[2021] UKUT 87 (TCC)

Appeal number: UT/2019/0002

Capital allowances – LLPs – expenditure of software licences – ambit of closure notices – valuation of software licences

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

(1) DAARASP LLP **(2) BETEX LLP**	**Appellants**
-and-	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondent**

TRIBUNAL: THE HONOURABLE MR JUSTICE MARCUS SMITH
JUDGE GUY BRANNAN

Sitting in public by way of remote video hearing treated as taking place at The Royal Courts of Justice, Strand, London on 9 and 10 March 2021

Andrew Thornhill, QC and Ben Elliott instructed by Charterhouse (Accountants) Limited for the Appellants

Aparna Nathan, QC and Harry Sheehan, instructed by the General Counsel and Solicitor to Her Majesty's Revenue and Customs for the Respondent

DECISION

The parties

1. According to the Respondent in this appeal, the Commissioners for Her Majesty's Revenue and Customs (**HMRC**), the Appellants – to whom we shall refer, respectively, as **Daarasp** and **Betex** and, collectively, as the **Appellants** – are LLPs formed in order to take part in a marketed tax avoidance scheme aimed at securing capital allowances in respect of the acquisition of information or communications technology assets (**the software licence(s)**) for its members. The scheme was disclosed to HMRC under the Disclosure of Tax Avoidance Schemes regime and given scheme reference number 46091087.

2. The Appellants, for their part, say that the scheme is not a tax avoidance scheme and that it was disclosed to HMRC out of an abundance of caution.

The nature of the scheme

3. In very broad brush terms, the scheme involved:

(1) The establishment of an LLP (here: Daarasp or Betex), the designated members of which were involved in setting up and implementing the scheme. Individual scheme users would become members of the LLP and would fund their contributions out of a mixture of personal resources (approximately 20%) and borrowed funds (approximately 80%).

(2) The funds borrowed were, in each case, advanced by a bank (**Hambros**), various branches or associate companies of which were involved in each scheme in multiple different ways. For present purposes, the precise transactional details of Hambros' involvement do not matter.

(3) The LLP would use the contributed funds to acquire a computer software licence. In each case, that acquisition was complex, but in general terms:

(a) A licence was acquired from the software designer by an intermediary company. In the case of the Daarasp scheme, the software in question was equity trading computer software (the **Daarasp Software**), the software designer was **Parjun Enterprises** and the intermediary company was **Damats**. In the case of the Betex scheme, the software in question provided on-line gambling functions (the **Betex Software**), the software designer was Ecoholdings Media Group Limited (**Ecoholdings**) and the intermediary company was **Piebet**.

(b) In each case, there were close links between the LLP (Daarasp or Betex, respectively) and the intermediary (Damats or Piebet, respectively).

(c) In each case, Hambros advanced a significant sum to the LLP for the purchase of the software. Daarasp acquired the software

from Damats for a total consideration of £18,188,244, yet Damats only paid Parjun Enterprises £1.4 million for the licence to its software. Similarly, Betex acquired the software from Piebet for an initial consideration of £58,427,394, but Piebet paid Ecoholdings only £1.6 million.

(d) The reason for the very different levels of payment down the chain from Daarasp to Damats and from Damats to Parjun Enterprises was that Damats provided to Daarasp various guarantees as to the operating income that Daarasp would receive, whereas Parjun Enterprises provided no such guarantees. These guarantees were, in turn, themselves guaranteed by Hambros, albeit that this was conditional upon most of the money advanced by Hambros to Daarasp and paid by Daarasp to Damats being held in an account with Hambros.

(e) Similarly in the case of Betex: although the transaction was considerably more complex than that involving Daarasp, there were similar warranties from Piebet (and not from Ecoholdings) that a minimum net operating income would be payable, and similar secured guarantees by Hambros of those obligations.

(4) Thus, the sums paid for the licence by Daarasp and Betex respectively were paid in part and indirectly to the ultimate owner of the software licence, but in part went to fund and/or guarantee the payment of operating income under the licence each obtained from the intermediary (respectively, Damats and Piebet).

(5) A large proportion of the sums paid, or allegedly paid, for the acquisition of the software was placed on deposit as security for the loans made to the partners and/or the LLP.

(6) The LLP would in each case sustain a first-year loss equivalent to the capital allowances claimed in respect of the expenditure on the software licence. The individual members would seek to claim income tax loss relief, under sections 380/381 of the Income and Corporation Taxes Act 1988, in respect of their respective shares of the LLP's first year loss.

HMRC's investigation

4. HMRC commenced an investigation into both schemes. The investigation was prolonged and wide-ranging. The investigation included consideration of:

(1) Whether either Daarasp or Betex carried out a trade at the time or during the accounting period when the qualifying expenditure was incurred and whether activities were carried on on a commercial basis.

(2) Whether the expenditure which Daarasp or Betex claimed to have incurred could properly be treated as incurred on software licences.

(3) Whether any expenditure was incurred by a "small enterprise" within the meaning of section 45(1) of the Capital Allowances Act 2001.

