CAPITAL ALLOWANCES - Plant and machinery - Acquisition by Appellant of equipment from Alpha Newco for £166 million - Prior purchase by Alpha Newco from US parent with leaseback for 11 years - Leaseback by Appellant to Alpha Newco for 30 years - Deposit by associate of Alpha Newco and its US parent with bank associated with Appellant of £147 million as security under lease to Alpha Newco - Whether lease by Alpha Newco to US parent relevant lease for CAA 1990 s.42 - Yes - Whether section 42(3)(d)(e) applied - Yes - Whether section 42(3)(c) applied - No - Acquisition by Appellant evidenced by unstamped Bill of Sale - Whether equipment belonged to Appellant for CAA s.24 - No - Whether only £19 million net expenditure incurred in light of Westmoreland and Ensign Tankers

THE SPECIAL COMMISSIONERS

DELTA FINANCE NEWCO Appellant

- and -

THE COMMISSIONERS OF INLAND REVENUE Respondents

Special Commissioners: THEODORE WALLACE

DR A N BRICE

Sitting in London on 2-6 and 9-11 July 2001

Two leading counsel, instructed by Slaughter and May, for the Appellant

Leading and junior counsel, instructed by the Solicitor for Inland Revenue, for the Respondents

DECISION

1. This appeal concerns a claim by the Appellant for writing down allowances on the purchase on 18 December 1995 for £165.8 million from a company resident in the UK ("Alpha Newco") of moveable plant and machinery ("the Equipment") being used in the factories of the parent of Alpha Newco in the USA. Alpha Newco had acquired the Equipment on the same day from its US parent ("Alpha"). Also on the same day the Appellant leased the Equipment back to Alpha Newco for a term of 30 years and 19 days ("the Headlease") at an escalating rent and Alpha Newco, with the Appellant's consent, subleased it to Alpha for a term of 11 years at a fixed rent ("the Sublease").

2. Again on the same day an associated company of Alpha Newco deposited £146.7 million with the Appellant's associated bank as security for Alpha Newco's obligations under the Headlease from the Appellant. The deposit was to be adjusted at six monthly intervals to reflect inter alia the rent due from Alpha Newco and the interest payable to Alpha Newco's associated company on the deposit.

3. The rent payable by Alpha Newco to the Appellant took account of the Appellant's capital allowances on the purchase and if there is no entitlement will be adjusted upwards. It increased by 2.5 per cent each six months and was designed to amortise the Appellant's investment with interest over the term, taking account of capital allowances.

4. The deposit of the security had the effect of reducing the risk weighting for regulatory purposes of the lease of the Equipment which was purchased with the £166 million committed by the Appellant, thus freeing up lending capacity for other transactions by 80 per cent of the £166 million. The improved risk weighting was reflected in the rent payable which was also adjusted with the London Inter-Bank Lending Rate ("LIBOR").

5. Alpha guaranteed the obligations of both Alpha Newco and the depositor.

The issues

6. A whole series of issues arise under the Capital Allowances Act 1990, since consolidated with some amendments, in the Capital Allowances Act 2001.

> (1) Whether the "lease" referred to in section 42(3) was the Headlease to Alpha Newco and fell within section 42(3)(d) as exceeding 13 years;
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> (2) Whether, if the "lease" in section 42(3) was the Sublease, Alpha Newco "may in certain circumstances, become entitled to receive from . [the Appellant] a payment . of an amount determined before the expiry of the [Sublease] and which is referable to a value of the machinery or plant at or after that expiry" within section 42(3)(e), by reason of the termination provisions in the Headlease by the Appellant;
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> (3) Whether, if the "lease" in section 42(3)(d) was the Sublease to Alpha Newco's parent, there was "provision for extending or renewing the lease or for the grant of a new lease", so that the Equipment could be leased for over 13 years;
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> (4) Whether, if the "lease" in section 42(3) was the Sublease, the Headlease was "an agreement which might reasonably be regarded as collateral to the lease" for the purposes of section 42(3)(c);
>
> (5) Whether the Appellant "incurred capital expenditure" of £166 million within section 24(1)(a), given that the deposit of £147 million by Alpha Newco's associated company with the Appellant's parent bank was a pre-condition both of the acquisition of the Equipment and of the obligation to pay for it;

(6) Whether the Equipment "belonged" to the Appellant within section 24(1)(b) as a result of the purchase, given that no Bill of Sale was produced to the Tribunal.

