010, approximately a further 10 per cent of the £26.7 billion Irish portfolio will become impaired by the 2010 year end. Furthermore, the Board believes that it is prudent to increase the level of provisions against the portfolio, and currently anticipates an increase in the impairment charge relating to Irish exposures for the full year 2010 to approximately £4.3 billion on a combined businesses basis. This would result in an increase in provisions as a percentage of impaired Irish loans to approximately 54 per cent at the 201 0 year end."

330. 19 December 2010

331. E-mail from SH to SW cc'd to TTO and DJ subject: "Relief for Irish losses as a consequence of the CBM"

> "There was push back at the audit committee re the above, as PWC said that while they supported the technical analysis they were concerned that we would not be able to ensure no PE in Ireland over time and hence there was significant operational risk in respect of recognising the Irish losses for tax purposes. That led some to say that maybe we shouldn't include them … I feel that if we are not prepared to show confidence that we undermine our position with HMRC.
>
> Firstly we in any case need to have concluded the CBM to support recognition. Please can you confirm that this is on course and given the retirement of the seaview securities the value of the losses that will be sheltered and not sheltered and hence the value of the tax relief that will flow through capital.
>
> In respect of the PE 'risk' can you confirm what we will need to demonstrate to HMRC and how that will happen. … I'm seeking to ensure that all interested parties know what has to happen so that there cannot be any mishaps through lack of understanding regarding how the Irish operations must be handled to be consistent with the CBM tax analysis. …
>
> I'd appreciate your thoughts so that we can be confident pre-Xmas in respect to the treatment of the losses as we start the January YE close and reporting processes.
>
> For the 26th January AC I would like a precis of the advice received from counsel, discussions with PWC etc, an update in respect to the valuation process, the advice we have provided to Wholesale/W&I as above and a tax risk assessment in respect to the PE point and the financials as above and in respect to capital."

21 December 2010

332. E-mail from SW to SH cc'd to TTO, DJ, JB, GS, MS and others subject "Re: relief for Irish losses as a consequence of the CBM":

> "The CBM is on course. The court process has been completed and the legal process will now complete on 31/12/2010 …
>
> … the Irish Group relief claim could amount to £3.2bn … comprises £3bn UK tax capacity [and other amounts] … Accordingly it is prudent to assume that available UK tax capacity will be £3.2 bn" … Recognising the benefit of £3.2 bn losses would result in a capital benefit of £3bn x 28% = £0.9bn.
>
> …
>
> Both Jon Breaks and Moira Sced from Group Tax have worked over the course of the past weeks with the project team and we have reviewed and

ensured that our requirements are incorporated into the following agreements and operational manuals

…

We have held a number of discussions with Derek Woodhead (Director Ireland BSU) and his direct reports as they have been appointed, to educate and explain the principles involved. A tax workshop was held on 9 December for all senior members of IBSU to allow the training of all IBSU staff and to ensure the structure is understood.

…

We have in addition reviewed in detail the IBSU and Certus training materials and staff handbooks, proposing amendments where wording or principles were ambiguous. … It is envisaged that Craig's risk team will perform a monthly control review on activity in Ireland and Group Tax will review the output of these reviews, to ensure we comply with having no activity in Ireland that can be regarded as a permanent establishment. … We have also developed a "Rules of the Road" document for IBSU staff to show in detailed areas what must occur in the UK, and similarly, what cannot happen in Ireland."

333. E-mail from TTO to SW and SH cc'd to DJ, GS, JB, MS and others subject "Re: Relief for Irish losses as a consequence of the CBM":

> "So Susie what is the group tax view of the confidence level that the various affected persons know what each entity can and cannot do – and thus should we recognise the tax benefit at 0% or 100%?"

334. E-mail from SW to TTO and SH cc'd to GS, MS & others subject: "Relief for Irish losses as a consequence of the CBM"

> "From a technical perspective we are comfortable that everything will be in order … Recognition of 100pc of the losses is, I feel, supportable."

335. E-mail from SH to TTO and SW (cc'd to GS, MS & others) – re "Relief for Irish losses as a consequence of the CM". States this issue will need to go into a paper for the Audit Committee and will need to include "a few lines of detail with the measures in place to ensure we don't cross the PE line… and how we have sought to ensure we continue to operate in a way consistent with the tax treatment and how the op risk is being mitigated… can we add this to the monthly tax risk dashboard so we all have visibility given the value concerned".

22 December 2010

336. E-mail from TTO to SW and SH cc'd to GS, MS & others subject "Re: relief for Irish losses as a consequence of the CM"

> "for the money/capital at stake, I think we should recognise the benefit and manage activity tightly to avoid a PE. Maybe we should demand that the Servco exco has somebody like [GS] on it."

337. E-mail from Wilson Downs (W&I) to GA cc'd to MW, SC and Derek Woodhead from IBSU – subject "Hermes Programme Update 20/12/10" (high importance). Refers to "worry beads" to include "IBSU Day 1 readiness. Insufficient time onboarding training and proofing. I'm now expecting a more difficult Go live start for IBSU – action plans being worked through."

338. E-mail from Derek Woodhead to Wilson Downs and GA cc'd to SC and MW subject "Hermes Programme Update 20/12/10"

> “I think it is important we all understand just how challenging this is … with effectively only 2 working days to go this is extremely tight.. There are also some critical processes which have only just been identified… this is going to be a very bumpy landing”

339. E-mail from GA to Derek Woodhead from IBSU to Wilson Downs cc’d to SC and MW subject “Hermes Programme Update 20/12/10” in which GA states that he has “previously warned” TT, TTO and CS “that not all processes will have been tested”.

31 December 2010

340. CBM under European Directive 2005/56/EC, pursuant to which BOSI’s assets and liabilities were transferred to BOS by way of a merger of absorption and BOSI ceased to exist (without being liquidated). This was the completion of Project Hermes.

18 January 2011

341. Note of meeting between HMRC and LBG records:

> “IS read from his notes of the 18 Jan 2010 meeting “Group Tax was currently heavily involved in BOSI related matters, particularly in ensuring processes to ensure that there is no continuing presence of BOSI in Ireland”. IS requested clarification of what GS had meant. GS explained that LBG have a business model for the run off of the Irish loan book with no Irish presence. They are currently reviewing all areas to satisfy LBG, the auditors & HMRC that there is no presence in Ireland, that no-one is ignoring the guidelines and that operations in Ireland don’t affect how the Irish loan book is dealt with now that responsibility has passed to the UK.”

25 February 2011

342. LBG 2010 Results News Release which confirmed:

> “Bank of Scotland (Ireland) Limited
>
> In February 2010, we announced that we would close our retail and intermediary business in the Republic of Ireland, and in August 2010 we announced that we would transfer, subject to the necessary approvals, the [BOSI] business to [BOS]. The business was transferred to [BOS] on 31 December 2010, including all of the strategic management and decision making activities, at which point BOSI ceased to exist. As a result [LBG] no longer has any regulated banking business in the Republic of Ireland. [BOS] will utilise its extensive operational and management capability, including general and credit management, oversight and control, within the UK in relation to the Irish portfolio, aiding the efficient run-down of the existing lending portfolio.”

343. LBG 2010 Results Presentation by ED and TTO. Slides confirm that BOSI now dissolved, assets fully managed from UK and rundown driven by experienced BSU team. The transcript of the presentation stated:

> “[TTO] Subsequent to our Interim Management Statement on 2 November of last year, we all saw a further significant deterioration in market conditions in Ireland, including concerns over the country’s fiscal position which ultimately led to the approval of its application for EU and IMF financial support.
>
> As you know, our Irish operations are now closed to new business, and our focus is now on the efficient run-down of the portfolio. Having closed the regulated banking business in Ireland, we are managing the run-down using our UK based expertise.

> [ED in response to a question] What we feel is that the 54% in Ireland is entirely adequate. Our actual impaired loans did not go up by much in the fourth quarter. What we thought was, that as Tim suggested in his prepared comments, that in fact the economy was going to be weaker and we would have the loans on our books for longer."

WITNESS EVIDENCE

ED's witness evidence

344. ED's witness evidence was as follows:

(1) The events took place around 11 years ago and whilst he had attempted to recall the event to the best of his ability he could not recall the specifics of every discussion he was involved in however, he was able to recall the reasons for implementing the disputed transaction.

(2) ED joined LTSB in October 2001 as Group Executive Director of Retail Banking and became CEO of LTSB in April 2003. When LTSB became LBG (following its acquisition of HBOS in January 2009) he became CEO of LBG. He remained in post until February 2011 and ceased employment with LBG in September 2011.

(3) As CEO, ED was responsible for: developing and recommending objectives and strategy for LBG and its subsidiaries for approval by the LBG Board, successful implementation of that strategy and responsible for LBG Group structure including recommending changes. In discharging those responsibilities, regard had to be had to LBG's key stakeholders including shareholders, regulators, creditors, employees and customers. Strategy and direction was set from the top down with ED being assisted by the GEC. The GEC reviewed all significant proposals relating to the development and execution of that strategy before they were recommended by ED to the LBG Board for approval. The GEC was chaired by ED and GEC members reported to ED. The GEC members were the senior management of LBG.

(4) A formal meeting of the GEC was held once a week. These meetings were lengthy and typically focused on the key issues within the LBG Group, strategy and its execution. Each item on the agenda was sponsored by a GEC member who was responsible for the presentation of that item and for circulating any relevant background papers or other materials in advance of the meeting. ED was able to add items or remove them from the agenda. ED would not normally see the GEC papers prior to the meeting but from his regular contact with GEC members he had a good sense of the contents of the papers before their circulation. The meetings of the GC were minuted and then approved by ED and the GEC.

(5) Once a strategy or decision had been approved by the GEC, if it was a matter that required the approval of the LBG Board, ED would then put it forward to the LBG Board with his recommendation for approval. The LBG Board comprised the Chairman, ED, TTO and various NEDs.

(6) It was the responsibility of the Division Heads to manage their business in accordance with the approved strategy or decision. ED did not typically get involved on a day-to-day basis in the operational aspects of managing and executing the strategy within the operating divisions but had regular discussions with each of the Division Heads. The discussions took place formally through quarterly business reviews (QBR) and month 1-to-1s as well as discussions outside those meetings. This enabled ED to stay up-to-date and provide his input into any major projects or issues.

(7) A QBR was held with each of the four operating divisions. The meetings were led by ED and typically attended by TTO and CS as well as the relevant Division Head and other executives from their divisional management teams. AP and PF often attended as well. In those meetings the performance of the division, the progress of ongoing projects within the division and any issues facing the division would be discussed.

(8) ED's management style was to empower and support his direct reports (including Division Heads) to carry out their roles within the parameters of the LBG Group's strategy. ED was focused on ensuring that communication between the different business divisions was fluid and conversational. To achieve this, the entire LBG senior management team sat on the same floor and ED encouraged a culture of walking into each other's offices and talking to each other frequently and informally. TTO had his office close to ED's and he would usually have several conversations with TTO each day. ED had discussions with the other members of the senior management team, such as TT, several times a week, depending on what was going on within LBG at the time and which areas were facing issues or had ongoing projects that required his input.

(9) The global financial crisis had a particularly severe impact on the HBOS group. HBOS was on the verge of insolvency. Although the GEC and the LBG Board knew that BOSI was performing poorly it was not an immediate priority in 2009 because of the global financial crisis and HBOS's financial position. LBG was facing a number of very critical issues ("life and death" issues) related to regulatory capital, liquidity and the EU's State Aid challenge which arose from the support that LBG had received from the UK Government. That is why BOSI was not at that time, prioritised and provides important context for the decision to exit the Irish market.

(10) In the midst of the global financial crisis, the FSA introduced new regulatory capital requirements for UK banks to force them to strengthen their capital ratios. This meant that UK banks had to have more regulatory capital and many of them had to carry out large scale recapitalisations in order to be able to meet the new regulatory capital requirements, LTSB was required to raise an additional £5.5bn of share capital and HBOS was required to raise an additional £11.5bn of share capital shortly before the two groups merged in January 2009. As there was minimal appetite in the market for shares in banks, the required regulatory capital had to be raised from the UK Government. The UK Government's participation in further capital raises throughout 2009 resulted in the UK Government owning around 44% of LBG at a cost of about £20bn. The Government's investment was managed by UK Financial Investments ("UKFI"), a body specifically established to manage the UK Government's shareholdings in LBG, the Royal Bank of Scotland ("RBS") and others. The Government's shareholding in LBG led to the appointment of two directors approved by UKFI, Glen Moreno and David Roberts, onto the LBG Board.

(11) In January 2009, new prescribed stress tests were introduced by the FSA for banks in the UK which required LBG to increase its regulatory capital even further. This represented a major challenge for LBG because it was very difficult to raise equity capital in 2009. An extraordinary amount of time was invested by LBG throughout 2009 and 2010 to come to grips with the new regulatory capital environment and ensure LBG maintained compliance with its minimum regulatory capital requirements. Accordingly, ED and the GEC (especially TTO) and the LBG Board were extremely focused on LBG's regulatory capital position. Given the challenges of raising capital, LBG had to look to reduce LBG's risk weighted assets so as to reduce LBG's regulatory capital requirements. Assets, such as BOSI, which were not a core part of LBG's future business strategy, consumed regulatory capital unnecessarily. When

BOSI joined the LBG Group, it had a book of approximately £30bn, including portfolios of mortgage and other retail loans (approximately £9bn), corporate loans (approximately £9bn) and CRE (approximately £12 billion).

(12) The introduction in early 2009 of UK Government Asset Protection Scheme ("GAPS") provided banks with insurance against losses on financial assets that were covered by the scheme, with the bank bearing the first loss. By participating in GAPS, banks were able to eliminate some of the risk associated with the assets that were within the scheme. This reduced the risk weighting of those assets and, accordingly, the amount of regulatory capital required to support those assets. Following the FSA's prescribed stress testing introduced by the FSA and the difficulty in raising additional capital, LBG had no choice but to participate in GAPS. ED's preference was not to participate as it was expensive, his concern was that it would be seen as additional State Aid. He, along with TTO and the Division Heads dedicated a lot of time and energy throughout 2009 to ensure the LBG's participation in GAPS was avoided or kept to a minimum. In November 2009, Project Seaview, was implemented successfully to recapitalise LBG and secure its regulatory capital position thereby avoiding LBG participating in GAPS. Project Seaview was extremely complex and its planning and implementation required a lot of management time in 2009.

(13) As a consequence of the financial crisis and the HBOS acquisition, in addition to regulatory capital issues, LBG, along with other UK banks, was facing considerable liquidity challenges and had to rely upon the UK Government and the Bank of England for liquidity support. LBG's liquidity problems intensified when the UK Government and Bank of England decided to apply pressure on financial institutions to repay the liquidity funding provided by the Bank of England much earlier than the scheduled repayment dates that had been originally agreed. Much time and attention was invested, particularly by TTO, in managing the repayment of the UK Government and Bank of England funding.

(14) The EU had mounted a State Aid challenge against LBG as it had received financial assistance from the UK Government. This led to protracted negotiations with the EU which required LBG to make disposals of parts of its business as a remedy for the Government support it had received.

(15) A partial solution to the new regulatory capital requirements, the liquidity crisis and the EU's State Aid challenge was to reduce the size of LBG's balance sheet. One way to do this was to dispose of non-core assets. BOSI (and certain other parts of our business) were non-core. BOSI required regulatory capital and funding and, due to BOSI's poor financial position, that capital and funding had to be provided from the UK by LBG at a time when the UK business of LBG had its own regulatory capital and funding pressures. Minimising exposure to the Irish market made sense from the perspective of these pressures.

(16) ED was responsible for developing LBG's strategy following the acquisition of HBOS and how HBOS would be integrated into the LBG Group, how the combined balance sheet would be funded from a regulatory capital and funding perspective and how synergies could be obtained. LBG had flagged to the market that it would achieve synergy benefits of £1.5bn to £2bn savings by the end of 2011.

(17) After the HBOS acquisition, investors and analysts began asking about HBOS' assets and its financial state and how LBG intended to deal with HBOS' CRE and sub-prime mortgage portfolios and its plans for HBOS' international portfolios in Ireland, Australia and the USA. A key part of the strategy for integrating HBOS was to

determine which of HBOS' businesses should be retained and which should be exited. This was the subject of much discussion among the GEC and the LBG Board.

(18) ED's view was that LBG should reduce LBG's combined balance sheet to a certain size by disposing of assets and businesses that were not core to its future plans. Reducing the size of the balance sheet would ease the regulatory capital and liquidity pressures that LBG face and provide assurance to investors and analysts that LBG would manage down or exit non-core businesses. This strategy was approved by the LBG Board and it was announced in the 2009 interim results that LBG would reduce its £300bn of non-core assets by £200bn over the next five years. This also assisted with the EU State Aid settlement negotiations as LBG could agree to the winding-down/disposal of £200bn of assets over a specified time.

(19) BOSI was identified as non-core because Ireland was not a territory LBG wanted to be in in the long-term. BOSI, as a wholesale and retail bank, was regulated by the Irish financial regulator. BOSI fell within the remit of the W&I division, ED appointed JD as W&I Division Head. Unlike the other Division Heads, JD was not a Group Executive Director nor on the LBG Board.

(20) It was clear from the outset that BOSI's business was sub-scale and non core as: the Irish economy had been hit hard by the financial crisis, LBG's Chief Economist and other experts forecast the downturn would be deeper and longer than the UK and would take longer to recover, it was loss making, none of its portfolios were performing, it had a high concentration of CRE assets which were vulnerable to the plummeting Irish property market, it was dependent on LBG for funding as the CRE portfolio comprised long-term assets which BOSI was unable to fund, it was not in a position to raise any capital, it had followed poor lending practices which make enforcing defaulted loans problematic and its business could not be scaled in accordance with LBG's strategy as it only involved one product line- lending. Despite those concerns, because of other issues facing LBG, BOSI was not initially a priority

(21) Although BOSI's retail and intermediary portfolios were not in as bad a shape as its CRE and corporate lending portfolios, LBG could not compete in the retail and intermediary markets in Ireland which were dominated by the large Irish banks. The amount of the retail deposits that BOSI had was declining, and by mid-2009, it was decided to exit the retail and intermediary business. Implementation was paused pending State Aid negotiations with the EU.

(22) Consideration was given to a disposal of certain BOSI retail assets in Autumn 2009, Project Chicago. This was an Irish Government proposal to create a third bank to compete with the two big Irish banks by combining certain BOSI assets with a number of Irish building societies to create a new entity. ED approved JD's request for JH to meet with the Irish Finance Minister to discuss BOSI participation. BOSI did not participate as one of the building societies would not agree to a transaction involving BOSI. After the failure of Project Chicago, it was accepted that BOSI's retail and intermediary business would have to be closed. The closure (Project Memphis) was announced in February 2010.

(23) LBG adopted the strategy of managing down the portfolios and protecting shareholder value - the "manage for value" strategy.

(24) By early 2010, an analysis of all BOSI loans had been completed. Although LBG had disposed of some non-core assets during 2009, ED decided that LBG needed to accelerate the pace at which it disposed of non-core assets to manage regulatory capital and funding requirements. In the weeks before the April 2010 LBG Board Away Days,

ED asked the GEC to focus on accelerating the core/non-core strategy and consider the full range of exit options for the international businesses which did not create enough value.

(25) A number of factors had elevated BOSI in ED's priority list: other markets began to stabilise and the Irish market deteriorated (at the time of the Away Days, LBG's Chief Economist had advised that the outlook for the Irish economy for the foreseeable future was pessimistic); BOSI's impairments had continued to grow (€3bn for 2009, forecast to increase by several hundred millions in 2010); increased pressure from investors, analysts and rating agencies (the level of investor and analyst focus on LBG's problems in Ireland was distracting from the 2009 achievement); repeated capital injections (over €4bn by April 2010) and funding (BOSI's deposit base had fallen such that it was unable to fund itself).

(26) ED appointed TT in February 2010 as interim Division Head of W&I in place of JD. The change was made as ED concluded that W&I did not have the necessary experience to tackle the issues it was facing. TT had extensive experience in banking and considerable experience of dealing with non-performing financial assets. ED knew TT well and trusted him. Once TT took over as head of W&I, he brought clear direction and a sense of urgency to the Irish business and LBG's strategy in Ireland accelerated. TT's feedback on BOSI after his visit to Ireland in April 2010 was that LBG should wholly withdraw from Ireland. Although BOSI was non-core before TT's visit, the outcome of TT's visit crystallised his view to exit Ireland as soon as possible. TTO was of the same view but the decision was ED's.

(27) By "exit", ED wanted to make a clear statement to the market that Ireland was non-core and not part of BOSI's future plans such that there would be no growth or expansion of LBG business in Ireland, any future capital and funding to Ireland would be the minimum legally required, the ongoing commitment to Ireland was limited to maximising the value of BOSI's existing portfolio and LBG had eliminated any regulatory complexity in Ireland. Tax considerations did not play any part in his decision.

(28) There was no buyer willing to acquire BOSI's assets at or close to the impaired value and LBG was not prepared to have a "fire sale" of BOSI or its assets. Any loss arising on disposal of BOSI or its assets at less than impaired value would have reduced the regulatory capital reserves. Investment banks knew that BOSI and its business was non-core but no approaches were made by investment banks by potential buyers. ED's view was that there was no possibility that BOSI could have been sold.

(29) Once ED, TT and TTO had concluded that BOSI needed to exit Ireland, it was TT's responsibility, assisted by project teams, to identify and analyse the options for exit. That process was followed for all other non-core assets. ED was not involved on a day-to-day basis, that was left to TT. ED expected TTO to be closely involved in assessing proposals and considering their impact. As with any significant LBG project, many different work streams such as legal, accounting, regulatory, human resources, tax and pensions would have been involved. Whilst ED was not involved on a day-to-day basis he spoke daily to TT and TTO and had regular discussions about BOSI. Updates would be provided during those discussions and any required input from ED sought.

(30) Two essential factors to maximise value from BOSI's assets (which TT was aware of) were managing the assets by the BSU in London and to physically monitor customer activities on the ground in Ireland.

(31) The forecast at the time of the late June 2010 GEC suggested that BOSI would incur further losses in excess of €4.5bn over the next five years, would require funding of €18bn and a further capital injection of nearly €2bn. This confirmed ED's view that LBG needed to exit Ireland as quickly as possible. Project Hermes was discussed at the GEC in late June 2010 and July 2010 and approved by the LGB Board in August 2010. The final decision regarding the precise structure to be adopted for the exit from Ireland was delegated to a sub-committee comprising TT and TTO.

(32) ED recalled reading the Project Hermes papers presented at the meetings. The late June 2010 GEC meeting paper set out bullet points against each option and ED assessed the various options against his objectives. Option 1 (wind down the business in the current BOSI structure) was a non-starter as it did not achieve an exit from Ireland. Option 2 (transfer the business to LBG and manage the wind-down from the UK) was a more attractive option as it gave the clear message that LBG had drawn a line under Ireland and exited. The downside was that there were no "feet on the ground" in Ireland to physically monitor the loans as they could be managed by the London BSU team. Option 3 (transfer the business to LBG and manage the wind-down through an LBG-owned Irish servicing entity staffed by former BOSI employees) was the better option but required a LBG subsidiary in Ireland detracting from the message that LBG had exited Ireland. Option 4 (transfer the BOSI business to LBG and manage the wind-down through an independently-owned Irish servicing entity staffed by former BOSI employees) and Option 5 (transfer the business to LBG and manage the wind-down through one or more third-party service providers) were preferable and met his objectives. Under these options, LBG would exit Ireland but retain "feet on the ground".

(33) He could not recall the detail of the discussions that took place at the relevant June GEC, July GEC or LBG Board meetings. Options 4 and 5 were supported by the GEC, the LBG Board approved the proposal to exit Ireland and left the choice of which option and implementation details to TT and TTO. He could say with confidence neither his purpose nor the purpose of the GEC or LBG Board in proceeding with Project Hermes and in choosing Options 4 or 5 was to obtain any tax benefits.

(34) He did not recall being consulted about an alternative proposal Plan B put forward by the Structured Transactions Group ("STG") after the LGB Board had approved the decision to exit Ireland. When preparing his witness statement, LBG's representatives informed him that Plan B was designed to maximise the value of BOSI's tax losses by continuing to operate BOSI's business in Ireland. If he had been consulted he would have made it clear that Plan B was not an acceptable proposal and he would not have approved it. He doubted if the LGB Board would have approved it.

(35) He did not accept that the main purpose or driver of Project Hermes was to obtain the benefit of BOSI's tax losses, the decision to exit Ireland was a strategic business decision. Whilst reference was made to the tax benefits in the GEC and LBG Project Hermes papers, the tax benefits had no bearing on his preference for either of Option 4 or Option 5 as his decision had been made before he saw the first Project Hermes paper.

(36) He would have expected that all the tax, accounting, capital, liquidity, pensions, human resources, information technology, real estate etc. consequences of the exit would have been considered and it would have been entirely normal for external advice to have been obtained on these matters but the decision and method to exit Ireland were not dictated or influenced by any tax considerations. He was confident that neither the

GEC's nor the LBG Board's decision was influenced or affected by the availability of any tax benefits.

(37) Whilst the GEC and LBG Board papers mentioned possible tax benefits of between £600m to £1bn this was not a large number by comparison to LBG's combined portfolio value of almost £1 trillion. The financial drag that BOSI was having on LBG (€20bn of net funding, total cumulative impairments approximately €8bn in 2009 with approximately €4.5bn forecast over next five years) was considerably greater that any potential tax benefits.

(38) He did not agree that the timing of the implementation of Project Hermes was driven by tax considerations. He was not involved in setting the timing of the various implementation steps. Completing the exit by the year end allowed LBG to factor in the cost of exit into LBG's 2010 results and sent a clear message to the markets that LBG had exited Ireland.

TT's witness evidence

345. TT's witness statement repeated information that is set out in the factual chronology above and in ED's evidence. In the interest of avoiding repetition that information is not repeated, his witness statement relevantly stated as follows:

(1) The events took place many years ago and whilst he had attempted to recall the events to the best of his ability he could not recall each and every detail of every discussion with ED, TTO, the Project Hermes steering committee, Board and GEC meetings but he did recall the reasons for implementing the disputed transaction.

(2) He had over 40 years of experience in finance at senior executive and board level in large international banks. In 2003 he was offered a position as managing director of Corporate Banking at LTSB by ED. In August 2004, he was appointed to the LBG Board as Group Executive Director ("GED") of W&I. Following the acquisition of HBOS in 2009, he was appointed GED of the Wholesale division and in February 2010 he took over responsibility for W&I (in addition to his existing role as GED of Wholesale) on an interim basis until the first quarter of 2011. He was a GEC member and LBG Board member from 2004 until 2011. He left LBG in February 2012.

(3) The management culture of LBG was informal and very interactive, the offices of all the GEC members were located on the same floor and an "open door" policy was operated. He was regularly in and out of the offices of GEC members (particularly ED and TTO) discussing issues as they arose and brainstorming ideas. He reported directly to ED. The divisional management teams reported direct to the GED but also had reporting lines based on their role: the W&I Chief Risk Officer would also report to CS and the W&I finance director would also report to TTO. The W&I divisional management team included MW, GA, SC and JH.

(4) Due to the regulatory and funding pressures that LBG faced in 2009 the HBOS international portfolios did not receive the immediate attention of the LBG Board or the GEC. He recalled that the way JD conveyed the state of the international business (including BOSI) during her time as head of W&I did not give a sense of urgency around the problems in BOSI.

(5) Throughout 2009, his responsibility was the Wholesale division but, due to being on both the GEC and the LBG Board, he was aware that BOSI's asset book was of poor quality and loss making, and the Irish economy was in difficulty. When JD "left LBG abruptly" in February 2010, he was asked by ED to assume responsibility for W&I on an interim basis in addition to his existing responsibilities. He believed he was

selected for this additional role as his experience meant that he was familiar with the types of issues facing the international business and ED wanted a greater focus on HBOS's international portfolios and to accelerate progress in dealing with those issues. He was initially reluctant to accept the W&I role as he was concerned it was in a worse state than had been communicated by JD, which turned out to be the case. He was also concerned about the impact on his other responsibilities particularly the time consuming integration project in Wholesale that required cutting £1.8bn of costs and reducing the number of roles by 18,000. He accepted the role on the basis that it would be a high level "bridging" role whilst ED found a permanent replacement.

(6) Prior to his involvement, consideration had been given to the closure of BOSI's retail and intermediary business, Project Primrose. The project was due to complete in July 2009 but was deferred. In January 2010, JD recommended proceeding with Project Memphis, an expanded version of Project Primrose but which also included the closure of the asset finance business of BOSI. There was a strong commitment to Project Memphis which was announced before his appointment to the W&I role. He vaguely recalled that around the time of Project Memphis, JD attempted to ease the effect of the closure by selling some of BOSI's retail assets to a third party under a project called Chicago Lite but there was little interest from third parties and Project Chicago Lite was terminated in March 2010.

(7) He inherited the "manage for value" strategy for BOSI. His impression was that the BOSI Board's belief that they would be able to retain and grow the commercial and corporate banking business was influenced by JD's thinking. As he discovered more information about BOSI he came to the conclusion that that strategy was fundamentally flawed and a more radical solution was required.

(8) His first credit risk review of BOSI raised serious concern: 40% of the balance sheet was CRE loans; 40% of the assets were "stressed" and over a third impaired; Irish property prices had fallen by approximately 55% from their 2007 peak and a further decline was predicted with LBG's credit risk team forecasting that almost all of BOSI's property development loans would be in default by the end of 2010; the mortgage portfolio accounted for more than a quarter of BOSI's assets and house prices had fallen by 20% year on year from their peak in 2007; and, despite the closure of the retail business, the mortgage portfolio would have remained on the books until the mortgage was repaid. After his appointment he instigated a "deep dive" into BOSI's impairment position and it was clear to him that Project Memphis was not the solution to the most problematic aspect, the CRE and corporate and commercial books, and that MFV was a flawed strategy. He realised that the project impairments for 2010 were understated and had to be increased and something drastic needed to be done. He asked GA to undertake a special credit/risk review to ensure he had a fresh view of the impairment situation across the W&I division. Having the correct impairment charge in Ireland was critical because if the amounts that LBG had provided for were too low, LBG would end up disappointing the market and this would have had repercussions for his and ED's credibility. GA's review in or about March 2010 showed that the impairment forecast should be increased by about €400m. This raised questions in his mind about whether LBG or, in particular, JD, had really understood the level of risks in BOSI's book.

(9) As the Irish economy deteriorated throughout 2010, so did BOSI's impairment position rising by about €200m-300m every quarter. The position was even worse than he feared when he took over with BOSI dependent on LBG for funding and capital injections. His recollection was that BOS had provided a guarantee to BOSI to support

its regulatory capital position and that there was building pressure from the financial regulator in Ireland to replace the BOS guarantee with further capital injections.

(10) The creation of NAMA by the Irish Government in late 2009 had a detrimental effect on the sufficiency of the level of impairments in BOSI. NAMA's role was to purchase distressed financial assets outright from banks as a means of underwriting the value of these assets and providing liquidity. The purchase price for the assets was set by NAMA, the discounts applied by NAMA were close to 50%. Every time NAMA increased its discount rate the market value of BOSI's assets fell and BOSI had to recognise more impairments. NAMA continued to increase the level of its discounts as the Irish property market deteriorated throughout 2010 creating a sense that the Irish economy was in a downward spiral.

(11) LBG had a very effective BSU in London which was extremely adept at enhancing returns from distressed loan assets. A BSU of approximately 100 people had been built up in Ireland by the time of his appointment as head of W&I. He realised that the BSU was not a viable solution as: apart from a few exceptions, all the expertise was in London; it had taken years to build up the experience in London and there was insufficient time to do the same in Ireland; he had serious doubts that an Irish BSU would be as effective as the London BSU; and the key part of the London BSU's success was that they were all in one place and able to collaborate, build on each other's experience and expertise to come up with creative solutions whereas the Irish BSU would not be large enough to replicate the depth of experience. He wanted the BOSI book to be managed by the London BSU to maximise recovery.

(12) The acceleration of LBG's non-core asset reduction strategy was another factor that determined BOSI's fate. ED focused on the reduction in non-core assets at the LBG Board Away Days and all GEC members were asked to speed up the reduction. He read this as a clear sign that ED expected to see a stronger commitment to the reduction of assets in non-core businesses and, in particular, the international businesses, including Ireland. The direction from ED was reflected in his presentation to the LBG Board at the Away Day, he set out the objective of reducing the international asset book by £20bn and managing down the Irish and Australian portfolios.

(13) By April 2010, there had been little progress towards finding a permanent head of the W&I. In light of the issues that he had identified with BOSI and the increased focus on the non-core strategy, he realised that he needed to take ownership of the strategy in Ireland. He decided to visit Ireland to assess BOSI at first hand. He met with the BOSI executive committee, the BOSI board, some key customers and some employees of BOSI. He carried out a "deep dive" into BOSI's credit position, focusing on BOSI's top customer relationships and also met with the FR. He realised that BOSI had large single-borrower concentrations which created real vulnerability. It was clear to him that BOSI was very poorly run: credit control was poor, it had undertaken inadequate due diligence when lending, its records were inadequate and filing system chaotic. His view was that there was no prospect of turning BOSI around and the only viable strategy was to exit the Irish market and have the BOSI loan book managed by the London BSU. When he met with the FR, Matthew Elderfield, he did not share his concerns as he had not discussed his thoughts with ED and it was ED's decision to make.

(14) He attended a BOSI Board Meeting, was careful what he said and did not share his views as he saw no reason to provoke discontent amongst directors that LBG would need to work with.

(15) He briefed ED on his return to explain his view that there was no future for BOSI and LBG needed to withdraw from Ireland. ED was not particularly surprised although TT sensed that he had not fully appreciated how poor a state the BOSI business was in. ED agreed that LBG needed to draw a line under Ireland.

(16) Whilst his visit to Ireland that led him to conclude that LBG needed to exit Ireland as soon as possible, there were a number of additional factors around the time of his visit that led to BOSI and Ireland becoming more urgent. Those factors were: pressure from external stakeholders; pressure from UKFI; and staff morale issues.

(17) By about early May, ED, TTO and he had concluded that exiting Ireland as quickly as possible was the only viable option. Having reached that conclusion, the options had to be for achieving that had to be considered before a formal proposal could be recommended to the LBG Board. As BOSI fell within his remit, it was his responsibility to assess proposals and make a final recommendation to ED and the GEC on how to effect the exit. He relied on the W&I divisional management team to assist him. An existing working group became the Project Hermes Steering Committee ("PHSC") comprised of MW, SC, JH, GA and SRS as well as individuals from other business areas. He believed that MW and SC generally organised the meetings.

(18) He set out the objectives that he wanted to achieve and the role of the PHSC was to carry out research, consider alternatives, liaise with other group functions whose input was required and then report the findings to him. If appropriate, he would sponsor a proposal to the GEC, which, if approved, would be recommended by ED to the LBG Board for approval. This was typical of how a project of that nature would be handled in LBG. The role of the PHSC was not to make a decision but to facilitate the making of the decision by him, the GEC and LBG Board. As head of W&I he was ultimately responsible for the successful delivery of Project Hermes and responsible for setting the strategic direction of PHSC. The PHSC were drawn from specific areas of expertise within LBG and they typically analysed problems from their own narrower perspective and were not necessarily aware of all the wider factors that were relevant to LBG's decision making. He had regular catch-up meetings with MW and he would provide MW with feedback, guidance and direction. In addition he sometimes received updates from SC, although SC directly reported to him, he also reported to TTO and worked more closely with TTO.