(4) Whether the expenditure was "long-life asset expenditure" within the meaning of section 44(2) of the Capital Allowances Act 2001.

(5) Whether the "anti-avoidance" rule at section 215 of the Capital Allowances Act 2001 was engaged.

5. HMRC closed the investigation into Daarasp by way of a closure notice dated 26 January 2011 (the **Daarasp Closure Notice**), which stated:

"**Check of the Partnership Tax Return for Daarasp LLP – year ended 5 April 2004 (Section 28B(1) & (2) Taxes Management Act 1970)**

I have now completed my check of the Partnership Tax Return for Daarasp LLP for year ended 5 April 2004. I am sending a copy of this letter to your adviser.

My conclusion

That following the detailed review of the relevant partnership documents and the lengthy discussions held with James Edmond of Charterhouse (the Promoter) and their legal representative Michael Sherry, I conclude of the losses claimed only a currently unquantifiable part may be allowable.

I have amended your partnership loss figure to reflect this. The figure for your partnership loss is as follows:

- The original Partnership loss figure was £18,192,004.00
- The Partnership loss figure is now £0.00

What to do if you disagree

If you disagree with our decision, you or your adviser can appeal…"

6. The closure notice in the case of Betex (the **Betex Closure Notice**) was in very similar terms:

"**Check of the Partnership Tax Return for Betex LLP – year ended 5 April 2006 (Section 28B(1) & (2) Taxes Management Act 1970)**

I have now completed my check of the Partnership Tax Return for Betex LLP for year ended 5 April 2006. I am sending a copy of this letter to your adviser.

My conclusion

That following the detailed review of the relevant partnership documents and the lengthy discussions held with James Edmond of Charterhouse (the Promoter), I conclude of the losses claimed only a currently unquantifiable part may be allowable.

I have amended your partnership loss figure to reflect this. The figure for your partnership loss is as follows:

- The original Partnership loss figure was £25,482.181.00

- The Partnership loss figure is now £0.00

What to do if you disagree

If you disagree with our decision, you or your adviser can appeal…"

7. A number of the points taken by HMRC were what the Appellants termed **"knock out" points** (a helpful shorthand term which we adopt) which precluded the Appellants from claiming a capital allowance at all. Thus, by way of example, HMRC's contention was that neither Daarasp nor Betex was carrying out a trade at the time or during the accounting period when the qualifying expenditure was incurred. If that was right, then neither Daarasp nor Betex would be able to claim a capital allowance at all: their allowance would be nil by virtue of the fact that a necessary condition to claiming any allowance had simply not been met.

8. There was no statutory review of the closure notices in respect of Daarasp or Betex.

The appeal to the FTT

9. Both Daarasp and Betex appealed against the Closure Notices, without requesting a statutory review. The appeal came before the First-Tier Tribunal (Tax Chamber) (**FTT**) (Judge Rachel Short and Mr John Adrain). The points under appeal included those set out in paragraph 4 above. However, there was an additional point, introduced by the Appellants shortly before the substantive hearing before the FTT. This point was that, given the terms of the Daarasp and Betex Closure Notices, the FTT lacked jurisdiction to consider any of the "knock out" points on which the Closure Notices were said to be based. The basis for this contention – which is considered in detail below – was that the Daarasp and Betex Closure Notices both either expressly or by necessary implication accepted that some losses were allowable. This was, according to the Appellants, the only possible meaning of the words "I conclude [that] of the losses claimed only a currently unquantifiable part may be allowable" (emphasis added).

10. By its decision dated 13 September 2018 (the **Decision**), the FTT concluded:

> (1) That it had jurisdiction to consider the "knock out" points by way of which HMRC contended that the allowable losses could be assessed at nil: Decision at [311] to [324].
>
> (2) That neither Daarasp (Decision at [424] and [425]) nor Betex (Decision at [465] and [466]) was carrying out a trade at the relevant time, and that accordingly none of the losses claimed were allowable. This was, accordingly, a "knock out" point, reducing the allowable losses to nil.
>
> (3) That the expenditure which both Daarasp and Betex claimed to have incurred on acquiring the software licences could only properly be treated as incurred on software licences to a limited extent. Daarasp and Betex were claiming as allowable losses the amounts set out in their returns (namely, £18,192,004.20 and £25,482,181.00 respectively). The FTT concluded, in relation to both Daarasp and Betex, as follows (with our emphasis):

"563. Overall, we have concluded that the description of the financing given by Walker LJ in *Tower MCashback* applies just as well here:

> "In this case, there was a loan, but there was not, in any meaningful sense, an incurring of expenditure of the borrowed money in the acquisition of software rights. It went in a loop in order to enable the LLPs to indulge in a tax avoidance scheme" (at [75])

564. For these reasons, we have concluded that <u>if any real expenditure was made</u> for the real purpose of Betex or Daarasp acquiring software assets for the relevant periods, that expenditure was limited to amounts equal to the initial payments which were made to [Ecoholdings] and Parjun Enterprises. Any qualifying expenditure for which capital allowances are available should therefore be limited to those amounts, being for Betex the £1.641 million paid to [Ecoholdings] on 4 November 2005 and for Daarasp the £1.4 million paid to Parjun Enterprises on 25 March 2004…"

The FTT's conclusion was, therefore, that <u>if any allowance was appropriate</u> (a point on which the FTT did not express a concluded view), then the qualifying expenditure was the sum paid (indirectly) by Daarasp and Betex to the ultimate software licensor (Parjun Enterprises or Ecoholdings respectively).

