APPLICATION – for determination of amount of tax the payment of which should be postponed pending determination of appeal – whether having regard to the representations made and the evidence adduced there were reasonable grounds for believing that the Appellant was overcharged to tax – no - whether there was an agreement to postpone – no – if so, whether there was any change in the circumstances of the case since such agreement – yes – application dismissed - TMA 1970 s 55 (4), (6) and (7)

THE SPECIAL COMMISSIONERS SpC 00289

SPARROW LIMITED

Appellant

- and -

(H M INSPECTOR OF TAXES)

Respondent

SPECIAL COMMISSIONER : DR NUALA BRICE

Sitting in private on 30 March and 3 April 2001

ANONYMISED DECISION

The application

1. Sparrow Limited (the Appellant) applied on 8 January 2001 for a determination of the amount of tax the payment of which should be postponed pending the determination of its appeal. The appeal was against an assessment to tax of £36,872,465.76. The application stated that the Appellant believed that it was overcharged to tax by the full amount of the assessment and the grounds of the application were that the Appellant had no tax liability.

The legislation

2. The application was made under the provisions of section 55 of the Taxes Management Act 1970 (the 1970 Act) the relevant parts of which provide:

"55(1) This section applies to an appeal to the Commissioners against- …

(b) an assessment to tax …

(2) Except as otherwise provided by the following provisions of this section the tax charged by the … assessment shall be due and payable as if there had been no appeal.

(3) If the appellant has grounds for believing that he is overcharged to tax by the … assessment he may, by notice in writing given to the inspector within thirty days after the date of the issue of the … assessment apply to the Commissioners for a determination of the amount of tax the payment of which should be postponed pending the determination of the appeal.

A notice of application under this subsection shall state the amount in which the appellant believes he is overcharged to tax and his grounds for that belief. …

(4) If, after any determination of the amount of tax the payment of which should be so postponed, there is a change in the circumstances of the case as a result of which either party has grounds for believing that the

amount so determined has become excessive, or, as the case may be, insufficient, he may, by notice in writing given to the other party at any time before the determination of the appeal, apply to the Commissioners for a further determination of that amount. …

(5) An application under subsection (3) … shall be heard and determined in the same way as the appeal, and where any such application is heard and determined by any Commissioners, that shall not preclude them from hearing and determining the appeal …

(6) The amount of tax the payment of which shall be postponed pending the determination of the appeal shall be the amount (if any) in which it appears to the Commissioners, having regard to the representations made and any … evidence adduced that there are reasonable grounds for believing that the appellant is overcharged to tax …

(7) If the appellant and an inspector come to an agreement, whether in writing or otherwise, as to the amount of tax the payment of which should be postponed pending the determination of the appeal, the like consequences shall ensue as would have ensued if the Commissioners had made a determination to that effect under subsection (6) above on the date when the agreement was come to, but without prejudice to the making of a further agreement or of a further determination under that subsection."

The issues

3. The Appellant argued that it was overcharged to tax by the full amount of the assessment. Alternatively, the Appellant argued that, on 15 January 2001, the Respondent had agreed to postpone the payment of the full amount of the tax charged by the assessment. The Appellant accepted that, if there had been such agreement, then the application could be treated as an application for a further determination under section 55(4) in which case the Appellant argued that there had been no change in the circumstances of the case since the agreement.

4. The Respondent accepted at the hearing that the assessment overcharged tax of £688,008 but argued that the rest of the tax assessed, amounting to £36,184,457, should not be postponed. He argued that, having regard to the representations made and the evidence adduced, there were no reasonable grounds for believing that the Appellant was overcharged to tax by the assessment (other than by the £688,008). He denied that there had been any agreement on 15 January 2001 to postpone the payment of the tax. However, if there had been such an agreement then he argued that there had been substantial changes in

the circumstances of the case since that date.

5. Thus the issues for determination in the application were:

(1) whether, having regard to the representations made and the evidence adduced, there were reasonable grounds for believing that the Appellant was overcharged to tax by the assessment (less the sum of £688,008) within the meaning of section 55(6);

(2) whether there had been an agreement on 15 January 2001 within the meaning of section 55(7) and, if so

(3) whether there had been any change in the circumstances of the case since that agreement within the meaning of section 55(4).

The evidence

6. A blue bundle of documents was produced by the Appellant. A statement by a witness (John Partridge) dated 26 March 2001 was produced on behalf of the Appellant.

7. Expert evidence was given on behalf of the Appellant by an expert witness who had prepared a report dated 29 March 2001. The Appellant applied at the hearing for this evidence to be admitted. That application was opposed by the Respondent on the ground that the procedure in Regulation 12 of the Special Commissioners (Jurisdiction and Procedure) Regulations 1994 SI 1994 No. 1811 had not been complied with. He argued that he (the Respondent) had not been given the opportunity to consider the expert evidence in advance and could not, in the time available, produce an expert of his own to give evidence and to assist in preparing the cross-examination of the expert witness. I offered the Respondent an adjournment so that he could instruct his own expert witness but he did not wish the hearing to be adjourned. Regulation 12 applies "unless a Special Commissioner otherwise directs". Accordingly, I directed that the evidence be heard. Between 1995 and 2000 the expert witness was the senior vice president of an international bank. The expert witness's report and his oral evidence dealt with the banking procedures adopted in the transactions the subject of the application. The expert witness was a composed and precise witness but he accepted that he had no banking qualifications and was not an expert in banking law.

8. A red bundle of documents was produced by the Respondent. Oral evidence was given by the Respondent on his own behalf; his evidence was limited to the operation of the computer which issued the Form 64-5 on 15 January 2001.

9. A feature of the documentary evidence was that all the

documents produced were photocopies and no original documents were available. Also, as will be seen, the documents which were produced were not complete and were, in some cases, unexplained or inconsistent.