(19) ED, TTO and he were the GEC members who were most familiar with BOSI's issues. CS had some involvement because of the Irish portfolio risks. A Project Hermes paper was presented by MW and SC on his behalf at the GEC meeting in June 2010. He recalled reviewing and commenting on the paper before it was circulated to the GEC. The paper put forward his recommendation, Option 4, to withdraw from Ireland. Option 4 provided the clear message that LBG had exited Ireland whilst maintaining people on the ground thereby minimising loss of value to shareholder and job losses (staff could be employed by the ServCo). The GEC agreed in principle to support the recommendation that BOSI be closed and its assets and liabilities be transferred to a LBG UK subsidiary, it was agreed that PHSC would carry out further investigations regarding the best option for the run-down of the BOSI portfolio and the use of a ServCo. Option 4 was not immediately accepted. It was agreed that an update would be presented at GEC meeting in July 2010. He did not recall any discussion about any tax benefits that might be available. He suspected that, like him, the GEC members, were more focused on the business issues rather than any possible tax upside. He viewed any possibility of a tax benefit, if any, as a potential consequence of the decision to exit

Ireland. After the meeting he met with both the FSA and FR and briefed them on LBG's intent

(20) He attended the July 2010 GEC. As requested, MW and SC presented a further paper on Project Hermes which updated Options 3, 4 and 5. He had reviewed the paper before it went to the GEC. Since the June 2010 meeting the PHSC had had negotiations with BOSI management on a possible servicing arrangement with a BOSI management-owned Irish ServCo (Option 4). They also had discussions with a third party about servicing Irish assets on behalf of LBG (Option 5). He was kept up-to-date on those discussions by MW and JH. He did not recall any discussion about tax at the meeting. The GEC agreed to support the exit from Ireland and ED decided to recommend it to the LBG Board.

(21) He sponsored the paper for the LBG Board meeting recommending Option 4 whilst retaining the possibility of a third-party owned ServCO. The main focus of the meeting was the ownership of the Irish ServCo. Some NEDS, including David Roberts (one of the UKFI approved directors), like him, were keen to ensure that the impairments were not exacerbated by LBG becoming too remote from the underlying credit risks in the portfolio. That necessitated a balance between retaining an appropriate mix of existing employees within the servicing entity and also not being seen to reward those that had created "the problem" in Ireland. The LBG Board supported the recommendation to exit Ireland and agreed that a sub-committee comprising TTO and he should have authority on behalf of the LBG Board to decide the outstanding details of the proposal. The PHSC continued to work on outstanding aspects of the project with his continued supervisory involvement.

(22) A meeting of the sub-committee of the LBG Board was held in mid-August 2010 which approved the CBM, the legal process for transferring the BOSI assets to the UK. The decision was announced the following day.

(23) Shortly before the August 2010 sub-committee meeting, he had been informed by PHSC that the STG had proposed an alternative to the CBM, Plan B. Plan B was expected to provide additional benefits, mainly tax. As he understood it, it required BOSI to remain in place and expand its Irish operations. This alternative proposal conflicted with the clear message of exiting Ireland. Although the CBM had been announced, he allowed further work to be done to Plan B. Tom Murphy, head of STG, reported direct to him and was a strong advocate of Plan B. Despite his reservations and the fact it would have required LBG to reverse the CBM announcement, he thought it best to test Plan B in the expectation that it would not provide the required solution. He did not want to be faulted for not thoroughly examining all possibilities.

(24) Towards the end of September, a meeting attended by him, TTO, CS, SH, SC, GA and TM, was held to discuss Plan B. He and TTO had authority to make the final decision but he wanted the pros and cons aired particularly by TM and SH who were in favour of Plan B. His view was that TM and SH did not understand the strategic objective and had approached Plan B from a very narrow perspective. SH had a finance role and did not appreciate the wider commercial objectives and TM expected that STG would be given the role of managing the Irish operations to maximise the tax advantages from Plan B. TM and SH did not understand the objective was not to seek tax benefits but to address bigger concerns. Following discussions between him and TTO, ED was briefed on Plan B. ED was very dismissive of Plan B. He informed TM the decision was to continue with the CBM and not Plan B.

(25) Following the August 2010 CBM announcement, the PHSC progressed the steps required to implement the CBM. He had discussions about the terms of the agreement with the ServCo and ongoing dialogue with the FSA. He had to approve and sign the ServCo agreement and various other legal documents.

(26) He did not accept that the main purpose or one of the main drivers of Project Hermes was to access BOSI tax losses to reduce taxes payable in the UK and that exiting Ireland via a CBM had nothing to do with tax or any tax losses. He was aware of the possibility of there being a tax benefit from the PHSC papers he sponsored that were presented to the GEC and LBG Board. He understood the level of any tax benefit was uncertain and he did not ask Group Tax or any external advisors to explain the tax benefit because it was not relevant to his view on what he needed to do about BOSI. He did not see any papers prepared by external tax advisers but would not be surprised that advice was taken on tax and other relevant matters. He did not place any special weight on the possibility of a tax benefit when considering the potential exit options; it was merely a factor to be considered alongside many others e.g. pension or severance consequences. If a tax benefit followed from the decision, he believed it would have been foolish not to claim it.

(27) The timing of the transaction was not driven by tax but the desire to demonstrate that BOSI had been resolved in 2010, the deteriorating Irish economy was another factor. On a personal level, he knew that BOSI would not be his responsibility in 2011 and he wanted Project Hermes completed under "his watch" and he did not want any delay in completing to reflect adversely on his individual performance.

(28) Whilst the sale of BOSI to a third-party was the best option for exiting Ireland, he considered that to be a complete non-starter as there was no interest in buying a bank of BOSI's size. Any buyer would need to put in billions of regulatory capital and provide tens of billions of pounds of liquidity. He did not accept that BOSI could have been sold to anyone and at any cost as: any sale required the approval of the FR, a sale at a substantial discount would have destroyed LBG's share value (UK Government was a 44% shareholder) and such a sale would have been completely contrary to LBG's commercial interests.

(29) He did not believe, with his considerable experience of buying and selling loan portfolios, that there were any buyers for BOSI's assets other than at a very significant discount. If he believed that a sale of the whole or part of BOSI's portfolio could have been achieved at a sensible price he would have considered the option. NAMA confirmed to him that they were not aware of anyone interested in acquiring Irish loan portfolios and the failure of the Irish Government sponsored Project Chicago demonstrated how difficult it was to dispose of financial assets.

TTO's Witness Evidence

346. TTO's witness statement repeated information set out in the chronology and facts above, in ED's witness statement and in TT's witness statement. In the interest of avoiding repetition that information is not repeated, his witness statement relevantly stated as follows:

(1) The events took place around 12-13 years ago and he had attempted to recall these events to the best of his ability. Given the length of time that has passed, he was unable to recall the specifics of every discussion with fellow directors and other employees of LBG, nor each and every detail of every board or GEC meeting but that he did recall the main issues raised by BOSI issues and the reasons why the transaction was implemented.

(2) He is a Chartered Accountant and joined LTSB in April 2006 as the Deputy Group Finance Director. In April 2008, he was appointed acting Group Finance Director and was appointed to the board as Group Finance Director in October 2008. He left LBG in February 2012.

(3) ED favoured an informal collaborative management style and, in addition to the more formal sessions, he would often have impromptu meetings in ED's office to discuss and debate various issues.

(4) His role as Group Finance Director, was to lead Group Finance and he was responsible for overseeing LBG's capital and liquidity position, financial forecasts, budgets and financial reporting, tax and investor relations activity. He reported to ED and, ultimately, the LBG Board.

(5) Each of LBG's 4 operating divisions had a divisional management team that included a divisional finance director. Although the divisional management teams reported to the divisional heads, the divisional finance directors also reported to him. He would have one-to-one meetings every 6 weeks or so with each of the divisional finance directors and would be updated on what was happening in each division. In addition to the scheduled meetings, he had frequent ad-hoc interactions with the divisional finance directors as and when he wished to discuss any matter with them or when they wanted his advice or discuss a particular proposal. The divisional finance directors also sat on the Finance Board which would typically meet monthly. The Finance Board was more concerned with the running of the Group Finance function rather than dealing with divisional financial performance or other issues within the divisions.

(6) In the run-up to the acquisition of HBOS a due diligence exercise was undertaken which included assessing the quality of the assets but attention was focused on the quality of HBOS' UK loan book because this formed the largest part of the HBOS business. Confidentiality and competition law issues restricted the amount of due diligence that could be undertaken prior to completion of the HBOS acquisition. The true extent of HBOS's issues only came to light once the acquisition had completed and the balance sheet stress tested. In 2009, the main concerns related to the quality of HBOS UK assets as BOSI and Australia were a small part of the LBG balance sheet.

(7) A consequence of the global financial crisis was that the regulation of banks came under increasing scrutiny. In early 2009, the FSA introduced a prescribed capital adequacy stress test which gauged a bank's ability to survive potential losses and continue lending in the event of another financial crisis. The newly enlarged LBG was immediately required to stress test the ability of its capital base to withstand the impact of another material economic deterioration in its business with the outcome that LBG needed to increase its required regulatory capital. As a result, throughout 2009, ED and he were very focused on measures that could help improve LBG's regulatory capital position and avoid relying on GAPS. One of the mitigating measures was to reduce the size of LBG's balance sheet by disposing of non-core assets.

(8) LBG, like many other banks, faced a liquidity crisis and was forced to rely on the Bank of England's Special Liquidity Scheme ("SLS") and the UK Government's Credit Guarantee Scheme ("CGS"), schemes introduced to address the liquidity crisis within the banking sector. By the end of 2009, LBG was dependent on about £160bn of such funding. Although funding within LBG was generally fungible, part of the SLS and CGS funding was used to fund BOSI. Both the SLS and CGS funding, however, were temporary solutions and needed to be replaced in the short to medium term with

funding from the markets. One of his responsibilities was to manage the Group's ability to repay or refinance the SLS and CGS by the various specified maturity dates. Throughout 2009 and 2010, he had regular meetings with ED to update him on LBG's regulatory capital and funding position as well as quarterly presentations to the Bank of England, the FSA and the Treasury on LBG's general funding, cash flow position and plans for repaying the CGS and SLS. In order to raise wholesale funding, it was crucial that the markets had confidence in LBG's capability to tackle issues and strategy, this was why LBG had to act decisively and quickly with BOSI.

(9) By the summer of 2009, the LBG Board (including NEDS) and the market had become concerned about BOSI and its weak financial position. At the same time, LBG was also trying to tackle the regulatory, liquidity, funding and EU State Aid issues and could not immediately prioritise BOSI.

(10) By early 2010, the LBG Audit Committee (which he attended) had identified Ireland as a primary risk within LBG's international portfolio and there were intense discussions at committee meetings about the level of impairments in BOSI and whether they were sufficient. The level of impairments continued to increase over the course of 2010, exceeding all forecasts. It was clear that LBG needed to address the situation in Ireland, the issues within BOSI became more acute because elsewhere across LBG impairments had been reduced and kept within market and analyst expectations. Additional capital had to be injected as the level of BOSI impairments increased; in 2010 in excess of €4.5bn of share capital was provided.

(11) BOSI was regulated by the FR whilst BOS and the rest of LBG UK by the FSA. The FR imposed limits on the level of property lending exposures that BOSI could have. There had historically been a parent Guarantee in place under which BOS effectively underwrote BOSI's lending exposures and this enabled BOSI to make more property loans than its regulatory capital levels would otherwise allow. Initially, the Guarantee covered up to €5bn of risk but, in April 2009, the Guarantee had to be increased to cover up to €20bn of risk to enable BOSI to remain compliant with its regulatory capital requirements. In the absence of the Guarantee, BOSI's capital requirements would have significantly increased. During 2009 and 2010, the Guarantee came under increasing scrutiny from both regulators. The FR did not like the Guarantee and applied pressure on LBG to replace it with additional share capital so that BOSI was not exposed to the parent guarantee not being honoured by BOS. The FSA did not like the Guarantee as it was considered to be a high-risk exposure for BOS and the LGB UK. It was not feasible to continue relying on the Guarantee but its absence would require an additional capital of about €2bn into BOSI putting more pressure on LBG's funding and liquidity levels. Additional adverse factors were the declining retail deposit base in BOSI and NAMA. LBG were unsure whether NAMA would be available to BOSI as a foreign owned bank, this was not investigated as participating in NAMA could have exposed LBG to a further State Aid challenge. NAMA was seen as a buyer of last resort for bad Irish assets due to the very heavy discount it applied. For the first set of loans acquired by NAMA, the discount rate applied was close to 50%. The discounts had a further adverse effect on BOSI's portfolio because NAMA effectively became the "market" for Irish financial assets. NAMA's discounts heightened the market sense that BOSI's assets had plummeted in value and, compounded by the lack of available funding for other potential purchasers, it became virtually impossible for LBG to sell BOSI's assets.

(12) During 2010, the BOSI impairments became a focal point for investors, analysts and the LBG Board. He and ED were questioned by investors and analysts at the 2009

results announcement about the strategy for Ireland with concern expressed at the level of the final 2009 impairments. In 2010, the markets were easily "jittered" and any downgrading of LBG by rating agencies due to lack of confidence in LBG's response to the BOSI issues would have had a major impact on the share price and ability to access wholesale market funding. He and ED saw it as "mission critical" to retain the market's confidence in LBG's ability to deal decisively and quickly with BOSI.

(13) Various different strategies to address the problems with BOSI had been considered. Project Primrose had been developed in the first half of 2009 but was deferred because of ongoing EU State Aid negotiations. Following the conclusion of the EU State Aid negotiations in February 2010, Project Memphis was announced and the focus then shifted to BOSI's non-retail business. In early 2010, he and ED were presented with a business review by the BOSI board, the MFV strategy. He was not supportive of waiting a few years to see how things developed particularly given the deteriorating Irish economy and the on-going need for additional regulatory capital and funding to support BOSI. He also did not like the proposal as it meant that the same individuals under whose control BOSI had come into such difficulties would remain in charge of BOSI while the MFV strategy was followed.

(14) Not long after Project Memphis was announced, ED replaced JD with TT. He believed that ED had been frustrated with the slow progress being made by JD in addressing the problems relating to BOSI. TT's appointment was a clear signal from ED that he wanted decisive action taken to resolve the issues with BOSI. In the first few months of 2010, ED shifted his emphasis towards "right-sizing" LBG's balance sheet and accelerating LBG's non-core asset reduction strategy. As part of the planning for the LBG Board Away Days in April 2010, ED asked the GEC members to examine all exit options for the non-core businesses, especially the international portfolio (including BOSI). After ED's direction, there was an increased impetus to tackle the issues in Ireland. Around the same time TT visited Ireland, his feedback was that it was much worse than feared and TT and ED were convinced that there was no future for BOSI. He had come to the same conclusion as it was not feasible to continue pumping money into BOSI in the hope that it could be turned around in the foreseeable future. TT's assessment reinforced his view. He, ED and TT were focused on drawing a line under the BOSI impairments and thought that the BOSI portfolio should be managed by the London BSU team, who were very skilled at dealing with distressed assets, to minimise the impairments.

(15) He and ED agreed that they needed to respond to the pressure from investors and analysts by sending a clear and definitive market message that LBG had exited Ireland. By "exit", they meant being able to say to the market that LBG were not going to be writing any new business in Ireland and had no intention of going back in the future. To his mind, this was the only logical thing to have done given the circumstances. His view was that LBG also needed to deal with the Guarantee which both regulators did not like and which would not be required if there was no regulated presence in Ireland (that meant surrendering BOSI's Irish banking licence). Another advantage was that LBG would only have to deal with one regulator and no longer inject regulatory capital into BOSI.

(16) His recollection was that prior to the PHSC, various teams and their work streams had never been brought together in a cohesive manner. He believed that as TT had responsibility for the exit from Ireland, he would have initiated the formation of the PHSC that reported to him. The PHSC did not work in isolation and as the regulatory capital, funding, liquidity, financial reporting and tax consequences of the exit fell

within his remit as Group Finance Director, he was kept abreast of the work being done by his regular updates and interactions with SC. He had explained to SC what his objectives were and what he wanted to achieve with the exit from Ireland. He also had numerous informal exchanges with TT about Project Hermes as it developed.

(17) In contrast with the strategic approach of the GEC members, the divisional teams and PHSC were more focused on the financial, value and operational impact of any proposals and less focused on the bigger picture. In particular, nobody who was a member of PHSC would have had any interaction with investors, analysts or shareholders and therefore could not be expected to fully understand and appreciate the pressure LBG was facing from external stakeholders in 2010. For that reason approval of any proposal identified by PHSC was made by him, ED, TT and other GEC members.

(18) With regard to the paper prepared for the GEC end of June 2010 meeting he thought that Option 4 was preferable as it retained the services of BOSI staff who were familiar with the loan book, it offered them a role going forward, delivered a clear message to the market and avoided a regulated presence in Ireland that required capital or funding from LBG. He thought that Option 5 would be more expensive to implement and, importantly, whether it could be achieved by 31 December 2010. He did not recall there being any specific discussion of the tax consequences of the various options at the June 2010 GEC meeting. It was agreed in principle at that meeting that withdrawal from Ireland and closure of BOSI by year-end should be pursued but no decision was taken whether to pursue Option 3, 4 or 5. A more detailed plan for exiting Ireland would be brought to the July 2010 GEC meeting.

(19) An update on Project Hermes was provided at the July 2010 GEC meeting, he would have seen the draft paper before its circulation. The paper referred to various issues including regulatory, staff issues, pensions, retention/incentivisation as well as tax considerations. The GEC approved the proposal to exit Ireland. ED then recommended the decision to the LBG Board. He again did not recall any specific discussion regarding the tax consequences of the various options.

(20) At the LBG Board meeting in August 2010, TT presented the Project Hermes recommendation that LBG exit Ireland. The paper circulated in advance of the meeting was a slight redraft of the July 2010 GEC paper. Following unanimous approval in principle by the LBG Board to exit Ireland, authority was delegated to a sub-committee of the LBG Board comprised of himself and TT to proceed with the proposed transaction and to determine timing. He did not recall any discussion at the GEC or LBG Board regarding the legal mechanism for transferring BOSI's business to BOS. He was not familiar with the concept of a CBM but understood it involved a court process.

(21) The sub-committee met in mid-August 2010 to authorise proceeding with the CBM, in his absence SH attended on his behalf and was briefed to approve the CBM. The decision to exit Ireland by end of 2010 was announced the next day.

(22) The FSA and FR were briefed on the decision in Autumn 2010 and confirmation given that BOS would not have a permanent establishment in Ireland.

(23) Plan B was presented as an alternative in August 2010 by TM who believed it would give a better tax outcome than the CBM. Plan B was a complex proposal which he initially did not fully grasp. He thought it should be considered further from a good governance perspective because SH strongly supported Plan B. TT made clear that he preferred the CBM. LBG proceeded to file the court papers for the CBM but as all the

issues (including some Irish tax issues) arising from the CBM had not been bottomed out, consideration was given to the inclusion of a condition that allowed LBG to pull out of the CBM. At a meeting in late September 2010, the pros and cons of the CBM and Plan B were considered. Prior to the meeting he realised that Plan B was not an exit from Ireland as it required the retention of BOSI and its loan book with the TRS shifting the credit exposure on the BOSI book to LBG in the UK. At the meeting he and TT canvassed the views of those present; the votes were evenly split. He and TT wanted to continue with the CBM as it meant exiting Ireland and this outweighed the tax benefits of Plan B. He and TT had a telephone discussion with ED who dismissed Plan B. On that basis he and TT decided to continue with the CBM and notified TM and the steering committee explaining that they had discounted the availability of any tax benefit.

(24) He did not accept that obtaining CBGR was a main purpose of Project Hermes. LBG was not short of tax losses and the BOSI tax losses of around £4bn were not a material consideration in the overall scheme of things. He was cautious about the potential tax value of the BOSI losses and considered them uncertain and optimistic. The possibility of using the BOSI tax losses was not an important consideration at GEC or LBG Board level, the focus was on exiting Ireland. He was clear that if CBGR was available then LBG intended to claim it but if it was not available the same decision would have been made irrespective of any tax benefit.

(25) He was not surprised that SC and his team had focused on using the BOSI losses as divisional teams focused on financial, value and operational matters and not on the wider strategic aims of LBG. That was the reason why decisions like Project Hermes were taken at GEC and LBG Board level. If he required any tax advice he would ask Group Tax and not the W&I divisional finance team. Whilst he may have seen papers from W&I finance team and Group Tax on the tax consequences of Project Hermes, he did not pay any attention to the BOSI tax losses until shortly before the June 2010 meeting. He was not surprised that advice had been taken from external tax advisers but did not accept this indicated that CBGR was a main purpose of Project Hermes. He did not request and nor did he recall seeing any advice from Deloitte. Whilst SC and his team emphasised the regulatory capital benefits if the BOSI losses were available to set off against UK profits this was not critical to his decision as he knew it would only be available until 2013 when the Basel III rules took effect and LBG had completed Project Seaview.

(26) It was not a main purpose of completing the CBM by the end of 2010 to access the BOSI tax losses, there were other relevant benefits to have exited by that date.

(27) He was not directly involved in any attempt to sell BOSI but it was his view that no buyer would have been interested in acquiring the whole bank and finding a buyer would have been a futile exercise. If there was a willing purchaser it was likely that any such purchase would have been at a significant discount such that, as a LBG director, he would have been unable to discharge his fiduciary obligations by recommending the sale. Project Chicago was the closest that LBG came to selling BOSI's assets.

EXPERT EVIDENCE

347. We set out at the outset that we have concerns regarding the manner in which the experts were instructed. It is clear from the instructions to the experts that they were provided with very little or no background information or documentation. In certain instances, the experts were not provided with all the information relevant to the very issues that they were instructed to advise upon. The instructions were framed in such a narrow way which, together

with the minimal information and documentation provided to the experts, resulted in expert reports which did not greatly assist the Tribunal nor discharge the experts' duty to assist the Tribunal rather than the instructing party. For the reasons set out at paragraphs 515 to 544 below, we concluded that the expert evidence was largely irrelevant to the issues in dispute before us. For the sake of completeness and, in the event that the appeal proceeds further, we have summarised the expert evidence.

Mr Rodgers

348. Mr Ciarán Rogers is a partner in A&L Goodbody LLP ("ALG") and former head of the Banking and Finance Department of ALG. He qualified as a solicitor in England and Wales at Linklaters LLP and has advised the financial services industry in Ireland on Irish legal and regulatory law and regulation. He has extensive experience advising on Section 33 and CBMs involving Irish credit institutions. He was instructed by the Appellant to provide an expert report on the legal mechanisms available in 2010 to facilitate the transfer of a banking business from an Irish credit institution to an entity incorporated outside of Ireland, principally focusing on:

(1) The transfer of assets and liabilities pursuant to section 33 of the Irish Central Bank Act 1971; and

(2) CBMs pursuant to the European Communities (Cross-Border Mergers) Regulations 2008 (S.I. No. 157/2008) (the Irish CBM Regulations), which transposed into Irish law European Union Directive 2005/56/EC (the CBM Directive).

349. Schedule 1 to his report confirmed that he had been provided with and considered the following six documents when preparing his report:

(1) A briefing paper for Irish Corporate Law Expert from Simpson, Thacher & Bartlett LLP ("STB"), setting out the background to the matter and the request for an independent corporate law expert evidence;

(2) A memorandum from Arthur Cox (an Irish law firm) dated 16 June 2010 discussing (at the time) the proposed transfer of the assets and liabilities of BOSI to BOS and the various methods available to achieve this;

(3) Legal Appendix prepared by Arthur Cox for the BOSI Board of Directors dated 28 July 2010;

(4) Common Draft Terms dated 18 August 2020 of a proposed CBM of BOSI and BOS;

(5) BOSI Directors' Explanatory Report adopted by a resolution of a committee of the Board of Directors of BOSI on 18 August 2010; and

(6) Directors' Report and Consolidated Financial Statement of BOSI for year ended 31 December 2009.

350. The report set out the following:

(1) His understanding of the background to the transfer of all the assets and liabilities of BOSI to BOS (the BOSI Transaction);

(2) The available legal mechanisms under Irish law in 2010 for transferring the assets and liabilities of an Irish credit institution at that point in time;

(3) The principal advantages and disadvantages of each such legal mechanism; and

(4) His conclusions regarding the use of the CBM (and the possible use of s33) for the BOSI Transaction.

351. In summary, he concluded that taking account of (i) the background to the BOSI Transaction, (ii) the legal mechanisms available in 2010 to transfer the assets and liabilities of an Irish credit institution; (iii) the principal advantages and disadvantages of the use of a s33 transfer and CBM given the particular circumstances of the BOSI transaction, in his opinion it was reasonable and credible from a legal perspective for the BOSI Transaction to be structured using a CBM rather than a s33 transfer.

352. He confirmed that ALG was not directly involved in the BOSI Transaction but ALG did act for the then existing BOSI management team to set up Certus in Ireland to provide outsourced loan administration services back to BOS immediately following the transfer of the loans to BOS pursuant to the CBM. He was not personally involved in advising on the Certus matter. ALG also acted for a number of acquirers of loan portfolios originated by BOSI (and included in the CBM) which were subsequently sold by BOS. Again, he was not personally involved in advising the acquirers on these loan portfolio sales and he did not regard this work as creating a conflict of duty that would interfere with his duty to the Tribunal nor his ability to provide impartial advice.

353. He understood and was advised that:

(1) BOSI was a wholly owned indirect subsidiary of BOS. It was an Irish credit institution incorporated and tax resident in Ireland. BOSI operated as both an Irish retail and commercial bank and it had a significant market presence in both Ireland and Northern Ireland.

(2) BOSI had significant exposure to both the Irish residential and commercial property sectors and faced significant issues caused by the losses in its loan portfolio (and, in particular, on its Irish commercial property loan book). It required substantial funding (and capital support) from LBG.

(3) In early 2010, a decision was taken to close the retail banking (including that carried out through intermediaries) and asset finance businesses of BOSI in Ireland. That closure completed in mid-2010. As challenges still remained (the continuing need for the LBG group to fund BOSI, BOSI's worsening impairment position and the ongoing need to inject capital into BOSI for regulatory capital reasons), LBG decided to exit from Ireland and to wind-down BOSI's loan book. A key commercial objective of the BOSI Transaction was for LBG to be able to send a clear message to the market that it had exited Ireland and to ensure that LBG minimised and simplified the regulation of its banking activities in Ireland.

(4) Prior to the CBM becoming effective BOSI and BOS entered into a servicing agreement with Certus, Certus agreed to perform on a non-exclusive basis certain administrative functions and services relating to the business transferred to BOS (the ServCo Agreement). These administrative functions and services carried out by Certus were done so under the direction of BOS. This structure enabled BOS to utilise its extensive operational and management capability (including general and credit management, oversight and control) within the UK in relation to its Irish portfolio, while retaining local administrative capability and historic knowledge and customer relationships through the ServCo Agreement, in a way that would seek to maximise recovery on the loans. It also ensured that BOS' regulated activities in respect of the merged BOSI business would be subject to regulatory supervision by one regulatory authority, the FSA, rather than having split regulatory supervision between two regulators: FSA and FR.

354. He considered that in order to transfer the assets and liabilities of a credit institution in 2010 three options were available under Irish law: a contractual transfer, a s33 transfer and a CBM.

Contractual transfer

355. He did not consider that a contractual transfer would have been a practical solution for the BOSI Transaction given its commercial objectives. Any contract under which BOSI had an obligation or a liability (i.e. a bank deposit arrangement) could have only been transferred by way of a novation and with the consent of the contractual counterparty (i.e. each depositor or customer). This would have been too problematic from an operational and execution perspective. The only practical solution was the use of a s33 transfer or CBM.

Irish statutory transfer schemes

356. A s33 transfer was the mechanism largely used by an Irish credit institution to transfer all or part of its banking business to another Irish credit institution, it was amended to permit the transfer by an Irish credit institution of all or part of its banking business to the Irish branch of another EU credit institution. It is domestically focussed. It does not envisage or facilitate the transfer of an Irish banking business to an entity incorporated or domiciled outside of Ireland which does not have a branch in Ireland. This domestic focus is also reflected by the recognised limitations of Section 33 to effect a transfer of assets or liabilities governed under the laws of a country/jurisdiction which is not Ireland.

357. CBMs were introduced under the CBM Directive (and transposed into Irish law under the Irish CBM Regulations) as part of an EU initiative relating to the functioning of the single market and to facilitate cross-border mergers between various types of limited liability company governed by the laws of different Member States. It facilitated cross border mergers between limited liability companies operating in Ireland and another EU member state without the need to establish a branch in Ireland and also facilitated the transfer of contractual arrangements and liabilities which were governed by the laws of another EU member state and not just contracts governed by Irish law.

358. He set out the principal advantages and disadvantages of a s33 transfer.

Advantages

(1) Is the "traditional" mechanism and has been used since 1971;

(2) It is well understood by both the MF and the CBI; the respective government minister and regulatory authority which needs to approve and be consulted on any s33 transfer. A tried and tested path had been developed to implement s33 transfers with a standard timeline for approval of the s33 transfer contained in the legislation and the documentation is relatively standardised.

(3) The timeframe for implementing a s33 transfer is well understood and not open ended. Any proposed s33 transfer must be submitted to the MF for approval not less than four months before the proposed transfer date or effective date for the scheme. The decision whether to approve or decline to approve the s33 scheme must be made not less than two months before the proposed transfer date.

(4) Section 33, unlike a CBM, also allows for a partial transfer or merger of a banking business.

(5) Section 33 has enabling provisions to facilitate the transfer of employees and the transfer of real estate and security interests without the need for formal registration of the transfer of such interests with the land registry or company registration systems in Ireland.

Disadvantages

(1) Section 33 is domestically focussed and is not designed to be used to facilitate a transfer or merger of an Irish credit institution with another credit institution located or operating outside of Ireland. It was not introduced to facilitate the transfer of the assets and liabilities of an Irish credit institution to another EU jurisdiction.

(2) An EU credit institution could avail itself of EU "passporting arrangements" and could arrange through its regulator in its home Member State to establish a branch in Ireland and once this branch was established it could look to use a s33 transfer to transfer an Irish banking business to its Irish branch, this has been done by EU credit institutions. He was not aware of an EU credit institution specifically establishing a branch in Ireland solely with a view to using s33 to facilitate a bank transfer or merger scheme with the intention of then immediately or shortly thereafter closing the Irish branch or consolidating that branch with the rest of its operations in its home Member State. He could not comment (i) on the local home Member State requirements for establishing a branch of a credit institution in Ireland and whether any minimum requirements would apply for the types of business to be carried out by the branch or its structural organisation or (ii) whether the competent authority in a home Member State would regard the establishment of a branch in Ireland to solely avail of s33 as acceptable from their perspective. He believed that both the CBI and MF would have been reluctant to allow s33 to be so used as it was introduced to facilitate domestic transfers and mergers of banking businesses. Notwithstanding the broad powers under s33, the MF would want to ensure they did not act *ultra vires* and it was his opinion that there was a reasonable likelihood that the MF would have decided (or would have been advised) not to progress with the approval of such a s33 transfer.

(3) A s33 transfer scheme has limited jurisdictional effect, it did not purport to have extra-territorial effect under Irish law and it would be a matter for the other jurisdiction to determine whether to recognise and give effect to a s33 transfer scheme. It was generally accepted that a s33 transfer scheme would not effect a transfer of non-Irish law governed contracts and a separate transfer procedure would be required to ensure the transfer of non-Irish law governed contracts. Such separate transfer procedure would require due diligence to determine if the contract prohibited or restricted assignment; legal advice on how best to execute the transfer of the contracts in accordance with the contract's stated governing law; and any additional legal documentation required to effect the transfer of non-Irish law governed contracts.

(4) He was advised that in 2010 BOSI had a significant Northern Ireland mortgage loan book and a number of hedging or derivative contracts governed by English law; given the traditional approach taken by Irish legal practitioners, he did not consider that a s33 transfer would have been sufficient to facilitate the transfer of those contracts without following the approach in paragraph 3 above.

CBM advantages and disadvantages

Advantages

(1) the Irish CBM Regulations were transposed into Irish law in 2008 as a result of the CBM Directive.

(2) The Irish CBM contained a detailed and comprehensive procedure which was readily understood.

(3) A CBM facilitated the transfer of all EU law governed contracts and not just Irish law governed contracts thereby reducing transaction costs and execution risks.

(4) A key consequence of the CBM is that the transferor company is dissolved without the need to go into liquidation and it no longer exists. Dissolution without the need for a liquidation process reduces transaction costs and execution risks.

(5) The CBM process is a court supervised process providing significant legal comfort regarding the recognition of the merger in both jurisdictions which is not available under Section 33. A CBM avoids the requirement to obtain the consent of the MF avoiding the risk of the CBM being delayed or subject to the vagaries of the political system.

Disadvantages

(1) A CBM can be more procedural and document heavy than a s33 transfer and requires the filing and registering of documents with public bodies and courts in each jurisdiction.

(2) An expert's report is required to confirm that the shares or other securities consideration shareholders will receive in the successor company is fair and reasonable. An expert's report is not required where the proposed CBM is a merger by absorption, as happened here following the restructuring in September 2010 where the shares in BOSI were transferred to BOS from SIF. The restructuring was required because under UK company law, a subsidiary cannot hold shares in its parent company which would have been the consequence of the CBM except where the CBM is a merger by absorption and involves a wholly owned subsidiary transferring all its assets and liabilities to its direct parent.

(3) The transfer of employees under a s33 transfer or a CBM is governed under the Irish European Communities (Protection of Employees on Transfer of Undertakings) Regulations 2003. In addition, Part 3 of the Irish CBM Regulations contains detailed provisions on employee participation and engagement in a CBM process but these provisions only apply where an Irish company is the successor company following the CBM. They do not apply where the Irish company is the transferring company under the CBM and will be dissolved upon completion of the CBM.

(4) In 2010 the Irish CBM Regulations were relatively new which may have been perceived as a disadvantage.

(5) Unlike s33, the Irish CBM Regulations are not very prescriptive on timing and there are timing risks in relation to a court hearing and court delays although the Irish commercial court has generally looked to accommodate any reasonable timing requests around CBM processes. He could not comment on the timing of CBM applications in the High Court of England and Wales nor the Court of Session in Scotland.

(6) The CBM regime only allows for a full merger of the assets and liabilities of the transferring company with the assets and liabilities of the successor company, it does not permit a partial transfer of assets and liabilities of the transferring company. In the case of the BOSI Transaction, he was advised that it was always intended there would be a full transfer of the assets and liabilities of BOSI to BOS. Therefore, this perceived limitation or disadvantage of the CBM regime was not applicable to the BOSI.

(7) A CBM is only available for a cross-border merger which is defined in the Irish CBM Regulations to be a "merger involving at least one Irish company and at least one EEA company". This restriction did not apply to the BOSI transaction as BOSI was governed by the laws of Scotland which was an EEA state at the time of the transaction.