(4) That neither Daarasp nor Betex could be regarded as a "small enterprise" within the meaning of section 45(1) of the Capital Allowances Act 2001: Decision at [581]. Accordingly, none of the losses claimed were allowable. This was another "knock out" point.

(5) That, so far as Daarasp was concerned (the point did not arise in relation to Betex), the expenditure was "long-life asset expenditure" within the meaning of section 44(2) of the Capital Allowances Act 2001 and so did not operate to deny Daarasp's claim for first year capital allowances: Decision at [595].

(6) That – on a brief consideration, given the FTT's conclusions on other points, Daarasp's claim was caught by the "anti-avoidance" rule at section 215 of the Capital Allowances Act 2001, whereas Betex's was not: Decision at [604] to [605] and [624].

11. Accordingly, both Daarasp's appeal against the Daarasp Closure Notice and Betex's appeal against the Betex Closure Notice failed and were not allowed: Decision at [625] and [626]. The FTT specifically concluded that its determinations, which we have set out in paragraphs 9(2), (4), (5) and (6) above, were all matters which, notwithstanding their "knock out" nature, were matters within the FTT's jurisdiction that it could properly consider: Decision at [627].

<u>The grounds of appeal to the Upper Tribunal</u>

12. The Appellants sought permission to appeal against the Decision and were given permission to appeal on what proved to be two grounds:

(1) First, on what we shall refer to as the **Closure Notice Issue**, that the FTT was wrong to conclude that the Daarasp and Betex Closure Notices permitted it to consider the "knock out" points determined by the FTT, as we have described in paragraphs 9(2), (4), (5) and (6) above.

(2) Secondly, on what we shall refer to as the **Expenditure Issue**. Here, it was contended by the Appellants that the FTT erred in law in concluding from the primary facts that it found that the only expenditure incurred on the software licences were sums equal to those paid by Damats and Piebet to the software developer and not the full sums paid by Daarasp and Betex.

There was a third ground of appeal, which (in the hearing before us) became subsumed into the Expenditure Issue. Mr Thornhill, QC, the Appellants' leading counsel, explicitly contended before us that if and to the extent that this third ground had any independent force, it was best considered as part of the Expenditure Issue. Ms Nathan, QC, HMRC's leading counsel, dealt with the point in this way, as do we.

13. There is, therefore, no appeal against the FTT's conclusions on the "knock out" points. If the Appellants fail on the Closure Notice Issue – which is essentially a procedural issue – their appeals fail completely. Conversely, if the Appellants succeed on the Closure Notice Issue, they need also to succeed on the Expenditure Issue. Thus, the Appellants must win on both issues in order to prevail.

14. We proceed to consider, in turn, the Closure Notice Issue and the Expenditure Issue, beginning with the former.

Closure notices: the relevant statutory provisions

15. As we have described, both the Daarasp and Betex Closure Notices related to partnership enquiries (because both Daarasp and Betex were LLPs) made under section 12AC of the Taxes Management Act 1970. Section 12AC provides that an officer of the Board "may enquire into a partnership return if he gives notice of his intention to do so ("**notice of enquiry**")" and the various requirements of section 12AC are met.

16. Entirely unsurprisingly, a notice of enquiry commences an enquiry, which must (in some way) be concluded. In the case of an enquiry into a partnership return, the relevant provision is section 28B of the Taxes Management Act 1970, which relevantly provides as follows:

"(1) An enquiry under section 12AC(1) of this Act is completed when an officer of the Board by notice (a "**closure notice**") informs the taxpayer that he has completed his enquiries and states his conclusions.

…

(2) A closure notice must either –

(a) state that in the officer's opinion no amendment of the return is required, or

(b) make the amendment of the return required to give effect to his conclusions."

17. Section 28A of the Taxes Management Act 1970 relates to the completion of an enquiry into a personal or trustee return. As such, it is not a provision directly relevant to this appeal, but because it was referred to in the course of submissions, we set out its material provisions below:

"(1) An enquiry under section 9A(1) of this Act is completed when an officer of the Board by notice (a "closure notice") informs the taxpayer that he has completed his enquiries and states his conclusions.

…

(2) A closure notice must either –

(a) state that in the officer's opinion no amendment of the return is required, or

(b) make the amendments of the return required to give effect to his conclusions."

As is clear, there is no material difference between the two provisions.