The facts

10. From the evidence before me I find the following facts for the purposes of this application only. The Appellant should be put to strict proof of all these matters in the substantive appeal. Although I describe the contents of the copy documents produced at the hearing I make no finding that the documents are effective.

11. Counsel for the Appellant accepted that the transactions were part of a tax avoidance scheme. Included in the papers annexed to the report of the expert witness was a letter dated 24 September 1993 from a firm of chartered accountants to an Overseas Bank. The letter described the details of a scheme and the role of the Overseas Bank in the scheme.

The Appellant and the Group

12. In August 1996 the Appellant had an authorised share capital of £1,000 divided into 1,000 ordinary shares of £1 each, two of which had been issued and were fully paid. The shares were owned by a company called Investments. The Appellant had four directors who were no doubt connected with the same group as Investments and to whom I refer as "the Group directors". The Appellant carried on a property investment business.

13. Until 20 August 1996 the name of the Appellant was Properties Limited. It was a member of a group of companies which owned and leased a large number of shops. Rents from many of these properties were paid directly or indirectly to the Appellant. The companies within the group which paid rent to the Appellant received tax deductions for those payments and, in the normal course, the Appellant would have been liable to pay tax on the rents received.

14. Sometime before 18 September 1996 the Appellant received a loan from Group Plc of £75,442,075.

August 1966 - the business transfer agreement

15. On 16 August 1996 the Appellant entered into an agreement (the business transfer agreement) with Sparrow Limited for the sale of all its assets and business as a property investment company except for certain excluded assets which were defined as the rental income receivable by the Appellant from Investments in respect of certain properties. The value of the excluded assets retained by the Appellant was £112,857,276 which was rent receivable

on 19 September 1996. The copy business transfer agreement produced at the hearing indicated that it was prepared by a large firm of City solicitors and that it was executed by both parties to it.

16. On 20 August 1996 the Appellant changed its name to Sparrow Limited and Sparrow Limited changed its name to Properties Limited (new Properties).

17. On 18 September 1996 the balance sheet of the Appellant showed, as a current asset, the rent receivable from Investments of £112,857,276 and, as a creditor, the loan from Group of £75,442,075. Also shown as a creditor was taxation of £37,242,901 payable in respect of the rent receivable from Investments. Net assets were shown as £182,300.

18 September 1996 – the share sale agreement – Nightingale

18. On 18 September 1996 Investments, new Properties, and Group entered into an agreement (the share sale agreement) under which Investments sold its two shares in the Appellant to a company called Nightingale for £20,460,181. Nightingale had been incorporated as a private limited non-trading company on 5 September 1996. In the share sale agreement Investments undertook with Nightingale to pay the sum for rent of £112,857,276 to the Appellant on 19 September 1996. Investments also undertook to procure the Appellant to repay the debt of £75,442,075 owing by the Appellant to Group. (This was an unusual provision as, after the sale, it would have been for Nightingale to procure such repayment.) Nightingale covenanted with new Properties that the Appellant would perform its obligations under the business transfer agreement.

19. The copy of the share sale agreement produced at the hearing indicated that it had been prepared by a large firm of City solicitors. There was no photocopy of the signatures on the agreement but there was a typed copy of the names of the signatories and of the names and addresses of the witnesses. Mr Partridge signed for Nightingale .

20. Nightingale lodged its first annual return with Companies House on 5 September 1997. The company secretary was stated to be Mr Kestrel of an overseas country and the director to be Mr Partridge, who was of foreign nationality and who also lived overseas. All the shares were said to be held by Pheasant Holdings Limited (Pheasant) of an offshore jurisdiction. The contact address was given as a firm of chartered accountants .

21. With the annual return were lodged the financial statements for the period ending 30 September 1997. These stated that the company had not traded during the

year and that its only asset was cash of £100 balanced by called-up share capital of the same amount. The financial statements also recorded that the company had been dormant throughout the period ended 30 September 1997. There was no indication that it had purchased the Appellant for £20,460,181 nor that the Appellant expected to receive rent valued at £112,857,276. The financial statements were in respect of "the period ended 30 September 1997" but did not state when that period commenced. Neither did they give comparables for any earlier period. Also, the return of the Appellant for the period ending on 26 June 1997 showed that at that time Nightingale remained the registered holder of all of the shares of the Appellant.

22. I was informed by Counsel for the Appellant that the share sale agreement evidenced a company purchase scheme whereby a large company would sell a subsidiary to a third party who would become liable to discharge the tax liability which was, in effect, divided between seller and purchaser.

18 September 1996 – the nominee agreement and the trust

23. Also on 18 September 1996, The Plover Trust (the Trust), a settlement established under the law of an overseas jurisdiction, entered into an agreement (the nominee agreement) with Nightingale for the purchase of all the shares of the Appellant to be held by Nightingale as nominee for the Trust. The agreement was to be governed by the law of another overseas jurisdiction. The copy agreement produced at the hearing had the same signature (that of Mr Partridge) for the Trust and for Nightingale.

24. Also on 18 September 1996 Mr Partridge appointed Pheasant as a new and additional trustee of The Trust. (It will be recalled that Pheasant held all the shares in Nightingale). There was no evidence as to the establishment of the Trust nor the identity of the existing trustees.

19 September 1996 – the guarantee agreement

25. On 19 September 1996 a European Bank entered into a guarantee agreement with Investments and New Properties. The bank was described as the parent of Nightingale which was described as a wholly owned subsidiary of the bank. Under the agreement the bank purported to guarantee the obligations of Nightingale under the share sale agreement (namely to procure the Appellant to fulfil its obligations under the business transfer agreement). The copy agreement produced at the hearing had been signed on behalf of the European Bank and the signature witnessed.

26. However, the annual return submitted by Nightingale to the Companies Registry for the year ending on 5 September 1997 did not mention the European Bank but did indicate that all the shares of Nightingale were held by Pheasant. The significance of the European Bank in the transactions the subject of the applications was not explained. All the other banking facilities were provided by the Overseas Bank.