7. The Revenue did not pursue submissions originally raised under sections 75 and 76.

8. The issues under section 24(1)(a) as to "incurred capital expenditure" and as to the "lease" for the purposes of section 42(3) involved extensive consideration of the recent decision of the House of Lords in *Macniven v Westmoreland Investments Ltd* [2001] 2 WLR 377; [2001] STC 237, where the decision of the House of Lords in *W T Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 was considered at length.

9. Counsel for the Revenue submitted that "incurred capital expenditure" in section 24(1) and "lease" in section 42(3) referred to commercial concepts and did not bear a purely juristic meaning and that, on the true legal effect of the arrangements as a whole, the Appellant only incurred capital expenditure of the difference between the sum which it paid Alpha Newco and the amount which Alpha Newco's associate deposited with the Appellant's parent and that the "lease" was to Alpha Newco's parent by reason of the conjoined effect of the headlease and the sublease.

10. Counsel for the Appellant submitted that neither concept was commercial as opposed to juristic so that the *Ramsay* approach was not relevant. Even if they were commercial concepts, he submitted that the transactions were wholly commercial.

The statutory provisions

11. The main relevant provisions in the Capital Allowances Act 1990 were sections 24(1) and 42. Section 24 provided,

> "24(1) Subject to the provisions of this Part [sections 22 to 83], where -
>
> > (a) a person carrying on a trade has incurred capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade, and
> >
> > (b) in consequence of his incurring the expenditure, the machinery or plant belongs or has belonged to him,
>
> allowances and charges shall be made to and on him in accordance with the following provisions of this section."

Subsection (2) provided for a writing-down allowance of 25 per cent on the reducing balance. This was reduced to 10 per cent by section 42(2) for expenditure falling within section 42(1). The Appellant accepted that section 42(1) did apply and only claimed 10 per cent.

12. At the relevant time section 42(1), as amended by the Finance Act 1993, provided,

"42(1) This section has effect with respect to expenditure on the provision of machinery or plant for leasing where the machinery or plant is at any time in the requisite period used for the purpose of being leased to a person who -

(a) is not resident in the United Kingdom, and

(b) does not use the machinery or plant exclusively for earning such profits or gains as are chargeable to tax (whether as profits or gains arising from a trade carried on in the United Kingdom or by virtue of section 830(4) of the principal Act),

and where the leasing is neither short-term leasing nor the leasing of a ship, aircraft or transport container which is used for a qualifying purpose by virtue of section 39(6) to (9)."

Subsection (3) provided,

"(3) No balancing allowances or writing-down allowances shall be available in respect of expenditure falling within subsection (1) above if the circumstances are such that the machinery or plant in question is used otherwise than for a qualifying purpose and -

(a) there is a period of more than one year between the dates on which any two consecutive payments become due under the lease; or

(b) any payments other than periodical payments are due under the lease or under any agreement which might reasonably be construed as being collateral to the lease; or

(c) disregarding variations made under the terms of the lease which are attributable to -

(i) changes in the rate of corporation tax or income tax, or

(ii) changes in the rate of capital allowances, or

(iii) changes in any rate of interest where the changes are linked to changes in the rate of interest applicable to inter-bank loans, or

(iv) changes in the premiums charged for insurance of any description by a person who is not connected with the lessor or the lessee,

any of the payments due under the lease or under any such agreement as is referred to in paragraph

(b) above, expressed as monthly amounts over the period for which that payment is due, is not the same as any other such payment expressed in the same way; or

(d) either the lease is expressed to be for a period which exceeds 13 years or there is, in the lease or in a separate agreement, provision for extending or renewing the lease or for the grant of a new lease so that, by virtue of that provision, the machinery or plant could be leased for a period which exceeds 13 years; or

(e) at any time the lessor or a person connected with him will, or may in certain circumstances, become entitled to receive from the lessee or any other person a payment, other than a payment of insurance moneys, which is of an amount determined before the expiry of the lease and which is referable to a value of the machinery or plant at or after that expiry (whether or not the payment relates to a disposal of the machinery or plant)."