18. By section 31(1)(b) of the Taxes Management Act 1970, a right of appeal lies against "any conclusion stated or amendment made by a closure notice under section 28A or 28B of this Act…".

19. Pursuant to section 49D of the Taxes Management Act 1970, an appellant may notify its appeal to the FTT and, on such notification, the FTT must determine the "matter in question". In particular:

"(2) The appellant may notify the appeal to the tribunal.

(3) If the appellant notifies the appeal to the tribunal, the tribunal is to decide the matter in question."

20. Section 49I of the Taxes Management Act 1970 defines the expression the "matter in question as follows":

"(1) In sections 49A to 49H—

(a) "matter in question" means the matter to which an appeal relates…"

Closure notices: the case-law

21. The following paragraphs draw on the law as expounded in the following cases:

(1) *Tower MCashback LLP v. Revenue and Customs Commissioners*, [2011] UKSC 19 (***Tower MCashback***);

(2) *Fidex Ltd v. Revenue and Customs Commissioners*, [2016] EWCA Civ 385 (***Fidex***);

(3) *Bristol & West plc v. Revenue and Customs Commissioners*, [2016] EWCA Civ 397 (***Bristol & West***);

(4) *B & K Lavery Property Trading Partnership v. Revenue and Customs Commissioners*, [2016] UKUT 525 (TCC) (***Lavery***);

(5) *Investec Asset Finance plc v. The Commissioners of Her Majesty's Revenue and Customs*, [2020] EWCA Civ 579 (***Investec***).

We are, of course, very conscious that these are decisions ranging from the Upper Tribunal up to the Supreme Court. The paragraphs below take account of statements of the law that we consider to be binding on us, as supplemented by statements of the law which, although not binding, elucidate and are consistent with those binding statements.

22. An enquiry, begun by way of an enquiry notice, is concluded by a closure notice. The closure notice comprises two elements:

(1) A statement of the officer's conclusions; and

(2) A statement of what, if anything, must be done to give effect to those conclusions.

23. The whole point of tax returns and enquiries into them is to ensure that the public interest in taxpayers paying the correct amount of tax is met. To that end, HMRC must have an appropriate ability to examine the return, but the taxpayer must have a fair opportunity to challenge (by way of appeal) either (i) the conclusions of HMRC or (ii) the manner in which those conclusions have been given effect to (by way of amendments to the return). As can be seen from section 28A of the Taxes Management Act 1970, a closure notice quite clearly contains – and must contain – both elements; equally, as section 31(1)(b) of the same Act provides, an appeal lies against both "any conclusion stated" or any "amendment made".

24. It is important to appreciate that the conclusions of a closure notice are distinct from the amendments that may arise out of those conclusions. Obviously, there is a nexus between the two – the amendments implement the conclusions reached – but they are very different things. The conclusions in a closure notice consist of a statement <u>why</u> the taxpayer's return is incorrect (if it is), whereas the amendments set out <u>how</u> the return must be corrected in order to give effect to those conclusions. A closure notice must state the officer's conclusions; and having issued a closure notice, HMRC has no power to amend the relevant return other than to give effect to the conclusions: *Bristol & West* at [24]; *Investec* at [51].

25. Turning, then, to the operation of closure notices more specifically:

(1) There is no obligation on the officer to set out or state the reasons which have led him to his conclusion(s). What matters is the conclusion that the officer has reached upon the completion of his investigation, not the process of reasoning by which he has reached those conclusions: *Tower MCashback* at [15]; *Fidex* at [45]. This means that, on any appeal, the conclusions in the closure notice may be justified by reasons that were not articulated either at the time the closure notice was issued or during the enquiry that preceded it.

(2) It follows that when justifying a conclusion that has been reached by the officer and stated in the closure notice, reasons <u>other than</u> those in play at the time of the closure notice may be relied upon to justify it. On any appeal,

the FTT will form its own view on the law, without being restricted to what HMRC state in their conclusion or the taxpayer states in the notice of appeal. Either party can change its legal arguments, but such changes in argument cannot be used as an ambush, and the FTT must be astute to prevent this, by using its case management powers: *Tower MCashback* at [15], [18].

(3) That does not, however, mean that an appeal against a closure notice opens the door to a general roving inquiry into the return. The scope and subject matter of the appeal will be defined by the conclusions stated in the closure notice and by the amendments (if any) made to the return (as well as the overriding question of fairness): *Tower MCashback* at [15].

(4) How the conclusions of a closure notice are framed will very much depend upon the nature of the issues arising in relation to the enquiry. Lord Walker said this in *Tower MCashback* at [18]:

"This should not be taken as an encouragement to officers of the revenue to draft every closure notice that they issue in wide and uninformative terms. In issuing a closure notice an officer is performing an important public function in which fairness to the taxpayer must be matched by a proper regard for the public interest in the recovery of the full amount of tax payable. In a case in which it is clear that only a single, specific point is in issue, that point should be identified in the closure notice. But if, as in the present case, the facts are complicated and have not been fully investigated, and if their analysis is controversial, the public interest may require the notice to be expressed in more general terms…"

See, also, *Fidex* at [41].