359. His opinion was that taking account of (i) the background to the BOSI Transaction, (ii) the legal mechanisms available in 2010 to transfer the assets and liabilities of an Irish credit institution; (iii) the principal advantages and disadvantages of the use of s33 and CBM given the particular circumstances of the BOSI Transaction, it was reasonable and credible from a legal perspective for the BOSI Transaction to be structured using a CBM rather than s33.

360. In cross-examination, Mr Rogers accepted that he had not been made aware of the MTP strategy to manage for value nor the decision that a branch option was effectively ruled out in June 2010 [6/8/11-22 and 6/11/15-12/6]. He confirmed that "the background to the BOSI Transaction" referred to at paragraph 1.3 of this report was based upon the six documents provided to him, [6/25/2-26/7] and that he had just followed the information in his instructions, [6/78/4-11]. He accepted that there was nothing in s33, which he accepted gave MF a very broad discretion [6/84/17-23], that indicated that a s33 transfer would not be possible where the transferee branch was to be closed shortly after transfer. The MF's power/discretion would have to be interpreted and exercised in accordance with EU law and there was nothing in Regulation 23 of the EC (Licensing and Supervision of Credit Institutions) Regulations 1992 that confers an entitlement on the host Member State regulator/authority to withhold conferring a banking licence on a branch of an undertaking exercising its EU law passporting rights, [6/87/9-17]. He accepted that the requirements for the exercise of the passporting right are essentially procedural and the only question is whether the FSA would have processed LBG's application, [6/60/21-23].

Mr Sharma

361. Mr Paul Sharma has over 20 years of experience as a senior UK, EU and global regulator of banks and insurance companies including as Director of Prudential Policy at FSA, UK's alternative member of the Board of Supervisors of the European Banking Authority ("EBA") and a member of the Basel Committee on Banking Supervision ("BCBS"). In 2013, he was an Executive Director of the Bank of England and the Deputy Head of the Prudential Regulation Authority ("PRA") before taking up his current position as the managing director of Alvarez & Marsal ("A&M").

362. He was instructed to address the following areas in relation to LBG's decision to undertake the CBM, focusing specifically on the period between 1 January 2008 and 31 December 2010 ("Relevant Period"):

(1) The regulatory context of LBG's decision to end its regulatory presence in the Irish market, including the approach of both the UK and Irish financial regulators; and

(2) The likely perspectives of the UK and Irish regulators on the various options identified by LBG to end its regulatory presence in the Irish market including whether any sale of BOSI and/or its portfolios would have required regulatory approval and, if so, whether such approval would have been granted.

363. He confirmed that the above paragraph was the extent of his instructions and that he had been assisted in the preparation of his report by staff at A&M but the opinions stated were his own. Paragraph 1.4.3 of his report stated that "*A full list of the information that I have relied upon is set out at the start of this Report, which includes documents that I have obtained from LBG and from publicly available sources*."

364. It suffices for these purposes to set out the executive summary which is summarised as follows:

(1) Financial regulators, such as the FSA and the FR, are responsible not only to ensure compliance with financial laws and regulations but their responsibilities extend to the consideration of a broad range of factors to achieve their regulatory objectives.

The FSA and the FR have wide-ranging powers that can be exercised where there is a perceived risk to these objectives (even in circumstances where there are no violations of specific requirements) and both have the power to block actions which they deem to present such a risk.

(2) BOSI's history and relationship with LBG presented challenges for both the FR and the FSA. Historically, BOSI had been dependent on its parent (HBOS, then LBG) for both funding and capital. Consequently, LBG was both the shareholder and the main creditor of BOSI.

(3) During the global financial crisis ("GFC"), BOSI lost a substantial proportion of its customer deposits, partly because it did not participate in any of the guarantee support schemes offered to banks by the Irish government. This decision was taken before LBG took control of HBOS. It was considered that the Irish guarantee would restrict BOSI's ability to compete, and it did not need to participate in two schemes when HBOS had entered into the UK guarantee scheme. Additionally, BOSI was required to follow the deposit pricing policy set at LBG group level which caused it to become uncompetitive in the Irish market. BOSI therefore became increasingly reliant on wholesale funding, the only viable source of which was from its parent.

(4) Following the onset of the GFC, the regulatory landscape (including the priorities and focus of regulators) changed. It led to a greater intervention by regulators, and this increasingly interventionist approach led to a growing 'regulatory mismatch' – where requirements from different regulators diverge and sometimes directly compete – between the FR and the FSA, which manifested in the following ways:

> (a) a notable increase in 'financial nationalism' and a lack of coordination between national regulators;
>
> (b) an increase in quantitative requirements;
>
> (c) an increased role for regulators in assessing, and even dictating prudential requirements for banks, this was particularly the case in the UK following the introduction of a new capital adequacy framework from the FSA in October 2008;
>
> (d) an increased level of guidance with which banks were required to comply, much of which imposed significant administrative and/or management burdens.

(5) BOSI's inability to source deposits or funding domestically in Ireland presented a serious UK prudential risk to LBG. The FSA was not able to compel or direct BOSI due to its Irish regulatory jurisdiction; it was only able to influence actions (which may have affected BOSI) taken by the parent LBG, as its home regulator.

(6) The only feasible way that LBG could eliminate the mismatch was for LBG no longer to have a permanent establishment in Ireland for regulatory purposes. To replace BOSI (a subsidiary of LBG) with an LBG branch in Ireland, which would still have been subject to Irish prudential requirements in relation to its liquidity and Irish regulation in relation to its conduct, would not have achieved this outcome.

(7) Any mechanism that LBG undertook to end that mismatch would need to have the consent (or at least the non-objection) of both the FSA and the FR. The feasibility of the options identified by LBG in relation to its exit from Ireland therefore needs to be considered in light of the likely perspectives of the regulators.

(8) The options considered by LBG for exiting Ireland fell into two broad categories (i) a change of ownership; and (ii) a wind-down. The former category included the sale

of BOSI itself (i.e. selling BOSI's shares) or a sale of its assets. In his view, neither a sale of BOSI's shares nor a sale of its assets would have been acceptable from a regulatory perspective given the circumstances at the time as the FSA would have objected or withheld its consent to both alternatives on the basis that they were a threat to the FSA's statutory objectives. The two main reasons were:

(a) the sale of BOSI or its assets would not have resulted in the immediate repayment to LBG of the c. €20bn owed by BOSI and would have presented a disproportionately large long-term counterparty risk to LBG which would, in the FSA's view, have posed an unacceptable risk to the stability of LBG and thus the UK financial system; and

(b) In the case of an asset sale, until that had been completed, BOSI would remain within the jurisdiction of the FR which would: i) not remove the regulatory mismatch until such time that all assets were sold; and ii) leave any future repayment to LBG subject to the risk of being blocked or delayed by the FR, exposing LBG to the risk that a key element in its financial strength (repayments of amounts lent by LBG) was dependent on an overseas regulator.

(9) Any sale could also have been blocked by the FR if it did not fit with its overall objective of financial stability in the Irish market.

(10) In relation to a wind-down, five options were presented to the LBG Group Executive Committee in the June 2010 GEC Paper. The first option, would require a permanent establishment for regulatory purposes in Ireland and would not have ended the regulatory mismatch until such time that all assets were realised. A protracted wind-down was an ongoing regulatory risk in both Ireland and the UK, since the collapse of BOSI could contribute to the destabilisation of the Irish and UK financial systems. The remaining four options involved a transfer of the BOSI business to LBG either through a s33 transfer or a CBM. As no decision was made until 3 August 2010 it was highly unlikely due to the significant regulatory administration involved for the FR, the FSA and BOSI/LBG that a s33 transfer could have been effected by 31 December 2010 as the regulators have up to five months to approve a passporting application. In contrast, no counterparty risk arose with a CBM of BOSI as the assets passed outside the jurisdiction of the FR. No counterparty risk would have arisen with a s33 transfer but would only have covered the transfer of assets and liabilities governed by Irish law.

(11) It was his view that a transfer of the BOSI business to LBG (via a CBM), with the wind-down being managed by an independent Irish service company (i.e. one not owned by LBG) staffed by former BOSI employees was the option most likely to be acceptable to the FR and the FSA. This would reduce the risk that the FR would deem LBG to have a regulatory permanent establishment in Ireland, ending the regulatory mismatch. The involvement of former BOSI staff and the day-to-day servicing of the loan book from Ireland would address some of the concerns of the FR regarding the movement of assets outside the scope of its regulation.

365. In cross-examination, Mr Sharma confirmed that he had made a request to his instructing solicitors for further information, the additional documents that he had been provided were not listed in his report but were only referred to in his report and exhibited if they had been relied upon, [7/4/5-5/2 and 7/6/4-22]. He confirmed that only one document exhibited to his report, AM49, detailed LBG's interaction with either of the regulators, [7/6/25-7/14/7], and that his report in some instances provided opinions on alternatives that were not put to the regulators but hypothesised as to what would have been the regulatory considerations if they had been put to the regulator, [7/7/15-7/9/6].

Mr Tom Godfrey

366. Mr Tom Godfrey ("TG") is the Chairman and Chief Executive of IBI Corporate Finance Limited ("IBI"), a Corporate Finance adviser in the Irish market, advising on Mergers and Acquisitions ("M&A"), debt and equity capital raising and providing strategic advice to Irish public and private companies, Irish State and semi-state agencies. He had advised on banking transactions mainly for BoI but also for BNP Paribas, Irish Permanent, Irish Life & Permanent and the Irish Government in relation to TSB Bank and ACC Bank. He is a fellow of the Securities and Investment Institute.

367. He was instructed by LBG to provide an expert report on the possibility of a sale by LBG of BOSI or its portfolio of loans in the period 1 January 2009 to 31 December 2011 ("the Relevant Period"). He was not provided with any of the appeal documents [8/3/21-4/17] and the reference to Project Hermes paper at page 26 of his report was based upon the information provided by his instructing solicitors, he had not seen the document [8/2/24-3/20] He confirmed that he did not need to see any of BOSI's own documents in order to provide his expert report [8/4/5-12].

368. The Executive Summary of his Report stated that in his opinion it would not have been possible to sell BOSI or its loan portfolio in the Relevant Period. His opinion was based on:

(i) His M&A experience during the Relevant Period – in particular, advising BoI Group;

(ii) The poor state of the Irish economy which was effectively bankrupt and had received a bailout from the EU/IMF towards the end of 2010;

(iii) The very poor perception of Ireland as one of the so called PIIGS countries i.e., Portugal, Ireland, Italy, Greece and Spain;

(iv) Concerns over the future of the Eurozone itself which persisted until the 3rd quarter of 2012;

(v) The state of the indigenous Irish banking system where five of the six Irish banks were nationalised, some of which were in a superior financial position to BOSI (i.e. significantly lower loan losses);

(vi) The unattractive BOSI business/loan portfolio due to its risk taking/volume led business strategy, wholesale-funded financial profile and unseasoned (relatively recent) loan book;

(vii) The prohibition of acquisitions by banks in receipt of State Aid from the Irish State;

(viii) The lack of a "floor price" for loans which inhibited loan portfolio sales; and

(ix) The beleaguered state of banks globally and their focus understandably on balance sheet preservation.

369. His advice, during the Relevant Period, would have been for LBG to recapitalise, work out the loans as rigorously as possible, wait for the bottom of the market and position for sale of loan portfolios when the market showed signs of recovery and there was an established buyer group. His opinion was that the best way to maximise value from BOSI in LBG's exit from the Irish market would have been to sell the individual constituent parts over time when the markets improved to buyers who had an appetite for each asset class e.g., non-performing loans ("NPLs"), commercial, performing residential etc. This had been the method adopted by all the foreign banks that had exited the Irish market after the Relevant Period: Rabobank, Danske Bank, KBC Bank and Ulster Bank (NatWest). Save for the mergers of two

nationalised banks with other nationalised banks as directed by the Irish State and the purchase of impaired property loans by the NAMA, he was not aware of any Irish bank or portfolio sales in the Relevant Period. It was a matter of public record that Anglo Irish Bank ("Anglo"), Irish Nationwide Building Society ("INBS"), and the Educational Building Society ("EBS") all sought purchasers in the Relevant Period, and none were successful. He was also aware of another Irish bank that was proposed for sale without success. It was his view that there was no market for Irish Banks and he was not aware of any disposal of Irish loan portfolios in the Relevant Period. He considered BOSI to be a very poor asset, a view shared by the market. There would have been no market for BOSI in the Relevant Period.

370. His view, based on the Project Hermes paper prepared for the LBG Board on 3 August 2010, was that the internal forecasts at that time would have given rise to grave concern by any potential buyer about the magnitude of future capital/funding commitments.

371. In his experience any Private Equity buyers/Sovereign wealth funds etc. looking to acquire banks or bank assets in Ireland in the Relevant Period would have:

(1) Sought risk protection from the Irish State concerning the valuation of assets – this was not forthcoming as the Irish State would remain "on risk" notwithstanding the sale of the bank;

(2) been unlikely to be able to raise the necessary funding to fund the business and provide regulatory capital due to the dislocation of wholesale funding markets; and

(3) faced challenges in obtaining regulatory approval.

372. On the introduction of the Guarantee in September 2008 the fate of the Irish State became intertwined with the banks which in time also brought down the Irish State. This link between the Irish banks and the Irish State was described as a "doom loop" in which State and domestic bank risks fed each other, the Irish banking system became the most supported banking system in Europe in 2008.

373. As the Irish economy deteriorated, so too did the fiscal position of the banks and NPLs started to increase at a rapid rate. Early attempts to bolster banks' capital turned out to be woefully inadequate and several rounds of stress tests gave rise to larger and larger capital requirements.

374. The Irish economy, suffering from a domestic property crash and the global financial crisis, was unattractive for investors in the Relevant Period. The economy had grown significantly on the back of property development. Banks held significant amounts of security in the form of property assets. Post the crash in 2008, the face value of the loans significantly exceeded the underlying security value. Given falling property prices, a floor could not be established for the value of the underlying security. He considered it clear from this backdrop that, during the Relevant Period, the Irish economy was in a major crisis with even speculation about the future of the Eurozone. It was his view that a market for M&A in the Irish banking sector simply did not exist in the Relevant Period.

375. He was aware that a number of such potential buyers considered potential transactions but none proceeded. He referred to a media report (Sunday Tribune - "After two false dawns, night falls on Halifax", 14 February 2010) in the Relevant Period which stated that LBG hired a UK corporate finance adviser, Hawkpoint, to examine the potential sale of BOSI without local management's knowledge. It was reported that a US private equity firm, believed to be Blackstone, baulked at a deal to buy BOSI's assets at a significant discount having completed six weeks of due diligence. It was further reported that BOSI continued to seek purchasers for elements of the business from both local and international banks without

success. He concluded by stating that he could make no comment on the veracity of these reports.

376. He did not consider that the sale of BOSI for a nominal amount would have been a realistic proposition as a purchaser would have been exposed to the risk of potential claims and would need to arrange funding of €19.3bn to replace existing/LBG funding and inject regulatory capital of around €1.6bn. In his opinion, there was no possibility of BOSI's tax losses being taken into account in the pricing of any transaction by a purchaser as it was unclear whether there would have been any opportunity to use the losses.

377. In cross-examination he was asked why he did not ask his own client to furnish documents relating to the Hawkpoint instruction and the details of the proposed sale to Blackstone, and in particular the price being offered and the reason why the sale fell through. His response was that he had asked his instructing solicitors for the documents but that nothing was provided other than "*a response to proceed with my document as I saw fit*." [8/61/13-63/7]. He was not re-examined on that point. He confirmed that he was not aware of the MTP strategy [8/20/3-9]. He stated that he knew better than the senior staff at BOSI or LBG as to what was worth saving or not in 2009, [8/31/21-32/11].

378. Following Mr Godfrey's oral evidence that he had asked his instructing solicitors for documents in respect of the proposed sale to Blackstone, the Tribunal received a letter from STB the following day which stated:

> "Upon receipt of Mr Godfrey's report, we raised this matter with our client. LBG confirmed to us that having checked their internal records, LBG did not, in fact, engage Hawkpoint and LBG did not have any discussions with Blackstone. Further, LBG confirmed that they were not aware of any due diligence having been conducted by Blackstone with regard to BOSI. Accordingly, there were no documents to be shared with Mr Godfrey."

As HMRC submitted, the reference to Mr Godfrey's report in the letter was presumably on receipt of Mr Godfrey's draft report before it was finalised and served. STB's letter does not address whether Mr Godfrey did request the documents or, if he did, that he was told to proceed as he saw fit. In our judgment, the letter from STB is, as HMRC, submitted, an impermissible attempt by STB to give evidence after the event. Accordingly, we have attached no weight to the letter and accept Mr Godfrey's evidence in respect of Hawkpoint and the prospective deal with Blackstone.

Dutch Law Experts

379. The Dutch law expert reports were agreed by the parties and the experts did not attend to give evidence. The experts agreed on the relevant Dutch law and the availability of tax relief in the Netherlands. The experts were agreed that, as a matter of Dutch tax law, there was no possibility to transfer or utilise losses sustained by BOSI and SIF could not have taken into account a liquidation loss.

380. The principal reason that SIF could not claim such liquidation loss as a form of relief for the losses of BOSI, is that SIF transferred its shareholding in BOSI by way of a sale to its parent company BOS (which company was not subject to tax in the Netherlands or in any case not with respect to the acquired shares in BOSI). Only an actual liquidation of a subsidiary company could lead to recognition of a liquidation loss.

381. A fiscal unity was in place comprising the Dutch Permanent Establishment (PE) of BOS together with Quion BV (a 100% subsidiary of BOS) (BOS fiscal unity). The BOS fiscal unity was headed by the PE of BOS. SIF joined the fiscal unity from 1 January 2009.

382. The 2010 corporate income tax (CIT) return in the name of BOS shows that SIF had a stand-alone taxable profit of €128,675 which was off-set by a carried-forward pre-fiscal unity (2008) loss of €128,675. The loss of €5,318,193,445 in respect of the holding of shares in BOSI, included in the 2010 CIT return, was not deductible in the Netherlands as it was subject to the participation exemption. The Dutch tax authorities confirmed the existence of the BOS fiscal unity and its enlargement in 2009 and there were no queries in respect of it for 2010.

383. As a result of SIF joining the BOS fiscal unity from 1 January 2009, for CIT purposes, its balance sheet and profit and loss account (P&L) were absorbed in the balance sheet and P&L of the Dutch PE of BOS, the 'parent' of the BOS fiscal unity. This resulted in a full consolidation of its balance sheet and P&L for Dutch CIT purposes. For CIT purposes, profits were no longer calculated individually at the level of SIF or other members of the BOS fiscal unity, rather, there was one single taxable profit calculation for the entire BOS fiscal unity, which was considered the consolidated result of the Dutch PE of BOS.

384. Annually, the Dutch PE of BOS filed one single CIT return on behalf of the BOS fiscal unity and CIT was levied as if the consolidated taxable profits had been generated by the Dutch PE of BOS. For purposes of collecting the CIT though, any member of the BOS fiscal unity, including SIF, remained jointly and severally liable.

385. The 2010 stand-alone taxable profit of SIF, calculated in accordance with the profit split rules prescribed by the Dutch Corporate Income Tax Act (*Wet op de vennootschapsbelasting*) 1969 (CITA), was only relevant in the context of the BOS fiscal unity's use of the pre-fiscal unity losses of SIF in 2010.

386. The application of loss carry-over by the BOS fiscal unity, and in particular pertaining to the SIF pre-fiscal unity losses, took place in accordance with Dutch CIT rules. Such loss compensation, as far as financial year 2010 is concerned, was exhaustive.

387. The BOS fiscal unity (including SIF) could not utilise the BOSI 2010 losses under Dutch law. Furthermore, it could not utilise such losses under EU law, as interpreted by the Dutch tax courts and the CJEU. In accordance with Dutch tax law, it is not possible to transfer or utilise losses sustained by foreign subsidiary companies. As a matter of Dutch tax law, there was no possibility to transfer or utilise losses sustained by BOSI and SIF could not have taken into account a liquidation loss. The principal reason that SIF could not claim such liquidation loss as a form of relief for the losses of BOSI, is that SIF transferred its shareholding in BOSI by way of a sale to its parent company BOS (which company was not subject to tax in the Netherlands or in any case not with respect to the acquired shares in BOSI). Only an actual liquidation of a subsidiary company could lead to recognition of a liquidation loss. Therefore, given the way in which the restructuring involving BOSI was in fact implemented, there was no possibility for relief in the Netherlands in respect of the losses sustained by BOSI, nor for an investment loss sustained by SCI on the shares held in BOSI.

388. Both experts stated that the Dutch State Secretary of Finance was of the view that the Dutch liquidation loss regime is an adequate regime for importing foreign final losses and should be considered in line with *M&S*.

389. Articles 15-15al and 15a CITA form the legal basis of the Dutch fiscal unity. A Dutch tax resident parent company and its Dutch tax resident subsidiaries may, under certain conditions set out in article 15 CITA, most importantly a 95% or more shareholding and having the same fiscal year, jointly request the establishment of a fiscal unity. The request is filed with the Dutch Revenue Service and may have a retroactive effect of up to three months. Once established, the fiscal unity files a CIT return as one single entity. Pursuant to article 15(1) CITA, the effect of the fiscal unity is that the balance sheet and P&L of the

subsidiaries that are members of the fiscal unity are consolidated with the balance sheet and P&L of the parent of the fiscal unity and CIT is imposed on the members of the fiscal unity as if they were absorbed by the parent. A loss, incurred by a fiscal unity will be vertically carried back or forward against the taxable profits of the fiscal unity in previous and future years, as per the normal rules set out in CITA and subject to the relevant timing limitations.

Irish law experts

390. SH was instructed by the Appellant and MA by HMRC. Mr Hogan's report was dated 9 December 2022 and Mr Ashe's report dated 19 January 2023. SH is an Irish qualified solicitor, chartered accountant and chartered tax adviser and a partner and head of tax at Matheson LLP, Dublin. MA is a barrister and has practised at the Irish Bar since 1978 and was appointed a Senior Counsel in 2000. He has also practised at the bar in England and Wales since 1978 and is a KC. The experts were not instructed to provide their opinion on the same questions of Irish tax law. The joint expert report set out areas of agreement and disagreement, we have incorporated their respective responses into the summary of their reports below.

Mr Hogan's expert report

391. Mr Hogan's report addressed seven issues as follows:

(1) Issue 1: Whether any other options were available to the LBG group to use the BOSI 2010 Trading Losses in Ireland in its 2010 accounting period or in prior periods.

Mr Hogan was informed by STB that in the 2010 accounting period BOSI (i) surrendered as much of the BOSI 2010 Trading Losses by way of Group Relief to other Irish tax resident group companies as was possible; and (ii) made a claim for Terminal Loss Relief in respect of the BOSI 2010 Trading Losses. On 19 December 2013, that the Irish Revenue wrote to LBG confirming that "All permissible claims under Irish tax law for all available loss relief or loss surrenders by or to [BOSI] have been made and effected and in respect of the residual unrelieved Irish tax losses of BOSI". He agreed as all other avenues for utilising the relevant trading losses must have been exhausted before Terminal Loss Relief could be claimed.

Mr Ashe considered the question of whether other options were available to BOSI was a question of fact.

(2) Issue 2: Where BOSI had continued to carry on its business as usual, whether there were any circumstances in which the BOSI 2010 Trading Losses could have been carried forward and used in future (or other) periods.

Mr Hogan considered that whether BOSI could be considered to be carrying on the same trade is a question of fact.

Mr Ashe agreed.

(3) Issue 3: On the assumption that BOSI had been sold to an unrelated third party, in what circumstances (if any) could the BOSI 2010 Trading Losses have been used by BOSI itself or by the third party purchaser of BOSI (or any member of the third party's group).

Mr Hogan considered that the sale of BOSI to an unrelated third party would not have altered the availability of the BOSI 2010 trading losses for future use by BOSI subject to circumstances where the s401 restriction applied. The s401 restriction applied if in addition to the change in ownership of BOSI there was a "major change in the nature or conduct" of BOSI's trade in the prescribed 3 year period or if BOSI's trade had become "small or negligible". The question of whether there was a "major change in

the nature or conduct" or the trade had become "small or negligible" were questions of fact.

Mr Ashe agreed.

(4) Issue 4: Whether there were any circumstances in which the BOSI 2010 Trading Losses could have been transferred to a third party purchaser of the whole or part of the assets or business of BOSI or used, post-transfer, by BOSI.

Mr Hogan's view was that had BOSI's whole trade or part only been transferred to a third party it would not have been possible for the third party to utilise the BOSI 2010 trading losses. Where only part of the trade had been transferred it would be a question of fact whether BOSI was continuing to carry on the same trade.

Mr Ashe agreed.

(5) Issue 5: The circumstances in which the BOSI 2010 Trading Losses could have been transferred to BOS (or another member of the LBG group).

As Mr Hogan stated at (1), Group Relief surrenders were made to the maximum extent possible. The Group Relief provisions apply to the current period only, it would not have been possible for BOSI to carry forward the losses to offset against the income of an Irish branch or Irish subsidiary of BOS in a future period. Reconstruction relief may have been available where the s400(5) conditions were satisfied but would not be available to a successor unless it succeeded to BOSI's trade and was within the charge to Irish tax, a question of fact. A service provider, such as Certus, could not have been said to have succeeded BOSI's trade.

Mr Ashe agreed.

(6) Issue 6: Whether, in circumstances where BOSI had simply wound down its business under its then current structure, there would have been any restrictions on its ability to carry-forward and utilise the BOSI 2010 Trading Losses in future periods.

Mr Hogan considered that BOSI should have been in a position to carry forward the BOSI 2010 Trading Losses for offset against the first available profits of the same trade in future periods (section 396(1) TCA). It would be a question of fact whether BOSI was carrying on the same trade particularly in the context of winding down its business and cessation of new loans.

Mr Ashe agreed and noted that winding down a business may indicate that the trade continued but on a smaller scale but it was a question of fact.

(7) Issue 7: Whether there would have been any Irish tax difference between the CBM and a transfer of BOSI's business pursuant to section 33 of the Central Bank Act 1971.

Mr Hogan considered that a s33 transfer of BOSI's trade to an Irish branch or subsidiary of BOS may have resulted in the losses transferring on the basis of Reconstruction Relief (provided the s400(5) conditions were satisfied) and being available for offset against the profits of the Irish branch or subsidiary as long as it continued to carry on the same trade. If, immediately after a s33 transfer, the assets had been transferred to the UK and the Irish branch was used to perform a service function (of the type provided by Certus) or if Certus was used to perform the service function it is likely it would not be carrying on the same trade and the losses would not be available for use in future periods.

Mr Ashe agreed.

Mr Ashe was instructed to opine on the following questions:

(8) We request your expert opinion on the scope of Irish law, during the relevant periods, as to the ways in which and extent to which tax relief for corporate losses such as BOSI's could be obtained by way of transfer, sale or other application of corporate losses both (i) generally (including, but not limited, to "sideways loss relief" and carrying forward of losses, (ii) in the circumstances described in para. 6.4.

Both experts agreed the relevant provisions of Irish law (set out at paragraph 27 above)

(9) We further request that you set out:

(a) the facts and circumstances which are or could be relevant in determining whether BOSI's losses could have been utilised in Ireland;

(b) a reasoned opinion as to the circumstances in which BOSI's losses could have been utilised in Ireland (regardless for present purposes of whether it was commercially viable to do so or not) including any legal bars which would have prevented BOSI's losses to continue to be carried forward and deducted by another company of the LBG group or any third party in Ireland.

Had BOSI not ceased to exist and its trade remained the same then the losses could be carried forward without limit and utilised against future profits. A loss sustained by BOSI in a particular accounting period could have been surrendered inter-group in Ireland to a claimant company to set against its total profits for the corresponding accounting period. If there had been a company reconstruction without change of ownership the discontinuance of trade provisions would not apply and the successor company could utilise and carry forward the losses. There was limited scope for a third party to utilise the losses, there were specific anti-avoidance provisions to avoid the abuse of reliefs to gain a tax advantage. There would be no bar in Irish law to selling a loss-making company, if the share capital were sold to a third party carrying on the same trade.

SH agreed subject to minor clarifications and the question of whether the trade remained the same was a question of fact.

(10) In considering the circumstances in which BOSI's losses could have been utilised in Ireland, please provide your opinion on the possibilities to use or transfer BOSI's losses in Ireland in the following scenarios:

The possibility of a sale of BOSI's trade (or part of a trade) and/or assets together with the associated losses to a third party, whether the sale was conducted by BOSI itself or via its intermediate parent company (SCI and later BOS) or its ultimate parent.

The sale of the trade would be the occasion of discontinuance of the trade and could not be carried forward and used by a third party and BOSI would have a terminal loss.

SH agreed.

(11) In considering the circumstances in which BOSI's losses could have been utilised in Ireland, please provide your opinion on the possibilities to use or transfer BOSI's losses in Ireland in the following scenarios:

The possibility of a sale of BOSI's trade (or part of a trade) and/or assets together with the associated losses to SCI.

Such a transaction would have been within s400 TCA as a company reconstruction without change of ownership and the trade would not have been treated as discontinued

so that SCI as successor carrying on the same trade could carry forward the losses to set against future profits.

SH agreed subject to the question of "carrying on the same trade" is a question of fact and ensuring the s401 restriction was not triggered.

(12) In considering the circumstances in which BOSI's losses could have been utilised in Ireland, please provide your opinion on the possibilities to use or transfer BOSI's losses in Ireland in the following scenarios:

> The possibility of a transfer of the trade or part of a trade to an associated Irish company of the LBG group which would then be sold to a third party

If the transaction fell within s400 TCA followed by the sale of the trade to a third party that would then have given rise to a discontinuance of the trade.

SH agreed and clarified that once a trade has been discontinued then losses in that trade will be lost and not available to carry forward.

(13) In considering the circumstances in which BOSI's losses could have been utilised in Ireland, please provide your opinion on the possibilities to use or transfer BOSI's losses in Ireland in the following scenarios:

> The possibility of the sale of the shares in BOSI to an associated Irish company of the LBG group in Ireland.

If the BOSI shares were sold then the losses could have been utilised by BOSI in the usual way.

SH agreed subject to not triggering the s401 restriction.

(14) In considering the circumstances in which BOSI's losses could have been utilised in Ireland, please provide your opinion on the possibilities to use or transfer BOSI's losses in Ireland in the following options as described in the Project Hermes paper of June 2010

> Option 1: Wind down the business in the current structure so that its future residual income is covered by losses brought forward.

The carry-forward of losses provision would be relevant and whether the trade continued is a matter of fact.

SH agreed.

(15) Option 2: Transfer the business to LBG and manage the wind down from the UK.

LBG would be managing from the UK the wind down of the former BOSI business and that trade would have discontinued on the transfer of the business.

SH agreed.

(16) Option 3: Transfer the business to LBG by means of a cross-border merger and manage the wind-down of its loan book via a LBG-owned Irish resident servicing entity staffed by current BOSI colleagues.

LBG would probably not be continuing the trade of BOSI as it would be a service company managing the wind down and not within s400 TCA and therefore not entitled to the losses. The question of whether the trade continued would be a matter of fact.

SH agreed.

(17) Option 4: transfer the business to LBG by means of a section 33 transfer under Irish law, but manage the wind down of its loan book via an independent Irish resident entity albeit one which would be staffed with ex-BOSI colleagues.

It may be possible to comply with s400 TCA so that the successor could utilise the losses, it would be a question of fact whether the same trade was carried on.

SH agrees but on the basis that the BOSI business remained within the charge to Irish tax following the s33 transfer and subject to his comments in the second sentence at issue (7) above.

(18) Option 5: transfer the business to LBG and manage the wind-down of the loan book via an Irish resident third party provider.

The same points apply as per option 4. SH agrees but if the transfer of BOSI business was to a UK entity then the position would be more akin MA's response to query 9 (Option 3).

(19) In considering the circumstances in which BOSI's losses could have been utilised in Ireland, please provide your opinion on the possibilities to use or transfer BOSI's losses in Ireland in the following scenarios:

> The possibilities of a transfer by means of a derivative – the idea known as Hermes "Option B".

As he understood Option B, this required BOSI to remain in place and expand its Irish operations. Assuming that such an expansion was the expansion of the trade BOSI had been conducting then the losses accumulated could have been carried forward and set against the profits of that trade.

SH agreed.

(20) Assuming that BOSI, an Irish resident company, had several branches in Northern Ireland constituting a non-resident Permanent Establishment ("NRPE"), which had profits or losses attributed to it under the Ireland-UK Double Tax Agreement for the business carried out in Northern Ireland, how would these losses be treated in Ireland?

The Double Tax Treaty is concerned with the avoidance of double taxation in any particular tax period. It is not concerned with tax losses specifically and indeed Schedule 24 TCA is not so concerned as it is dealing with what can be credited against a liability to Irish tax. In his opinion, the issue is whether Ireland is bound to give a credit under the Treaty against Irish tax in relation to UK tax on profits attributable to the permanent establishment of the Irish enterprise. There is no independent system of losses of the permanent establishment under the provisions of the treaty. Under Irish law there would have been no separate calculation of loss necessary in Ireland for the UK permanent establishment as it was subject to charge on its worldwide income.

SH agreed.

(21) Is there any domestic legislation in Irish law that would prevent the double deduction of a loss incurred by a company with a NRPE. For example, in this case could the NRPE's losses be relieved in the UK and Ireland i.e once in Ireland by being offset against profits in the year or carried forward to offset against profits in future year, and once again by the UK NRPE in the UK by being carried forward to offset against future UK branch profits? Would any part of the amount unutilised as at 31st December 2010 still be available for offset against the Northern Ireland profits even if,

from 1st January 2011, the Northern Ireland branch may have been subsumed into BOS as part of the merger?

No. Under the Double Taxation Treaty BOSI is only taxable in Ireland unless it carries on business in the UK through a permanent establishment, it was within the charge to Irish tax on its world-wide income including UK income. The Irish computation of BOSI's profits would bring into account the expenses permitted under UK law attributable to the UK permanent establishment. Where there is a loss in Ireland that will mean that no corporation tax was payable on BOSI's world-wide trading income and the loss will have been carried forward in Ireland until BOSI ceased to exist on 31st December 2010. With regard to the "Northern Ireland profits" while BOSI existed, those profits would have been part of its profits for Irish tax notwithstanding the UK's taxing rights. After 31st December 2010 it was solely a matter of UK law as to how those profits in Northern Ireland were dealt with. Once BOSI ceased to exist the permanent establishment under the Treaty ceased to exist.

SH agreed.

(22) Does Irish tax legislation provide for any part of a loss of an Irish resident company to be attributable to its non-resident permanent establishment for Irish tax purposes? If so, how does this apply to the unused BOSI loss and its UK permanent establishment for the APE 31st December 2010?

A permanent establishment is a creature of the Double Tax Treaty. Irish tax legislation does not deal with permanent establishments as such because the world-wide profits of the enterprise which has the permanent enterprise are brought into charge in Ireland subject to any credit for UK tax being allowed. At APE 31st December 2010 he would expect the computation for corporation tax in respect of BOSI to have included the world-wide income of that company together with its world-wide allowable expenses and any claim for losses carried forward.