13. Section 50(1) provided,

"(1) In this Chapter references to a lease include references to a sub-lease and references to a lessor or lessee shall be construed accordingly."

14. Section 159(3) provided,

"(3) . an amount of capital expenditure is to be taken to be incurred on the date on which the obligation to pay that amount becomes unconditional (whether or not there is a later date on or before which the whole or any part of that amount is required to be paid)."

We cover other relevant provisions as they arise in the decision.

The facts

15. The following paragraphs are taken from the limited agreed facts, from the agreements and other documents and from the witness statements and oral evidence. These are the primary facts. Except where otherwise indicated in the decision, we accept the evidence.

16. The Appellant is a wholly owned subsidiary of Delta Finance Ltd ("Delta Finance") of which the ultimate parent is Delta Plc.

17. Delta Finance was incorporated in 1967. Its principal activity is the provision of leasing and other financial facilities to business customers by way of leasing of equipment and vehicles. The consolidated accounts of Delta Finance to 31 December 1995 show a pre-tax profit of £55 million on turnover and gross profit of £452 million; £969 million was spent on assets acquired for use in finance leases and £4,291 million was due to parent undertakings. Over 800 employees

were seconded from parent undertakings. At the year end it had 58 subsidiaries of which the Appellant was one.

18. The Appellant company was formed in 1988. Its profits for 1995 were £635,000, up from £416,000 in 1994. At 31 December 1995 it had fixed assets for operating leases of £345,000 and current assets of £176 million; included in the latter figure was the £165,812,000 acquisition cost of the Equipment from Alpha Newco, being described as "Finance Lease Receivables." £170 million was shown as due to group undertakings. Net assets, after provision of £5 million for deferred taxation, were £927,000.

19. Delta Bank Plc is another subsidiary of Delta Plc. In December 1995 it had total assets of many billions of pounds and liquid assets of over a third of total assets.

20. The Appellant, Delta Finance and Delta Bank Plc ("Delta Bank") were and are all resident in the UK for tax purposes.

21. Alpha Inc ("Alpha") is a large American manufacturer of mechanical equipment. It is incorporated in Delaware and quoted on the New York Stock Exchange. At the relevant time its manufacturing activities produced an annual turnover of several billion dollars and pre-tax profits of in excess of $1 billion.

22. The Equipment was situated at neighbouring plants in U.S.A. It comprised cranes and hoists, factory furniture, production machinery and equipment, storage and distribution equipment, industrial material handling equipment, tools, patterns and flasks, group patterns, special tools, tote boxes and special storage equipment. All of the Equipment was in use for Alpha's business but was capable of being removed and sold.

23. In the five days to 3 November 1995 the Equipment was inspected and appraised by independent valuers, Valuer Inc. In a report dated 15 December 1995 they valued the Equipment at $255 million. They gave a residual value if sold and removed in 2025 of at least $49 million (in 2025 dollars) or $86.7 million in place, allowing for annual inflation of 3 per cent. They valued the Equipment in place after 11 years at $154.4 million, or $98 million if moved. They stated that its remaining useful economic life in 1995 was at least 30 years. They stated that the fixed fair level rental value for an 11 year lease from 1995 would be $24,510,000. All of the above figures except those for 2025 were at constant or 1995 dollars.

24. Alpha Newco is a wholly owned subsidiary of the Alpha group. It was incorporated in Delaware on 31 October 1995 as a limited liability company ("LLC"). The LLC agreement was amended and restated in its entirety on 14 December 1995, when three persons were appointed to serve as the initial directors (see paragraph 104 below). Alpha Newco is registered in the UK as an overseas company subject to branch registration. It is resident in the UK for tax purposes.