27. Also on 19 September 1996 the £20,460,181 due to Investments under the share sale agreement was paid by Nightingale to Investments and Investments transferred the shares in the Appellant to Nightingale.

28. Also on 19 September 1996 the Appellant received the rent of £112,857,276 and, on the same day, repaid the intra-group debt of £75,442,075 leaving it with a balance of £37,425,201. As the balance sheet of the previous day indicated, this was almost the same as the amount of tax due on the rents received.

19 September 1996 – the loan agreement

29. Also on 19 September 1996 the Appellant entered into an agreement with Pheasant (the loan agreement) under which the Appellant agreed to lend to Pheasant the sum of £37,415,822.92 interest-free, repayable only after 20 years. The loan agreement was stated to be governed by a foreign law. The photocopy of the loan agreement produced at the hearing was signed by Mr Kestrel for the Appellant and by Mr Partridge for Pheasant. Neither signature was witnessed.

30. On the same date (19 September 1996) a cheque for £37,415,822.92 was signed by the Manager of an English Bank but payable to a foreign bank for the account of Sparrow Limited.

31. Counsel for the Appellant agreed that, as Pheasant was a trustee of the Trust, which by virtue of the nominee agreement was the beneficial owner of the shares of the Appellant, the loan by the Appellant to Pheasant of 19 September 1996 meant that the trust was, in effect, taking the value out of the Appellant. However, he argued that the funds remained part of the trust fund. He accepted that Pheasant would have to prove that it intended to, and did, hold the loan monies as trust assets.

The Overseas Bank

32. On 18 September 1996 the Overseas Bank (the Overseas Bank) wrote to the Directors of the Appellant saying that the Bank was prepared in principle to invest in a zero-coupon bond to be issued by the Appellant subject to the conditions outlined in the letter. One condition (condition 3) was that the security for the bond would be a

fixed and floating charge over the Appellant and the assets.

33. It will be recalled that on 18 September 1996 the directors of the Appellant were still the Group directors. Also, on that date the balance sheet of the Appellant showed, as a current asset, the rent receivable from Investments of £112,857,276 and, as a creditor, the loan from Group of £75,442,075. Also shown as a creditor was taxation of £37,242,901 payable in respect of the rent receivable from Investments. Net assets were shown as £182,300. The bond issued by the Appellant ten days later was for the sum of £1,765,500,000. However, on 19 September 1996 the rent was received, the loan from Group was repaid and almost the whole of the balance of the assets were lent to Pheasant.

34. The status of the Overseas Bank was clarified on 1 July 1998 when the monetary authority of its country wrote to the Financial Services Authority in London (with a copy to the Bank of England). The letter stated that the Overseas Bank held a special banking licence which did not permit the Bank to conduct banking business with any person in its country other than another licensee or an exempted or non-resident company. The Overseas Bank did not have any physical presence in its country except through a firm of notaries who acted as the bank's authorised agent. A London subsidiary of the bank provided the necessary administrative support.

35. Before the hearing of this application the Respondent had made further enquiries of the Overseas Bank in another country as it was an address in that other country which appeared on the bank statements which were subsequently issued by the Overseas Bank. The Respondent consulted the internet site of the Central Bank of that other country and obtained a print of the banks and financial institutions. There was no entry for the Overseas Bank.

27 September 1996 – the zero coupon note instrument

36. On 27 September 1996 the Appellant executed an Instrument constituting a zero coupon note with a nominal value of £1,765,500,000 due on 26 September 1997. The note was issued at a discount for the sum of £1,650,000,000. Thus the note was issued at a discount of £115m or 7%. The Instrument provided that each note-holder would be provided with a certificate for the Note held by him. The Appellant did not have a copy of any certificate held by any note-holder. The agreement also provided that a register of note-holders was to be kept but no such register was available. Clause 8 of the Instrument stated that the Instrument and the note were governed by a foreign law. The photocopy of the Instrument produced at the hearing was not executed in the usual place, before the schedules, but on the very last page (on which only the

signatures appeared). It was executed on behalf of the Appellant by Mr Kestrel and witnessed by Mr Partridge.

37. Although the Instrument contained a number of provisions about the issue and redemption of the Note, the certificate, and the registration and transferability of the note, it did not constitute any security or charge on the assets of the Appellant. The letter of 18 September 1996 from the Overseas Bank had said that a condition of the Bank's investing in the note was that security of a fixed and floating charge over the Appellant and the assets would be given. There was no evidence of such a charge.

38. On 27 September 1996 the Overseas Bank issued a credit advice to the Appellant indicating that the amount of £1,650,000,000.00 had been credited to the account of the Appellant. On 30 September 1996 the same bank issued a statement of the account of the Appellant showing that on 27 September 1996 the sum of £1,650,000,000.00 had first been credited to the account and then, on the same day, debited, leaving a nil balance.

39. On 1 March 2001 the Overseas Bank, writing on paper headed with one address but subscribed with an address in another country, wrote to the auditors of the Appellant in a European Member State. The Bank said that on 27 September 1996 it had advanced £1.65 billion to the Appellant in the form of an investment in a one year zero coupon bond with a redemption value of £1,765,500.000. The Bank had immediately sold a 100% participation in the bond. On 18 September 1997 the sum of £112,968,493 had accrued on the bond. The bond was redeemed on 26 September 1997 when the Appellant had paid £1,765,500,000 to the Overseas Bank. Apart from this letter there was no other evidence of any other participation in the loan and no explanation of the derivation of the funds of £1.65 billion which the Overseas Bank had purported to lend to the Appellant.