(5) It is desirable that the statement by the officer of his conclusions should be as informative as possible: *Tower MCashback* at [83]; *Fidex* at [42]. Furthermore, notices are given at the conclusion of an enquiry, and must be read in context. It will be rare for a notice to be sent without some previous indication during the enquiry of the points that have attracted the officer's attention: *Tower MCashback* at [84]; *Fidex* at [42], [45]; *Lavery* at [37]. That said, a narrowly drawn closure notice – properly construed – cannot be widened by reference to the scope of the enquiry which preceded it: *Lavery* at [34].

(6) It is not appropriate to construe a closure notice as if it were a statute: *Fidex* at [51]; *Lavery* at [28]. The ordinary rules of construction apply to closure notices, and the question of construction is a mixed question of fact and law: the identification of the relevant circumstances and context in which the document is to be construed is a question of fact, whilst the meaning of the document – construed within that context, as found – is a question of law: *Lavery* at [36]. Essentially, when approaching the question of construction, it is appropriate to consider how the reasonable recipient of the notice, standing in the shoes of the taxpayer, would have construed it: *Lavery* at [42].

(7) The issue of a closure notice represents an important stage in closing the officer's enquiry. In *Bristol & West*, the Court of Appeal stated at [35]:

"We do not doubt that the conclusion of an inquiry and the expression of HMRC's conclusions in a closure notice leaves open for further debate, negotiation and settlement the final outcome as to the extent of the taxpayer's tax liability. But we reject any notion that the closure of the inquiry and the expression of HMRC's conclusions arising from it can be belittled as a mere procedural pause. Closure marks an important stage at which the inquiry (with HMRC's attendant powers and duties) ends, HMRC is required to state its case as to the amount of tax due, in the closure notice itself, following which its power to amend the assessment is limited to such amendments as will give effect to those conclusions…"

Indeed, the closure notice marks the beginning of a series of "precisely timed stages" whereby the return is amended and/or the closure notice challenged by way of appeal: *Bristol & West* at [36]. In particular, the jurisdiction of the FTT – to which any appeal is made – is fixed by the terms of the closure notice: *Lavery* at [19]; *Investec* at [70]. Furthermore, the scope of the closure notice and the matters arising out of any appeal of closure notice are matters for the FTT, and an appellate court should be slow to interfere with the FTT's decision unless it is clearly outside the scope of the statutory provisions: *Investec* at [71].

(8) "[T]he matter to which the appeal relates" for the purposes of section 49I(1)(a) must be the [conclusion and/or] the amendment and either the conclusion or the amendment is therefore the "matter in question" which the FTT is required to determine by section 49I(1) of the Taxes Management Act 1970. That then restricts the ambit of the appeal at the conclusion of which the FTT may decide that there has been an overcharge or an undercharge and so make a reduction or an increase in the assessment pursuant to section 50(6) or (7) of the Taxes Management Act 1970 as appropriate. There is a limit on the jurisdiction of the FTT which is not simply a matter of ensuring procedural fairness. Any purported exercise by the FTT of a broader power to consider matters beyond that would be an error of law: *Investec* at [70].

(9) The authorities do not support a narrow construction of the key phrase in section 49I of the Taxes Management Act and they establish that the FTT is the appropriate stage at which the scope of "the matter in question" in the appeal is to be determined. The FTT is a specialist tribunal and an appellate court should not interfere with that decision unless it is clearly outside the scope of the statutory provisions. There are likely to be boundary issues whatever the test to be applied. Those issues are much more likely to be problematic and time-consuming if a narrow view is adopted. Such a construction of the provisions would simply multiply the number of appeals: *Investec* at [71].

(10) There are other checks and balances in the legislative scheme designed to protect the taxpayer. Those protections are the time limit imposed on HMRC in opening an enquiry, the fact that only one enquiry can be opened into any one tax return and the ability of the taxpayer to seek a direction for the issue of a closure notice. A narrow confinement of the subject matter of the appeal is not intended to be one of the protections

conferred on the taxpayer. The "venerable principle" – that taxpayers should pay the right amount of tax – is also an important underlying factor in any tax matter. Proceedings before the FTT are not simply a dispute between two private parties and the venerable principle has a role to play here: *Investec* at [72].

The FTT's Decision

26. As we noted in paragraph 9(1) above, the FTT determined that it had jurisdiction to consider the "knock out" points by way of which HMRC contended that the allowable losses of the Appellants could be assessed at nil at [311] to [324] of the Decision:

"311. We agree with the approach of HMRC that a closure notice cannot and should not be interpreted as if it were a statutory provision. It is intended to communicate HMRC's decision to a taxpayer and so should be interpreted as a layperson and not a lawyer's document.