25. Alpha (Bermuda) Ltd ("ABL") was incorporated on 12 December 1995 in Bermuda as a wholly owned subsidiary of Alpha. Neither Alpha nor ABL is resident in the UK.

26. Evans Randall Ltd ("Evans Randall") is a company registered in the UK with offices in Westminster; they were described as the lease arrangers.

27. Mr B, a director of Delta Finance, was first asked to consider a proposed transaction with Alpha by telephone in February 1995. Alpha was an existing and well-regarded customer of the Delta group.

28. In March 1995 Evans Randall provided detailed proposals covering 33 pages in relation to the UK/US Lease financing of certain manufacturing equipment located in the USA to the Vice-President Taxation of Alpha. A copy was sent to Delta Finance for information. A letter of 20 March 1995 from Mr Evans, of Evans Randall, to SY, managing director of Alpha (UK) Ltd, who later became a director of Alpha Newco, stated,

> "Evans Randall completed a US $103 million financing in December 1994 using the proposed structure and hence we have a developed structure as well as pro-forma documentation which could be used as the basis for a new transaction. You may be aware that Slaughter and May acted as UK Counsel and McDermott, Will & Emery as US Counsel on the previous transaction."

We reproduce the Executive Summary of the proposal.

> **"ALPHA INC.**
>
> UK Finance Lease in respect of Manufacturing Plant located in USA
>
> **Executive Summary**
>
> The objective of the proposed transaction is to refinance Manufacturing Plant located in USA, at a value equal to the lower of cost, of US $100,000.000, or current Fair Market Value ("FMV"), in a tax efficient manner, to achieve a substantial Net Present Value Benefit ("NPV").
>
> The financing will, in the base case, provide the following economic benefit:

Full Payout NPV Benefit 12.03% US $12.03m

> Alpha will set up a subsidiary, Alpha LLC ("ALLC"). Alpha will own 99% of ALLC and another member of Alpha's US group will own 1%. ALLC will be managed and controlled, in the UK, by staff of Alpha UK Ltd ("UK Co"). ALLC will not be part of the UK tax consolidation but will be a Limited Liability Company ("LLC") and a Dual Resident Company ("DRC") under the UK/USA Double Tax Treaty.
>
> Alpha will transfer the plant to be leased to ALLC in exchange for equity instruments. The transfer should be tax-free to Alpha in the US. ALLC will lease the plant back to Alpha under an 11 year operating lease. ALLC and Alpha may enter into new operating leases of 11 years or such shorter periods as are agreed, following the end of the initial operating lease, only if Alpha and ALLC both agree to do so. Such operating leases will have level semi-annual rental payments.

> ALLC will, as a separate, unrelated, transaction, sell the plant to a UK lessor, the leasing subsidiary of a leading UK bank, which will lease the plant back to ALLC under a 30 year, finance lease.
>
> ALLC will transfer the proceeds of sale to Alpha through a redemption of the equity instruments. Such a partnership distribution should be tax free for US tax purposes.
>
> If ALLC enters into such a Head Lease then, following the inception of this lease, and transfer of the proceeds of sale to Alpha, Alpha will place a Security Deposit with an affiliate of the UK Lessor, to meet its obligations to ALLC over the sublease term. This Security Deposit will be charged to the UK Lessor to secure ALLC's obligation to the UK Lessor.
>
> Early termination provisions will enable Alpha and ALLC to terminate their respective leases, in the event of commercial need, at any time.
>
> The UK Lessor may need the ability to collapse the transaction in certain circumstances. This may include a maximum credit term exposure of 15 years, which will generate the following NPV Benefit:
>
> "

15 year NPV Benefit 9.34% US $9.34m

There was no mention of capital allowances in that Executive Summary: this came later. In the section headed "Transaction Structure and Diagrams" there appeared the following:

> "b. ALLC will lease the Equipment to Alpha under an Operating Lease, for a maximum term of 11 years. The Operating Lease will comply in all respects with CAA 1990, s.42(3) ."