27 September 1996 – the forward share purchase agreement

40. On 27 September 1996 the Appellant entered into an agreement with Woodpecker Holdings Limited, a company incorporated under the laws of an overseas jurisdiction (the forward share purchase agreement). The agreement was said to relate to the sale and purchase of the entire issued share capital of a company in a specified jurisdiction. That company was not identified in the agreement but was defined as "a company incorporated under the laws of the [specified jurisdiction] the entire issued share capital of which will at the date of completion, be owned by the Vendor (Woodpecker)". Completion day was defined as 26 September 1997 (the date of the redemption of the zero coupon note). The consideration payable by the Appellant under the agreement was £1,650,000,000.00 and was

payable on the date of the agreement (and not at the date of completion) by way of transfer to the account of Woodpecker with the Overseas Bank. The agreement recorded that before completion Woodpecker would have subscribed for £1,000 ordinary shares of £1 each in an unidentified company for the amount of £1,765,500 per share (making a total of £1,765,500,000.00). The shares were to be transferred to the Appellant at completion on 26 September 1997.

41. The forward share purchase agreement was made on the same date as the zero coupon note Instrument. The £1,650,000,000 paid to Woodpecker by the Appellant under the forward share purchase agreement was the amount credited to its account with the Overseas Bank on the security of the zero coupon note Instrument.

42. The expert witness suggested that, on receipt of the £1.65 billion from the Appellant, Woodpecker acquired on the same day a 100% sub-participation in the zero-coupon note. However, there was no evidence to support this suggestion.

43. The photocopy of the forward share purchase agreement which was produced at the hearing had a front sheet and 14 numbered pages. The agreement finished on page 11 and included space for the signatures of the parties and the witnesses. There were no signatures or witnesses on that page. Pages 12 and 13 contained a schedule. Page 14 did contain the signatures of Mr Partridge for the Appellant and Mr Kestrel for Woodpecker but nothing else. The body of the document contained several references to schedules but only one schedule was attached.

27 September 1996 – the charge

44. The forward share purchase agreement also provided that Woodpecker would grant the Appellant such security over the assets of Woodpecker as the Appellant required. On 27 September 1996 Woodpecker and the Appellant entered into a deed of charge (the charge). Woodpecker charged in favour of the Appellant the "security assets". These were defined as "all present and future interest and benefit of [Woodpecker] in the Share Sale Agreement, the Receivables, and all other assets the subject of this security". The Share Sale Agreement was defined as the agreement of the same date between Woodpecker and the Appellant. "Receivables" were defined as "all present and future moneys and claims which may be paid to or become payable to or for the account of [Woodpecker] in connection with any of the Security Assets including, but not limited to, all present and future moneys and claims payable to [Woodpecker] in respect of the Security Assets."

45. On the photocopy of the charge produced at the

hearing the signatures appeared on the last page with no other text. Mr Kestrel signed for Woodpecker and Mr Partridge for the Appellant.

One year later - 26 September 1997 - Rook

46. The Appellant's accounts for the year ending on 18 September 1997 showed that on 26 September 1997 the Appellant "took delivery" of a company called Rook which was incorporated in an overseas jurisdiction and that the Appellant held 100% of its ordinary shares. The Appellant was unable to produce the Memorandum or Articles of Association of Rook nor any share transfer document. There was no other evidence of the acquisition of Rook by the Appellant.

47. It will be recalled that under the forward share purchase agreement Woodpecker had agreed to transfer to the Appellant an unidentified company in a specified jurisdiction which was not the overseas jurisdiction in which Rook was incorporated.

48. The expert witness suggested that Rook was a cash rich company and that the Appellant immediately borrowed its funds of £1.7655 billion and used them to repay the zero coupon bond. However, there was no evidence to support this suggestion.

49. On 30 September 1997 the Overseas Bank issued a statement to the Appellant showing a credit of £1,765,500,000 and a debit "transfer Woodpecker" on the same day.

The Appellant and Nightingale

50. Also on 30 September 1997 Nightingale purported to declare that it held 1,000 ordinary shares of £1 each fully paid in the Appellant upon trust for Pheasant in its capacity as trustee of the Plover Trust. The declaration was signed by Mr Partridge. It will be recalled that, when the Appellant was sold, it had only two issued and paid up shares.

51. Both the Appellant and Nightingale have as their registered address the same premises in the United Kingdom which is the address of a business services agency. The annual return submitted by the Appellant on 28 June 1997 showed that the company secretary was Nightingale and that the director was Mr Kestrel. In the annual return up to 28 June 1999 the company secretary was shown as Magpie Services Limited and the director as Pigeon Limited, both of an overseas jurisdiction. The Appellant has not submitted any accounts to Companies House for any period subsequent to its change of ownership

The assessment and the appeal

52. On 12 December 2000 the Appellant was assessed to corporation tax in the sum of £36,872,465.76 on estimated profits of £115 million in respect of its accounting period from 19 September 1996 to 18 September 1997. At the time of the assessment the Inland Revenue were aware of the share sale agreement under which the Appellant had been sold to Nightingale but were not aware of any subsequent transactions. They took the view that tax was due in respect of the rentals received by the Appellant from Investments and that it should be paid.

53. On 8 January 2001 the Appellant appealed against the assessment on the grounds that the amount was estimated and was in excess of the company's taxable profits for the period. The Appellant also applied to postpone the whole of the tax charged by the assessment as the company had no tax liability for that period. The letter of appeal was sent under cover of a fax from Pheasant who said that they acted as tax agent for the Appellant. The fax gave Pheasant's address in an overseas jurisdiction but gave no telephone or fax number. It was signed by a representative of the Appellant. The letter of appeal contained no telephone or fax number and was signed by an unidentified signatory.

54. On 12 January 2001 the Inland Revenue acknowledged receipt of the appeal and said that this would be listed for hearing before the General Commissioners. The letter also referred to the application to postpone the payment of the whole of the tax charged and said that this application was not accepted. It was made clear that the tax charged in the assessment remained due and payable. The letter went on to say that Form 64-5 would be issued proposing that the full amount of tax should remain payable and asked for details of a telephone and fax number so that communications could be made expeditiously.