312. On the other hand, HMRC have to accept that a closure notice is a significant document from a taxpayer's perspective and should make clear HMRC's view of the correct tax which is due and the reasons for this. As stated in *Tower MCashback*:

> "In issuing a closure notice an officer is performing an important public function in which fairness to the taxpayer must be matched by a proper regard for the public interest in the recovery of the full amount of tax payable…" (Lord Walker at [18])

313. In an ideal situation, a closure notice would, as suggested in *Tower MCashback*, state clear conclusions by reference to a single clear point at issue:

> "In a case in which it is clear that only a single specific point is in issue, that point should be identified in the closure notice. But if, as in the present case, the facts are complicated and have not been fully investigated, and if their analysis is controversial, the public interest may require that the notice be expressed in more general terms" (Lord Walker at [18])

314. This case certainly falls into the second category, but the question remains whether, even accepting that this is a complicated case, the "general terms" used by HMRC are adequate to include HMRC's arguments that none, rather than only part of, the capital allowances claimed should be allowed.

315. HMRC suggest that it is possible to extrapolate back from the amendment (no capital allowances available) to construe the reasons, but we have some doubts about the logic of this. In our view, while the actual amendment was a complete denial of capital allowances, the conclusion stated in the Closure Notices did not suggest that this was the necessary result of HMRC's conclusion.

316. In our view, on its face, the Closure Notices do not identify even in the "general terms" referred to by Lord Walker, the full scope of the points in issue.

317. However, we are clearly allowed to look further than the face of the Closure Notices, again relying on *Tower MCashback*:

> "Notices of this kind, however, are seldom, if ever, sent without some previous indication, during the enquiry, of the points that have attracted the officer's attention. They must be read in their context." (Lord Hope at [84])

318. In our view, there is evidence in the Notices of Enquiry to indicate that HMRC were considering a range of reasons why the capital allowance claims made may be disallowed in whole or in part. HMRC's Notice of Enquiry to Daarasp of 22 December 2004 says: "My enquiries centre on the partnership's trade and capital allowance claims". Exactly the same phrase is used in the Betex Notice of Enquiry of 31 October 2006.

319. We also accept Ms Nathan's point that other correspondence between the parties' representatives and HMRC referred to arguments raised by HMRC which would have led to the complete denial of capital allowances.

320. This approach is supported by the suggestion, particularly in the *Tower MCashback* decision, that our role should not be unduly restricted by the terms of the Closure Notice, picking up on the statements of Dr John Avery Jones in *D'Arcy*:

> "The appeal against the conclusions is confined to the subject-matter of the enquiry and of the conclusions. But I emphasise that the jurisdiction of the Special Commissioners is not limited to the issue whether the reason for the conclusion is correct. Accordingly, any evidence or any legal argument relevant to the subject matter may be entertained by the Special Commissioners subject only to his obligation to ensure a fair hearing." (Quoted by Lord Walker in *Tower MCashback* at [16])

321. On that basis, the scope of this appeal should be limited only for two specific reasons:

(1) The appeal should not be allowed to "open the door to a general roving enquiry into the relevant tax return" and the taxpayer should not, by reason of new arguments being introduced, be deprived of an opportunity to properly respond to them.

In our view, by including arguments about the nature of the Appellants' trading activities and considering other detailed rules which are relevant to the availability of the capital allowances which are the subject of this appeal, HMRC have not advanced issues which are not relevant to the core question of whether capital allowances are available.

(2) If any purported extension of the legal arguments under consideration by HMRC has put the taxpayer at an unfair disadvantage and "ambushed" him with arguments to which he has not had a chance to respond. This could and should be managed as part of the case management process and in our view that has been achieved here.

In our view, there is no question in this appeal of the Appellants not being sufficiently aware of the arguments which were to be raised by HMRC. The best test of this is to consider the information provided by the parties in response to the Tribunal's directions, intended to ensure that the parties were aware of the issues in dispute before they got to the Tribunal hearing.

HMRC's proposed statement of issues provided in October 2015 dealt in some detail with the points which they now raise as did their amended statement of case also produced in 2015.

322. If the *Towers Watson* case needs to be distinguished we would say that, rather than considering an issue which was a fundamental component of the tax losses claimed (the valuation of the goodwill) the Tribunal in that case was asked to consider a parallel issue (the amortisation of the goodwill) and one which had not been raised prior to the Tribunal hearing.

323. In these circumstances, there is no reason for the Tribunal to accept a restricted approach to the Closure Notices for fairness reasons, on the contrary to fail to consider issues which are fundamental to the availability of the disputed losses would result in the Tribunal providing only a partial decision.

324. For these reasons, we accept HMRC's position on this point and are proceeding on the basis that each of the "knock-out" points are under appeal and open to us to consider as part of this decision."

Approach in relation to the Closure Notice Issue

27. It is clear that the question of whether certain points arising out of an appeal of a closure notice are or are not properly before the FTT is a matter for the FTT, with whose conclusions an appellate court will only interfere if it is clear that the FTT has erred as a matter of law: see paragraph 25(7) above.