SH agreed.

(23) In respect of corporate losses that can be carried forward for offset against profits in future accounting periods by the loss-making company, does Irish tax legislation provide for such carried-forward corporate tax losses to be relieved against profit made in future accounting periods by related companies which are part of the same group such as sister companies or other affiliated companies from 2010 onward i.e. sideways relief for carried-forward losses?

There is no sideways relief for carry-forward losses (the exception is considered below). Section 420 TCA provides that a loss suffered by a surrendering company in an accounting period may be surrendered and set off against the total profits of a claimant company in its corresponding accounting period.

SH agreed save that the reference should be s420A TCA.

(24) If not set out in your response to the above question, what would have been the implications for historic tax losses carried forward if property-related debts of BOSI had been acquired by the Irish Government in return for government guaranteed securities under the National Management Agency Scheme ("NAMA")?

(25) If BOSI had been designated by the Minister as a participating institution under s67 NAMA s396C TCA provided for relief for losses of such institutions. Section 396C TCA permitted a participating institution with unused losses brought forward in an accounting period to transfer an amount of those losses to another group company

participating in the NAMA scheme that had the same accounting period. Section 393C TCA placed a limit on the amount of the trading income against which losses carried forward could be set off in any accounting period. In effect the losses brought forward by the participating institution could be used to offset group income up to a limit of 50% of that income.

SH agreed and emphasised that entering NAMA was not within BOSI's control.

(26) Please also set out and explain in your report the conditions for section 401 of the Taxes Consolidation Act 1967 to apply and, in particular, what would constitute, under that section, a major change in the activities of a trade so that the deduction of unrelieved losses could be denied.

Section 401 TCA disallows the carry forward of a trading loss if (a) within a period of three years there is both a change in ownership of a company and (either earlier or later in that period, or at the same time) a major change in the nature or conduct of the trade by the company; or (b) at any time after the scale of the activities in a trade carried on by a company has become small or negligible and before any considerable revival of the trade, there is a change in ownership of the company (s. 401(2) TCA). Schedule 9 provides the detailed rules on change of ownership but suffice it to say for present purposes that a change in ownership would occur where more than 50% of the beneficial ownership of the ordinary share capital changed hands. A change of ownership within a group is disregarded. Section 401(1) TCA sets out the definition of "*a major change in nature or conduct of a trade*". Whether or not there was a major change in the nature or conduct of a trade would be a matter of fact for the fact finding tribunal.

SH agreed.

392. In cross-examination SH accepted that the four-page briefing paper appended to his report was the totality of his instructions and information provided, he had not been provided with any case documents. SH confirmed that he was not made aware that BOSI's decision not to write any new loan business in retail or wholesale had been taken and effected in 2009 contrary to what was stated in paragraph 2.5 of his report – "*In early 2010, the decision was taken ... and to cease all loan origination*" stating "*It was news to me*." [9/9/3]. His evidence was that he did not consider that the new information would change anything in his report. He further confirmed that he was not made aware of the extent of the impairments in 2010.

SUBMISSIONS

While we are grateful to counsel for their detailed and comprehensive submissions, both written and oral, which have been carefully considered, it has not been necessary to address each and every argument advanced on behalf of the parties in reaching our conclusions.

LBG'S SUBMISSIONS

393. LBG's submissions are summarised as follows.

394. In 2009 and 2010, LBG grappled with the consequences of the acquisition of HBOS. In early 2009, LBG was able to review HBOS's books in detail for the first time. At the same time, LBG's risk function advised that the economic outlook was far worse than LBG (and most of the market) had predicted in 2008; LBG increased its forecasts of HBOS's impairments such that the total impairment figures for 2008 and 2009 were estimated at that time to be £23.9bn.

395. During 2008, as markets worsened, bank capital ratios became a key measure of financial strength and a point of focus for regulators and investors. The FSA nearly doubled the amount of capital that it expected banks to hold. Around the same time that LBG was coming to terms with HBOS's books, the FSA conducted stress tests on LBG to ensure that its capital was sufficient to withstand future adverse events. The stress tests used more severe economic reference points than had previously been applied, as a result LBG had to raise an additional £24-£29bn of Core Tier 1 Capital in 2009. Some of the capital had to be raised by the issue of shares to the UK Government.

396. LBG spent much of 2009 exploring ways to raise additional capital. Because of its 2008 impairments (and other reasons), in 2008, HBOS made a loss of approximately £11bn. In 2009, BOS made a loss of approximately £16bn and Lloyds Bank plc (the main banking entity within the legacy LTSB) made a loss of approximately £4.38bn. Although the LBG accounts showed a consolidated pre-tax accounting profit of approximately £281m in 2010, in that year the group suffered a significant increase in loss before tax in the W&I division, which was driven by a higher impairment charge, predominantly due to the material deterioration of the economic environment in Ireland.

397. When LTSB acquired HBOS, BOSI was a full service wholesale and retail bank in the Republic of Ireland and Northern Ireland. BOSI, as an Irish credit institution, was subject to regulation by the FR and was required to maintain a prescribed level of regulatory capital and liquidity as a condition to maintaining its Irish banking licence. At the same time, the LBG group, as a UK based financial business, was subject to regulation by the UK financial regulator, which at the time was the FSA. This dual regulation (in Ireland and the UK) created challenges as bank regulators imposed more stringent regulatory requirements on banks.

398. In the years leading up to 2009, BOSI had grown substantially to hold approximately €33bn of assets. Approximately 40% of BOSI's loan assets comprised loans made by it to the CRE sector in Ireland. Of its remaining loan assets, approximately 30% comprised non-CRE commercial loans and the rest were retail mortgages and loans. BOSI's loans to the CRE sector had grown significantly and this growth had been facilitated by the provision of the Guarantee from BOS.

399. Against a backdrop of the worsening economic environment in Ireland, BOSI's performance deteriorated rapidly. In 2008, BOSI suffered an impairment charge of £526m. However, in 2009 this grew significantly and BOSI's impairment charge for 2009 was £2.949bn. During 2010, the position deteriorated even further than had been anticipated. The full year position in 2010 was that BOSI suffered an impairment charge of £4.26bn. As at the end of 2010, BOSI's cumulative impairments on its loans and advances to customers stood at £7.8bn. As a public listed company, LBG had to periodically update the market on the group's impairment charges and it had to increase its forecast for the Irish impairments several times throughout 2010. LBG struggled to ensure adequate control and stem the increasing impairment losses in Ireland.

400. This led to regulatory pressure on LBG from different directions. BOSI needed additional capital to ensure it met minimum Irish regulatory requirements. At the same time, LBG was required to maintain an appropriate capital position in the UK. Management of these dual regulatory requirements was a significant consideration for LBG because raising additional regulatory capital in 2009 and 2010 was difficult. LBG also came under pressure from both the FSA and the Irish financial regulator regarding the Guarantee. The Irish financial regulator became concerned that BOS may default on the Guarantee and therefore wanted it replaced with share capital. At the same time, the FSA wanted LBG to limit the UK

group's exposure to the Guarantee because it wanted the assets of BOS to support the risks in the UK business rather than in the Irish business.

401. Due to BOSI's poor financial state, BOSI was unable to raise its own liquidity and funding. It became almost entirely dependent on the LBG group. At the same time, LBG was facing its own liquidity and funding challenges. By the end of 2009, LBG was reliant on £157bn of funding and liquidity support from the UK Government and Bank of England. Part of this had to be used to fund BOSI. By the Spring of 2010, LBG had provided €20bn of loan funding to BOSI to prop up its business and BOSI was totally reliant on LBG for survival.

402. To deal with the regulatory and funding challenges LBG was facing, as well as the challenge from the EU in respect of the state aid that LBG had received from the UK Government, in 2009, LBG's directors decided that the LBG group should have a UK focus. In the Summer of 2009, LBG publicly announced that it would reduce the size of its non-core assets by approximately £200bn over the next 5 years. Having made this announcement, LBG was expected to both measure and report progress on its non-core asset reductions to the market. LBG determined, at the outset of its non-core asset reduction strategy that BOSI was non-core. There was also significant market and shareholder pressure on LBG to clarify its strategy in Ireland, particularly given the development of the PIIGS (Portugal, Italy, Ireland, Greece and Spain) Eurozone crisis and the continually increasing impairments in BOSI.

403. Following the required recapitalisations, UKFI held approximately 43% of LBG's shares, and two representatives of UKFI sat on the Board of LBG as non-executive directors (NEDs). These NEDs were in favour of LBG's strategies of mainly focussing on the financial service markets in the UK and reducing LBG's non-core business, which included the Irish business.

404. In addition, there were significant challenges to colleague morale and engagement in Ireland. It was against the backdrop of all of these issues that the GEC took the decision in early Summer 2010 to recommend a full exit from Ireland to the LBG Board. The appropriate mechanism for exiting Ireland needed to be determined but it had to meet the desired commercial objectives which included:

(1) communicating a strong and decisive market message that LBG had exited the Irish market permanently;

(2) utilising LBG's well established and strong BSU in the UK to maximise recoveries from the Irish portfolio;

(3) eliminating the need for a regulated presence in Ireland so that LBG was able to deal with a single regulator in the UK going forward;

(4) utilising key BOSI employees who had considerable knowledge and experience of the Irish portfolio and were close to the customers to help with managing this portfolio; and

(5) being achievable quickly and cleanly.

The exit on 31 December 2010 achieved those aims.

405. The CBM was favoured because there were significant disadvantages associated with a s33 transfer, as it required the approval of the MF. In addition, the s33 transfer did not cover the transfer of non-Irish law governed contracts (BOSI had a substantial Northern Ireland branch with non-Irish law assets and was party to derivatives which were not governed by Irish law) and would have required significant legal due diligence to determine which assets were not covered. Assets not covered would have to be transferred individually which would have required obtaining the consent of each and every counterparty. This was not feasible. A

s33 transfer also had to be a transfer to an Irish regulated company or an Irish branch of an EU credit institution which would have required prior regulatory approvals and would have been subject to ongoing regulatory supervision by the FR. The existence of an Irish branch would have meant continued Irish regulation and would not have enabled a clear message to be given to the market that LBG had exited the Irish market (unlike the CBM, which allowed the immediate surrender of BOSI's Irish banking licence). In addition, LBG believed that a liquidation of BOSI following a s33 transfer would be optically less attractive to external stakeholders, including the FR.

406. LBG wished to move control of the Irish loan book to the UK in order to manage and maximise asset recoveries by the London BSU. At the same time, LBG wanted to maintain contacts and relationships with the customers who BOSI had lent to. That was why LBG engaged the services of Certus, an independent loan serving entity staffed by former BOSI employees. Certus provided local services to BOS in relation to the Irish loan book but control and decision making regarding the loan book resided with the London BSU. Certus assisted with the processing of collections from customers and provided administrative services in relation to the Irish loans. Certus was chosen for this role as it was run and staffed by those familiar with the Irish loan book and, compared with other third party providers, was cheaper and only required one contract. A final decision to use Certus was not taken until after the LBG Board meeting on 3 August 2010.

407. On 17 September 2010, the Dutch intermediary holding company, SIF, transferred its holding of the entire share capital of BOSI to BOS. This transfer was effected in order to enable the merger of BOSI into BOS to be by way of a merger by absorption. Under the CBM by way of absorption, BOS acquired all the assets and liabilities of BOSI without the need to issue any shares in BOS. If SIF had remained the intermediary holding company of BOSI, it would not have been possible to effect a CBM because a CBM in this case would have required the issue of shares by BOS to the shareholder of BOSI (i.e. SIF). That would have resulted in SIF becoming a member of BOS, which it could not do as a matter of company law. Accordingly, BOSI needed to become a direct subsidiary of BOS which is why BOSI was transferred from SIF to BOS.

Section 119 qualifying loss condition

408. The main issue is whether the qualifying loss condition in s119 was met. The UK domestic legislation imposes its own test of finality of losses, namely the qualifying loss condition in s119. To the extent that the test in s119 is met, losses will be "final" in accordance with the UK's domestic law, irrespective of whether or not the para 55 conditions were met. The qualifying loss condition in s119 is met if the losses which are the subject of the CBGR claim could not be taken into account in calculating the taxable profits or gains of BOSI or any other person for Irish tax purposes, or otherwise be relieved (e.g., by credit or reduction of tax liability) for Irish tax purposes, in any future period (the "no possibilities test").

409. Under s119(4), the determination of the no possibilities test is to be made "*at the time immediately after the end of the EEA accounting period*". BOSI's EEA accounting period terminated immediately upon the CBM taking effect. Accordingly, immediately after the end of the EEA accounting period (i.e., the time at which the no possibilities test is required to be determined pursuant to UK domestic law) BOSI had no assets or source of income and had ceased to exist. The qualifying loss condition in s119 was therefore met in respect of the CBGR claimed by LBG. LBG does not accept, per HMRC's Statement of Case, that "*options*" were available as none of those were factually or legally possible as BOSI had ceased to exist at the time at which the no possibilities test is to be determined. As all

permissible claims under Irish law for all available loss relief and/or loss surrenders by or to BOSI were made, the residual losses of BOSI to which the claim by LBG for CBGR relates are final losses in respect of which the no possibilities test and the qualifying loss condition in s119 were met.

Section 121 precedence condition

410. Section 121 provides that an amount of losses will meet the precedence condition "*so far as no relief can be given for it*" in any territory which is outside the UK, is not the same territory as that in which the surrendering company is resident (which is Ireland in the present case) but is a territory in which a company is resident that owns, directly or indirectly, ordinary share capital in the surrendering company (BOSI). Here, the precedence condition is met because there was no territory in which relief could have been given for the losses of BOSI. There was no company resident in a territory outside the UK that owned ordinary share capital in BOSI at the time that the precedence condition is to be applied.

Section 127 main purpose

411. Section 127 disallows a loss if it would not have been eligible for group relief but for any arrangements the main purpose, or one of the main purposes, of which is to secure that the loss or part of it may be surrendered as group relief.

412. The purpose of the arrangements was the exit from the Irish market in a manner that met LBG's commercial requirements: to send a clear signal to shareholders, investors, analysts and ratings agencies that LBG had exited the Irish market permanently; to have the Irish loan book managed by the experts in the London BSU so that recoveries from that loan portfolio could be maximised; to eliminate the challenges presented by being regulated by two sets of regulators; and to ensure that LBG would not be required to commit further resources such as regulatory capital, liquidity and funding to Ireland. An exit by way of a CBM achieved these objectives. Other ways of exiting Ireland had legal and/or commercial disadvantages that made them unattractive compared with a CBM. Project Hermes was a wholly commercial transaction and the decision was not driven by any tax analysis.

413. The main purposes of the relevant arrangements are to be tested by reference to the purposes of the ultimate "decision makers" unless those persons have ceded control to other persons, *Oxford Instruments.* In this case, control had not been ceded and the "decision makers" were the members of the LBG Board and the Sub-Committee appointed by that Board. Considering whether CBGR is available in particular circumstances does not mean that securing such relief was a purpose, let alone a main purpose, of the arrangements. There is no requirement to effect transactions in the most tax inefficient manner possible. The manner in which HMRC is seeking to apply s127 is not consistent with EU law which only precludes group relief surrenders involving "wholly artificial arrangements" which was not the case here. The possibility of obtaining CBGR was a potential benefit flowing from the transaction but it was not a main purpose (*Euromoney Institutional Investor plc v HMRC* [2021] S.F.T.D. 891 ("*Euromoney*") at [95])

414. In the further and final alternative, even if it could be demonstrated that the arrangements in question did fall within the ambit of s127 CTA, the manner in which HMRC has sought to apply s127 to deny CBGR contravenes Article 49 (in conjunction with Article 54) TFEU. Section 127 must be construed in a way so as not to undermine the objectives of EU law or frustrate applicable EU jurisprudence as regards the rights conferred on nationals of EU Member States. Despite the UK having left the EU at the end of 31 December 2020, UK domestic law enacted before that date, such as the CBGR rules, must be interpreted in accordance with EU law as applicable at that date.

415. Section 127 must therefore be interpreted in accordance with the decision of the CJEU in *Cadbury Schweppes* (C-196/04) ("*Cadbury Schweppes*"). This means that any purpose test should only apply to "*wholly artificial arrangements*". To the extent that the provision is applied in a manner that goes further than necessary to achieve the legitimate purpose of excluding "*wholly artificial arrangements*", s127 would represent an infringement of EU law.

HMRC'S SUBMISSIONS

416. HMRC's submissions are summarised as follows.

417. LBG has sought to re-characterise the nature of the primary evidence. The contemporaneous documentary evidence makes clear that seeking CBGR was either the main driver or one of the main drivers when LBG considered the options available in 2009/2010 before executing the CBM. It is significant that LBG has not adduced witness evidence from those individuals who, it is clear from the contemporaneous documentation, were closely involved in the design and implementation of the arrangements which are the subject of this appeal.

418. Questions of direct tax are matters of retained competence. It is therefore for each Member State to design their own system of taxation as they see fit. As confirmed by the CJEU in *FII* at [47], who is liable to direct forms of taxation, on what basis and in what amounts are therefore matters of retained Member State competence.

419. *M&S* is a foundational authority on the question of when a Parent company in Member State A might be entitled to seek to use losses incurred in a trade carried on by its subsidiary established in Member State B by setting them off against its own profits chargeable to tax in Member State A, thereby reducing its liability to corporation tax in Member State A. The CJEU accepted that the differential treatment of resident and non-resident group subsidiaries could be objectively justified on three bases:

(1) Protecting the balanced allocation of the power to impose taxes.

(2) Member States must be entitled to prevent losses from being used more than once.

(3) The risk of tax avoidance.

420. The CJEU agreed that those three justifications together were legitimate objectives which were compatible with Article 49 TFEU. The CJEU said that measures denying group relief in respect of a loss from a non-resident subsidiary would be disproportionate only where the para 55 conditions were met.

421. In *Re A Oy* the CJEU confirmed that the burden of proving the no possibilities test was on the taxpayer, [at 49]. It was for the national court to determine whether the taxpayer discharges that burden on the facts, [at 54].

422. LBG suggests that the UK legislation that seeks to implement the principles in *M&S* must be read separately to that case and the CJEU case law that followed it. Parliament's clear intention was to enact legislation that would comply with the principles in *M&S*. Parliament was seeking only to amend its legislation to ensure that CBGR was available to meet the Para 55 conditions and no more. Plainly what became Chapter 3 of Part 5 was not seeking to "*gold-plate*" the CJEU's ruling, by making CBGR available in a wider set of circumstances than the Para 55 conditions required.

423. Case C-172/13 *Commission v UK* ("*EC v UK*") involved a challenge to the way the UK responded to the judgment in *M&S* in its reform of the group loss regime by way of the CTA . Specifically, the Commission contended that the CTA did not in fact comply with the CJEU's decision in *M&S*, because "*the possibility of obtaining cross-border group relief is*

virtually impossible under United Kingdom law", a challenge that was comprehensively rejected by the CJEU and which cannot now be revisited by LBG. The Court held that: "*Sections 118 and 119(1) to (3) of the CTA 2010 allow losses sustained by a non-resident subsidiary to be taken into account by the resident parent company in the situations contemplated in paragraph 55 of the judgment in Marks & Spencer…*".

424. The Court further rejected the Commission's contention that s119(4) made it virtually impossible to be able to claim CBG relief in respect of a non-resident's losses. LBG seeks to rely on s119(4) insofar as it provides that the time at which the "*no possibilities*" test is to be taken into account is "*at the time immediately after the end of the EEA accounting period*". LBG seeks to contend that because the CBM took place immediately before the end of the EEA accounting period (31 December 2010) there was no possibility of BOSI's losses being used in Ireland because it had ceased to exist and had no assets or source of income and accuse HMRC of ignoring the clear words of s119 by seeking to apply the "*no possibilities*" test immediately prior to the dissolution of BOSI. It is simply not the case that EU law gives a parent the power to dissolve a non-resident subsidiary and, through that choice, generate definitive losses. BOSI had a range of possibilities prior to the end of the 2010 accounting period. Several of those possibilities would have enabled BOSI's losses to be used such as to preclude the possibility of there being definitive losses. On LBG's construction, a parent has a power to elect to create definitive losses: that is plainly inconsistent with the case law that s119 was enacted to give effect to and in light of which it must be interpreted.

425. Decisions post *M&S* have narrowed the para 55 test. Whether a loss might be a final or definitive loss was considered in case C-322/11 *K*. In *K ,* the CJEU made clear that a Member State is not required to take into account losses from a non-resident activity if taking the losses into account at the place where the activity took place is precluded by law ('*the legal bar exclusion of final or definitive losses'*), at [76]-[81].

426. In case C-123/11 *A Oy*, the CJEU concluded that the liquidation of a subsidiary which had essentially ceased trading was not sufficient in itself to support the assumption that there was no longer any possibility of relief for it in its State of residence such as to give rise to final or definitive losses.

427. Whether a loss might be a final or definitive loss was considered again in *Memira* and *Holmen*. The AG in *Memira* applied the principle in C-123/11 *A Oy* in concluding that where a non-resident subsidiary was liquidated following a merger with the resident parent, the existing losses in the subsidiary's State of residence could not be automatically regarded as final or definitive losses (AGO, paras 49 – 50).

428. The unilateral choice of LBG to pursue a CBM (over other available options) is a further reason why those losses cannot be final or definitive as such losses are not within the gift of the taxpayer: a point reinforced by the fact that choice was exercised in order to crystalise the losses to support a claim for CBGR. Thus, BOSI's 2010 losses cannot become final losses by, immediately before the end of the 2010 accounting period, pursuing a CBM by which BOSI ceased to exist whereupon, by operation of law, it can no longer exist such that, for example, it is no longer able to sell its business or assets, or to sell its shares to a third party such that BOSI might continue to trade, or to undergo a group restructure to permit another group company to continue the trade, even in run-off. Thus, a distinction must be drawn between losses that cannot be used in law (which losses cannot be final losses, those losses arising as a result of a legal bar, and where other Member States cannot be expected to adapt their tax legislation to provide for the consequences of those legal bars) and losses that cannot be used in fact (which can be final losses), AGO at [66] *Memira*.

429. LBG seeks to play down the significance of *Memira* and *Holmen* and also ignores the fact that the CJEU has, in effect, sought to further narrow the application of the para 55 conditions. The Court has, in *A Oy* and *Memira*, clearly held that exercising an option to merge, whether or not that involves a liquidation of the subsidiary, precludes the existence of final losses, where such a choice means that there can be, as the legal consequence of the CBM, no possibility for the surrendering company to use those losses (being an effective legal bar – a company is precluded from using losses to the extent that the legal consequence is that 'it' no longer has losses to use, and/or because 'it', legally no longer exists such as to be capable of using those losses).

430. *M&S* has undoubtedly been confined in scope over the course of the case law since. LBG's reliance on the Para 55 conditions as interpreted by the UK courts has been superseded by the later case law of the CJEU which transparently narrows the Para 55 conditions further.

431. Section 121, the precedence condition, deals with the possibility that relief is available in more than one territory. More particularly, it deals with the possibility that an intermediate non-UK resident parent or parents (but not resident in the relevant EEA territory) which itself is owned by a UK resident company may be able to claim relief in which case that intermediate parent has precedence over the relief of the EEA amount. If relief is available to the company in another territory in question it is again excluded from the EEA amount. LBG is wrong to suggest that losses can only be surrendered to an intermediate to the extent of the intermediate's available profits: there is no basis for that in s121.

432. Arrangements will be excluded from CBGR relief if they fall within s127(3) which provides: "*Arrangements are within this subsection if their main purpose, or one of their main purposes, is to secure that the amount (or part) may be surrendered for the purposes of group relief.*" The purpose of s127 is to prevent groups creating a cross border loss or creating the conditions where a cross border loss could be claimed. Moreover, because s127 (in contrast to the unallowable purpose legislation) focusses on the object of the arrangements, the FTT is not restricted to considering what was in the mind of the directors who made the decision to exit Ireland. It is legitimate and necessary to consider what was in the minds of senior individuals and advisors who were involved in the formulation and implementation of the arrangements by which the exit was effected. It will in any event be necessary to consider the views and papers from the senior managers and advisers insofar as they were communicated to the directors and / or otherwise informed the directors' decision-making.

433. LBG contends that if s127 is operative, the manner in which HMRC applied it in the present case contravenes Art 49 TFEU. This is incorrect. There is nothing in s127 itself that contravenes EU law – and having infracted the UK in relation to the CTA leading to *EC v UK*, the Commission notably took no point on s127. Moreover, the operation of a purpose test is inherently fact sensitive and not something the CJEU interferes with – that is a matter for the domestic court.

BURDEN OF PROOF

434. The burden of proof in this appeal is on LBG to establish on the balance of probabilities that the closure notice and the consequent amendments made by HMRC to its tax return are incorrect. HMRC's reliance in its Statement of Case on the precedence condition in s121 is accepted by LBG. Therefore, in this appeal, LBG bears the burden of establishing on the balance of probabilities that the qualifying loss condition in s119 was satisfied; the precedence condition in s121 had been met; and s127 does not apply to exclude group relief.

ADVERSE INFERENCE

435. HMRC submitted that the Tribunal should draw an adverse inference from the fact that relevant witnesses have not been called to give evidence about a relevant matter (*Hannah and Hodgson v HMRC* [2021] UKUT 0022 ("*Hannah*") at [171]-[172] and that documentary evidence that might have undermined a party's case has not been adduced (*Wetton v Ahmed* [2011] EWCA Civ 610 at [14]).

436. In respect of the first point, at [171] in *Hannah* the UT stated:

> "[171] It is clearly established that a court or tribunal can take into account the fact that a relevant witness has not been called to give evidence on a relevant matter and can draw an inference that, if the witness had been called, the witness's evidence would not support the case being advanced. Before a court or tribunal can draw such an inference, there must be a case to answer in relation to the finding which the court or tribunal is asked to make. There must be some admissible evidence, even comparatively weak evidence, which points in the direction of the suggested finding. If there is such evidence, then the court or tribunal is able to draw the inference, but is not obliged to do so. The court or tribunal can take into account any explanation given as to why a potential witness has not given evidence. Whether the court or tribunal does draw the inference, and the weight which it gives to the failure to give evidence, is a matter for the court or tribunal charged with the task of finding the relevant facts."

437. It is immediately apparent from the extensive correspondence and documents referring to tax/tax planning and the options available to LBG (set out in detail above) that the same senior individuals repeatedly appear or are referred to: GS, MW, MS, SC, AK and SH. In our judgment, the witness evidence of those individuals would be clearly relevant to the determination of the role that tax/tax planning played in the timing and manner in which LBG exited Ireland. The witnesses would be able to confirm to the Tribunal their role, remit and the instructions they had received. We therefore do not accept LBG's submission that the only relevant witness evidence is that of the three decision makers: ED, TT and TTO. We understand that some of the individuals referred to in the opening sentence to this paragraph were present at the hearing and therefore available to give evidence if required. We have therefore drawn an inference that, if the individuals had been called to give evidence, their witness evidence would not have supported LBG's case.

438. In respect of the second point, HMRC submitted that LBG has failed to disclose relevant documents that might have undermined its case. Mr Milne referred us to correspondence dated 5 September 2018 from HMRC to LBG which referred to previous discussions regarding the deletion of a data site holding a large number of documents and, as requested by LBG, provided confirmation that: "*1. HMRC confirms its consent to the deletion of the documents contained in the data site; 2. HMRC confirms that it will not be seeking any further disclosure of documents as part of the enquiry and proceedings before the First Tier Tribunal. 3. We are unsure as to what you mean by your "disclosure obligations" but can confirm that in our view LBG have made every effort to uncover and disclose to HMRC all relevant documents to the enquiry that may have been held on the data site.*" HMRC's position in respect of disclosure of documents could not have been made any more clearly and, in our judgment, it is unconscionable for HMRC to now submit that the Appellant has failed to disclose relevant documents and we decline to draw an adverse inference. It is clear that some of the documents in the hearing bundle are incomplete but would note that the burden of proof in this appeal, which is not disputed, lies with LBG.

APPROACH TO THE EVIDENCE

439. The witness statements of ED, TTO and TT made minimal reference to the contemporaneous documents and great reliance was placed upon their recollection of the events between 2009 and 2012. We found elements of their witness evidence troubling. During their oral evidence, the witnesses were frequently argumentative, discursive in their answers and keen to advance LBG's legal case. Some of the assertions contained in the witness statements were clearly contradicted by the documentary evidence. Despite that evident contradiction, the witnesses, when taken to the documents were unwilling to accept that their recollection was incorrect, reluctant to accept what the document clearly stated/recorded: ED "I think the presentation is happy talk" [1/144/17-23]; the document did not accurately record what happened [1/176/11-18]); the document was for "*show/public consumption*" and did not record the real discussion/thinking [1/178/4-12, 2/82/2-15, 2/84/9-14, 2/28/7-11 and 2/97/5-11]); "*That was our strategy of record. That doesn't mean it was set in stone*"; TTO "That still doesn't change my view, my opinion, which I stand by my witness statement … The board minutes are not a verbatim discussion of what took place. I don't know whether I raised that point in the board or not. I don't recall" [3/16/6- 13]; no documents recording his frustration with the BOSI management team [3/25/9-26/2], he could not agree that a PowerPoint deck with TT's name on it would necessarily represent TT's view [3/111/1-112/13], he did not accept that he had asked AK to make enquiries but suggested that AK might have been using his name to elicit responses/co-operation [3/134/13-23]; and suggested that SH (who he had accepted was his deputy/number two) did not have a good understanding of his priorities despite appointing her as his delegated representative for the LBG Board sub-committees meeting deciding the final exit mechanism [4/106/4-8]; TT denied that W&I Business Review report prepared for ED bearing TT's name and setting out his views reflected his views at the time [5/33/13-11]; his oral evidence was that the 31 December 2010 deadline was just a "coincident factor" [5/128/2-3] when his handwritten notes for the LBG Board meeting state that "the timing is a tax issue". In addition, the witnesses asserted that there were documents that they could clearly recollect which supported their assertions but, for reasons unexplained, were not in the hearing bundle, interpreted the documents in a way that was at variance with what was plainly stated and sought to apply a strained meaning to the plain language used. We have concluded that the witnesses were seeking to advance LBG's legal case, this was reflected in their evidence and recollection of the events of 2009 to 2012 and their role in LBG's decision to exit Ireland.

440. We consider that what was said in *Gestmin SGPS SA v Credit Suisse (UK) Ltd & Anor* [2013] EWHC 3560 (Comm) ("*Gestmin*") is apposite to the witness evidence in this appeal. In *Gestmin*, Leggatt J (as he then was) observed:

> "15. An obvious difficulty which affects allegations and oral evidence based on recollection of events which occurred several years ago is the unreliability of human memory.
>
> 16. While everyone knows that memory is fallible, I do not believe that the legal system has sufficiently absorbed the lessons of a century of psychological research into the nature of memory and the unreliability of eyewitness testimony. One of the most important lessons of such research is that in everyday life we are not aware of the extent to which our own and other people's memories are unreliable and believe our memories to be more faithful than they are. Two common (and related) errors are to suppose: (1) that the stronger and more vivid is our feeling or experience of recollection, the more likely the recollection is to be accurate; and (2) that the more confident another person is in their recollection, the more likely their recollection is to be accurate.

17. Underlying both these errors is a faulty model of memory as a mental record which is fixed at the time of experience of an event and then fades (more or less slowly) over time. In fact, psychological research has demonstrated that memories are fluid and malleable, being constantly rewritten whenever they are retrieved. This is true even of so-called 'flashbulb' memories, that is memories of experiencing or learning of a particularly shocking or traumatic event. (The very description 'flashbulb' memory is in fact misleading, reflecting as it does the misconception that memory operates like a camera or other device that makes a fixed record of an experience.) External information can intrude into a witness's memory, as can his or her own thoughts and beliefs, and both can cause dramatic changes in recollection. Events can come to be recalled as memories which did not happen at all or which happened to someone else (referred to in the literature as a failure of source memory).

18. Memory is especially unreliable when it comes to recalling past beliefs. Our memories of past beliefs are revised to make them more consistent with our present beliefs. Studies have also shown that memory is particularly vulnerable to interference and alteration when a person is presented with new information or suggestions about an event in circumstances where his or her memory of it is already weak due to the passage of time.

19. The process of civil litigation itself subjects the memories of witnesses to powerful biases. The nature of litigation is such that witnesses often have a stake in a particular version of events. This is obvious where the witness is a party or has a tie of loyalty (such as an employment relationship) to a party to the proceedings. Other, more subtle influences include allegiances created by the process of preparing a witness statement and of coming to court to give evidence for one side in the dispute. A desire to assist, or at least not to prejudice, the party who has called the witness or that party's lawyers, as well as a natural desire to give a good impression in a public forum, can be significant motivating forces.

20. Considerable interference with memory is also introduced in civil litigation by the procedure of preparing for trial. A witness is asked to make a statement, often (as in the present case) when a long time has already elapsed since the relevant events. The statement is usually drafted for the witness by a lawyer who is inevitably conscious of the significance for the issues in the case of what the witness does nor does not say. The statement is made after the witness's memory has been "refreshed" by reading documents. The documents considered often include statements of case and other argumentative material as well as documents which the witness did not see at the time or which came into existence after the events which he or she is being asked to recall. The statement may go through several iterations before it is finalised. Then, usually months later, the witness will be asked to re-read his or her statement and review documents again before giving evidence in court. The effect of this process is to establish in the mind of the witness the matters recorded in his or her own statement and other written material, whether they be true or false, and to cause the witness's memory of events to be based increasingly on this material and later interpretations of it rather than on the original experience of the events.

…

22. In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and

> conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

441. We note that in *Kogan v Martin & Ors* [2019] EWCA Civ 1645 Floyd LJ, giving the judgment of the Court of Appeal, said:

> "We start by recalling that the judge read Leggatt J's statements in *Gestmin v Credit Suisse* and *Blue v Ashley* as an "admonition" against placing any reliance at all on the recollections of witnesses. We consider that to have been a serious error in the present case for a number of reasons. First, as has very recently been noted by HHJ Gore QC in *CBX v North West Anglia NHS Trust* [2019] 7 WLUK 57, *Gestmin* is not to be taken as laying down any general principle for the assessment of evidence. It is one of a line of distinguished judicial observations that emphasise the fallibility of human memory and the need to assess witness evidence in its proper place alongside contemporaneous documentary evidence and evidence upon which undoubted or probable reliance can be placed. Earlier statements of this kind are discussed by Lord Bingham in his well-known essay The Judge as Juror: The Judicial Determination of Factual Issues (from The Business of Judging, Oxford 2000). But a proper awareness of the fallibility of memory does not relieve judges of the task of making findings of fact based upon all of the evidence. Heuristics or mental short cuts are no substitute for this essential judicial function. In particular, where a party's sworn evidence is disbelieved, the court must say why that is; it cannot simply ignore the evidence.

442. Mindful of the above comments in *Gestmin* and *Kogan*, we have assessed the witness evidence by reference to the contemporaneous documentary evidence and the scrutiny afforded by cross-examination. Where the witness evidence of ED, TTO and TT is not supported by the available contemporaneous documents or, in instances, contradicted by the contemporaneous documents we have attached greater weight to the documentary evidence.