55. On 15 January 2001 Form 64-5 was issued by the Inland Revenue to the Appellant. It stated, under the heading of "Amount agreed to be postponed", the sum of £36,872,465.76 and, under the heading "Amount payable " the sum of £0.00. This was followed by another letter from the Inland Revenue dated 17 January 2001 which enclosed another Form 64-5 which was said to supersede the previous Form. The Form 64-5 dated 17 January 2001 stated, under the heading "Tax to be postponed", "Nil" and, under the heading "Tax not to be postponed" the sum of £36,872,465.76.

56. The Respondent gave evidence, which I accept, that in past years, if the Inland Revenue had written (as they wrote on 12 January) that Form 64-5 would be issued, then the form would have been sent with the letter. However that procedure was no longer available. It was now

necessary to input the computer and something had gone wrong at that stage. He accepted that someone had pressed the wrong button. The letter of 15 January (sent on a Saturday) was wrong and, as soon as that was appreciated another letter had been sent on 17 January (which was a Monday). The matter was put right as soon as possible. It had not been possible to get in touch with the Appellant earlier because the Inland Revenue did not have a fax or telephone number for the Appellant.

57. Pheasant wrote again to the Inland Revenue on 24 January 2001 but this time from another overseas address. Despite the request made in the Inland Revenue's letter of 12 January the letter contained no telephone or fax number. The Inland Revenue retained the envelope in which this letter arrived which showed that it had been posted in yet another country. Also on 24 January 2001 the Appellant wrote to the Inland Revenue informing them that its tax agent was Pheasant. Again, no telephone or fax number was given for either the Appellant or Pheasant.

58. On 7 February 2001 Pheasant wrote referring to the Form 64-5 of 15 January and saying that the writer was pleased to note that the proposal contained in the Appellant's letter of 8 January 2001 had been accepted. The writer considered that this was an agreement within the provisions of sections 54 and 55 of the 1970 Act. The Form 64-5 of 17 January 2001 could not revoke that agreement as there had been no change in the circumstances of the case since 15 January 2001 and so the agreement of 15 January should stand. The identity of the writer was not revealed. The Inland Revenue kept the envelope in which this letter arrived which showed that it had been posted in the same country as the letter of 24 January.

March 2001 - the documents produced for the General Commissioners

59. On 15 March 2001 the application to postpone the tax was to be heard by the General Commissioners. On 13 March the representative of Pheasant sent a fax to the Inland Revenue from one address but giving a fax number in another country. The fax enclosed 60 pages giving some (but not all) of the details of the transactions subsequent to the sale of the Appellant to Nightingale.

60. One of the documents produced for the first time on 13 March was the Appellant's accounts for the year ending on 18 September 1997. The accounts were signed on 31 January 2001 and were prepared by a firm of auditors in a European Member State. A partner in that firm was a qualified chartered accountant in that country. The accounts showed that the four Group directors had resigned on 19 September 1996 on which date Nightingale and Mr Kestrel were appointed as directors. They both resigned on

1 March 1999 when Pigeon Limited was appointed a director. The company secretary was Magpie Services Limited. At the hearing before the General Commissioners the Inland Revenue identified 16 instances where the accounts failed to comply with United Kingdom accounting standards. A revised version of the accounts was presented to the hearing before me. These contained 78 amendments to the previous version

61. On 15 March 2001 the General Commissioners agreed to transfer the hearing of the application to postpone to the Special Commissioners.

62. At the hearing before me the Respondent saw some of the documents for the first time. These included the nominee agreement.

Reasons for directions

Issue (1) – what amount of tax should be postponed?

63. The first issue in the application is to determine the amount of tax the payment of which should be postponed pending the determination of the appeal. That amount is defined in section 55(6) as such amount as it appears, having regard to the representations made and the evidence adduced, that there are reasonable grounds for believing that the Appellant is overcharged to tax.

64. Counsel for the Appellant argued that before 1975 the tax charged by an assessment was not due and payable until the determination of the appeal. Section 55 was enacted in 1975 and its purpose was to require tax to be paid notwithstanding an appeal unless the grounds of appeal were real and not fanciful, that is reasonable as opposed to irrational. He cited Australian Doctors' Fund Limited v Commonwealth of Australia (1994) 49 FCR 478. It was not necessary to consider whether the appeal was likely to succeed. Where the amount of tax was substantial, and where the inability to postpone payment could mean the bankruptcy of the taxpayer, Parliament would not have intended that an appellant should be deprived of his right of appeal except where the grounds of appeal were fanciful or non-existent. The test was similar to that for deciding whether an appeal should be struck out. The fact that the Appellant did not have the funds to pay the tax should not alter the approach to the section. He did not rely upon Article 6 of the Convention in Schedule 1 of the Human Rights Act 1998.

65. Counsel for the Appellant went on to argue that there were reasonable grounds for believing that the Appellant had no liability to corporation tax. His first argument was that, in the relevant period, the Appellant did not own the investment properties but only the right to receive one payment of rent and so there was no source in the period.

He cited Bray v Best (1989) STC 159.

66. Alternatively, Counsel for the Appellant argued that the issue of the zero coupon note at a discount of £115M was a loan relationship debit under section 83 of the Finance Act 1996 which could be offset against the Appellant's taxable profits for the period. He went on to argue that the £115M arising under the forward share purchase agreement was at the time not a taxable profit (although after 6 February 1998 it would have been taxable under section 99(1) of the Finance Act 1998 which inserted a new paragraph 4A into Schedule 5AA of the 1988 Act). The transactions were not a sham within the meaning of Hitch v Stone [2001] STC 214 (CA) at 224, 227 and 229. It would be necessary to prove an intention to mislead and that would be a heavy burden for the Inland Revenue to discharge. The fact that circular transactions of many millions of pounds were entered into was not fundamentally different from normal commercial transactions and he relied upon the evidence of the expert witness. The transactions were not a fiscal nullity under the principle in Ramsay v The Commissioners of Inland Revenue [1981] STC 174 and the burden would be on the Crown at the substantive appeal to prove that that authority applied and he cited MacNiven v Westmoreland Investments Limited [2001] STC 237. Counsel accepted that there might be some errors in the accounts but argued that these could be put right before the substantive appeal.