A further section was headed "Principal Terms and Conditions of the Head Lease." Under "B The Head Lease" there appeared this at "10 UK Lessor Tax Assumptions":

> "In calculating the rentals it has been assumed that:
>
> > (i) The UK Lessor will be eligible for and will retain a 10% writing down allowance on the Equipment Cost.
> >
> > (ii) The rate of corporation tax is 33%.
> >
> > (iii) The UK Lessor's tax payment date is 9 months after its year end.
>
> Variations to these tax assumptions will result in an increase or decrease in the rentals due to the UK Lessor, the liability or benefit of which will flow through to ALLC."

29. A fax from AD, Large Value Leasing at Delta Finance, to the Delta's local office in USA, on 23 March referred to "the opportunity we have with regard to Alpha Inc" and to "the attractiveness of this proposed financing when measured in Risk Adjusted Pricing terms". It stated "we would like to express interest certainly for a minimum US $200m 15 year transaction with cash security being no less than circa US $175m."

30. A further fax to the Delta US office, on 28 March stated that key indicators for the likely returns when measured using their Risk Adjusted Pricing Model were "some 300 or more per cent above our 'hurdle-rates' of acceptable returns, reflecting the high cash-secured element." It asked the addressee to "confirm your views on our likely appetite for the Alpha credit, having discussed matters with your risk management functions." It stated that "Your earlier indication that a transaction of $200 million may be supportable" had been conveyed to Evans Randall and Alpha, on a "without commitment" basis.

31. After meetings in London on 3 April between Evans Randall and Alpha at Evans Randall's office and a further meeting on 4 April at Alpha Finance's office, approval was sought by Alpha Finance within the Alpha group for a $250 million transaction, with circa $32 million uncovered by cash.

32. On 20 April Alpha Finance circulated the Evans Randall proposals within the group as "the basic s.42 structure we are trying to pursue with Alpha."

33. On 21 April 1995 an application recommended by Mr B was sent to the Delta US office for onward transmission to Credit Risk Management Division, New York, for approval for a credit line of £22.4 million (£170.8 million gross) for leasing of complete manufacturing facilities and two aircraft costing £167 million with a security deposit covering 87.5% of asset cost and a guarantee from Alpha.

34. An accompanying report referred to an unresolved strike commencing in June 1994 at eight Alpha manufacturing facilities but said that an alternative work force had been organised and that the strike had had virtually no impact on Alpha's financial results; it referred to very recent upgrade of Alpha's debt by Standard & Poor. It said that advantages from heavy spending were being realised.

35. The proposal stated that the lessor would be a wholly owned subsidiary of Delta Finance having an accounting year end to suit the transaction date and the lessee would be a newly created dual resident subsidiary of Alpha which would sublease to Alpha on an 11 year operating lease. Delta Finance's "return from the transaction would be the post-tax equivalent of a gross margin of 50 basis points" with compensation by rental adjustments for any increase in risk asset weighting from zero on that part of its investment in the lease for which there was cash collateral. There would be an adjustment for any disallowance of the claim for capital allowances "to assist the Lessee minimising the resultant loss of benefit from the structure."

36. We return to risk asset weighting at paragraph 117.

37. An Interim Review dated 9 May prepared by Mr B and JD (Credit Risk Management Division) included the following:

> "A proposed limit of £155.3 [million] (the sterling equivalent of US $250 [million]) to a special purpose subsidiary (SPS) of Alpha Inc has been requested in order to allow Delta Finance to enter into a

sale and leaseback transaction with the SPS. This company's obligations under this lease will be fully guaranteed by Alpha Inc and secured by a cash deposit equal to 87.5% of the financing, based on current assumptions. The initial deposit size will equate to 30 semi-annual rental payments and a capital termination sum that will accrete to a level that will cover any outstandings under this transaction by the end of the fifteenth year. This deposit is a critical aspect of this financing in that it reduces the WRA requirements to only that portion of the financing not covered by cash. We will be receiving a margin of 50 basis points on the total limit. Other security for this transaction will include approximately US $250 million (FMV based on a 30 year term and a 30% residual value) of Alpha assets being sold and leased back in accordance with this transaction.