28. Accordingly, we approach the Closure Notice Issue in two stages. First, we consider whether there has been an error of law on the part of the FTT on this point. Secondly, and only if we answer the first question in the affirmative, we consider the true construction of the Daarasp and Betex Closure Notices.

Stage 1: Error of law in relation to the Closure Notice Issue

29. The Appellants contended that, whilst the FTT's analysis in [311] to [316] was essentially unimpeachable, the FTT's analysis went badly wrong thereafter. In [311] to [316], the FTT focussed on the officer's conclusions as stated in the Daarasp and Betex Closure Notices. The FTT rightly, at [311], considered that the Closure Notices should be interpreted from the standpoint of a layperson and not a lawyer.

30. Approaching the Closure Notices in this way, the FTT appeared to reach the provisional view (at [315] to [316]) that the conclusions articulated were not wide enough to embrace the "knock-out" points on which HMRC sought to rely. On this basis, of course, they could not be used to justify the amendments to the Appellants' returns.

31. The Appellants contended that the FTT erred in its reasoning after this point:

(1) The Appellants accepted that the FTT was entitled to look beyond the face of the Closure Notices (as *per* [317]), and further accepted that during the course of HMRC's enquiries, the "knock-out" points were articulated by

HMRC and put to Daarasp and Betex. So far as we are concerned, the FTT was clearly entitled to look at material going beyond the Closure Notices themselves (see paragraph 25(5) above); and we would be very reluctant to interfere with the FTT's findings of fact as to the scope of the enquiry in relation to both the Daarasp and the Betex return.

(2) The Appellants' contention was that the scope of the enquiry prior to the Closure Notices was only relevant as part of the factual matrix or context within which the Closure Notices had to be construed. The FTT was obliged to consider whether this contextual material justified a different (wider) interpretation of the conclusions stated in the Closure Notices.

(3) To put the same point another way, the FTT was not entitled to use the prior history relating to the scope of the enquiry to widen an otherwise narrowly drawn closure notice: see paragraph 25(5) above. Rather, it had to consider the Closure Notices in their full context, and construe them as a whole in that context.

(4) This, according to the Appellants, the FTT failed to do. We agree with this contention. Whilst we entirely accept the findings of the FTT at [318] and [319] of the Decision as to the scope of the enquiry, the FTT failed to consider whether – and, if so, how – this broader scope affected what the Appellants contended was the otherwise clear wording of the Closure Notices: namely that both the Daarasp and the Betex Closure Notices either expressly or by necessary implication accepted as their conclusion that some losses were allowable: see, further, paragraph 9 above.

(5) At this point, we express no view as to the true construction of the Closure Notices. However, we do consider, for this reason, that the FTT has erred in law in its approach to construing the Closure Notices, and that it is therefore incumbent upon us to reconsider this question of construction, which we do in paragraphs 33*ff* below.

(6) We conclude that the FTT's finding at [323] – that there was "no reason" to accept a restricted approach to the Closure Notices – involves the FTT asking itself essentially the wrong question. The question is not whether there is any reason to accept a "restricted approach" or whether a "wide" approach would be unfair to the taxpayer. These questions are not irrelevant, but they are subsequent to the anterior question, which the FTT did not address, which is precisely what conclusions were stated in the Daarasp and Betex Closure Notices, when correctly construed. If those conclusions are too narrow to support the amendments intended to implement them, then the amendments cannot (properly) be made.

Stage 2: The true construction of the Daarasp and Betex Closure Notices

32. We turn, then, to the true construction of the Daarasp and Betex Closure Notices. It was uncontroversial before us that:

(1) We should construe the Closure Notices from the standpoint of the reasonable recipient of the Closure Notices, standing in the shoes of the taxpayer: paragraph 26(6) above.

(2) The ordinary rules of construction applied. To the extent necessary, we expand on these below.

(3) The scope of the enquiry conducted by HMRC prior to the Closure Notices extended to the "knock out" points. As we have stated, this is a finding of fact that we would be reluctant to interfere with; and the Appellants did not invite us to do so.

33. One point on which HMRC placed particular emphasis – and which we must address at the outset – is the relationship between the parts of a closure notice that express the officer's conclusion(s) and the parts of a closure notice that set out the amendments to the taxpayer's return consequential upon these conclusions.

34. We have no doubt that closure notices must be construed as a whole; and that it would be an error to view those parts of a closure notice expressing the officer's conclusions as fundamentally distinct from, and always unaffected by, those parts of a closure notice dealing with consequential amendments.

35. However, to go beyond this (we would suggest) uncontroversial proposition seems to us to be dangerous. If were to be suggested that – to the extent that they were wider in ambit than the conclusions expressed in a closure notice – the consequential amendments should generally be used to construe the conclusions more widely than their ordinary meaning would otherwise permit, then we do not consider that such analysis can be correct as a general proposition. It overlooks the very obvious point that amendments to a return, intended to give effect to the conclusions expressed in a closure notice, may fail properly to articulate the necessary consequential amendments, and so themselves to susceptible of a successful appeal under section 31(1)(b) of the Taxes Management Act 1970. In short, whilst the nature of the consequential amendments in a closure notice may affect the construction of the conclusions expressed in the same closure notice (whether to widen or to narrow them), they can never be anything more than a part of the process of construction. At the end of the day, what is at issue is the true meaning of the conclusions themselves, read in context and in the light of the entirety of the factual matrix, including the whole of the closure notice in question. If the meaning of those conclusions is clear, then those conclusions cannot be widened by reference to the consequential amendments – even if these are, in themselves, clearly and distinctly wider than the true meaning of the conclusions.