67. The Respondent accepted that the issue as to whether the documents were genuine and had achieved their desired objective was a matter for the hearing of the substantive appeal. For that reason he did not deal with the Appellant's arguments about the source of the income nor the application of the principle in Ramsay. In any event he argued that there were not enough facts available to form any view as to the possible success of either argument. He simply argued that, when the Appellant had been sold to Nightingale, it had a tax liability of £37,242,901 and that it had not shown that that liability had been eliminated. The accounts were unreliable and the documents upon which the Appellant relied were fundamentally flawed. They had not been proved and some appeared to relate to different transactions from those relied upon.

68. In particular the Respondent argued: that the annual return of Nightingale did not mention its purchase of the Appellant; that the various trust documents did not present a coherent picture; that the guarantee agreement was completely unexplained as there appeared to be no other involvement of the European Bank; that the guarantee expired in September 2001; that the guarantee agreement recited that Nightingale was a wholly owned subsidiary of the European Bank but that was not consistent with the return made by Nightingale to Companies House which showed the only previous owner as Pheasant; that the correspondence with the Appellant and Pheasant about the

appeal appeared to come from an overseas country and gave no fax or telephone numbers; that the present company secretary and director of the Appellant were companies in another overseas country where companies were difficult to trace; that the Appellant appeared to be owned by a trust in one country, run by corporate officers in a second country and represented by tax agents of a third country while operating out of a fourth country and having auditors in a fifth country; that no reliable accounts had yet been submitted; that when the offer from the Overseas Bank of 18 September was made (to invest in the zero coupon note) the directors of the Appellant were still the four Group directors and yet the Overseas Bank assumed that the Appellant had by then been sold; that the Overseas Bank did not appear to have made any checks of the Appellant before offering to make such a substantial loan; that the zero coupon note Instrument did not evidence the issue of a note and there was no certificate or other evidence that a note had been issued; that the forward share purchase agreement had referred to a company in a specified jurisdiction but the Appellant appeared to have acquired a company from another jurisdiction instead from which it would appear that the forward share purchase agreement was never completed; that the loan agreement was uncommercial in lending £37M interest free for 20 years; that the loan agreement referred to a number of clauses and schedules which did not exist in the copy supplied; and that the money which purported to be paid by the Appellant to Pheasant under the loan agreement was actually paid into the account of the Appellant and not to Pheasant at all.

69. In considering the arguments of the parties I start with the provisions of the legislation. Section 55(2) sets out the general principle which is that tax charged by an assessment is due and payable as if there had been no appeal. Section 55(5) provides that an application to postpone the payment of tax shall be heard and determined in the same way as an appeal. And section 55(6) provides that the amount of tax the payment of which shall be postponed shall be the amount (if any) in which it appears to the Commissioners, having regard to the representations made and any evidence adduced, that there are reasonable grounds for believing that the Appellant is overcharged to tax.

70. Although section 55(5) provides that this application is to be heard and determined in the same way as an appeal, I am not required to determine the appeal. Also, section 55(6) refers to "reasonable grounds for believing that" the Appellant is overcharged. That means that the Appellant at this stage does not have to prove all the facts or succeed in all the legal arguments which will have to be proved or established at the hearing of the substantive appeal. Thus my limited task is to determine whether the Appellant has demonstrated reasonable grounds for believing that it is overcharged to tax. However, section 55(6) does require

me to have some firm basis for believing that the Appellant has been overcharged by the assessment and here I must have regard to the evidence adduced.

71. In identifying the meaning of "reasonable grounds" I have referred to Australian Doctors' Fund Limited. Although that authority did not concern section 55 I have found it of assistance. Under the Australian Freedom of Information Act 1982 certain documents were exempted from disclosure and, if a Minister signed a certificate that disclosure would be contrary to the public interest, such certificate was conclusive subject to review by a tribunal. The tribunal had to determine whether there existed "reasonable grounds" for the claim that disclosure would be contrary to the public interest. In his judgment Beazley J referred to a number of authorities one of which said:

"To be "reasonable", it is requisite only that they be not fanciful, imaginary or contrived, but rather that they be reasonable; that is to say based on reason, namely agreeable to reason, not irrational absurd or ridiculous."

72. And later at page 487F:

" When a statute prescribes that there must be "reasonable grounds" for a state of mind … it requires the existence of facts which are sufficient to induce that state of mind in a reasonable person."

73. I have adopted that principle in considering the representations made by the parties and the evidence adduced.

74. I start from the undisputed fact that Appellant received rents from Investments and, in the normal course, the Appellant would have been liable to pay tax on such rents in the amount of the assessment, less the sum which the Respondent agreed should be postponed. The Appellant argues that it has no such liability and it relies upon a number of transactions which it admits constitute a tax avoidance scheme. I do not have to decide at this stage whether such a scheme will be found to be effective but do have to have regard to the evidence adduced and decide whether that evidence supports the Appellant's representations.

75. There are very many unexplained inconsistencies in the documentation produced. Some have been mentioned by the Respondent but there are more. However, I have focussed on two parts of the scheme which are crucial if the Appellant is to establish that it is overcharged to tax by the assessment. These two are the zero coupon note and the forward share purchase transaction.