Section 127 CTA (amounts excluded because of certain arrangements)

Was the main purpose, or one of the main purposes, of the arrangements to secure that the amount (or part) of losses may be surrendered for the purposes of CBGR?

443. LBG submitted as follows. What secured CBGR was BOSI's exit from Ireland. Lord Pearce in *IRC v Brebner* [1967] 2 AC 18 at [27 B-G] provided helpful guidance on the meaning of arrangements in this context. The decision to leave Ireland was not driven by any tax analysis. Once the key decision makers had made the decision to exit the Irish loan market, the question arose as to how that exit could be achieved. That was purely an implementation question – how best to implement the commercial decision consistently with the commercial objectives.

444. The witness evidence and documents confirm that the overriding purpose of the arrangements that were implemented were to achieve an exit from Ireland. The possibility of obtaining CBGR was a potential benefit flowing from the transaction but it was not a main

purpose. Those taking the decision would have made the same decision absent a tax benefit. As Lord Upjohn said in *Brebner* at [30 E-G]:

> "… when the question of carrying out a genuine commercial transaction, as this was, is reviewed, the fact that there are two ways of carrying it out—one by paying the maximum amount of tax, the other by paying no, or much less, tax—it would be quite wrong, as a necessary consequence, to draw the inference that, in adopting the latter course, one of the main objects is, for the purposes of this section, avoidance of tax. No commercial man in his senses is going to carry out a commercial transaction except upon the footing of paying the smallest amount of tax that he can."

445. As noted by the FTT (at [95]) in *Euromoney*:

> "the purpose or purposes of arrangements is not necessarily to be equated to the known and inevitable consequences of carrying them out (see *Versteegh v HMRC* [2013] UKFTT 642) and that the purpose or purposes of arrangements is not necessarily to be equated to the chosen means of carrying them out (see *Inland Revenue Commissioners v Brebner* [1967] 2 AC 18 per Lord Upjohn at [p30E-G])"

446. The decision in *Euromoney* was upheld by the UT. Similar conclusions were reached by the Tribunal in *Allam v HMRC* (upheld by the UT) and *Burlington Loan Management DAC v HMRC* [2023] S.F.T.D. 68.

447. Even if obtaining CBGR were to be regarded as a purpose of the transaction, it was not a main purpose. Although the size of the potential tax benefit was significant in absolute terms, it was modest by comparison to BOSI's portfolio and the prospect of an improved recovery from the portfolio. The same conclusion, therefore, should be reached as in *Euromoney* where the FTT found that *Euromoney* had a tax purpose but that it was not a main purpose: "The prospective tax advantage in this appeal was not "of such significance in the context that gaining it must have become a main purpose" (at [104]) and "Euromoney's subjective intention was focused on the commercial purpose, which was a main purpose, and the company considered the tax advantage to be no more than a bonus"([107]). Claiming a relief prescribed by law for a genuine economic loss (and having the purpose of doing so), cannot be a basis for denying relief and would undermine the objectives of the legislation and the *Marks & Spencer* line of cases. There is no purpose test in the context of domestic UK group relief.

448. Contrary to HMRC's contentions, the withdrawal from Ireland on 31 December 2010 was not planned to maximise the tax advantage to be obtained from the CBGR and did not constitute a main purpose. The purposes of the key decision makers, ED, TTO and TT, are the purposes that need to be considered and not the purposes of the other business units in LBG notably tax, finance team and Group Tax. The key decision makers did not cede control to anyone else given the commercial significance of the decision they were taking. Once the key decision had been taken to exit Ireland, there was no requirement to implement the decision in a way that was most unfavourable to the taxpayer from a tax perspective. It was permissible to see whether LBG could implement that decision in a way that would enable it to obtain any benefit from the genuine economic losses that had arisen in BOSI. As with the *Brebner* case, in Project Hermes there were many commercial objectives and possibly different ways of potentially achieving them and, following *Brebner*, nothing required the most tax inefficient structure to be chosen.

449. Whilst establishing and retaining an Irish permanent establishment would potentially in certain circumstances have negated any benefit of the losses (at least in the UK) there is no requirement to structure a transaction to be tax inefficient. Maintaining an Irish permanent

establishment conflicted with LBG's desire to exit from Ireland. An Irish permanent establishment would also have raised regulatory issues, likely requiring regulatory approval, so it was not a clear "default" structure to be used.

450. In the alternative, the manner in which HMRC has sought to apply s127 CTA to deny CBGR in the present case contravenes Article 49 (in conjunction with Article 54) TFEU.

451. HMRC submitted as follows. The purpose of s127 is to prevent groups creating a cross border loss or creating the conditions where a cross border loss could be claimed. The provision focusses on the concept of blocking choice in choosing the regime in which the loss is relieved. Section 127 (in contrast to the unallowable purpose legislation) focusses on the object of the arrangements, the FTT is not restricted to considering what was in the mind of the directors who made the decision to exit Ireland. It is legitimate and necessary to consider what was in the minds of senior individuals and advisors who were involved in the formulation and implementation of the arrangements by which the exit was effected.

452. In *Travel Document Service and Anor v HMRC* [2018] STC 723 the Court of Appeal held that the Finance Act 1996, schedule 9, para 13 (which had disallowed debits claimed under section 91B where they resulted from loan relationships that had an unallowable purpose) applied to deemed loan relationships as well as actual loan relationships. At para 25, the Court cited, with approval, the following passage from the UT's decision:

> "The First-Tier Tribunal found as a fact that one of TDS's main purposes in holding the shares in LGI during the period of the Swap was to secure a tax advantage. The First-Tier Tribunal was fully entitled to make that finding on the evidence before it. The fact that TDS had a valid commercial purpose in owning the shares before, during and after the Swap did not preclude the First-Tier Tribunal from finding that, during the period of the Swap, TDS had an additional purpose in owning them. The use to which an asset is put is perfectly capable, in appropriate circumstances, of shedding light on the owner's purpose in owning that asset. This is such a case. TDS entered into the Swap in order to make the shares it owned in LGI non-qualifying shares, and it entered into the Novations in order to depreciate the shares. Thus TDS's purposes in owning the shares during that period included the purpose of making them non-qualifying and then depreciating them, so as to secure a tax advantage. Mr Turner did not deny this. On the contrary, he was frank that one of TDS's main purposes in entering into the Swap and the Novations was to obtain the tax advantage."

453. At para 41(iii) the Court of Appeal further observed (citing *Brebner*) that: "It was company's subjective purposes that mattered … The question whether one of the main objects is to obtain a tax advantage is subjective, that is, a matter of the intention of the parties." At para 41(iv), it further confirmed that: "When determining what the company's purposes were, it can be relevant to look at what use was made of the shares … The benefits you hope to derive as a result of holding an asset may also evidence your purpose in holding it."

454. At para 46, the Court of Appeal further considered that had the tax advantage in issue been small, there might have been scope for the argument as to whether an intention to use the shares to achieve it implied that obtaining the advantage was not a main purpose of holding the shares. In fact, however, the hoped-for gain in that case was large. That being so the inescapable inference was that securing the advantage had become a main purpose of holding the shares. The prospective advantage was of such significance that gaining it must have become a main purpose of holding the shares as well as of the Swap and Novations. The

same applies here a fortiori where LBG were seeking to secure a tax windfall of in excess of £575 million. In this regard, Newey LJ held:

> "As I see it, there is no necessary inconsistency between these points and securing a tax advantage having in fact become, while the Deloitte scheme was being implemented, a "main purpose" of holding the LGI shares within the meaning of paragraph 13 of schedule 9 to FA 1996."

455. Therefore, in that case, the FTT, the UT and the Court of Appeal all found that securing a tax advantage was a main purpose of the Appellant, notwithstanding evidence to the contrary from directors with respect to their stated intention. At [48], the Court of Appeal held that a "main purpose" will always be a 'more than trivial' one, but the converse is not the case. A purpose can be 'more than trivial' without being a 'main' purpose. 'Main' has a connotation of importance.

456. In *Blackrock Holdco 5, LLC v HMRC* [2022] UKUT 199, the UT upheld the FTT's finding that both a commercial and tax advantage existed as the taxpayer's main purposes notwithstanding its director's evidence that tax advantage was not the main purpose. The UT upheld the FTT's approach of not just focussing on the Board meeting at which the decision was made but also the planning (in particular tax planning) that pre-dated and informed the Board meeting. The UT held that whilst it is the company's subjective purpose that matters, that subjective purpose is not simply a question of the director's stated subjective intentions but also a matter of inference and therefore the FTT was entitled to look beyond the stated motives of the directors when determining the subjective purposes of the company in entering into the arrangements (see UT at [162] and [165-166]. Significantly, at [165] the UT held: "The effectiveness of anti-avoidance legislation cannot be undermined by tax advisers telling parties to ignore the tax advantage purposes of a transaction which has been planned by them or others for precisely that purpose." Relevantly for present purposes, given the heavy involvement of Deloitte in the tax planning prior to the CBM in December 2010, the UT in *Blackrock* held that the FTT had been entitled to examine all the circumstances when deciding the company's purposes in entering into the transactions including the planning and preparation by the Tax group and Ernst & Young which the UT stated was "critical context": see UT170 and 171.

457. In *JTI Acquisition Company (2011) Ltd v HMRC* [2022] UKFTT 166 (TC) the Tribunal had to determine whether the main purpose, or one of the main purposes, for which the appellant became party to the loan relationship was to obtain a UK tax advantage for the purposes of s.441 and S.442. The FTT stated in respect of the Appellant's only witness:

> " … helpful in understanding the operation and business of the group, I find that the material aspects of Mr Olsen's testimony as respects the adoption of the acquisition and financing structure involving the Appellant represent an account of events given with the legal issues in mind. Consequently, I have accorded more weight to contemporaneous records, and the email exchanges at the material times amongst the key personnel. I consider the value of Mr Olsen's oral evidence lies chiefly in the opportunity which cross-examination afforded, by subjecting the documentary evidence to critical scrutiny, and for the Tribunal to ascertain the intentions of the relevant decision makers that represented the corporate body (para 6)."

458. The FTT held at para 174 that the prospective advantage was of such significance in the context that gaining it must have become a main purpose.

459. In *Kwik-Fit Group Limited v HMRC* [2021] UKFTT 283 the FTT held that it was necessary to distinguish between debits relating to pre-existing loans with a genuine commercial purpose and those which had been entered into purely to obtain a tax advantage,

which was an "unallowable purpose" under the Corporation Tax Act 2009 s.441. The FTT at [56] summarised the applicable principles:

> a. At para 56(2), the FTT relied on *Vodafone Cellular Ltd v Shaw* [1997] STC 734 to the effect that some consequences are so inevitably and inextricably involved that unless they were merely incidental, they must be taken to be a purpose.
>
> b. At para 56(4), the FTT held that in determining purpose "all the facts" or "the whole of the evidence" should be considered. In that regard, at para 86, the FTT quoted from Lord Upjohn's speech in *Brebner* to the effect that: "The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence."

460. At para 96, the FTT held that it was the Director's intention not that of the Group Tax Manager that was relevant but on the facts found, it was clear from the contemporaneous documents that the directors had read and understood the information provided by the Group Tax Manager etc. and this was taken into account in the decision-making of the directors of the Appellants. At para 110, the FTT found that securing a tax advantage was a purpose and that purpose was an important purpose and so a main purpose. Importantly, in reaching this conclusion the FTT again relied significantly on papers/correspondence from the Tax Manager and tax advisor and how that informed the group's purpose. At para 116, the FTT held that the prospective commercial and tax advantages were both main purposes of the taxpayer.

461. In closing submissions, the Tribunal was referred to the UT decision in *Seven Individuals v HMRC* [2017] UKUT 0132 (TCC) at [99] and [104] and to *Simon Padfield & Ors v HMRC* [2020] UKFTT 513 (TC), where the FTT provided a helpful summary of the relevant authorities on the main purpose test, including the dicta in *Seven Individuals*, at [275].

Discussion

462. Section 127 CTA is an anti-avoidance rule that is designed to deny group relief where arrangements have been made creating a cross border loss or creating the conditions where a cross border loss could be claimed. Arrangements are widely defined in s127(4) – "includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable*)"*. It was common ground that the relevant arrangements that fall to be considered are those put in place by LBG to exit Ireland. There was no disagreement on the purpose behind s127, where the parties disagreed was whose purposes were relevant when determining whether the purpose was a main purpose or one of the main purposes.

463. We do not accept LBG's submission that the purposes of the relevant arrangements put in place by LBG to exit Ireland are to be tested solely by reference to the stated purposes of the ultimate decision makers (the LBG Board and the sub-committee appointed by the Board comprised of TTO and TT) and only the documents submitted to the LBG Board and sub-committee. We note that there is an inherent contradiction in LBG's submission which, on the one hand relies upon the Tribunal decision in *Oxford Instruments* (concerning unallowable purpose and the loan relationship rules) in respect of who are the relevant decision makers but, on the other hand, wholly dismisses HMRC's reliance on the principles in respect of main purpose derived from decisions of the Tribunal concerning unallowable purpose and the loan relationship rules. We do not accept LBG's submission, in our judgment the principles in respect of main purpose derived from decisions considering unallowable purpose and loan relationship rules are relevant and of assistance. We agree

with HMRC that s127, in contrast to the unallowable purpose legislation, focusses on the object of the arrangements and we are not restricted to only consider what was in the mind of the directors who made the decision to exit Ireland. In our view, it is legitimate and necessary to not just focus on the purposes of the ultimate decision makers but, given their heavy involvement, to also consider the views and advice of senior individuals in BOSI, Group Finance and Tax (as advised by external professional advisers) which informed and shaped the formulation and implementation of the arrangements by which the exit was effected by the LBG decision makers, per *Blackrock* at [162] and [165-166].

464. We have considered the cases relied upon by both parties and consider that the relevant legal principles to be applied are as follows.

465. In *Simon Padfield & Ors v HMRC* [2020] UKFTT 513 (TC), the Tribunal (Judge Tony Beare) at [275] provided a helpful summary of the relevant authorities on the main purpose test based on the proposition that the case law relating to "main objects" is equally applicable to the phrase "main purposes":

> "275. … The relevant legal principles are as follows:
>
> (1) the mere fact that arrangements may have a commercial purpose as one of their main purposes does not mean that the arrangements cannot also have the securing of a tax advantage as one of their main purposes – see Lightman J in *Sema* at paragraph [48] and Rimer LJ in *Lloyds* at paragraph [65];
>
> (2) in determining whether the securing of a tax advantage is one of the main purposes of the arrangements, it is merely necessary to consider the importance or significance of that purpose. There is no authority for the proposition that there can be more than one main purpose to arrangements only in a case where there are two or more purposes to those arrangements which are of equal significance. Instead:
>
> > (a) it is simply a case of identifying which purposes are important enough to be described as "main purposes"; and
> >
> > (b) a purpose can be a "main purpose" even if it is of less importance than another "main purpose".
>
> As noted by Rimer LJ in *Lloyds* at paragraph [52], "*in any particular case there may be a hierarchy of objectives motivating the transaction…and … the inquiry must then be as to which of them are 'main' and which are not*";
>
> (3) in determining whether the securing of a tax advantage is a main purpose of the arrangements, "*it is necessary to consider with care the significance to the taxpayer of the tax advantage*". Only if the tax advantage is mere "icing on the cake" will it not be a main purpose (see Lightman J in *Sema* at paragraph [53]);
>
> (4) the purposes of arrangements are to be determined by reference to the subjective intentions of the taxpayer in entering into the arrangements, coupled with certain objective elements as determined from the evidence. That evidence includes the features of the arrangements, the way the arrangements were marketed and the views of those who were involved in creating, promoting and advising on the arrangements – see Nugee J at paragraphs [97] to [104] in *Seven Individuals v The Commissioners for Her Majesty's Revenue and Customs* [2017] STC 874 …"

In addition, we consider the following legal principles are also relevant:

> The object or purpose of the company must be distinguished from the effect. The company's subjective intentions are determinative, but these are not

limited to the conscious motives which were in its mind – some consequences are so inevitably and inextricably involved that unless merely incidental they must be taken to be a purpose (*Vodafone Cellular Ltd v Shaw* [1997] STC 734).

Whether a tax purpose is one of the 'main' purposes of the arrangements is a matter of subjective intention, involving a careful analysis of all the reasons the taxpayer had for carrying them out (see *Versteegh & Ors v HMRC* [2014] SFTD 547 at [155] and *Brebner*, per Lord Upjohn at [p32]).

The Tribunal is entitled to look beyond the stated motives or intentions of the decision makers to determine the subjective purpose (*Blackrock* at [165]

In determining purpose, "all the facts" or "the whole of the evidence" should be considered (*Kwik-Fit Group Limited v HMRC* [2021] UKFTT 283), determining purpose was an "evaluative exercise" considering "all the facts and circumstances" (*JTI Acquisition Company (2011) Ltd v HMRC* [2022] UKFTT 166 (TC) at [154(2)]).

Even if the primary or even the main object is commercial this does not preclude tax still being a main object (*Lloyd's TSB Equipment Leasing (No 1) Ltd v HMRC* [2014] EWCA Civ 1062 at [64] – [65])

Findings of fact for the purpose test

466. Having considered all of the evidence in accordance with our approach to the evidence at paragraphs 439 to 442 above and applying our approach the legal principles set out at paragraph 465 above, we find the following facts for the purpose test:

(1) BOSI was a priority within LBG in 2009 and had not been overlooked because of other pressing priorities within LBG. A granular and detailed review of BOSI and its loan book had been conducted by LBG in January 2009. LBG was aware from that time of the issues that BOSI faced.

(2) LBG's strategy, following the granular and detailed review was MFV: run down the business and not write any new business.

(3) LBG had no intention to exit Ireland prior to the identification of the potential tax benefits in May 2010. LBG's strategy, following the initial review in January 2009 and reviews in January and February 2010, remained MFV. That strategy was only revised on 29 June 2010 when the GEC agreed in principle to support the recommendations of Project Hermes.

(4) Extensive tax planning and legal advice was taken by LBG. References to tax planning and/or tax benefits were removed or "played down" in the final versions of documents and face-to-face or telephone discussions held to avoid reference to tax in e-mails and meeting notes.

(5) TT's trip to Ireland on 22 to 23 April 2010 was not the catalyst nor the genesis of the decision to exit Ireland. No concerns were expressed about the Irish BSU by TT, he was positive about the progress being made. His positive views were echoed by ED and TTO. No negative concerns were expressed about the Irish BSU such that the BOSI loan book was required to be managed and administered in London.

(6) There were valid commercial reasons for LBG exiting Ireland but it was the identified potential tax benefits that determined LBG's decision to exit Ireland and the choice of mechanism for exiting Ireland. LBG's decision to choose Option 4 was based on the potential tax benefits. The 31 December 2010 deadline to exit Ireland was determined by the potential tax benefits.

(7) The size of the potential tax benefits were significant to LBG and were a material consideration when determining the method by which to exit Ireland.

(8) The relevant decision makers were ED, TTO and TT acting on the authority of the LBG Board. ED, TTO and TT did not delegate that authority to the Project Hermes committee. Discussions on structuring the exit from Ireland and tax planning took place between ED, TTO and TT. Those discussions were informed by information provided to ED, TTO and TT by the Project Hermes project team and senior individuals from various LBG business areas including Group Tax, W&I, BOSI and Group Finance about the potential tax benefits and exit structure.

(9) Avoiding a PE in Ireland because of the adverse tax and regulatory consequences was the main driver in determining the way in which Certus was set up and operated.

(10) SIF was removed as the intermediate holding company to enable the CBM to take place.

(11) LBG did not face challenges by being regulated by both the FR and FSA such that it would be required to commit further resources such as regulatory capital, liquidity and funding to Ireland.

Reasons for findings of fact

BOSI not overlooked

467. We do not accept the evidence of ED, TTO and TT supports LBG's submission that Ireland was not an immediate priority as LBG was dealing with more pressing "*life and death*" issues, [ED's witness statement para 20]. That evidence is not supported by the contemporaneous documents and witness evidence:

(1) a granular review was undertaken in January 2009 following the merger, Annual Report and Accounts 2008;

(2) ROC paper 17 April 2009: "To obviate any potential danger during the implementation process, the higher risk W&I assets are being monitored, assessed and supported by the existing resources and framework within the Wholesale Business Support Unit";

(3) Project Chicago paper for ED on 18 September 2009: "BoSI has recently completed a strategic review" and "updates will be provided to Eric Daniels/GEC.";

(4) [ED 1/103/7-13].

> Q. And it says: "A strategic review had been undertaken by BOSI in July 09". So the position was that by July 2009 the decision had been taken that there would be no new originations; correct?
>
> A. Correct

(5) A new CEO and management team were appointed in 2009. ED accepted that this was "one of the important decisions and steps that he had taken in 2009", [1/125/13-21];

(6) GEC meeting on 21 July 2009 attended by ED, the minutes record: "The position in relation to Ireland was considered carefully, and would be kept under review."

Strategy for BOSI

468. LBG's strategy for BOSI was MFV and that strategy only changed when Project Hermes was approved in principle by the GEC on 29 June 2010:

(1) Following the strategic review of BOSI in March/April 2009 the stated strategy in June 2009 was "Non-core International Banking businesses managed-for-value in the near-term, with a view to managing down when markets improve", Draft LBG Forward Plan dated 19 June 2009;

(2) LBG Corporate Strategy Presentation to the Board on 19 June 2009 stated: "Manage distressed assets & protect group value through BSU";

(3) ED confirmed in cross-examination at [1/100/13-17]:

> Q. But the strategy at the, in June 2009, for the impairments, was to manage the distressed assets and protect group value through the business support unit; yes?
>
> A. That's correct

(4) That strategy remained unchanged in July 2009 with no new business being written, W&I Integration Update, dated 21 July 2009;

(5) *The strategy adopted was a "medium term plan", "manage for value" strategy [ED* 1/103/18-104/20 and ED's witness statement para 47].

> Q. And so, therefore, the strategy had switched to the medium term, the manage for value strategy that we previously discussed?
>
> A. I think it may be splitting hairs but I'm not sure I understand the difference between the shift that you're suggesting. We were trying to determine whether there was any market for the assets. There was none. So we pretty quickly realised the only way we were going to be able to preserve value was to manage on a loan by loan basis. That, I guess we can call it managing for value. We weren't going to sort of wholesale fire sale the portfolio.

(6) That strategy was approved by the GEC on 21 July 2009 at a meeting chaired by ED and attended by TTO. The GEC minutes do not record any objection or concern about the MFV strategy: "The position in relation to Ireland was considered carefully, and would be kept under review." No objection or concern about the MFV strategy is recorded in subsequent GEC or LBG Board minutes.

(7) Both TTO's and TT's witness statements referred to their concerns about the MFV strategy. TT, at paragraph 38 of his witness statement, stated:

> "I inherited the manage for value strategy in Ireland. However, as I discovered more information about BOSI, I came to the conclusion that that strategy was fundamentally flawed and a more radical solution for BOSI was required.".

TTO, at paragraph 83 of this witness statement, stated:

> "In early 2010, the BOSI board presented a business review to Eric and me. The review proposed continuing the residual business and reviewing its performance in a few years. This was called the "manage for value" strategy. However, I was not supportive of waiting a few years to see how things developed, as the BOSI board had proposed, particularly given the deteriorating Irish economy and the on-going need for additional regulatory capital and funding to support BOSI. I also did not like this proposal as it would have meant that the same individuals under whose control BOSI had come into such difficulties would remain in charge of BOSI while the manage for value strategy was followed."

ED in his witness statement at paragraph 88 stated:

> "My decision to exit Ireland had already been made before I saw the first GEC Project Hermes paper."

There are no contemporaneous documents that record ED, TTO or TT expressing any concern about the LBG's MFV strategy. ED, TTO and TT were all cross-examined on this point and each accepted that there was no documentary evidence to support this assertion, [ED 2/24/16-24, 2/28/24-29/1, 2/37/18-38/21; TT 4/200/6-19, 4/203/24-204/11 and TTO 3/27/10-28/10]. ED accepted that the MFV strategy was the "best option for LBG" [1/113/19-25] and "but I nevertheless believed it was the right thing to do" [1/176/2-4]. We have not accepted the evidence of ED, TTO and TT on this point.

(8) ED stated in the press release dated 9 February 2010 that LBG had completed the strategic review and adopted MFV. Paragraph 47 of his witness statement confirmed "we adopted a medium term strategy for the residual business. This medium term strategy was to manage down these portfolios and protect shareholder value to the extent possible. This was the "manage for value" strategy." The strategy was summarised in the 13 October 2009 Note to the GEC by JD.

(9) ED confirmed in cross-examination that on 22 January 2010 that the strategy at that time remained MFV, to manage the run-off over the next two years in 2010/11 with a view to reassessing future strategy for the business in 2012, [1/153/15-19 and1/163/1-10]. TT confirmed in his meeting with the FSA on 4 May 2020 that he had been appointed as head of W&I on an interim basis and that it was not his role to develop strategy for W&I prior to the appointment of a permanent head of W&I.

(10) The GEC minutes dated 2 February 2010 record under the heading of Project Memphis Update, ED stating that whilst the proposed MFV strategy would have material repercussions for the Irish business "Nonetheless, this was the right course of action for the Group to take". TT, in evidence accepted that the strategy at the time was MFV, [3/19/5-20/6]. He further confirmed that the plan was to review the strategy as part of the 2012-2017 planning stage, [3/24/20-23].

(11) The LBG press release dated 9 February 2010 confirmed that strategy. ED accepted that the press release reflected the true position [1/180/4-182/6] and communicated that strategy to the outside world [1/191/1-4].

(12) The 2009 results published on 26 February 2010 publicly confirmed the MFV strategy in Ireland: "In the International businesses, the priority is to maximise value in the short to medium term." ED confirmed that he supported MFV at that time, [1/164/12-165/2 and 1/167/14-16].

(13) In March 2010, the position remained unchanged as confirmed in the Group Credit Portfolio Review March 2010 Special Feature - Ireland under the heading of LBG Actuals & Medium Term Plan (MTP) Impairments.

(14) The April 2010 W&I Board update by TT confirmed the MFV strategy.

(15) The first mention of exiting Ireland was in TTO's e-mail to ED on 4 June 2010 following his meeting with AP and MW on 3 June 2010 at which Hermes was discussed following receipt of Deloitte's advice dated 3 June 2010.

Tax and legal advice

469. Extensive tax advice was taken by LBG on how to maximise the use of the BOSI tax losses. We accept that obtaining tax advice from external advisers is a prudent and entirely normal course of action for a commercial organisation such as LBG; however, the advice was

obtained not on the basis of how to implement a commercial decision to exit Ireland in the most tax efficient way but in the converse way: the decision to exit was based upon the potential tax benefits and then commercial reasons sought to justify the decision to exit:

(1) The 18 May 2009 Deloitte paper titled "Tax Losses in BOSI and HBOSA Overview of Strategic Options" had previously advised that group relief could be claimed by liquidating BOSI;

(2) Advice was sought by JB from KPMG in early April 2010 in respect of tax planning and advantages that could be gained.

(3) MS's e-mail to Deloitte on 27 April 2010 confirmed that whilst the main driver was "sorting out the capital position", AK, was "keen to do this in a tax efficient way and we also currently have several £bn in trapped losses in BOSI that we have no hope using. We'd like to have a discussion about the tax position and whether there is any planning that would be of benefit/any ideas that Deloitte can bring to the table." ED agreed that LBG were seeking Deloitte's advice at this point on how they could access the several billion pounds of losses trapped in BOSI that they had no hope of using [2/111/15-19], this followed earlier discussions with Deloitte on this how to capture the loss value [ED 2/112/12-15].

(4) The 3 June 2010 Deloitte draft advice titled "BoSI Losses/Closure" was focused on how best to access the value of the BOSI tax losses. The advice confirmed that a group relief claim could work to optimise tax but LBG would have to meet the 31 December 2010 deadline in order to capture the value of the 2010 losses – the 2010 loss would only be available if BOSI was "to be put into liquidation by the end of 2010". The paper raised the risk of a PE in Ireland which could prevent a claim for loss relief, but said: "it may be possible to structure the re-organisation of the BOSI business to either avoid the creation of a PE or have a PE that carried on a different business to that of BoSI such that the BoSI losses do not transfer to the new Irish PE".

(5) On 8 June 2010, e-mails were exchanged between Deloitte and BOSI to establish the tax capacity in 2010, this request was made by NMC on the basis that "I expect one of the drivers on timing will be tax capacity in UK for 2010.". Further e-mails were exchanged between the Deloitte and the PHSC on 9 June 2010 which discussed the potential options for the Irish entity following liquidation. Four options were identified which included a fully owned LBG subsidiary, an Irish branch and an outsource company. The focus of the advice was on tax and not whether from an operational perspective it would work. At a meeting held between PHSC and Deloitte on 10 June 2024 the focus was on tax (which was identified as a key driver), the title of the Deloitte paper presented was "BOSI: Tax analysis and closure options". The paper noted that "We understand in addition to tax considerations there may be commercial and strategic issues which will impact the closure by 2010."

(6) The e-mail from NMC to MS on 14 June 2010 subject "LBG Ireland (Draft V1 2 June 2010) advised in response to MS point about the "main purpose" test that "it is critical that this is a commercial decision as to the most effective way to extricate LBG from Ireland and that the tax analysis follows. This is true both of the liquidation and, critically, what is left behind." Similarly, the draft e-mail for SH sent by MS to GS on 14 June 2010 requested "access to the strategic documents relating to Ireland" to demonstrate that the "commercial decision to withdraw from Ireland completely was made before the decision to explore the current liquidation option". No documents demonstrating that the commercial decision to withdraw was taken before exploring the liquidation option were in evidence.

(7) Advice was received by the PHSC on 16 June 2010 from Arthur Cox on the proposed Irish restructuring. Following advice that a s33 transfer could take four months or more, the PHSC proceeded to focus on the CBM. The e-mail MA (Deloitte) to PHSC on 18 June 2010 confirmed that Deloitte had not been involved in "the detailed assessment of the decision to exit" but focused on the tax aspects of the options for exiting Ireland. Deloitte, similarly advised that a s33 transfer had been discounted as it would be very unlikely that the "balance sheet would be clean enough by 31/12/10" and focus had shifted to the CBM as it appeared to be a more effective mechanism for closure/cessation of trade by 31 December 2010. Reference was made to the provisional timeline that had prepared jointly with Arthur Cox noting that "not all of the steps on the UK end of the merger have been confirmed with English counsel" and that "Any timetable to deliver an exit from BoSI by the 31st December 2010 is extremely tight; however, the benefits (although not all are fully validated) are potentially very significant."

(8) Further legal advice was received from Arthur Cox on 25 June 2010 which identified the risk from a regulatory perspective that "the operations of SERVCO in Ireland will result in UKCO being deemed to have a permanent presence in Ireland." That legal advice was implemented when LBG determined how the remaining Irish business would be structured, that advice was followed by LBG and EY when preparing the detailed "Rules of the Road" for Certus to avoid the risk of a deemed permanent establishment.

(9) Following the GEC meeting on 29 June 2010, further extensive tax advice on Project Hermes was provided by Deloitte: "Project Hermes – Summary Tax Analysis" dated 29 June 2010; "LBG: Project Hermes Tax Considerations for GEC" dated 15 July 2010 and a cost benefit analysis v4 illustrating "the tax efficiencies v costs of Options 3, 4 & 5 in the Hermes paper II dated 26 July 2010". The cost benefit analysis document was not in the hearing bundle but was attached in the e-mail dated 26 July 2010 from MA to the PHSC for discussion the following morning.

(10) LBG took legal advice on the TRS option from legal advisors in both the UK and Ireland. The e-mail dated 16 September 2010 from HS to AK attached the following documents (which were not in the hearing bundle):

> "note from Arthur Cox on availability of trading losses for Irish tax purposes;
>
> note from Arthur Cox on the tax analysis of the alternative proposal;
>
> note from Linklaters on the UK tax analysis of the alternative proposal;
>
> and Irish regulatory analysis from KMPG"

We have drawn an adverse inference from LBG's failure to disclose the above legal advice. We accept HMRC's submission that it is a well established principle that a litigant cannot "cherry-pick" which legal advice privilege is waived: the established principle is that if a party wishes to waive privilege in respect of one piece of legal advice in order to rely on that advice, they have to waive privilege on other related advice. We have therefore drawn the adverse inference that the failure to disclose the legal advice was because it did not assist or support LBG's case.

(11) LBG Corporate Treasury/Structured Transactions Group put together a paper dated September 2010, based on the external and internal advice received, subject 'BOSI – Project Hermes Paper' and containing a "comparative analysis" of the CBM and TRS.

(12) Project Hermes Tax Considerations paper dated 3 August 2010 prepared by Group Tax states: "The complexity involved in the proposed merger raises a number of tax issues and we are working through these with Deloitte, Allen & Overy and leading tax counsel in the UK and with Arthur Cox in Ireland. BOSI is currently a subsidiary of SIF BV (the HBOS group's Dutch holding company) and Dutch advice will also be required, although we do not anticipate any significant Dutch tax issues."

Valid commercial reasons for exiting Ireland

470. HMRC accepted that LBG had valid commercial reasons for exiting Ireland. Paragraph 77 of their Statement of Case stated: "HMRC accepts that BOSI was a serious drain on LBG's resources and that the group had other commercial reasons to seek to put a stop to those losses and to exit the Irish loan market." Their skeleton argument at paragraph 151 stated: "In particular, although there were commercial reasons for exiting Ireland, a main purpose of the arrangements by which (and when) the decision to exit was implemented was the accessing of group relief and the arrangements were structured and implemented to achieve that group relief purpose." We accept that LBG had valid commercial reasons for LBG exiting Ireland but it was the identified potential tax benefits that crystallised LBG's decision to exit Ireland and the choice of mechanism for exiting Ireland. LBG's decision to choose Option 4 was based on the potential tax benefits. The 31 December 2010 deadline to exit Ireland was determined by the potential tax benefits.

Tax benefits were significant to LBG

471. The witness statements of ED, TTO and TT stated that the potential tax benefits were insignificant and irrelevant to LBG. We did not accept that evidence for the following reasons:

(1) TTO accepted in cross-examination, that the issues of BOSI capital and tax losses were "related" [3/56/11-14] and "intertwined" [3/175/11-16].

(2) The briefing paper for TTO dated 26 January 2010 recapped a presentation of 6 January 2010 stating "Creating significant level of tax losses with little prospect of usage in the medium term" and the recap of a workshop held on 14 January 2010 attended by key stakeholders from BOSI, W&I, Group Finance and Group Tax stated: "Designed to consider all issues and agree structuring priorities", "Trade off between tax, capital and funding considerations" and "Agreed conclusion to look to immediately extract value from tax losses through claim under BOS plc guarantee and then agree revised legal entity structure at a later stage as regulatory position becomes clearer." The attendance of key stakeholders confirmed the importance of the tax losses to LBG. ED and TTO accepted that tax may have been a "material" [ED 2/19/16-20] or a "key issue" [TTO 3/60/1-15] at the meeting. It was accepted that the key stakeholders at the meeting also believed the tax losses were "valuable" [ED 2/20/4-18] and "substantial" [TTO 3/61/13-15] to LBG.