36. With these preliminary points well in mind, we turn to the true construction of the Closure Notices in this case:

(1) Given the scope of the enquiry into the Daarasp and Betex returns, a reasonable recipient of the Closure Notices, standing in the shoes of the taxpayer, would have expected the officer to reach a conclusion – one way or the other – in relation to each of the "knock-out" points articulated in paragraph 4 above.

(2) That is not to say that the officer was obliged to state a clear conclusion on each of these "knock-out" points. As we have described, although the conclusions expressed in a closure notice ought to be as informative as possible (see paragraph 25(5) above), it will sometimes be either necessary and/or appropriate to express the conclusions in wider and less informative terms.

(3) The Closure Notices in this case are apt to be described as "unspecific" and "uninformative". It may be that they could have been better framed. But the question before us is not whether the conclusions in the Closure Notices could have been better framed. The question we must address is whether the reasonable recipient – knowing of the scope of the enquiry, and in particular knowing that the enquiry embraced the "knock-out" points – would nevertheless have considered, on reading the Closure Notices, that HMRC was concluding that some losses, albeit in an unquantifiable amount – were inevitably or definitely allowable. In short, that the officer was concluding that the "knock-out" points were all not being relied upon, such that the allowable loss figures of the Daarasp and Betex partnerships lay somewhere in the range of above nil and £18,192,004.00 (in the case of Daarasp) and above nil and £25,482,181 (in the case of Betex).

(4) We do not consider this to be a tenable construction of the Closure Notices in this case, for the following reasons:

(a) If this had been the true meaning of the conclusion expressed by the officer in the Closure Notices, then we do not consider that the consequential adjustments in the Closure Notices would have reduced the partnership loss figures to a figure as explicit as "nil".

(b) Rather, we consider that – if the officer had indeed concluded that HMRC was no longer relying on its "knock-out" points – the adjustment would have been expressed in a more nuanced way, so as (i) to reflect that only "unquantifiable" losses *were* allowable and (ii) to specify a route by which these "unquantifiable" losses could be quantified so that the return could be properly completed and the tax payable properly assessed.

(c) Of course, we must bear in mind that it is perfectly possible for the consequential adjustment in a closure notice itself to be in error, in that it fails to articulate the adjustment required by the conclusion articulated by the officer. We have carefully considered whether this is the case here, and have concluded that it is not.

(d) This is because the conclusion in each of the Closure Notices is equivocal as to whether some losses (albeit of an unquantifiable amount) are definitely going to be recoverable by the taxpayers in this case. It is to be noted, in this context, that the officer used the equivocal (modal auxiliary) verb "may" in

expressing his conclusion as to the availability of allowances rather than the more definite auxiliary verb "will".

(e) We consider that the conclusion expressed by the officer is not inconsistent with an allowable loss figure of zero. What the officer was saying – in the short phrase "I conclude [that] of the losses claimed only a currently unquantifiable part may be allowable" – was that: (i) if the "knock-out" points succeeded, then the allowable loss was zero; but that (ii) even if the "knock-out" points failed, all that could be said was that something less than the full amount claimed by the taxpayers could be allowable because of what we have termed the Expenditure Issue. In other words, the conclusion left open the possibility that some or none of the claimed allowances might be available. This interpretation of the officer's conclusion is consistent with the scope of the enquiry (as found by the FTT) and the amendment giving effect to that conclusion.

37. Accordingly, for these reasons, we have reached the same conclusion – albeit by a different route – as the FTT in relation to the Closure Notice Issue. It follows that the appeal must be dismissed on this point.

The Expenditure Issue

38. It was common ground between the parties that the Appellants needed to succeed on both the Closure Notice Issue and the Expenditure Issue in order for the appeal overall to succeed. That is because the FTT decided the Appellants' challenges to the "knock out" points in substance against the Appellants and, although the Appellants sought permission to appeal those points, permission to appeal was not granted.

39. Accordingly, if the appeal in relation to the Closure Notice Issue is dismissed – as it has been – the outcome of the Expenditure Issue is irrelevant. The "knock out" points prevail, for the reasons we have given.

40. In these circumstances, we do not consider that it is either appropriate or necessary for us to consider further the Expenditure Issue, and we do not do so.

Disposition

41. For the reasons we have given, the Appellants' appeal is dismissed.

Signed on Original

THE HONOURABLE MR JUSTICE MARCUS SMITH

JUDGE GUY BRANNAN

RELEASE DATE: 13 April 2021