76. Counsel for the Appellant explained that the significance of the zero coupon note was to ensure that the

Appellant incurred a deficit under a loan relationship for the purposes of section 83 of the Finance Act 1996 (which provided that if a company made a non-trading deficit on a loan relationship it could set that off against its profits for the deficit period.) He argued that the Instrument evidenced the loan relationship. When the appropriate fraction (357/365) of the discount of £115,000,000 had been taken, it exceeded the amount of the rent receivable of £112,857,276 with the result that the Appellant had no tax liability in that year.

77. I therefore ask whether there are reasonable grounds for believing that the Appellant will be able to establish the existence of a loan relationship with the Overseas Bank. Here the facts are that the Bank offered to lend the substantial sum of £1,650,000,000 secured by a fixed and floating charge over the assets of the Appellant which assets amounted to about £182,300. The Bank does not appear to have made any of the usual enquiries before agreeing to such a loan; it did not even know the correct names of the directors of the Appellant. It does not appear that the bank was given any security for the loan. There was no evidence that the Bank received the fixed and floating charge over the assets of the Appellant which was a condition of the loan. Further, there was no evidence of the source of the money which was lent by the Bank to the Appellant. Indeed the status of the bank leads to serious doubts as to whether it would have the funds to advance a sum of that amount. In this connection I consider the evidence of the expert witness.

78. The evidence of the expert witness was that he had seen a large number of transactions broadly comparable to those relating to the zero coupon note. In such transactions the sums involved would be substantial; the borrower would not have the credit status to support the sums it wished to borrow; and the purpose of the transaction might be to obtain a tax result. In such transactions the lending bank would provide a "daylight facility" that would provide credit to allow all the other transactions to take place and then, perhaps, would provide similar facilities at the end to unwind the arrangements. All parties to the transaction would open accounts at the bank providing the daylight facility and payments would take place in one day, generally move in a pre-arranged sequence, with the last step usually involving the bank being repaid. The bank would receive a fee, rather than interest, for its role in the transactions. In such transactions all the parties other than the bank would be connected in some way but if it were important for tax reasons, that one of the companies should not be connected, then that company would be owned by an unconnected trust. The international bank of which he was senior vice president provided credit for such transactions from time to time some of which transactions provided tax benefits to customers in overseas jurisdictions. Such loans were regarded as off-balance sheet and his bank did not allocate capital in respect of

them.

79. The letter dated 24 September 1993 from a firm of chartered accountants to the Overseas Bank, which set out the outlines of the scheme, mentioned that the loans to be made by the Bank would be sub-participated. The expert witness's evidence explained that this meant that the bank would sell a percentage interest in the loan, which could be 100%, usually in return for a payment or deposit to the value of the loan. The Bank remained the lender of record and payments from the borrower would be passed to the sub-participator.

80. However, there was no evidence of any sub-participation in the loan which was part of the transactions at issue in the application. In his evidence the expert witness stated that he assumed that the Bank did not have the wherewithal to lend the £1.65 billion. However, it was creating credit for a closed or circular structure and was happy to advance £1.65 billion in the expectation that it was sub-participating the loan immediately and would be put in funds "and made whole within the day". Any bank was justified in advancing funds if, when taken together, all its receipts and payments cleared against one another and it was not left with a shortfall.

81. In considering this matter I bear I mind that the sum of £1,650,000,000 is a very large sum indeed and it would be expected that a loan of such amount would be properly documented. I accept that, in general, it can be left to the substantive appeal for the relevant documents to be proved and for the originals to be produced. But the lack of complete documentation for a loan of £1,650,000,000 must give rise to real doubts about the loan relationship.

82. Having regard to the representations made and the evidence adduced I do not consider that there are reasonable grounds for believing that there was a loan relationship between the Appellant and the Overseas Bank. There are not sufficient facts to induce that state of mind in a reasonable person.

83. I now turn to consider the forward share purchase agreement. Counsel for the Appellant explained that the significance of the forward share purchase agreement was that before the enactment of paragraph 4A of Schedule 5AA of the Income and Corporation Taxes Act 1988 (the 1988 Act), by the Finance Act 1998, the transaction was effective to give the Appellant a 7% return which was not taxable because it was a forward share purchase transaction.

84. Under the forward share purchase agreement the Appellant was to pay the sum of £1,650,000,000 to Woodpecker in return for the transfer one year later of an unidentified company in a specified jurisdiction which company was valued at £1,765,500.000. For the reasons

mentioned above there is considerable doubt as to whether the Appellant in fact had the sum of £1,650,000,000 to pay to Woodpecker at the date of the agreement. There were a number of difficulties about the form of the agreement which have been identified in the findings of fact and which are surprising in an agreement relating to such a large sum of money. Further, when one considers carefully the charge of 27 September 1996 given by Woodpecker to the Appellant it is clear that the security given to the Appellant is not at all commensurate with the risk the Appellant was running by making, in effect, a loan to Woodpecker for a year. But by far the greatest cause for concern arises from the fact that, ultimately, Woodpecker did not complete the agreement. There was no evidence at all that it transferred the entire issued share capital of a company in the specified jurisdiction to the Appellant on the completion date. There is some (but not much) evidence to suggest that it transferred a company from another jurisdiction (Rook) but the forward share purchase agreement specifically mentioned a company in a specified jurisdiction

85. Having regard to the representations made and the evidence adduced I do not consider that there are reasonable grounds for believing that, if the Appellant did get a 7% return on the money it was to pay to Woodpecker (which is very doubtful), the return was not taxable because it was a forward share purchase transaction. There are not sufficient facts to induce that state of mind in a reasonable person.