(3) The "Ireland Update Paper" produced by W&I Finance/Group Tax circulated on 4 May 2010 referred to the plan to optimise the tax losses in BOSI. Reference was made to the paper being "an update to the recent papers and discussions around the significant losses, which have been, and are being incurred in Ireland without obtaining any tax relief either in the UK or Ireland" and noted that the "amount of the losses on which we are obtaining tax relief is minimal". TTO accepted that he may have been involved in those discussions up to May 2010 and that he would have been updated as "things developed", [3/121/4-11]. ED agreed that the paper originated out of the review which began in January 2010 [2/117/11-18] and that there had been papers and discussions about tax losses since that date [2/115/6-11].

(4) The Project Hermes project team viewed the potential tax benefits of a CBM as "very significant", which was accepted by TTO [3/138/19-23 and 3/181/9-11]. AK, a member of PHSC, in his e-mail dated 18 May 2010 referring to the £2bn of losses believed that "this will grow wings if I put it in front of Tim".

(5) TTO agreed that the tax benefit had the potential to be "the most significant" benefit for exiting Ireland by 31 December 2010, [4/79/20-23].

(6) Deloitte, in their e-mail dated 18 June 2010, stated that "the benefits (although not fully validated) are potentially very significant.".

(7) ED accepted that it was clear that W&I considered the tax losses as both material and significant [2/116/19-24].

(8) The "Ireland Alternative Strategy Note" prepared by AK for TTO referenced the significant work that had been undertaken across various LBG business areas to access the tax relief of the losses. TTO accepted that tax figure was significantly large to materially influence Group Tax and accepted that Group Tax were not "going off on a frolic of their own" [3/189/2-190/19].

(9) As at 18 August 2010, no final decision had been taken whether to exit Ireland via a CBM or TRS, which was still being investigated, [4/84/12-21, 5/139/13-15 and 5/148/12-15]. TTO sanctioned six weeks of work to consider the TRS despite knowing that the TRS required BOSI continuing in its existing form and retain a presence in Ireland, [TTO 4/84/12-23]. TT agreed that LBG were "balancing" these two options, each of which gave them significant tax benefits [5/152/7-12].

(10) On 27 September 2010, a further report on the TRS was prepared (Hermes plan B – pros and cons) which considered the pros and cons and risks of that option. TT accepted, there were "significant tax advantages" to both schemes [Day 5/144/23-145/4].

(11) LBG was prepared to pull the CBM before implementation if the TRS is "significantly better … This means better from a tax and regulatory perspective", e-mail from AK to MA dated 16 August 2010, [TTO 4/105/8-12].

Decision makers

472. We accept that ED, TT and TTO had not delegated their decision making for the following reasons:

(1) The LBG Board supported the decision in principle to exit Ireland and delegated the decision to an ad hoc committee comprised of TTO and TT together with ED as CEO of LBG. TTO confirmed in oral evidence: "So decisions were little "ds" and medium sized "Ds" and eventually the capital "D" is one that involves Mr Daniels." … "from a legal perspective it was the Board, based upon the recommendation of Mr Daniels, who is responsible for bringing such matters to the Board. It goes through GEC, which I think technically acts as an advisory committee to Mr Daniels in carrying out his responsibilities under the [Company's] corporate governance manual, but in practical terms, it is Mr Daniels, Mr Tate and myself." [4/170/16-171/3]

(2) TTO's evidence was that the vote by the project team to choose between the CBM and TRS reflected "the collaborative style in which we ran the bank", [TTO 4/141/4-8].

(3) The e-mail dated 29 September from TT to TM, confirmed that ED was invited to "hear the summary thoughts" of the project team but that "the final decision was

unanimous between/amongst all the GEC members present." The GEC members present were ED, TTO and TT.

473. We found that it was more likely than not that discussions on structuring the exit from Ireland and tax discussions took place between ED, TTO and TT which were informed by information about the potential tax benefits by the PHSC for the following reasons:

(1) The witness evidence of ED, TTO and TT was that they all operated an open-door policy, were located in close proximity to each other and had regular informal discussions/brainstorming, ED witness statement paras 13 and 17-18 and [2/133/14-16]

(2) ED in oral evidence confirmed that "Ireland was the subject du jour, it was on everyone's minds" [2/95/24-25], he was kept informed "from time to time that we were making progress and a paper would be coming to GEC" [2/167/2-4] and accepted that he was "regularly updated" on the day to day work of the Project Hermes project team through his discussions with TTO and TT [2/133/11-16].

(3) TT in oral evidence agreed that he was being kept updated on the project via updates from SC, MW and TTO [Witness statement paragraphs 96-97 and [5/12/5-20, 5/13/21-14/4, 5/70/13-16 and 5/89/7-90/6]. He received regular updates from SC, MW and GA from at least April 2010 [4/224/16-24].

(4) TTO accepted that the Project Hermes project team were working under his and TT's direction and their focus was a reflection of his and TT's priorities as communicated to the project team, [4/42/5-24].

(5) TTO was regularly "being briefed" on the work being done by the project team and "would have been kept up to date as things developed" [3/66/12-14, 3/104/2-6, 3/121/7-11, 3/147/20-22, 3/176/1-5, 3/202/7-11, 3/207/12-17]. This included regular updates in one to one meetings with SC, regular discussions with SH as his 'deputy', meetings, emails and telephone calls [3/176/1-5, 3/202/7-11, 4/20/7-19, 4/52/13-18 and 4/54/12-17].

(6) TTO was Group Finance Director. Two of TTO's direct reports, SC and SH (his deputy), were closely involved in the project and we find it more likely than not that they would have kept TTO updated.

(7) TTO accepted that his team would prepare papers for him if they thought it was something he "would want to know about" and "be interested in" [3/61/3-6] and that he would read such papers if they were prepared for him [3/52/18-24].

(8) On 4 June 2010, after the meeting to discuss Hermes presentation by MW and AK, TTO e-mailed ED confirming that he had met with AK and MW.

(9) TT was e-mailed by SC on 11 June 2010 with an update and his response "Wow If you keep Tim, Carol and me uptodate, the GEC, is, basically, there" could not have been given without there having been previous discussions such that he knew TTO's and ED's views on Project Hermes.

Dual regulation

474. We do not accept that the contemporaneous evidence supports LBG's assertion that one of the commercial reasons for LBG leaving Ireland was due to concerns about being subject to dual regulation in the UK and Ireland for the following reasons:

(1) There is minimal reference to this issue in the witness statements of ED (paragraph 23), TT (paragraph 21) and TTO (paragraph 31);

(2) There was minimal reference to the issue in the oral evidence of ED, TT and TTO;

(3) There is no reference in the contemporaneous documents recording dual regulation as being of significant concern to LBG;

(4) LBG and BOSI had very strong relationships with both the FSA in the UK and the Irish Regulator: "Strong relations with [FR] and proactive approach to queries/request for information … From a Regulatory perspective we are in line with the Banking industry" (Risk and Control section of Briefing Pack for TT dated April 2010).

(5) The documents record LBG's view that the meetings with the FSA and Irish Regulator went well during 2010:

> "we had a very good meeting with the FSA. Their questioning was relaxed and focussed around technical areas such as passporting and subsidiary companies. They don't want to see us again till early Dec, which has to be good news. (E-mail from GA to SC dated 18 October 2010)
>
> "I agree with your positive impression overall and it's positive that there were no follow up actions confirming that FSA were satisfied what they had heard … your comments which I believe gave comfort to the FSA (also reflected in Jean's relatively positive body language and questioning style)" (E-mail to TT from Angela Teke, W&I Head of Regulatory Liaison)

(6) There was a good line of communication in each jurisdiction. The International Banking ExCO MI Pack dated June 2010 under the heading of "Legal & Regulatory (including Fiduciary Risk) stated: "No material issues flagged by FR during recent senior level meetings (eg with Matthew Elderfield and round of meetings with Elaine Sheerin on 9th July 2010), indeed Head of Supervison [sic] commented favourably to JH and MA relative to our relationship with the FR."

(7) TTO accepted that setting up an Irish Branch would have removed the requirement to be dual-regulated and the need for the BOSI Guarantee, [3/73/12-73/4]. When the decision was taken to dismiss the Irish branch option the removal of dual regulation was not mentioned;

(8) The witness evidence of ED, TTO and TT was that LBG were concerned about the FR increasing the amount of capital required in BOSI such that further capital would be required. We did not accept their evidence. There is no support for this assertion in the contemporaneous documents that pre-dated that GEC meeting on 29 June 2010. It was noted in an e-mail dated 22 April 2010 from Russell Deyell to PB and others with Subject "Irish Capital" that there was a possibility that the capital requirements could be increased but that LBG was not concerned: "*I agree that we are not currently concerned*."

(9) LBG had subsidiaries and branches in the EU and around the world, there is no indication in the W&I Quarterly reports in the hearing bundle nor in any other document that dual regulation was an issue in any other subsidiary or branch. The W&I Quarterly reports referred to issues of concern in the W&I divisions in the EU, Australia and beyond, no mention is made of the issue of dual regulation.

(10) Implementing the TRS would have required BOSI to continue to operate in Ireland and remain subject to dual regulation. The TRS was not rejected until 29 September 2010. It was not rejected on the basis that LBG would remain subject to

dual regulation but on the basis that it was too late in the day to change their choice and concern about LBG being seen to be avoiding tax.

(11) The only reference to regulation in this regard was in TTO's e-mail dated 29 September 2010 at [3/2494] which expressed concern how a volte face would look to the regulator who had been told that LBG were pursuing option A: "worry about reputation risk with the regulator" and in TT's e-mail to TM of the same date at (E): "We worry about reputation risk with the regulators."

(12) We have attached no weight to the expert evidence of Mr Sharma in this regard. His expert report exhibited only one contemporaneous document that referred to and detailed LBG's interaction with either the FSA or FR. He accepted in cross-examination that he had simply accepted what he had been told by his instructing solicitors: dual regulation was of concern to LBG. Similarly, he was not told by his instructing solicitors that the TRS remained an option until it was rejected on 29 September 2010 despite the fact that implementing the TRS would retain the *status quo* of dual regulation. He accepted that point in cross-examination, [7/6/25-14/7]. He further accepted that his report in some instances provided opinions on alternatives that were not put to the regulators but were hypothesised as to what would have been the regulatory considerations if they had been put to the regulator, [7/7/15-7/9/6].

The economic forecasts for the Irish economy

475. There is no evidence in the contemporaneous documents of any concerns expressed in May/June 2010 regarding a further or sudden deterioration of the Irish economy such that LBG's stated strategy had to be urgently revisited.

(1) The BOSI Business Review briefing pack for ED and TTO dated January 2010 stated the Irish economy had "strong underlying" fundamentals, the Irish Government "is taking actions to facilitate a long term recovery underpinned by solid fundamentals".

(2) ED's oral evidence was that the economic forecasts for the Irish economy in the BOSI Board Meeting strategy update in January 2010 were simply "happy talk" by BOSI [ED 1/144/17-23], which was clearly not the case as he accepted that the forecast was "agreed with LBG economics" [ED 1/147/18-23].

(3) In February 2010, LBG was well aware of the economic issues that Ireland was facing. The e-mail dated 21 February 2010 from SC to ED stated: "the only concern really is Ireland but we need to keep this in perspective, both because of its overall size in the scheme of thing and also it is very well flagged as an issue."

(4) The Briefing Pack for TT dated April 2010 stated: "international markets believe in Ireland's capacity to recover over the medium/long term, as confirmed by a number of successful/oversubscribed bond auctions undertaken throughout 2009 and early 2010.

(5) The Briefing pack provided to TT for his visit to Ireland repeated the positive medium- to-long term view of the Irish economy, "as agreed with "LBG Economics", showing "Ireland returning to growth in 2011" and "in the "medium (2011-2014) the Irish economy expected to outperform OECD". TT in his oral evidence stated that he expressed the view that he did not agree with LBG Economist's view that there would be a modest recovery in the Irish economy in 2010 but there is nothing in the contemporaneous documents that records such views. If such concerns had been expressed by a GEC member we would have expected those concerns to be referred to in the contemporaneous documents. [TT 5/7/1-21]

(6) The briefing paper for TT for a meeting with the FR on 7 May 2010 confirmed "LBG's ongoing commitment to support BoSI (from both a capital and funding perspective)" and stated that LBG believed Ireland was likely to show "modest recovery from mid-2010 … strong growth in 2013". ED accepted that was the forecast in May 2010 [ED 2/79/2-11].

(7) The MFV strategy adopted by LBG was consistent with the economic forecasts that were provided by LBG Economics in the, Briefing Pack for ED and TTO January 2010.

(8) LBG's economic forecasts were cautiously optimistic about Ireland, the Divisional Finance Directors Report dated 11 February 2010 stated that "impairments are forecast to have peaked in Half 2 2009 in Ireland", and "Commercial property prices are expected to show growth in Ireland from 2011 under both base case and downside scenarios." There is no contemporaneous evidence of ED, TTO or TT raising concerns that the Irish economy was worsening or querying/challenging whether MFV was the right strategy for BOSI.

(9) That outlook remained unchanged in April 2010. The economic environment paper from LBG's Chief Economist's Office in the Board Away Day papers, dated 8 April 2010, noted that Ireland had "officially emerged from recession in 2009 Q3 as the government "had taken steps to restore the economy's fiscal and financial health [3/1313]. There is nothing in the economic environment paper that suggest that the MFV was inconsistent with the economic forecasts for Ireland in April 2010.

(10) There was significant deterioration in the Irish economy following the Irish Budget on 7 December 2010 (see LBG update on Irish Portfolio dated 17 December 2010) but that happened some four months after LBG's announced its decision on 19 August 2010.

Concerns about managing loans in Ireland

476. There were no contemporaneous documents that record any concerns expressed about the Irish BSU managing the loan book following TT's visit to Ireland nor that it was the reason for LBG's decision to exit Ireland:

(1) As at the end of 2009, there is no contemporaneous evidence recording any negative views of the new management in BOSI or the establishment of the Irish BSU. All the contemporaneous documents record positive views: BOSI minutes, 3 April 2009; the set up of the Irish BSU was "an essential step if the business model was to change to one that was sustainable in the difficult market conditions at that time (Group Credit Risk Assurance 12 November 2009]; incentive plans were put in place specifically for the Irish BSU to secure and incentivise colleagues through the manage for value years (BOSI minutes 4 December 2009).

(2) Mark Scrivens' (LBG's independent internal auditor), view on 3 December 2009 was that the BSU was making "excellent progress" in Ireland. The LBG Audit Committee Paper dated 10 December 2009 noted that a key element in the control framework for the impaired book was the formation of the BSU with "implementation of the BSU due to be completed by the end of Q1 2010 with the appointment of the remaining colleagues (bringing total resources to c.110 FTE)". The Executive Summary stated: "Substantial progress has been made on the establishment of the [BSU] and the clearing of outstanding CSA actions".

(3) ED's evidence to the Tribunal that he didn't believe BOSI had "the right team in place" and or "were acting with sufficient energy" to address the issues in Ireland [ED

2/12/23-13/1] was inconsistent with and not supported by the contemporaneous documents.

(4) ED accepted in cross-examination that TT's positive comments about BOSI reflected the view he had reported to the Board in January 2010: that BOSI had a strong and motivated management team [ED 2/73/16-22]. ED also accepted that BOSI's asset reduction was ahead of plan and "they were performing well" [ED 2/80/11-20].

(5) TT's oral evidence was that, following his visit to Ireland in April 2010, he formed the strong view that the London BSU needed to set-up buddying between the Irish BSU and London due to his concerns about the Irish BSU. [TT 5/36/2-5]. That evidence is not supported by the contemporaneous documents which confirm that the suggestion of buddying pre-dated TT's visit to Ireland and came from Robin Fanner, the Head of the Irish BSU (E-mail dated 12 March 2010 from RF to Karen James (Corporate Markets)).

(6) During TT's visit to Ireland he attended a BOSI Board Meeting at which it was confirmed that the BSU was now up and running, with "121 colleagues, c. 1,000 Customers, €9.6bn of exposure and badged Green. There were also now six regional BSUs to be located in Belfast, Waterford, Cork, Limerick, Galway and Sligo". TT was very positive about this in the Board meeting, saying that the UK BSU was "on a continuous learning curve" and that "the Irish BSU was only 6 months behind from an experience point of view", (TT 5/18/22-25). There is nothing in the contemporaneous documentation supporting TT's evidence that he had formed a negative view of the Irish BSU such that the book needed to be managed in London.

(7) TT's visit to Ireland was not motivated by any urgency nor any specific concerns, it was pre-planned visit and one of a number of visits that he made to various countries where W&I had a presence. The BOSI Board Minutes record TT's verbal update as stating: "Overall, Mr Tate had been comforted to see the excellent progress the team had made in Ireland in reshaping its business. The progress being made had left him with the distinct impressions that there was plenty to be positive about Ireland and reinforced how success could often be defined by spectacular execution." In oral evidence TT sought to characterise this as building morale and being encouraging and part of being "American. I am by nature effusive … I'm a positive guy". [5/21/22-23/1] We did not accept his oral evidence which was unsupported by the contemporaneous documents.

(8) TT accepted that there are no contemporaneous documents post his visit to Ireland, in May or early June 2010, that record him advocating shutting down BOSI for any commercial reason [5/63/15-20].

(9) TT and ED accepted that a "key element" of the MFV involved the loan portfolio being managed by the BSU in Dublin, [TT 3/29/22-30/3 and ED 1/138/11-15]. TT confirmed that the plan was to review this strategy again as part of the 2012-2017 planning stage [TT 3/24/20-23]. ED's evidence was that he told the GEC "we had reviewed the Irish strategy and we were content to move forward… that we had fully staffed [the BSU] and we were moving forward." [1/177/21-25]. We do not accept ED's assertion that that view was simply the "strategy of record. That doesn't mean that it was carved in stone" [ED 1/178/4-9], that assertion is unsupported by the contemporaneous documents.

(10) SRS's e-mail dated 17 May 2010 stated that "I agree the BSU needs to be maintained locally". There was no suggestion in the e-mail chain that the Irish Loan book needed to be managed from London nor that anyone was advocating such a step.

(11) LBG did not take any formal action between April (after TT's return from Ireland) and 31 December 2010 to have the BOSI loan book managed by the London BSU despite the alleged concerns. TT accepted that such a move to the London BSU did not need to wait until January 2011 [TT 5/35/25-36/2].

(12) We accepted Mr Godfrey's evidence that all the foreign owned banks operating in Ireland in 2010 moved the management and control of their portfolios to their home state and that such a move was "banking 101" and what he would have advised LBG to do in 2010. Whilst it may have been "banking 101", it was not what LBG did. [8/24/24-26/16]

Removal of references to tax

477. We found that references to tax planning and/or tax benefits were removed from final versions of documents and face to face or telephone discussions held to avoid reference to tax in e-mails and meeting notes for the following reasons:

(1) AK's e-mail dated 26 May 2010 confirmed that LBG were seeking to downplay the importance of tax in the decision making process and moved to discussing tax matters in person or via telephone calls:

> "From: Sharratt, Greig (Group Tax)
>
> Sent: 26 May 2010 08:42
>
> To: Kirkwood, Alan (Wealth & International); Holmes, Michael (Group Finance); Sced, Moira (Group Tax); Colsell, Steve (Wealth & International)
> Cc: White, Jacqueline (W&I Finance)
>
> RE: BOS Ireland - alternative strategy note
>
> I only managed to look at this late last night. I have comments and would like to discuss these with you. I think Moira left you a voicemail last night.
>
> Are you in London today? I'm in meetings until 6:00 tonight but Moira and I could get together with you then.
>
> Regards,
>
> Greig
>
> From: Kirkwood, Alan (Wealth & International)
>
> Sent: 26 May 2010 09:51
>
> To: Sharratt, Greig (Group Tax); Holmes, Michael Tax); (Group Finance); Seed, Moira (Group Colsell, Steve (Wealth & International)
>
> Cc: White, Jacqueline (W&I Finance)
>
> Subject: RE: BOS Ireland - alternative strategy note
>
> I got the gist of it from Moira's message last night. If you or Moira want to tone it down that would be fine by me. I guess you guys are even more sensitive to tax related papers than Tax were in my day!
>
> Alan"

(2) E-mail from NMC to AK confirmed that references to tax were being deleted from papers:

> "From: McCrea, Nigel R (UK - London) [mailto:nmccrea@deloitte.co.uk]
>
> Sent: 20 June 2010 10:38
>
> To: Kirkwood, Alan (Wealth & International)

Cc: Seed, Moira (Group Tax)

Subject: Re: Ireland

Alan, I saw a draft of Joe's paper. Asked for a couple of references to tax to be deleted.

Will track down final version.

Moira when are you around to discuss. Monday is bad for me, tues afternoon better

Regards nm

From: Sced, Moira (Group Tax)

To: Higgins, Joe (BOSI)

Cc: Kirkwood, Alan (Wealth & International); Breaks, Jon (Group Tax Insurance)

Sent: Wed Jun 23 10:57:34 2010

Subject: Hermes

Joe,

Many thanks for the paper that you have sent. Following on from Jon's note, we have discussed the content, along with a brief update from Deloitte, and I have the following comments to make:

we would prefer that the third bullet in Section 5 is removed, as it could be seen as giving more emphasis to the tax benefits than is the case."

(3) Changes made to the documents included the re-writing of a section headed "Tax Efficiencies" in the Project Hermes draft circulated on 17 June 2010 and the insertion of a new section titled "Key Transaction Risks". The Tax Efficiencies first draft stated that if the closure of BOSI was achieved 31 December 2010, "it may be possible to obtain group relief benefit of up to [£500m] for LBG". This section was re-written with new content suggesting that the tax relief was contingent on a number of factors including tax capacity in the business and the transfer value of assets. This section was expanded on again in a later draft. We accept that the documents were referred to as "drafts" but we find on the balance of probabilities that the changes made are consistent with the e-mails in the preceding two paragraphs requesting that references to tax be "toned down", removed or the emphasis on tax changed to emphasise other factors. The new "Key Transaction Risks" listed various different risks not mentioned previously including: legal and regulatory risk, operational delivery – "does not complete within the desire timeframe", finance and benefits – "risk that the overall business case (including any potential tax efficiencies) is not realised".

(4) The e-mail from AK dated 24 June 2010 on the draft GEC paper stated:

"The way it is drafted does it give us a problem with the "one of the main reason" test. It is really difficult not to mention tax in the paper at all given the nature of decision we are looking at here".

478. The GEC meeting held on 28 July 2010 was attended by ED, TT, TTO, SC and MW. SC and MW provided a Project Hermes update. It was accepted in cross-examination that there was likely to have been a discussion at this meeting [3/101/7-12, 5/130/12-16 and 4/75/7-17] about the tax benefits of the proposal, the importance of not having a PE in Ireland and the importance of completing by 31 December 2010 [4/101/7-21 and 5/130/12-16] despite the minutes not recording nor mentioning any such discussion(s). The GEC agreed to

recommend a CBM "*with a view to completion by 31st December 2010*". TTO agreed that he understood at least one of the benefits of completing by that date was the tax benefit [4/76/4-20].

479. TT's handwritten note for the LBG Board Meeting on 3 August 2010 stated that "timing is a tax issue and Tim will walk you through that". The minutes accurately record the contents of TT's handwritten up to that point but do not mention or record TTO "walking" the LBG Board through the tax and timing issues.

31 December 2010 deadline

480. We do not accept that the 31 December 2010 deadline was just a "coincident factor" [TT 5/128/2-3] for the following reasons:

(1) TT's handwritten note for the LBG Board Meeting on 3 August 2010 states "the timing is a tax issue". TT accepted that, in line with his speaking note for this meeting, that he told the Board that LBG should exit Ireland "in a way and at a time which is tax and capital efficient… doing it before year end. The timing is a tax issue". [5/141-142].

(2) The documents do not record any imperative commercial objective(s) that required BOSI to exit Ireland by 31 December 2010. Despite the stated concerns in oral evidence regarding the ability (or lack of) of the Irish BSU and the need to have the Irish loan book managed in London there was no reason (commercial or otherwise) to wait until 31 December 2010 to manage the Irish loan book in London, (5/35/11-5/36/7). That move did not take place until January 2011.

(3) The BOSI Business Review dated June 2010 stated the need to revisit the MFV sooner than the planned review in 2011/12 was based on external and internal factors listed. None of the external or internal factors were new and had been considered in previous discussion and reviews. The Business Review headline stated "Tax benefit enhances benefit but reduces timescale for an exit The work on accessing the Irish tax losses has a very tight timescale for delivery with September announcement and December implementation". This Business Review paper makes clear that the main driver for the timing of the CBM by 31 December 2010 was tax.

(4) The e-mail to TTO dated 10 June 2010 and to TT dated 11 June 2010 from SC updating them on the Deloitte advice does not refer to or mention any commercial reasons for the 31 December 2010 deadline or the liquidation. Both TTO and TT accepted that tax was the only reason given in the e-mails for the deadline, [4/23/9-4/24/814 and 5/80/19-5/81/4].

(5) TTO accepted in cross-examination that pushing Project Hermes through governance so quickly meant that the level of analysis and due diligence that could be done was less that would be required in the normal course of business and accepted that, as stated by Deloitte, this was because of the very significant potential tax benefits [4/31/4-32/9].

(6) The e-mail from MS dated 24 June 2010 warned that they needed "to be careful of when we are looking at tax capacity – we may need to make sure that the trade ceases on 31/12/10 and not before if we are to be able to surrender against the full year UK profits".

(7) The Deloitte paper dated 15 July 2010, made clear that, in order to obtain the maximum tax benefit, LBG would need to effect the tax planning by 31 December 2010

(8) The Deloitte presentation to the Project Hermes steering committee on 10 June 2010 emphasised the 31 December 2010 deadline. TTO accepted that the project team and their advisors understood this to be a "tax deadline" [4/19/16-20]. ED understood that, if LBG were to capture a tax benefit, they would have to do it by 31 December [2/185/4-7]. Later the same day, SC e-mailed TTO with a "quick update". Deloitte sent a further email emphasising the 31 December 2010 tax deadline again. The e-mail referred to "three weeks intensive work" that would be required. This was based on the fact the 31 December tax deadline would be operationally difficult to achieve and the plan would need to get through the GEC in the next 3 weeks to meet this deadline. TTO agreed that it was a fair assumption AK would have updated him after this email [Day 4/4/17-21].

(9) TTO accepted in evidence that SC told him, in order to get the CBM done by 31 December, they would need to get this matter pushed through governance quickly and, to give themselves the best chance of hitting the 31 December deadline, to get this to the GEC by the end of the month [4/31/11-23]. No commercial reasons were given for either the liquidation or the 31 December deadline, only tax [5/80/19-23]. In our view, we consider that it is more likely than not that TT or TTO would have explained to ED the urgency of getting this matter onto the GEC agenda in the next few weeks in order to meet the 31 December tax deadline.

(10) It was suggested by ED in oral evidence that an exit by 31 December 2010 was necessary to enable the exit cost to be recorded in the LBG accounts for 2010 and to achieve finality on the finances for that period [2/187/20-188/1]. However, there is no mention of any such desire to include the Irish exit costs in the 2010 accounts in the contemporaneous documents nor were any such figures included in the 2010 accounts. We consider it is of note that LBG remained liable for costs associated with Certus, such as redundancy payments and premises costs [2/194/8-11], which would have gone into LBG's accounts after 2010. We do not accept that exiting Ireland by 31 December 2010 would have provided finality on any Ireland specific costs nor enabled such costs to be booked into the 2010 accounts.

(11) TT, in his oral evidence, stated that it was necessary to exit Ireland due to the need to have any redundancies covered by a pre-negotiated union agreement which expired at the year end [4/34/2-8]. There is no reference to or any evidence of that reason in the contemporaneous documents.

Tax determined the decision to exit Ireland via a CBM rather than a via a branch, a s33 transfer or the TRS

481. ED accepted in cross-examination that, LBG had "a number of options for the Irish business" and "a number of options on the table", only one of which was a CBM [2/50/17-20 and 2/51/5-8]. The other options open to LBG for the future Irish structure included: (i) a branch; (ii) a s33 Transfer; and (iii) the TRS. We have found that the decision to reject the three options in favour of the CBM was primarily determined by tax for the following reasons.

Branch

(1) Between January and April 2010, consideration was given as to whether there should be a branch or subsidiary structure going forward in Ireland for the remainder of the BOSI business, following the closure of Retail. It was listed as an option in the 26 January 2010 briefing paper for TTO and remained an option throughout April 2010.

(2) The branch remained an option until MS's e-mail dated 21 April 2010 identified that "there is a considerable tax downside to a branch" as a M&S claim would not be

possible. It was only after the tax downside was identified that LBG began to consider liquidating BOSI. This was accepted by ED [2/55/14-19] and TTO [3/91/2-9] in cross-examination.

(3) The e-mail from AK dated 4 May 2010 attaching the Ireland Update Paper confirmed that a branch would not allow LBG to access the group losses. It was stated in the Ireland Updated paper "We have looked into the detail of the M&S case (the leading case in this area) to see whether there is anything of use re circumstances in which we can make a Group Relief claim for BOSI (either in hybrid or full branch scenario). The facts of the case are not particularly helpful - at the time of the ECJ hearing, the M&S subsidiaries were no longer trading (but not yet in liquidation)."

(4) On 8 June 2010 the advice from Deloitte was now focused on ensuring that, for tax reasons, a branch did not remain in Ireland. Deloitte advised LBG that "we would need to make sure that the losses didn't transfer to an Irish branch of BOS PLC … I have assumed its [sic] a manageable risk, ie we could structure whats [sic] left to be an admin function only etc". The option of an Irish branch or subsidiary was ruled out by early June 2010 for tax reasons following e-mailed discussions between LBG and NMC on 9 and 10 June 2010.

(5) BOSI was one of a number of LBG subsidiaries located in Europe and further afield but there was no reference in the documents or witness evidence of any similar urgency or need to close any other subsidiary or branch in any other jurisdiction in 2010.

Section 33 transfer

(6) Advice was given by Arthur Cox to the Project Hermes Working Group on 16 June 2010 that a s33 transfer was likely to take at least 4 months or more which meant that it would be extremely difficult to achieve by 31 December 2010: "An application is made to the Minister for Finance on a day (the "Application Date") not less than four months before the date on which the transfer is intended to take effect - in this case the 15th December 2010 (the "Transfer Date") - importantly the application can be made more than four months in advance but cannot be made less than four months in advance."

(7) Concern was expressed in the 29 June 2010 GEC paper that even if it were possible to achieve the s33 Transfer by 31 December 2010 it was a more risky option than the CBM as "Based on legal advice, it would take up to 5 months from notification to the FSA for the establishment of an Irish branch by an LBG UK subsidiary. After the transfer, this branch would then have to be dissolved (consultation with the FSA and the Financial Regulator would be required) in order to ensure that LBG did not have a "permanent establishment" in Ireland relating to the banking business. However, even if this were possible by year-end it increases the risk around the delivery of tax efficiencies."

(8) Mr Rodgers' expert evidence was that the s33 transfer may not have worked as the FM may not have approved a s33 transfer in circumstances where it was intended to immediately close the Irish branch. In cross-examination he rightly accepted that there was nothing in s33 that indicated that a s33 transfer would not be possible where the branch was closed immediately or shortly after transfer and he accepted that the FM's power/discretion would have to be interpreted in accordance with EU law and there was nothing in Regulation 23 EC (Licensing and Supervision of Credit Institutions) Regulations 1992 which entitled a host Member State regulator/authority to withhold

conferring a banking licence on a branch of an undertaking exercising its EU law passporting rights. [6/67/2-72/12; 6/75/24-76/23; 6/78/4-12; 6/84/17-23 and 6/90/2-16]

(9) TT accepted that one of the reasons for not pursuing the s33 transfer was because it would not be possible to complete the s33 transfer by 31 December 2010 and the decision to proceed with the CBM rather than a s33 transfer was a decision of the project team. [5/83/21-84/21]

TRS

(10) The TRS had been considered by LBG as early as 18 May 2009 in the Draft Deloitte advice.

(11) The e-mail from MS to AK dated 27 April 2010 confirmed that the TRS was being considered: "I'm happy to wait if you are until I'm back/ Nigel's free. It will be a couple of weeks, but given that we are exploring the TRS option in the meantime, that may be no bad thing."

(12) No final decision was taken at the 3 August 2010 LBG Board meeting despite the CBM being approved in principle and it being clear that the TRS would not have achieved LBG's asserted objective of exiting Ireland and sending a clear message to the market as the TRS required BOSI's continued existence and presence in Ireland. This was accepted by TTO [3/118/8-10] and TT [5/113/4-8].

(13) SH's e-mail on 12 August 2010 to SC noted the "growing concern that the CBM is indifferent with the total return swap and structuring that STG have designed" and "*As the 2 seem not dissimilar in financial terms and given Risk's concerns re CBM soln I've asked Greig to find out if we can withdraw from CBM if we find in a few weeks when the full analysis has been completed that for risk, accounting or tax reasons that STG's soln is preferable*". TTO confirmed that LBG "*would be prepared to consider*" pulling the CBM if necessary [4/105/8-12 and 4/103/4-13] and accepted that tax "*continued to play an important role*" at the time [4/123/3-12].

(14) The Project Hermes e-mail dated 16 August 2010 from SC to TT and TTO titled "Update and Request for Board Sub-Committee Meeting" stated that the CBM "*may not be the optimum tax solution*" and reference in detail was made to the TRS which would enable LBG to access the 2009 losses. Confirmation was provided that the TRS would require an ongoing banking presence in Ireland which was less "*attractive from a strategic and messaging point of view*" and would be a "much less attractive solution for both regulators than the CBM." The advice was to proceed with the CBM to achieve the 31 December 2010 deadline but retain the option to pursue the TRS if the CBM proved not to be "*the optimum tax solution*" as "*There is a chance that one of Tom's options is more attractive than the CBM, or our conversations with the tax authorities are unfavourable in which case we can withdraw from the CBM. We recognise the embarrassment factor here and this was flagged at GEC and Board but we believe is a risk worth taking - however we will make sure the announcements, commitments and decisions we communicate minimise the issues associated with pulling the CBM at any stage*."

(15) AK's e-mail Mark Adams (Deloitte) dated 16 August 2010 stated: "*So we are going to lodge the CBM papers on Thursday and work up the enhanced TRS solution over the next few months and if it is significantly better then we might pull the CBM before implementation. This means better from a tax and regulatory perspective*.".

(16) AK's e-mail to GS and JB dated 17 August 2010 stated: "we would like Group tax to give us their best view of tax capacity in 2010 by end September so we can make an informed decision between the enhanced TRS and CBM."

(17) As at 18 August 2010, no final decision had been made about whether to implement the CBM or TRS. TT agreed that LBG were "balancing" these two options, each of which gave them significant tax benefits [5/152/10-12]. The 31 December 2010 deadline made it necessary for the Irish exit to be announced on 19 August 2010. As such, on 18 August 2010, the sub-committee, TT and SH (as duly authorised representative of TTO) – approved and ratified the plan to carry out a CBM by the end of 2010 . The following day, 19 August 2010, the decision to exit Ireland was announced. Six weeks of work was approved by TTO and TT on 19 August 2010 to further investigate the TRS despite the public announcement that LBG were exiting Ireland [4/84/12-21, 4/82/19-23, 4/122/21-25, 5/150/11-21 and 5/149/21-23] and further investigations would require significant resources [4/83/12-16 and 5/150/6-10]. The 16 September 2010 e-mail from He Shen to TM, GS JB , SC and others subject "Re: BOSI Alternative Proposal.ppt" confirmed that LBG obtained extensive legal advice on the TRS option from legal advisors in both the UK and Ireland including Arthur Cox, Linklaters and KPMG. The legal advice was not disclosed.