86. I have concentrated on the two transactions upon which the Appellant relies to establish that it is overcharged to tax by the assessment. There are many others which give cause for concern of which I mention a few. One is that the loan by the Appellant to Pheasant of 19 September 1996 was completely un-commercial being interest-free and only repayable after twenty years. At that time Pheasant was a trustee and held a beneficial interest in the shares of the Appellant. In any event the loan money seems to have been paid to the account of the Appellant and not to Pheasant. Another cause for concern is the position of the European Bank. This was not explained. It was described in the guarantee agreement as the parent of Nightingale but there was no evidence to suggest that it was and some evidence to suggest that it was not. Yet a third cause for concern is that the position of the Plover Trust was not fully explained. Again, under the share sale agreement Nightingale paid £20M for the Appellant but there was no indication as to the derivation of these funds. Nightingale had been incorporated only 13 days before the date of the agreement and was described as a private non-trading company. The agreement was not reflected in its accounts.

87 I conclude that, having regard to the representations made and the evidence adduced, there are no reasonable

grounds for believing that the Appellant is overcharged to tax, other than by the sum of £600,008 as agreed by the Respondent.

88. My decision on the first issue is that the amount of tax the payment of which should be postponed pending the determination of the appeal is the amount agreed by the Respondent, namely £600,008.

Issue (2) - Was there an agreement to postpone?

89. The second issue in the application is whether there was an agreement on 15 January 2001 to postpone the payment of the tax.

90. For the Appellant Counsel argued that there was an agreement to postpone all of the tax payable. The agreement consisted of the Appellant's written application to postpone on 8 January 2000 and the Form 64-5 issued on 15 January 2000 which agreed that all the tax should be postponed. That was an agreement unless the Appellant must have known that the Inland Revenue were acting under a mistake. He cited The Law of Contract by Sir Guenter Treitel Tenth Edition (1999) at pages 281 and 282 He distinguished the decision in Schuldenfrei v Hilton [1999] STC 821where silence by the taxpayer had been held not to constitute an agreement; here there had been an offer and an acceptance by the Inland Revenue. There had been a contract before it was revoked on 17 January.

91. The Respondent argued that the letter of 12 January made it quite clear that there was no agreement that the tax would be postponed.

92. Treitel at page 282 (2)(b) states:

"The objective principle applies where A's words or conduct induce B reasonably to believe that A is contracting with him; but it does not apply where B actually knows that (in spite of the objective appearance) A has no such intention. It follows that the objective principle will not apply, and that the mistake will be operative, if A's mistake is known to B."

93. Applying those principles to the facts of the present application it will be recalled that the letter of 12 January 2001 from the Inland Revenue made it clear that that the tax would not be postponed. Accordingly, when the Appellant received the Form 64-5 of 15 January 2001 it must have known that it had been issued under a mistake. Having received the letter of 12 January the Appellant could not reasonably have believed that the Inland Revenue were assenting to the postponement of the whole of the tax. The form was corrected on 17 January before the Appellant wrote on 7 February.

94. Thus the letter of 12 January 2001 meant that the Form 65-4 of 15 January did not induce the Appellant reasonably to believe that the Inland Revenue had agreed to postpone the whole of the tax charged by the assessment. The Appellant knew that the Inland Revenue had no such intention. The mistake of the Inland Revenue was known to the Appellant. Thus there was no agreement to postpone.

95. Applying the principles in Schuldenfrei it is clear that in this application the parties had not "come to" an agreement; they were not of the same mind; their minds had not met so as to form a mutual consensus; and there was no meeting of minds which had resulted from a process in which each party had, to some extent, participated.

96. My decision on the second issue in the application is that there was no agreement on 15 January 2001 to postpone the payment of the tax. That means that I do not have to consider the third issue but as arguments were put I briefly express my views.

Issue (3) – Were there new circumstances?

97. The third issue in the application is whether, if there were an agreement on 15 January 2001 to postpone the payment of all the tax, there were any changes in the circumstances of the case since the date of the agreement.

98. For the Appellant Counsel argued that, if there had been an agreement to postpone, then there could only be a further determination if there had been a change in the circumstances of the case which related to the Appellant's liability and he cited IRC v Savacentre Limited [1993] STC 344 at 351d-f and 352j. He argued that there had been no such change.

99. The Respondent argued that, even if there were an agreement to postpone on 15 January 2001, then there had been a material change in the circumstances of the case since then. He had known on 12 January of the sale of the Appellant by the Group but at that time did not know of any transactions after that. Just before the hearing in March 2001 before the General Commissioners the Respondent had received a 60 page fax with all the details of the zero coupon note and the share purchase agreement. Previously all he had was the statement in the accounts of a possible tax liability. Also many new documents had been put in that day for that hearing. Although he was aware of the sort of arrangements which were entered into in other company purchase schemes he had no knowledge of what the Appellant had done.

100. In Savacentre at page 351f Morris J said:

"The change of circumstances had to relate to the liability for the years 1984 to 1988 otherwise there could be no reason for thinking that tax had been overpaid for those years."

101. Within the context of that statement it is clear that Morris J was speaking about the facts of that appeal and not stating a general principle applicable to all applications to postpone. The words of section 55(4) are more general and refer to "a change in the circumstances of the case". On 15 January 2001 the Appellant's grounds of appeal were as stated in the letter of 8 January 2001, namely, that the assessment was estimated and was in excess of the company's taxable profits for the period. Since that date all the transactions since the sale of the Appellant to Nightingale have emerged. That, in my view, is a substantial change in the circumstances of the case.

102. I conclude that, if there had been an agreement to postpone on 15 January 2001, then there has been a change in the circumstances of the case within the meaning of section 55(4).

Decision

103. My decisions on the issues for determination in the application are:

(1) that, having regard to the representations made and the evidence adduced, there are no reasonable grounds for believing that the Appellant is overcharged to tax by the assessment (less the sum of £688,008) within the meaning of section 55(6);

(2) that there was no agreement on 15 January 2001 within the meaning of section 55(7); that means that I do not have to decide the third issue but my views are;

(3) that there was a change in the circumstances of the case since 15 January 2001 within the meaning of section 55(4).

101. The application is, therefore, dismissed.

DR NUALA BRICE

SPECIAL COMMISSIONER

SC 2007/2001