(18) The email dated 22 September 2010 from SH to TTO noted: "*It* [TRS] *doesn't tick the we are leaving Ireland box however in in practical terms I think the effect* [of the CBM and TRS] *is the same*". TTO accepted in cross-examination, this was because LBG could give the same message by announcing or reiterating that BOSI would not be writing any new business in Ireland [4/133/8-16]. TTO accepted that if the strategic goal of exiting Ireland was as important as claimed, LBG would not have spent six weeks investigating and discussing the option and could have stopped the TRS work earlier [4/140/5-11].

(19) The 27 September 2010 report on the TRS set out the Pros and Cons of that option. TT accepted, there were "significant tax advantages" to both schemes [Day 5/124/23-25]. The conclusion of the report was that the TRS allowed LBG to achieve more tax gains, but over a longer period [4/124/18-21 and 5/145/9-13]. Pros and Cons were identified for each option and it was not clear cut which was the best option for LBG despite the stated strategic aim of exiting Ireland. However, the risks associated with this option, included "greater reputational, tax, credit and regulatory risk". A key concern was that this option was "more aggressive from a tax point of view with no business story to back up… What is the reason for the about turn" [3/2490]. Therefore, there were advantages to each option and it was not immediately clear which was optimal for LBG despite its asserted objective.

(20) On 29 September 2010, a further Project Hermes committee meeting was held – with TT and TTO in attendance - to vote on which of Option A (the CBM) or Option B (the TRS) should be adopted. TTO accepted that as at late September, LBG still had not decided which of the CBM or TRS was the "optimal route" [5/113/4-8]. TTO's oral evidence was that he personally "hadn't made up my mind up about whether I wished to change horse" from the CBM to the TRS [4/137/18-19] despite the TRS requiring BOSI to have a continued presence in Ireland.

Certus arrangements were tax driven

482. We have found that the manner in which Certus was structured was for tax purposes for the following reasons:

(1) Certus was structured in accordance with the advice given by Arthur Cox on 16 and 25 June to avoid any risk of BOS being deemed to have a permanent presence for tax and regulatory purposes in Ireland following the transfer of all the assets and liabilities to BOS.

(2) The e-mail from SW to SH, TTO, GS, JB, MS and others dated 21 December 2010 stated that: “In giving advice to the business we have engaged extensively with A&O and tax counsel plus Arthur Cox in Ireland. Counsel provided input to the Certus service agreement and guidance on the activities to be carried out by Certus and the Irish BSU.”

(3) LBG’s requirement to avoid a PE in Ireland was incorporated into the Certus agreements, operational manuals and training manuals. Certus was provided with a "Rules of the Road" document developed jointly by LBG and EY for Irish BSU staff to show in detail what action must occur in the UK, and similarly, what actions or decisions could not be taken in Ireland.

(4) Group Tax provided training on 9 December 2010 to the Irish BSU to “ensure the structure is understood”. Review sessions were held on 8 and 20 December to ensure that Certus and IBSU staff understood what could and could not be done to avoid a deemed PE in Ireland.

(5) ED confirmed that LBG remained liable for the costs associated with Certus [2/194/4-11]

> Q. We know, though, don’t we, that in terms of costs we know that LBG underwrote the costs for the setting up of Certus, of the management owned company; yes?
>
> A. That’s correct.
>
> Q. We know that those 100−plus staff continued after 31 December to work from the same Lloyds−owned premises; correct?
>
> A. That’s correct.

(6) The timescale was extremely tight to get Certus up and operational in Ireland by 31 December 2010. Despite the concern expressed by PWC at the audit committee meeting referred to in SH’s e-mail to SW and TTO dated 19 December 2010 and internal concerns and reservations expressed about the rapid timescale and the numerous outstanding issues and challenges identified in e-mailed exchanges on 22 December 2010 between Wilson Downs and Derek Woodhead the decision was still taken to proceed.

Removal of BOSI’s Dutch parent company was tax driven

483. SIF was removed as BOSI’s immediate parent company on 17 September 2010. Prior to that date there is nothing in the contemporaneous documents to suggest any prior intention to remove SIF nor any commercial reasons given for its removal other than to enable LBG to execute the CBM:

(1) The letter from LBG to HMRC dated 22 December 2010 stated: “On 17th September 2010, BoSI was transferred from its current Dutch holding company, Scotland International Finance BV ("SIF BV"), to Bos for a nominal sum. This was to facilitate the legal mechanics of the merger.”

(2) If SIF had remained BOSI’s parent company at the time of the CBM it would not have been possible for BOSI to carry out the CBM as company law prohibited a

company from receiving shares in its parent company in exchange for shares in its own subsidiary.

(3) The Deloitte draft paper dated 15 July 2010 titled "LBG: Project Hermes Tax Considerations for GEC" identified the risk that the precedence condition could be in point such that relief for any final loss would be available in the Netherlands. Removal of SIF removed the risk that the precedence condition could be in point.

(4) The overview of the CBM process in the Legal Appendix draft 22 July 2010 annexed to the Project Hermes LBG Board paper dated 3 August 2010 confirmed that "As BOSI is not currently a wholly-owned subsidiary of BOS plc, it will be necessary to first transfer the shares in BOSI, all of which are held by Scotland International Finance B.V. ("SIF"), to BOS plc prior to the execution of the common draft terms of the Merger (described below) (the "Reorganisation"). It is likely that the common draft terms of Merger will be executed immediately following the shareholder meeting of BOS plc to approve the Merger".

(5) The Project Hermes Tax Considerations paper prepared by Group Tax dated 3 August 2010 confirmed that "The complexity involved in the proposed merger raises a number of tax issues and we are working through these with Deloitte, Allen & Overy and leading tax counsel in the UK and with Arthur Cox in Ireland. BOSI is currently a subsidiary of SIF BV (the HBOS group's Dutch holding company) and Dutch advice will also be required, although we do not anticipate any significant Dutch tax issues."

(6) On 7 September 2010 instructions were sent to Allen & Overy stating: "In order for us to effect a merger of BOS and BOSI, BOSI needs to be a wholly owned subsidiary of BOS. Consequently SIF is going to transfer the entire share capital of BOSI to BOS. I would be very grateful if you could prepare board minutes for SIF to approve this intra-group transfer."

Was the main purpose, or one of the main purposes, of the arrangements to secure that the amount (or part) of losses may be surrendered for the purposes of CBGR?

484. We have concluded in our findings of fact that the main purpose or one of the main purposes of the arrangements put in place by LBG to exit Ireland via the CBM on 31 December 2010 was to claim CBGR for BOSI's accumulated losses in the period 31 December 2010. It therefore follows that s127 applies to the arrangements put in place by LBG to exit Ireland via the CBM.

Is s127, or the manner in which HMRC has applied it to deny CBGR, compliant with Article 49 (in conjunction with Article 54) TFEU?

485. LBG submitted that s127 must be construed in a way so as not to undermine the objectives of EU law or frustrate applicable EU jurisprudence as regards the rights conferred on nationals of EU Member States.

486. Section 127 CTA must therefore be interpreted in accordance with the decision of the CJEU in *Cadbury Schweppes*. This means that any purpose test should only apply to "wholly artificial arrangements". This was re-iterated by the CJEU in *M&S* at [57]:

> *"… Member States are free to adopt or to maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or escape national tax law".*

487. To the extent that the provision is applied in a manner that goes further than necessary to achieve the legitimate purpose of excluding "*wholly artificial arrangements*", s127 would represent an infringement of EU law. As there was a commercial purpose for the existence of

BOSI and the arrangements, none of the arrangements can be viewed as wholly artificial such that s127 CTA 2010 does not prevent CBGR from being available.

488. HMRC submitted that there is nothing in s127 itself that contravenes EU law and, having infracted the UK in relation to the CTA 2010 leading to *EC v UK*, the Commission notably took no point on s127. Moreover, the operation of a purpose test is inherently fact sensitive and not something the CJEU interferes with – that is a matter for the domestic court. It is wrong to suggest that s127 must be read to apply only to wholly artificial arrangements. Nothing in Article 49 TFEU and the right to freedom of establishment precludes Member States from enacting anti-avoidance provisions. In *Cadbury Schweppes,* the Court was not concerned with an anti-avoidance provision but rather a deemed taxation provision. It is therefore of no assistance. Nor does the application of an anti-avoidance provision that extends beyond wholly artificial arrangements undermine Article 49 TFEU insofar as the CJEU has made clear that the balanced allocation of taxation, the avoidance of the double use of losses and the prevention of tax avoidance are all objective justifications for refusing CBGR relief. Nothing in the Court's case law suggest that the tax avoidance rationale has to be strictly and narrowly construed to capture only wholly artificial arrangements. On the contrary, given the very substantial detriment CBGR entails for the Member State of the parent company, it is perfectly proper for a Member State to adopt a more general anti-avoidance provision.

489. We noted at the outset that there is an inherent contradiction in LBG's pleaded case in respect of s127 and s119: decisions of the CJEU should be ignored post *M&S* in respect of s119 but "*domestic law must be interpreted, as far as possible, in accordance with EU law*" when considering s127.

490. We agree with HMRC's submission that if there was anything in s127 which contravened EU law it is highly unlikely that the issue would not have been raised by the Commission following their investigation into the CBGR provisions in CTA 2010 that culminated in *EC v UK*. Logically, that investigation would have considered all of the CBGR provisions including s127. There is no suggestion that s127 (nor indeed reference to s127) contravened EU law or went beyond what is necessary to achieve that objective. The Commissions' Application stated:

> "for a declaration that by imposing conditions on cross-border group relief that make it virtually impossible in practice to obtain such relief and by restricting such relief to periods after I April 2006, the United Kingdom has failed to comply with its obligations under Article 49 of the Treaty on the Functioning of the European Union and Article 31 of the Agreement on the European Economic Area."

491. The Commission's letter to the UK referred to the possible incompatibility of UK law with EU law but s127 was not one of the provisions mentioned:

> "The Commission would like to draw your Government's attention to the possible incompatibility with European Community law and the EEA Agreement of certain provisions of the United Kingdom's tax legislation concerning cross-border loss compensation."

492. We agree with HMRC's submission that there is nothing in Article 49 TFEU which states that the right to freedom of establishment precludes Member States from enacting anti-avoidance provisions. Whilst we do not accept HMRC's submission that the CJEU in *Cadbury Schweppes* was not construing an anti-avoidance provision (Part XVII of ICTA 1988 is headed "Tax Avoidance") we do not accept that *Cadbury Schweppes* is authority for the proposition that LBG advances that any purpose test should only apply to "*wholly*

artificial arrangements". The CJEU stated in its judgment that the application of UK CFC legislation was too general and therefore contrary to EU law when applied to actual establishments that had genuine economic activity in the host state. It further stated that CFC legislation is only acceptable if it is targeted specifically at wholly artificial arrangements. Notably, the CJEU said at [72] that it was a matter for the national court to determine whether the fact sensitive motive test could be interpreted as compatible with EU principle of freedom of establishment.

493. In our judgment, the operation of a purpose test is inherently fact sensitive and not something the CJEU interferes with, it is a matter for the domestic court, *Cadbury Schweppes* at [72]. We have been unable to find anything in CJEU case law relied upon by LBG that supports its submission that the tax avoidance rationale has to be strictly and narrowly construed to capture only wholly artificial arrangements. The CJEU has repeatedly made clear that the balanced allocation of taxation, the avoidance of the double use of losses and the prevention of tax avoidance are all objective justifications for refusing CBGR with the caveat that the measure does not go beyond what is necessary to achieve the objective. In *A Oy* the CJEU stated at [26], [28] and [31]-[38] that it was for the national court to assess whether a difference in treatment was appropriate and did not go beyond what was necessary to achieve that objective. Those principles were similarly stated in in *EC v UK* at [23]-[25] and *Oy AA* at [51]-[56] and [62]- [65]. At [62]-[63] in *Oy AA* the CJEU stated:

> 62. It should be noted at the outset that the objectives of safeguarding the balanced allocation of the power to impose taxes between member states and the prevention of tax avoidance are linked. Conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory is such as to undermine the right of the member states to exercise their tax jurisdiction in relation to those activities and jeopardise a balanced allocation between member states of the power to impose taxes (see the Cadbury Schweppes case (paras 55, 56) and the Test Claimants in the Thin Cap Group Litigation case (paras 74, 75)).
>
> 63. Even if the legislation at issue in the main proceedings is not specifically designed to exclude from the tax advantage it confers purely artificial arrangements, devoid of economic reality, created with the aim of escaping the tax normally due on the profits generated by activities carried out on national territory, such legislation may nevertheless be regarded as proportionate to the objectives pursued, taken as a whole. [emphasis added]

494. In light of the above, we do not accept that s127 or the manner in which HMRC has applied section s127 to deny LBG CBGR is not compliant with Article 49 (in conjunction with Article 54) TFEU and goes beyond what is necessary to attain the objectives pursued.

SECTION 119 CTA 2010 – QUALIFYING LOSS CONDITION.

495. We have considered the five particular issues at paragraph 4.(1) above to determine whether the qualifying loss condition is met in relation to the Appellant's claim for CBGR for its accounting period ended 31 December 2010.

IS SECTION 119 CTA 2010 REQUIRED TO BE INTERPRETED OR APPLIED IN A MANNER CONSISTENT WITH PARAGRAPH 55 OF THE JUDGMENT OF THE CJEU IN M&S?

496. LBG submitted that the claim for CBGR is a claim pursuant to UK domestic law as set out in Chapter 3 of Part 5 CTA 2010 (as that Chapter applied prior to its repeal by section 24 of the Finance Act 2022 with effect from 27 October 2021). It is not a claim on the basis of the UK's pre-2006 legislative provisions or on the basis of EU principle. LBG acknowledges that UK domestic law must be interpreted in a manner that is compatible with EU law and in

light of EU case law. Specifically this means that if Chapter 3 of Part 5 CTA 2010 infringes the freedom of establishment by Article 49 (and Article 54) of the TFEU it must be interpreted so as to permit a claim for CBGR where the para 55 *M&S* conditions are met. This does not mean that HMRC can rely on Article 49 and EU case law to preclude a claim for CBGR where UK domestic law clearly allows such a claim. Even if EU law were to impose a stricter test for the determination of final losses or for the availability of CBGR than that prescribed by UK domestic law, that does not mean that UK domestic law is to be accorded a stricter construction. The UK domestic legislation imposes its own test of finality of losses, namely the qualifying loss conditions in s119. To the extent that the test in s119 is met, losses will be "final" in accordance with the UK's domestic law, irrespective of whether or not the para 55 conditions were met.

497. HMRC submitted that it was Parliament's clear intention to enact legislation that would comply with the para 55 *M&S* conditions and no more and that legislation cannot be divorced from the CJEU ruling that caused it to be enacted. There is nothing to suggest that Parliament had enacted a more generous scheme of CBGR required by the para 55 conditions ("*gold plated*") and, furthermore, subsequent EU case law has confined the scope of the para 55 conditions. The CJEU's decisions are declaratory of EU law as it always has been, elucidating, from time to time, what EU law means and requires. Parliament was legislating to implement, not a directive or some other legislative measure, but an individual case of the CJEU; Parliament can be taken to know that case law does not stand still and can be taken to know that what certain principles mean or require will be further elaborated by the CJEU over time. Chapter 3 of Part V is 'retained EU law' for the purposes of the European Union (Withdrawal) Act 2018 ("EUWA"). The EUWA converted the body of existing EU law, as it applied to and within the UK prior to the end of the transition period, into domestic law and preserved the laws that implemented the UK's obligations whilst an EU Member State. Chapter 3 of Part V, being retained EU law, must be interpreted in accordance with the CJEU's case law that elucidates the very law which Chapter 3 of Part V sought to implement. It is therefore legally wrong for LBG to seek to contend that the words of s119 must be interpreted in isolation and without regard to the retained EU case law that in fact explains the scope of the very entitlement that Chapter 3 of Part V sought to implement. Decisions of the CJEU post *M&S* have narrowed the para 55 conditions.

498. We did not understand there to be any dispute regarding the provisions relating to retained EU law, rather the dispute was on the applicability (or not) of retained EU law. Section 6(7) of the EUW defines 'retained case law' as "(a) retained domestic case law, and (b) retained EU case law" where "retained EU case law" means "any principles laid down by, and any decisions of, the European Court, as they have effect in EU law immediately before IP completion day and so far as they—(a) relate to anything to which section 2, 3 or 4 applies, and (b) are not excluded by section 5 or Schedule 1, (as those principles and decisions are modified by or under this Act or by other domestic law from time to time)." Section 6(3) of EUW further provides that:

> "Any question as to the validity, meaning or effect of any retained EU law is to be decided, so far as that law is unmodified on or after IP completion day and so far as they are relevant to it—
>
> (a) in accordance with any retained case law and any retained general principles of EU law, and
>
> (b) having regard (among other things) to the limits, immediately before IP completion day, of EU competences."

499. Section 119 is headed "*The qualifying loss condition: relief for future periods*" and gives effect to the second part of para 55 *M&S*. HMRC submitted that LBG appears to

contend that s119 has effectively "*gold-plated*" *M&S* by "imposing its own test of finality of losses" thereby making it easier to claim CBGR as a matter of domestic law than EU law. The implicit contention appears to be that whereas domestic law "must be interpreted in a manner that is compatible with EU law", s119 should be interpreted without regard to the CJEU case law since M&S, notwithstanding that that case law has in the course of elucidating the meaning of the Para 55 conditions in Marks & Spencer clarified the meaning and scope of the principles in that case, including the meaning and application of the para 55 conditions. We agree with HMRC. We cannot see that there is any basis or support for LBG's submission that the words of s119 must be interpreted in isolation and without regard to the retained EU case law that in fact explains the scope of the very entitlement that Chapter 3 of Part V sought to implement. We consider that conclusion is clear from the consideration of case law by the Tribunals and Courts post the *M&S* decision.

500. In our judgment, it is clear from the Explanatory Notes below that it was Parliament's intention to enact legislation that would comply with the principles set out in *M&S* and not create its own test of finality of losses. We accept that there is no suggestion in the Explanatory Notes that Parliament intended to go beyond what was required to comply with and give effect to the *M&S* decision and "*gold plate*" the provision. Mr Milne referred us to *Akinsanya v SSHD* [2022] EWCA Civ 37 ("*Akinsanya*")to rebut HMRC's submission that there is a presumption against "*gold plating*":

> 63 As regards the second element, Mr Blundell relied on what he said was a presumption against "gold-plating" - that is (as defined in the Department for Business, Energy and Industrial Strategy's document Transposition Guidance: How to Implement EU Directives into UK Law Effectively (April 2013)) "going beyond the minimum necessary to comply with a Directive". The Guidance says that it is not Government policy to gold-plate in the absence of exceptional circumstances (see para 2.7). Mr Blundell referred also to the judgment of Lord Mance JSC in EnergySolutions EU Ltd v Nuclear Decommissioning Authority [2017] 1WLR 1373, which was concerned with UK legislation implementing the scheme for remedies for breach of the Public Procurement Directive (2004/18/EC). At para 39 Lord Mance JSC said that there was "a natural assumption that the UK legislator will not go further than required by EU law when implementing such a scheme, without considering this and making it clear.
>
> 64 I should start by saying that I do not accept that there is any general presumption against "gold-plating". The correct position is as stated by Lord Mance JSC in *United States of America v Nolan* [2016] AC 463, at para 14:
>
> > "Where a Directive allows a member state to go further than the Directive requires, there is . . . no imperative to achieve a "conforming" interpretation. It may in a particular case be possible to infer that the domestic legislature did not, by a domestic formulation or reformulation, intend to go further in substance than the European requirement or minimum."
>
> Although Lord Mance JSC is there referring to the requirements of a Directive, the same principle must apply to any provision of EU law; and in the present case articles 20 and 21of the TFEU would certainly not prevent a member state from granting further rights to third-country national carers of EU citizen children than *Zambrano* requires. What Lord Mance JSC says in that passage is not inconsistent with the phrase on which Mr Blundell relies from his judgment in EnergySolutions: that was not expressed as a general proposition but was explicitly directed to the particular scheme. In short, while it may well be relevant in construing implementing legislation of this

> kind to consider whether in the particular case the legislator is likely to have intended to go beyond the minimum required in order to achieve compliance with EU law, that is no more than a consideration forming part of the overall exercise of statutory construction."

501. As *Akinsanya* stated at [64], whether the legislator intended to go beyond the minimum required in order to achieve compliance with EU law is no more than a consideration forming part of the overall exercise of statutory construction.

502. The Explanatory Note to the Bill in respect of clause 27 and Schedule 1 to the Finance Act 2006 relevantly stated:

> "124 In summary, the Court ruled that the UK's group loss relief rules are in principle compatible with European Law but go too far in denying loss relief to a parent company for the losses of a foreign subsidiary where the parent company has demonstrated that the non-resident subsidiary has exhausted all possibilities of relief in its state of residence."

503. The Explanatory Notes to Chapter 3 of Part 5 of CTA 2010 relevantly stated:

> "406. This Chapter makes the United Kingdom group relief rules compatible with European Community law following the judgment in *Marks and Spencer plc v Halsey*, C446/03. That case decided that in some circumstances it is contrary to the provisions of the EC Treaty on freedom of establishment to deny group relief to a UK resident parent for the losses of a non-UK resident subsidiary."

504. In our judgment, it is clear from the Explanatory Notes that Parliament was seeking to only amend the UK legislation to comply with the para 55 conditions and not to provide CBGR that was broader than required nor impose its own test of finality of losses. In other words, the UK Government was doing no more than the "*bare minimum*" to ensure that UK group relief rules were compatible with EU law. We are reassured in that conclusion by the infraction proceedings taken by the *EC v UK* on the basis that UK legislation had given effect to para 55 too restrictively. It would not, as a matter of logic, have commenced infraction proceedings if the UK legislation had "*gold-plated*" the para 55 conditions.

UK CASE LAW

505. It can be seen from UK case law that the Courts and Tribunals have been interpreting the principles in M*&S* by reference to the CJEU's case law post *M&S*. We cannot see that it was submitted, as in this appeal, in either of the following cases that EU case law on CBGR and final losses should not be considered by the Courts and Tribunals when considering CBGR and final losses post *M&S*.

506. In *Esso Exploration and Production UK Ltd & Ors v HMRC* [2020] UKFTT 0139 (TCC) ("Esso") the Tribunal (Judge Anne Scott) considered the claim to the right to relief for trading losses, CBGR, incurred and surrendered by a company called ExxonMobil Denmark Holdings international ApS. The decision relevantly stated:

> "[13] In HMRC's Skeleton Argument there had been a reference to a draft Amended Statement of Case and an intention to seek leave to amend at the outset of the Hearing which did not materialise. On 16 April 2019, HMRC lodged a Submission seeking leave to amend the Statement of Case by the introduction of a further paragraph directed at all of the years in issue and headed 'No possibilities test not satisfied in any event'.
>
> [14] On 30 April 2019, the appellants confirmed that they offered no objection to the amendment although they took issue with one of the arguments advanced in the Submission by HMRC. That argument was

predicated on Advocate General Kokott's opinions in *Skatteverket v Memira Holding* ('*Memira*') and *Skatteverket v Holmen* ('*Holmen*').

…

[82] In both cases the judgments are in line with the Advocate General's Opinions issued in January 2019. In the introductions to both Opinions, in line with her previously oft expressed reservations about *Marks & Spencer*, she points out the problems with 'final losses', the lack of clarity giving rise to the repeated references to the CJEU and states that if the CJEU wishes to adhere to the 'final losses' exception then it had the opportunity to 'refine this category' ie the *Marks & Spencer* exception.

[83] She makes it explicit in her Opinion in *Holmen* that the first question concerns the interpretation of the judgment in *Marks & Spencer* and the judgment also makes that explicit.

[84] Similarly, in her Opinion in *Memira* she points out that, although the referring court focuses primarily on *A Oy*, that case applied the findings in Marks and Spencer. Beyond reciting the referred question the judgment makes no reference to *A Oy* but refers to *Marks & Spencer*.

[85] In both cases the formal Rulings refer explicitly to para 55 of *Marks & Spencer*.

[86] It is clear that both cases do indeed further refine and develop CJEU case law on CBGR and final losses.

…

DECISION IN RELATION TO THE APPLICATION OF HOLMEN

[110] During the course of the Hearing both Mr Aaronson and Mr Yates, very appropriately, referred to the evolution of the jurisprudence of the CJEU. *Holmen* and *Memira* are precisely that. It is clear to me that the Court adopted the Advocate General's invitation to 'refine' the category of 'final losses' as described in Marks & Spencer.

[111] I do not perceive any conflict between these cases and *Marks & Spencer*. Firstly, the fact that these were decided by the First Chamber is not a relevant factor.

…

[113] Secondly, it is very evident that in every stage of their deliberations, as evidenced by the references in *Memira* to *Marks & Spencer* rather than to *A Oy*, (see para [85] above) the CJEU were focussed on elucidating *Marks & Spencer*. In my view, much needed clarity has been shed on the nature and extent of the *Marks & Spencer* exception. I find that it is indeed acte clair and there is no need for a further reference.

507. LBG submitted that *Esso*, on the one hand, contained a helpful summary confirming that the *M&S* decision was "alive and well" as subsequent cases have clarified but not changed it but, on the other hand, it was not relevant as it was concerned with different legislation and the freedom of establishment was not engaged. It is clear from the decision in *Esso* that the Tribunal was considering legislation pre-2006 but considered it relevant to hear fully argued submissions on subsequent CJEU decisions considering *M&S*. Again, it is clear that the Tribunal determined that the EU right of freedom of establishment was not engaged but only after consideration of EU law post *M&S*. We do not accept the Appellant's submission and consider that *Esso* supports the approach taken by this Tribunal: interpreting

the principles in *M&S* by reference to the CJEU's case law post *M&S* which have "*elucidated and clarified*" *M&S*.

508. The Court of Appeal in *Volkerrail v HMRC* [2023] EWCA Civ 210 ("*Volkerrail*") considered the case law of the CJEU following *M&S* at [44]-[60] to determine whether Income and Corporation Taxes Act 1988 Pt X s.403D(1)(c), which prevented losses being surrendered by way of group relief where they were incurred by a UK permanent establishment of a non-resident company and were deductible from non-UK profits, had infringed the EU law principle of freedom of establishment. No equivalent provision restricted the surrender of losses made in the UK by a UK tax-resident company where those losses were deductible elsewhere. In *HMRC v Philips Electronics UK Ltd* C-18/11 ("*Philips*") the CJEU held that s.403D(1)(c) imposed a restriction on freedom of establishment which could not be justified. In *Volkerrail*, HMRC submitted that s.403D(1)(c) was compatible with freedom of establishment on the basis that the CJEU had departed from *Philips* in *NN A/S v Skatteministeriet* (C-28/17) EU:C:2018:526, [2018] 7 WLUK 34. The Court of Appeal agreed, allowing HMRC's appeal. The Court of Appeal (Falk LJ) stated:

> [91] As already explained, the CJEU's general approach is to follow its previous decisions; it is rare for it not to do so in fact and it is even more unusual for it to do so without being explicit. Further, *Philips* was obviously before the Court in *NN*. Indeed, the questions referred to it were framed with *Philips* in mind, and *NN* (and the Commission) argued that *Philips* resolved the question while the Danish Government maintained that it could be distinguished. The Advocate General in *NN*, Advocate General Campos Sa ´nchez-Bordona, made a number of references to *Philips*. He suggested at para 3 that its facts were 'so similar to those in [*NN*] that, at first sight, it would be possible simply to transpose the solutions in that judgment to this case'. He commented at para 63 that based on *Philips* it was difficult to classify the prevention of the double deduction of losses as an overriding reason in the public interest, but suggested at para 64 that:
>
> 'perhaps the time has arrived to moderate those assertions made in the judgment in Philips Electronics, in view of the fact that the EU legislature has paid special attention to the fight against double deduction since that judgment was delivered.'
>
> …
>
> [96] As already explained, the Court will depart from earlier case law if there are strong reasons to do so, including where it is justified by new matters brought to its attention (see [14] above). The developments referred to by the Advocate General might fall into the category, but it is also worth emphasising the importance of consistency. *NN* was a development of a line of cases starting with *M&S*. It is *Philips* that stands out as taking a different approach."

509. Whilst Mr Milne submitted that *Volkerrail* was concerned with an entirely different subject matter (branches not subsidiaries) we consider that the principles derived from *Volkerrail* are equally applicable here: this Tribunal should consider and take into account post-M&S CJEU decisions. That, of course, was the approach taken by the Supreme Court in M&S 2013. That is the approach we have followed.

What is the relevant time for determining whether the losses to be surrendered by way of CBGR cannot be taken into account and/or otherwise relieved?

510. HMRC submitted that LBG only seeks to rely upon s119(4) as it provides that the time at which the no possibilities test is to be taken into account is "*at the time immediately after the end of the EEA accounting period*" and because the CBM took place immediately before the end of the EEA accounting period there was no possibility of BOSI's losses being used in Ireland as it had ceased to exist and had no assets or source of income. This, it submitted, was a bad argument as BOSI only ceased to exist and had no assets because of the LBG's unilateral choice to dissolve BOSI and on LBG's construction, LBG had the power to elect when losses are definitive. LBG submitted that the wording of s119(4) clearly requires the test to be applied immediately after the end of the accounting period and that was held to be consistent with EU law by the CJEU in *EC v UK*. With respect to HMRC, its submissions do not address the timing point. However, this point can be dealt with in short order. It is clear from the wording of s119(4) and following the decision of the CJEU in *EC v UK* that the relevant time for determination of the no possibilities test is to be made as set out in the clear words of s119(4): "*at the time immediately after the end of the EEA accounting period*":

> "31 In that regard, it should be noted that Section 119(4) of the CTA 2010 sets the date by reference to which it must be decided whether losses sustained by a non-resident subsidiary are definitive, as described in paragraph 55 of the judgment in Marks & Spencer (EU:C:2005:763). Under that provision, that assessment is to be made 'as at the time immediately after the end' of the accounting period in which the losses were sustained.
>
> …
>
> 35 Under Section 119(4) of the CTA 2010, in fact, the assessment as to whether the losses sustained by a non-resident subsidiary may be characterised as definitive, as described in paragraph 55 of the judgment in Marks & Spencer (EU:C:2005:763), must be made by reference to the situation obtaining 'immediately after the end' of the accounting period in which the losses were sustained. It is thus clear from the wording of that provision that it does not, on any view, impose any requirement for the subsidiary concerned to be wound up before the end of the accounting period in which the losses are sustained."

The consequences of the relevant time for determination of the no possibilities test being "*at the time immediately after the end of the accounting period*" are considered next.

At the time of determination, must account also be taken of other legal possibilities that may have been available prior to the date of determination in accordance with the judgments of the CJEU in *Memira* and *Holmen*?

511. Mr Milne submitted that what the Tribunal must do is interpret s119(4) in the way in which the UK interpreted it to the CJEU in *EC v UK* in its Defence, Rejoinder and anonymised example annexed to the Defence in *EC v UK*. The anonymised example confirmed that evidence of an intention to wind-up a loss making subsidiary and commencing the liquidation process soon after the end of the accounting period were relevant factors that HMRC would take into account and the HMRC had accepted in those circumstances that there was no possibility of trading. The Rejoinder confirmed that the "no possibilities" is an entirely objective test. Therefore "no possibilities" test is straightforward and effective means of ensuring, by reference to objectively identifiable factors that a member state is only obliged to grant cross border loss relief where there is no possible threat to the balanced application of taxing rights. LBG did exactly what the UK had said to the Commission was permitted under s119(4), therefore there is no need for an objective enquiry why BOSI went into liquidation. For the Tribunal to find otherwise would be to find that the UK got it wrong

in its Defence and Rejoinder as did the Supreme Court in *M&S*. HMRC's own guidance, CTM81620, supports LBG's interpretation.

512. In the alternative, LBG submitted that HMRC's reliance upon the Opinions of AG Kokott issued in January 2019 in *Memira* and *Holmen* rather than the judgments of the CJEU is misplaced as, although the opinions of the AG are influential they are not binding on the CJEU nor on the UK courts. Furthermore, the views of the AG in *Memira* and *Holmen* were not endorsed by the CJEU in those cases in some important aspects. Furthermore, *Memira* and *Holmen* both concerned an advance clearance and are only of application to cases where advance clearance has been sought. Therefore, at the time of the judgments in *Holmen* and *Memira* all options were still available and so it was possible that they could carry forward losses and set them against income in the future. It was clear that *M&S* has been endorsed in subsequent CJEU decisions relying upon the "*careful analysis of those cases*", in *Esso* particularly at [248] it was confirmed that *Holmen* and *Memira* did no more than endorse and clarify *M&S*:

> "Undoubtedly not all the CJEU decisions referencing the *Marks & Spencer* exception are totally aligned. However, notwithstanding the many years of controversy and Advocate General Kokott's dislike of it [see paragraph 82] quite apart from *Philips*, *Felixstowe* and *A Oy*, since 2018, *Bevola*, *NN A/S Skatteministeriet*, *Holmen* and *Memira* have all not only endorsed but also clarified it."

513. HMRC submitted that *EC v UK* came several years after *M&S* and at a time when other decisions of the CJEU had begun to narrow the scope of the entitlement to CBGR in cases such as *K* and *A Oy*. Nothing in either the Commission's challenge or the CJEU's judgment suggested that formally putting a company into liquidation was sufficient for losses to be deemed final or definitive. It has never been the law that a taxpayer can opt to enter liquidation or a CBM with the consequence that CBGR can be claimed. The point, repeatedly made in CJEU case law post *M&S*, is that if it were otherwise taxpayers have a choice over the jurisdiction in which it could use its losses, something that the CJEU has repeatedly ruled out. The establishment of the legal bar principle in *K* is an important step in which the principles in *M&S* and the circumstances in which a definitive loss will arise, have been developed since *M&S*. The legal bar principle is not a refinement of the para 55 conditions but is the logical articulation of the prior objective of ensuring a balanced allocation of taxation between Member States, at [45]-[46] *M&S*. The CJEU considered the question of whether a loss might be final or definitive in *Memira* and *Holmen*. In Holmen, the CJEU endorsed at [38] paragraphs [57-[63] of the AG's Opinion and in *Memira*, the CJEU at [26] endorsed paras [65] to [70] of the AG's Opinion. The respective parts of AG Kokott's Opinion refer to the legal order permitting a transfer of losses to other persons. Where there is such a legal possibility, a sale of a business or its assets to a third party means that there will always be a possibility to use the losses. *Memira* at [70] (AGO) and *Holmen* at [62] (AGO) states:

> "The definitive nature of the losses in that case is thus also based either on the legal order of the Member State (preclusion of any possibility of transferring losses) or on the decision by the taxable person not to sell the company, but to place it in liquidation [by way of a merger - *Memira*] [place it in liquidation – *Holmen*]. In both cases, however, it is not obvious why non-use of losses in another Member State should be disproportionate. It is also not without reason the Court requires that all possibilities of having the losses taken into account have been exhausted. This includes the losses being transferred to a third party by way of a sale."

514. The principles derived from *Memira* and *Holmen* are applicable to this appeal to determine whether the loss is definitive. LBG's reliance on CTM81620 is misconceived: the guidance posits, for the purposes of the hypothetical it is considering, that there is no other possibility of loss relief in the subsidiary's state; it is not at all saying that because a company is wound up on the last day of the EEA period that, for that reason, there can be no possibility of using the losses.

DISCUSSION

515. Mr Milne submitted that what LBG did is on all fours with what the UK submitted to the CJEU in its Defence and Rejoinder in *EC v UK*, submissions that the CJEU accepted in its decision. We have therefore set out the relevant parts of the UK's Defence and Rejoinder below and then considered the basis upon which the CJEU rejected the Commission's complaint.

516. The Commission claimed that s119(4), which requires the assessment of the usability of losses for future years "at the time immediately after the end" of the accounting period when the losses were sustained, would make it "*virtually impossible for a resident parent company to obtain cross-border group relief*". The Commission submitted that under UK legislation CBGR may be granted in only two situations: (1) where no provision is made under the legislation of the Member State of residence of the non-resident subsidiary for losses to be carried forward and (2) where the non-resident subsidiary enters liquidation before the end of the tax year in which the losses are sustained. Therefore, "[CBGR] *is thus precluded in the normal commercial situation*" (outside of a liquidation). The Commission submitted that compliance with the *M&S* principle would require that the possibility of obtaining tax relief in the Member State of residence must be assessed at the time when the claim for group relief is made in the UK and on the basis of the actual facts of the case, and not on the basis of some theoretical possibility (of subsequently taking into account losses sustained by the non-resident subsidiary) which exists only because the foreign subsidiary has not yet been placed in liquidation.

517. The UK responded to the Commission's arguments by stating that it had applied the CJEU's guidance in *M&S* and that it considered that the *M&S* para 55 exception required the assessment of the possibility of losses being carried forward to be made immediately after the end of the accounting period in which the losses arose. It accepted the UK's legislative conditions for CBGR are restrictive but argued that the restriction resulted from the limited scope of the CJEU's decision in *M&S*. In rebutting the Commission's arguments, it submitted that the requirements in s119(4) could be met in cases beyond the two situations mentioned by the Commission as UK law did not require the subsidiary to be liquidated before the end of the accounting period in which the losses are sustained in order for its resident parent company to be able to obtain cross-border group relief. Instead, many factors could be taken into account immediately after the end of the accounting period in which the losses were sustained such as the intention of the parent company to wind up the loss-making subsidiary or the commencement of the liquidation process. In our judgment, it is clear from the UK's submission that by referring to cases beyond the two situations mentioned it accepted that liquidating a company before the end of the accounting period did satisfy the requirements of s119(4).

518. AG Kokott in her Opinion at [38] stated her understanding that both parties accepted that the *M&S* exception was satisfied when the subsidiary's State of residence does not permit loss carry-forward or if the subsidiary enters into liquidation in the tax year in which the loss is suffered:

> *" ... The Commission claims that the United Kingdom rules are too restrictive because they permit cross-border relief only if either the State of*

residence of the subsidiary does not permit loss carry-forward or if the subsidiary enters into liquidation in the tax year in which the loss is suffered. Both parties to the present case appear to agree that in these two cases at least the Marks & Spencer exception is satisfied. However, according to the Court's most recent case-law, that is not so."

519. The UK's Defence relevantly stated (emphasis added):

"*THE 'NO-POSSIBILITIES' TEST*

13. In the United Kingdom's submission, it is clear from the judgment of the Court of Justice in Marks & Spencer that the 'no-possibilities' test is to be applied as at the end of the accounting period in which the loss arises. Alternatively, even if this was not clear from Marks & Spencer, it has been put beyond doubt by the terms of the Court's subsequent jurisprudence.

...

17. The 'no-possibilities' test articulated by the Court in the second indent of paragraph 55 of its Judgment clearly contemplates a simple question to be answered prospectively as at the end of the accounting period in which the loss arose, namely whether there is there any possibility that the loss of the non-resident subsidiary could be taken into account in its state of residence in future periods. Given that the reference to 'future periods' is clearly intended to mean accounting periods chronologically following the accounting period concerned, such a test could only be applied at the end of the accounting period concerned, looking forward.

...

35. The 'no-possibilities' test is designed to ensure that a Member State is only obliged to grant cross border loss relief where there is no possible threat to the balanced allocation of taxing rights. Where there is no possibility of the losses being used in the Member State of residence of the surrendering company, the group is not able to exercise any choice as to where the losses are utilised (whether for commercial or fiscal reasons). If the 'no-possibilities' test is applied as at the date of claim then the group has further time to arrange its affairs in order to fulfil the UK cross-border loss relief conditions and therefore could exercise such a choice. This would tend to undermine the balanced allocation of taxing rights.

...

Availability of loss relief

45. At paragraph 24 of the Application, the Commission asserts that loss relief will only be available if the law of the State of residence makes no provision at all for loss carry-forward, or if the subsidiary enters liquidation before the end of the tax year in which the loss is suffered so that it can be said that there is no theoretical possibility of future relief.

46. ... There are other circumstances where the test for cross-border loss relief under the UK legislation may be satisfied. It is not the case, for example, that a loss-making subsidiary must be put into liquidation before the end of the tax year in which the loss is suffered. The relevant provisions do not mention being put into liquidation as a requirement and nor is it, in practice, a requirement that must be met. Evidence of an intention to wind up a loss-making subsidiary and commencing the liquidation process soon after the end of the accounting period would be factors to be taken into account. Further, whether the company in question has, for instance,

income-producing assets, premises and employees will also be taken into account in determining whether losses may be used in the future.

...

Consistency with EU law

49. In any event, however, the circumstances in which the UK legislation permits claims for cross-border loss relief are wholly consistent with the requirements of EU law. The legislative provisions mirror precisely the terms of the 'no-possibilities' test set out by the Court in Marks & Spencer, and for the reasons elaborated upon above, it is appropriate that this test should be applied at the end of the accounting period. Since they adopt the test of proportionality expounded by the Court itself, the legislative provisions in issue clearly themselves satisfy the requirement of proportionality."

520. The UK's Rejoinder stated (emphasis added):

"4. It is quite correct that the United Kingdom contends that the 'no-possibilities' test should be applied "extremely restrictively" as was explained by Advocate General Geelhoed at paragraph 65 of his Opinion in Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006) ECR 1-11673. However, this does not mean that the Court's judgment in *Marks & Spencer* is to be interpreted narrowly. Rather, a restrictive application of the "no-possibilities" test is, in the United Kingdom's view, precisely what was intended by the Court in Marks & Spencer.

…

8. It must also be emphasised that, as is evident from the case law, it is neither necessary nor desirable to make a detailed factual enquiry as to the purpose of the taxpayer or whether its inability to use losses in its Member State of establishment resulted from a free decision on its part. It is notable that AG Kokott in her Opinion in Case C-123/11 *A* at paragraphs 57-58 sought to engage in an enquiry as to whether the inability to use losses resulted from the free decision of the company concerned to merge its loss-making subsidiary, but the Court did not adopt that approach. Rather, it simply applied the "no-possibilities" test. The "no-possibilities" test is an entirely objective test. Where it is satisfied, the group is not able to take any steps which have the consequence of determining where its losses are utilised, whether for commercial or fiscal reasons, or otherwise. The "no-possibilities" test is therefore a straightforward and effective means of ensuring, by reference to objectively identifiable factors, that a Member State is only obliged to grant cross border loss relief where there is no possible threat to the balanced allocation of taxing rights.

14. Moreover, the "no-possibilities" test asks whether there "*is*" no possibility for the foreign subsidiary's losses to be taken into account in future periods, whereas as is evident from paragraph 6, the Commission's approach entails asking whether it "*was*" possible. These departures from the clear wording of the "no-possibilities" test in paragraph 55 of Marks & Spencer are a quite clear indication that something is wrong in the Commission's formulation.

…

27. Paragraph 15 appears to contemplate that an anti-abuse rule would preclude relief for losses where a parent company has "deliberately"

> arranged their affairs in such a manner as to eliminate the possibility of having the losses taken into account in the State of residence of the subsidiary. However, as has been explained above, conduct which had a valid economic rationale (and where the availability of UK group relief is not a factor) is nevertheless capable of undermining the balanced allocation of the power to tax between Member States. Moreover, this would entail an enquiry as to the purpose of the taxpayer which is not contemplated by the wholly objective terms of the "no-possibilities" test as articulated by the Court in *Marks & Spencer*.
>
> 28. At paragraph 16 the Commission queries whether the United Kingdom seeks to insinuate that *Marks & Spencer* contrived to bring about a situation in which it was able to satisfy the "no-possibilities" test. The United Kingdom makes no such allegation. As has been explained above, the "no-possibilities" test does not envisage any enquiry into the purpose of the taxpayer. …
>
> 29. The Commission contends at paragraph 19 that an alleged readiness to take into account an intention to wind up a foreign subsidiary is in itself inconsistent with the rule that account should be taken of the circumstances pertaining at the end of the period in which the loss is suffered. This is incorrect. There is no such inconsistency; the intention to liquidate is a circumstance pertaining at the end of the period in which the loss is suffered. The intention to liquidate will be taken into account along with all other relevant facts as at the end of the accounting period to determine whether the "no-possibilities" test is satisfied. This might also include, for example, that the company ceased to trade, and that it had no income producing assets, no premises or employees.
>
> 31. Secondly, the Commission points out that claims for relief were rejected on the ground that since the subsidiary was still operating at the end of each of the tax periods concerned by the claim, there was a possibility that losses could be carried forward. This is a straightforward application of the "no-possibilities" test. The Commission complains that no account was taken of subsequent facts, by which it presumably means, the fact that, looking back, there was no actual use of losses. However, a retrospective assessment of whether losses have in fact been used is not the test set down by the Court. The "no-possibilities" test is very clearly intended to be a prospective assessment. Moreover, as has been pointed out above, an actual use of losses test would mean the subsidiary could simply choose not to use losses and then seek relief in respect of them."

521. The Grand Chamber dismissed the Commission's challenge but for different grounds to those suggested by the AG and restated and clarified *M&S*. The Court noted at [32] that, in respect of the Commission's first claim that the loss deduction is "virtually impossible" that it was not claiming that the UK legislation made it impossible to claim loss deduction:

> "32 According to the Commission, that requirement makes it virtually impossible for group relief to be obtained for losses sustained by a non-resident subsidiary, since in practice it allows the resident parent company to take such losses into account in only two situations: (i) where the legislation of the Member State of residence of the subsidiary concerned makes no provision for losses to be carried forward and (ii) where the subsidiary is put into liquidation before the end of the accounting period in which the loss was sustained."

522. At [33], the CJEU rejected as irrelevant the Commission's argument that where the legislation of the Member State made no provision losses to be carried forward on the basis

that it was "settled law that losses sustained by a non-resident subsidiary cannot be characterised as definitive" as described in para 55 *M&S* and *K* paras 75 to 79:

> "33 It should be noted, however, that the first of those situations referred to by the Commission is irrelevant for the purposes of assessing the proportionality of Section 119(4) of the CTA 2010. It is settled law that losses sustained by a non-resident subsidiary cannot be characterised as definitive, as described in paragraph 55 of the judgment in *Marks & Spencer* (EU:C:2005:763), by dint of the fact that the Member State in which the subsidiary is resident precludes all possibility of losses being carried forward (see judgment in *K*, EU:C:2013:716, paragraphs 75 to 79 and the case-law cited). In such a situation, the Member State in which the parent company is resident may not allow cross-border group relief without thereby infringing Article 49 TFEU."

523. At [34] it rejected the second argument on the basis that the Commission had not established that s119(4) required the non-resident subsidiary to be put into liquidation before the end of the accounting period to obtain CBGR stating at [35] that it was clear that the provision did not impose any requirement for the subsidiary to be wound up before the end of the accounting period in which the losses are sustained:

> 34 As regards the second situation referred to, it should be noted, first, that the Commission has not established the truth of its assertion that Section 119(4) of the CTA 2010 requires the non-resident subsidiary to be put into liquidation before the end of the accounting period in which the losses are sustained in order for its resident parent company to be able to obtain cross-border group relief.
>
> 35 Under Section 119(4) of the CTA 2010, in fact, the assessment as to whether the losses sustained by a non-resident subsidiary may be characterised as definitive, as described in paragraph 55 of the judgment in *Marks & Spencer* (EU:C:2005:763), must be made by reference to the situation obtaining 'immediately after the end' of the accounting period in which the losses were sustained. It is thus clear from the wording of that provision that it does not, on any view, impose any requirement for the subsidiary concerned to be wound up before the end of the accounting period in which the losses are sustained.

524. At [36] it stated that the non-resident subsidiary's losses may only be characterised as definitive only if it no longer has any income in its Member State of residence even if that income received is minimal.

> "36 Secondly, it should be borne in mind that losses sustained by a non-resident subsidiary may be characterised as definitive, as described in paragraph 55 of the judgment in *Marks & Spencer* (EU:C:2005:763), only if that subsidiary no longer has any income in its Member State of residence. So long as that subsidiary continues to be in receipt of even minimal income, there is a possibility that the losses sustained may yet be offset by future profits made in the Member State in which it is resident (see judgment in *A*, EU:C:2013:84, paragraphs 53 and 54). [AB1996 *A Oy* C-123/11]"

525. At [37] it referred to the anonymised example annexed to the UK's defence which confirmed that the losses sustained by a non-resident subsidiary may be characterised as definitive where, immediately after the end of the accounting period in which the losses had been sustained that the subsidiary had ceased trading and sold or disposed of all its income producing assets.

> 37 Referring to a specific example of a resident parent company which obtained cross-border group relief, the United Kingdom confirmed that it is possible to show that losses sustained by a non-resident subsidiary may be characterised as definitive, as described in paragraph 55 of the judgment in *Marks & Spencer* (EU:C:2005:763), where, immediately after the end of the accounting period in which the losses have been sustained, that subsidiary ceased trading and sold or disposed of all its income producing assets.
>
> 38 In those circumstances, the first complaint must be rejected in so far as it is based on the alleged infringement of Article 49 TFEU."

526. It is notable that the CJEU did not accede to Advocate General Kokott's plea in her Opinion that the *M&S* exception should be abandoned but upheld the final loss doctrine. The judgment clarified that a loss could not be characterised as definitive by dint of the fact that the Member State of the resident subsidiary precludes all possibility of losses being carried forward and that the Member State in which the parent company is resident may not allow cross-border group relief without thereby infringing Article 49 TFEU. At [36] the CJEU confirmed and developed its decision in *A Oy* explaining that losses of a foreign subsidiary could only be characterised as definitive "*if that subsidiary no longer has any income in its Member State of residence*" as "*receipt of even minimal income*" would provide the possibility that the losses sustained may be offset by future profits made in the Member State in which it is resident. The CJEU in *Timac Agro Deutschland GmBH* C-388/14 at [55] confirmed paragraph [36] in *EC v UK*. It is clear from that confirmation that ceasing trading is not sufficient in itself to satisfy the *M&S* exception if some income is still being generated when the subsidiary's assets are liquidated. In our judgment, *A Oy* makes clear that only a subsidiary in completed liquidation or dissolved would be able to demonstrate that there is no possibility of any future income being generated.

527. It can be seen from the Defence and Rejoinder that the UK considered that s119(4), whilst restrictive, gave effect to para 55 *M&S* and was justified as protecting the balanced allocation of taxing rights and prevented the taxpayer from choosing where to utilise the losses. The UK's position at para 8 of the Rejoinder was clear, the "*no possibilities*" test is an objective and straightforward test and does not envisage any enquiry into the purpose of the taxpayer: "*It must also be emphasised that, as is evident from the case law, it is neither necessary nor desirable to make a detailed factual enquiry as to the purpose of the taxpayer or whether its inability to use losses in its Member State of establishment resulted from a free decision on its part*." Para 31 of the Rejoinder confirmed that the test is not retrospective: "*However, a retrospective assessment of whether losses have in fact been used is not the test set down by the Court. The "no-possibilities" test is very clearly intended to be a prospective assessment.*" The UK's position was made clear in its submissions: It is clear from para 38 of the AG's Opinion and para 48 of the Defence that it was accepted that liquidating a subsidiary would satisfy the no possibilities test but that it was not a requirement nor the only way in which the test could be satisfied. Whilst it was accepted by the UK that liquidating a subsidiary satisfied s119(4), details were provided of wider circumstances which would also satisfy the test.

528. Mr Milne submitted that it would be quite a bold step for this Tribunal to find that the UK Government got it wrong in 2015 when they made submissions to the CJEU in their Defence and Rejoinder to Commissioner's attack on s119(4) and for the Tribunal to accept that the CJEU got it wrong in accepting the UK Government's submission that s119(4) had not emasculated para 55 and that a group could do precisely what LBG did: liquidate a loss making subsidiary at the end of the year or indeed after the year in which the loss was incurred. We consider that there is considerable force in LBG's submission particularly when HMRC's submissions in this appeal are in stark contrast to those submitted by the UK

Government in its Defence and Rejoinder in 2015. No submissions were made by HMRC addressing that inherent contradiction. Rather, HMRC submitted that, on the Appellant's case, the "*no possibilities*" test would amount to no more than "*beat the buzzer*" and would be contrary to the need to safeguard the balanced allocation of taxing rights. We do not accept HMRC's submission which does not address the clear submissions made in the UK's Defence and Rejoinder in *EC v UK*. In any event, we do not accept that a parent company which liquidates or dissolves a loss-making subsidiary in compliance with the requirements of s119(4) can be said to be contrary to the need to safeguard the balanced allocation of taxing rights. Whilst it may be the case that, as the Commission submitted, that it was highly unlikely that losses be suffered, a decision taken to cease trading and the company placed in liquidation all within a single tax year, that is precisely what happened here.

529. In our judgment, it is clear from the wording of s119(4), the decision in *EC v UK* and the UK's Defence and Rejoinder that the "*no possibilities*" test in s119(4) is to be applied "*immediately after the end of the relevant EEA accounting period*". Immediately after the end of the relevant EEA accounting period, 31 December 2010, BOSI had ceased to exist and had no assets or source of income and the qualifying loss condition in s119 was met. HMRC's own guidance, CTM81620, is in accordance with that conclusion.

530. We do not consider that there is anything in the EU case law relied upon by HMRC (considered below) which cause us to change our conclusion that the "*no possibilities*" test in s119(4) is to be applied immediately after the end of the relevant EEA accounting period. HMRC's own guidance, CTM81620, supports LBG's interpretation.

K

531. HMRC relied upon the decision in *K* in which the CJEU made clear that a Member State is not required to take into account losses from a non-resident activity if taking the losses into account at the place where the activity took place is precluded by law, what HMRC have characterised as the "legal bar" exclusion of final or definitive losses. That position was restated at [33] in *EC v UK*. We agree with HMRC's submissions in respect of the legal bar set out in *K* as confirmed in *EC v UK* at [33]. We did not understand that point to be disputed by the Appellant.

532. HMRC relied upon [51]-[53] of *A Oy* which stated that where a non-resident subsidiary which had essentially ceased trading was liquidated following a merger with the resident parent, the existing losses in the subsidiary's State of residence could not automatically be regarded as final or definitive losses. HMRC submitted that if the fact that there are no final or definitive losses, because the operation of the merger regime is the legal reason why those losses cannot be used (beyond the ways in which they could prior to the merger), then it makes no difference whether the subsidiary retains legal personality after the merger or not. That was already the view of AG Kokott in *EC v UK* where she noted:

> "It is understood to be also the position in the case of a merger operation by which the subsidiary even loses its legal personality…. According to the judgment in A, the Marks & Spencer exception does not therefore clearly apply if the subsidiary enters into liquidation, or indeed if it subsequently loses legal personality. (para 40)".

533. HMRC submitted that it follows that where a subsidiary continues in existence, and is capable of receiving any (however limited) income from assets it holds then there remains the possibility for it to use its losses by setting them off against that further income: that only a limited amount of the losses can be used by way of set-off against that further residual income is irrelevant; it bars those losses from being final or definitive losses (AG at [39] and CJEU at [33] in *EC v UK*). It further follows that the extinguishing of the legal personality of

a non-resident subsidiary pursuant to a CBM will also constitute a legal bar to the use of the subsidiary's losses in the non-resident Member State such that those losses cannot be treated as final or definitive either. That precludes LBG from seeking to rely on the fact that BOSI's being extinguished pursuant to the CBM creates final or definitive losses. Not only is that not possible since it would give a parent a right to elect to create final or definitive losses, it also violates the legal bar exclusion since it is through operation of law that (if this were the case) BOSI could no longer use any remaining losses.

534. We do not agree that *A Oy* provides the support that HMRC seeks to derive from it. Mr Milne submitted, and we agree, that *A Oy* was a preliminary application for advance clearance and therefore all eventualities remained possible. In addition, the facts were that there were still leases that could still be assigned therefore there existed assets that could be realised and it was on that basis that that the losses could not be definitive and not because of the operation of the merger, [53]-[54]. At [26] the CJEU stated that the fact that *A Oy* had exercised a free choice motivated by tax considerations was not in itself capable of making articles 49 TFEU and 56 TFEU inapplicable:

> "[26] Finally, the fact that a merger operation is motivated solely by tax considerations and that the companies concerned are in fact attempting by that means to evade their national legislation is not in itself capable of making those provisions inapplicable."

535. At [48], the CJEU confirmed that position. What the CJEU did not do was to state that extinguishing the legal personality of a non-resident subsidiary pursuant to a merger or liquidation constituted a legal bar such that the losses could not be definitive. If that had been the CJEU's view it would have stated it after [51] where the proposed merger operation and liquidation steps were set out. Again, if that had been the view of the court it would not have left it open for the referring court to decide whether the subsidiary had indeed exhausted all possibilities of taking losses into account in the subsidiary's residence state; it would simply have referred to the operation of a merger or liquidation as conclusive.

Memira and *Holmen*

536. HMRC relied upon *Memira* and *Holmen* as a further narrowing of *M&S*. In both *Memira* and *Holmen* the CJEU was requested to provide a preliminary ruling as to whether CBGR would be available if the taxable person did not sell the company but placed it in liquidation (by way of a merger in *Memira*) The CJEU in *Memira* was requested to provide a preliminary ruling on the question of whether a Swedish parent company had the right, on the basis of Article 49 TFEU in conjunction with Article 54 TFEU, to deduct the losses of a wholly-owned subsidiary established in Germany from its profits where that subsidiary was planned to be wound up by way of a cross-border merger with the parent company and would not be able fully to 'use' its German losses in Germany. The first question required the CJEU to establish the significance which should be accorded, in the assessment of the finality of the losses of a non-resident subsidiary, within the meaning of para 55 of *M&S*, to the fact that the subsidiary's Member State of establishment does not allow the losses of one company to be transferred, in the event of a merger, to another company liable for corporation tax, but the parent company's Member State nevertheless authorises such a transfer via a merger between resident companies. The CJEU was requested to clarify whether a situation such as that envisaged by *Memira* is included in the second indent of paragraph 55 of the judgment in *M&S*, in which there is no possibility for the losses of the foreign subsidiary to be taken into account in its State of establishment for future periods. *Holmen*, handed down by the CJEU on the same date as *Memira*, broadly considered the same issues with slightly different facts. Accordingly, we have just referred to *Memira* in the following paragraphs but our comments are equally applicable to *Holmen.*

537. The AG at [49]-[50] of her Opinion applied the principle in *A Oy* when concluding at [56] that where a non-resident subsidiary was liquidated following a merger with the resident parent, the existing losses in the subsidiary's State of residence could not be automatically regarded as final or definitive losses:

> "56. If, according to the Court's case-law, losses cannot be characterised as definitive by dint of the fact that the Member State in which the subsidiary is resident precludes all possibility of losses being carried forward, this must also apply to a preclusion of a transfer of losses to a third party (here in the context of a merger). For that reason, the Swedish rules are not disproportionate.
>
> – Finality of losses carried over
>
> 57. In any case, the Court has ruled that it is not contrary to the fundamental freedoms if a loss which can be set off transnationally is always to be established as a final loss at the end of the assessment period. Therefore, any loss which can be carried forward is non-final, at least initially. This is important in the present case because loss relief is being sought for losses carried over for years in Germany.
>
> 58. Such accumulated (carried forward) losses which are regarded as non-final in one year (because they can be carried forward or setting off the losses was precluded under national law) cannot subsequently become final losses because they cannot be carried forward further on account of the liquidation.
>
> …
>
> 60. Along the same lines, the Court considers in *Commission v United Kingdom* that there can be no subsequent change to finality once absent. In any case, the statements made in that judgment indicate that at most the loss in the subsidiary made in the last year of liquidation must still be able to be set off (transnationally) somehow, but not the losses accumulated up to then and carried forward under national (here German) law. Freedom of establishment does not therefore require any cross-border setting-off of those carried over losses.
>
> …
>
> 66. Losses which cannot be used because they are not legally recognised in the Member State in which they arose or are not usable because of legal restrictions (for example, they cannot be carried forward or back) are not intended to constitute final losses in accordance with the Court's case-law. Only losses which would be usable in law but cannot be used in fact in future could be regarded as final losses. This is compelling on account of the autonomy of systems of tax law (point 54 et seq.).
>
> …
>
> 69. If the legal order in question permits a transfer of losses to other persons, it is also always possible in fact to use those losses. It may not be particularly successful in a specific case because the purchaser of a loss-making undertaking will not necessarily pay much money for such an undertaking. Nevertheless, this does not affect the usability in fact of the losses.
>
> 70. The definitive nature of the losses in that case is thus also based either on the legal order of the Member State (preclusion of any possibility of transferring losses) or on the decision by the taxable person not to sell the company, but to place it in liquidation by way of a merger. In both cases,

> however, it is not obvious why non-use of losses in another Member State should be disproportionate. It is also not without reason the Court requires that all possibilities of having the losses taken into account have been exhausted. This includes the losses being transferred to a third party by way of a sale."

538. HMRC submitted that the CJEU at [26] to [27] of its judgment endorsed paragraphs [65]-[70] of the AG's Opinion:

> "26 In fact, as the Advocate General stated in points 65 to 70 of her Opinion, it cannot be excluded from the outset that a third party may take into account for tax purposes the losses of the subsidiary in that subsidiary's State of establishment, for example following a sale of that subsidiary for a price including the tax advantage represented by the deductibility of losses for the future (see, to that effect, judgment of 21 February 2013, *A*, C 123/11, EU:C:2013:84, paragraph 52 et seq., and judgment delivered today, *Holmen*, C-608/17, paragraph 38).
>
> 27 Consequently, in a situation such as that envisaged by Memira, it is for Memira to demonstrate that the possibility referred to in the previous paragraph is precluded, as the mere fact that the subsidiary's State of establishment does not allow the transfer of losses in the event of a merger cannot, in itself, be sufficient to regard the losses of the subsidiary as being final."

539. We do not accept that the CJEU endorsed and followed the AG's Opinion that should the use of losses be precluded in Germany, no final losses existed. The CJEU took a different view:

> "24. It should be recalled in that regard that the grounds relied on by the Court in the second indent of paragraph 55 of the judgment in *Marks & Spencer* expressly envisaged that the absence of such a possibility on which the finality of the losses depends may be applied to the situation in which they are taken into account by a third party for future periods, in particular where the subsidiary has been sold to that third party.
>
> "28. … the fact that the subsidiary's Member State of establishment does not allow the losses of one company to be transferred, in the event of a merger, to another company liable for corporation tax, whereas such a transfer is provided for by the Member State in which the parent company is established in the event of a merger between resident companies, is not decisive, unless the parent company demonstrates that it is impossible for it to deduct those losses by ensuring, in particular by means of a sale, that they are fiscally taken into account by a third party for future tax periods."

540. Mr Milne submitted, and we agree, that *Memira* was a preliminary application for advance clearance and therefore all eventualities remained possible. That is reflected at *Memira* at [26] in the judgment where the court stated "*it cannot be ruled out from the outset that a third party may take into account for tax purposes the losses of the subsidiary in that subsidiary's State of establishment*" as that remained a possibility on the facts of the preliminary application. In our judgment, *Memira* confirmed that the losses of a non-resident subsidiary are not final if there remains a possibility of taking advantage of the losses by economically transferring them to a third party by way of a sale, the burden of proof falling on the taxpayer to demonstrate that such use is precluded. The CJEU did not state that, as the losses could not be transferred to a third party by way of a merger, they were legally exhausted rather, it considered that there was a factual exhaustion of the losses where the

losses could not be transferred by the subsidiary to a third party because the subsidiary's business activities had ceased and it had been wound up.

541. HMRC further relied upon [33] of the *Memira* decision, for the submission that even if the subsidiary's State permitted the transfer of whether by sale or merger, the fact that no other entity was in fact in a position to acquire the losses or the subsidiary itself is irrelevant and it was therefore possible to use the losses:

> "33 Consequently, the answer to the second question should be that, if the fact referred to in the first question becomes relevant, the fact that there is, in the State of establishment of the subsidiary, no other entity which could have deducted those losses in the event of a merger if such a deduction had been authorised is irrelevant."

542. We do not accept that HMRC's interpretation of [33] is correct. At [29] it stated:

> 29 By its second question, the referring court asks, in essence, whether, if the fact mentioned in the first question becomes relevant, account must be taken of the fact that there is, in the State of establishment of the subsidiary, no other entity which could have deducted the losses in the context of a merger if a deduction had been authorised in that country.
>
> 30 In that regard and as stated in the answer to the first question, the restrictions on the transfer of losses by merger stemming from the legislation of the subsidiary's State of establishment are not decisive so long as the parent company has not adduced evidence that it is impossible for those losses to be used by a third party, in particular after a sale for a price including the tax value of the losses.
>
> 31 If such evidence is adduced and the other conditions referred to in paragraph 55 of the judgment in Marks & Spencer have been met, the fiscal authorities are required to find that the losses of a non-resident subsidiary are final and that it is therefore disproportionate to not allow the parent company to take them into account at its level for tax purposes.
>
> 32 From that perspective, in the assessment of the finality of the losses, whether or not there were other entities in the State of establishment of the loss-making subsidiary which could have had the losses of that subsidiary transferred to them via a merger if such a possibility had been afforded is irrelevant."

543. It is clear from [29]-[32] that the CJEU said that it was irrelevant if there were other entities that could have had the losses transferred to them via a merger if such a possibility existed where evidence had been adduced that it was impossible for a third party to use the losses.

544. We do not consider that there is anything in the EU case law relied upon by HMRC and considered below which cause us to change our conclusion that the "no possibilities" test in s119(4) is to be applied immediately after the end of the relevant EEA accounting period. Immediately after the end of the relevant EEA accounting period (31 December 2010), BOSI had ceased to exist and had no assets or source of income and the qualifying loss condition in s119 was met. Accordingly, as Mr Milne presciently submitted in his closing, the expert evidence was not required.

If so, could the losses sought to be surrendered by way of CBGR have been so taken into account and/or otherwise relieved immediately after 31 December 2010 or such other time?

545. In light of our answer to the previous question it is not necessary to consider this question.

PRECEDENCE CONDITION S121

546. Mr Milne submitted that s121 provides that an amount of losses will meet the precedence condition "so far as no relief can be given for it" in any territory which is outside the UK, is not the same territory as that in which the surrendering company is resident (which is Ireland in the present case) but is a territory in which a company is resident that owns, directly or indirectly, ordinary share capital in the surrendering company (BOSI). Here, the precedence condition is met because there was no territory in which relief could have been given for the losses of BOSI. There was no company resident in a territory outside the UK that owned ordinary share capital in BOSI at the time that the precedence condition is to be applied, 31 December 2010. On 17 September 2010, SIF (which owned the entire share capital of BOSI) transferred the entire share capital to BOS to facilitate the merger of BOSI into BOS by way of absorption of a wholly-owned subsidiary. A CBM of BOSI into BOS by way of absorption would not have been possible if BOS has not been the sole shareholder of BOSI.

547. Mr McGurk submitted that LBG is unable to meet the s121 precedence condition as the Dutch intermediary company, SIF, that sat between BOSI and BOS Plc was only removed shortly before 31 December 2010. The very existence of SIF precludes LBG from meeting the precedence condition. Further or alternatively, there is no evidence that LBG ever sought to consider whether the losses could be used by BOSI's Dutch holding company, whether in Ireland, the Netherlands or elsewhere, see *Esso* where it was held, applying *Holmen* and *Memira*, that since the intermediate parent companies (established in Luxembourg) were not established in the same Member State as the Danish company, the appeal had to be dismissed (paras 110-115). In M&S, there was also an intermediate holding company within the M&S structure and, according to the Order of Reference, the ECJ was aware of this fact. However, in *Holmen*, the Advocate General noted (at [73] to [81]) that this fact was not examined by the Court in M&S and that a requirement to permit the "grandparent" (i.e. the parent to the sub-subsidiary) to have the right to claim the alleged definitive loss would result in a right to choose where a loss was to be relieved, which was not, however, permitted. The CJEU followed the Advocate General's approach in this regard at [23] of the Court's judgment, and at [26] to [29] it held that it is not disproportionate to refuse relief where there is an intermediate subsidiary between the parent and the loss maker which is not established in the same Member State as either parent or loss maker (as was the case with the Dutch subsidiary in this case). Section 121 defines relief (in the precedent Member State) as an amount brought into account in calculating any profits, income or gains of any person chargeable to non-UK tax under the law of the territory, or by way of payment by credit or the elimination of a tax liability, or in any other way. The example in the Explanatory Note for s121 (paras 450 – 456) suggests that if relief is "available" in the precedent Member State (in the example there, Germany; on the facts here, the Netherlands) then "no UK group relief is available" suggesting an all or nothing approach, an approach entirely consistent with the approach taken in *Holmen*.

Discussion

548. HMRC's position is that the very existence of the Dutch intermediary company, SIF, until its removal on 17 September 2010 precludes LBG from satisfying the s121 precedence condition. We do not agree. If HMRC's submission were correct, the prior existence of an

intermediary company (regardless of when it was removed/ceased to exist) would always prevent a taxpayer from satisfying the s121 precedence condition. If that had been Parliament's intention, we would have expected s121 to reflect that intention. We agree with LBG's submission that here, the precedence condition is met, because there was no territory in which relief could have been given for the losses of BOSI as there was no company resident in a territory outside the UK that owned the ordinary share capital in BOSI at the time that the precedence condition is to be applied: 31 December 2010. We do not accept that the cases relied upon by HMRC support its submission. In *Esso*, *M&S*, *Memira* and *Holmen* the facts were, in contrast to the position here, that the intermediate company remained in place at the time that the claim for relief was made.

DECISION

549. For all the reasons set out above, we find that LBG satisfied the qualifying loss condition in s119, the precedence condition in s121 was met by LBG but that s127 does apply to exclude group relief as the main purpose or one of the main purposes of the arrangements put in place by LBG to exit Ireland via the CBM on 31 December 2010 was to secure CBGR for BOSI's accumulated losses in the period to 31 December 2010. Accordingly, the appeal is dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

550. 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.

Release date: 20th JANAURY 2025