The lease term will be 30 years, although the Lessor (Delta Finance) will have the absolute right to terminate this facility after 15 years. Any extension beyond year 15, should Delta Finance choose to consider this option, is conditioned upon acceptable security terms and further credit review.

Other critical aspects of the transaction include the creation of a special purpose subsidiary (the Lessee) of Alpha that will qualify as a dual resident under the UK/US double tax treaty and the maintenance of a s.42 sub-lease to enable Delta Finance to claim the 10% Writing Down Allowance. Alpha Inc will be the sub-lessee for the first 11 years. In the event the sub-lease is not extended the transaction can be terminated. Delta Finance then receive repayment from one or all of, a sale of assets, utilization of the security deposit, or from the Alpha guarantee. Ownership of the assets will flow from Alpha to the SPS and onto Delta Finance. Proceeds of this financing will flow from Delta Finance through to the SPS and then to Alpha which will deposit approximately 87.5% of the funds with Delta Bank and pledge them as security for this transaction.

The rental stream under the sale and leaseback arrangement will be fully variable in regard to changes in interest rates, taxes, etc in order to maintain the integrity of the structure and security deposit.

Approval of this transaction is subject to receipt of appropriate tax and legal opinions confirming the efficacy of the transaction and the enforceability of Delta Finance's claims on the cash. Delta Finance will also obtain appropriate Alpha guaranteed indemnities covering fiscal and non fiscal terms. The assets will be appropriately insured to the satisfaction of Delta Finance.

In the event that the 10% write down allowance is disallowed by the inland tax authority, thus reducing the economic incentive for Alpha to enter into this transaction, the agreed margin of 50 basis points will be reduced to 25 basis points, which will still achieve a significant return . "

38. Minutes for a meeting on 11 May to sanction limits included this,

> "The increased exposure of US $250 million would be secured 87.5% by cash deposits, rising to 100% by year 15. Alpha Group were taking all tax risks and in addition to cash collateral would provide a covenant in support. The structure made no assumptions as to the residual value of the equipment being leased back."

Group credit committee approval was given on 15 May, subject to the cash security being fully perfected and in place at the outset.

39. For no very obvious reason nothing much happened over the summer until a timetable for signing in London on 15 December was fixed in late August.

40. On 23 October Alpha informed Delta Finance that Board approval to proceed with documentation and negotiation had been received.

41. On 6 November Alpha signed a 17 page letter from Delta Finance setting out the main terms and conditions of the offer.

42. Correspondence continued as to details and mechanics, in particular the preparation of complex financial schedules.

43. On 1 December the Appellant was selected by Delta Finance as the group company for the transaction.

44. On 14 December Delta Finance prepared a summary of the transaction and a final schedule for the steps to be taken and the "funds flow". Delta Finance (as agent for the Appellant) was to borrow £166.67 million from Delta Bank and deposit this with Gamma Bank on 15 December; it was to be re-imbursed by Alpha Newco for the interest differential of 12.5 basis points (⅛ %) over LIBOR. On 18 December the Financial Schedule numbers were to be re-run on the notional sterling dollar spot rate at 9 am and the final purchase price calculated. By 11 am lawyers were to confirm that all conditions precedent were satisfied. A security deposit of 88 per cent of the purchase price (approximately £145 million) was to be placed by ABL at Delta Bank at LIBOR less ⅛%. The purchase price was then to be transferred to Alpha Newco's account at Gamma, the balance of the sum deposited with Gamma being released to the Appellant. Alpha Newco was to pay the £350,000 rent for the initial 18 days to the Appellant. These steps were all carried out. On 18 December 1995 Alpha Newco instructed Gamma to transfer £146 million and £19.1 million to US bank for the account of Alpha both under Article VI of the LLC Agreement (see paragraph 103 below). On 5 January 1996 Alpha Newco paid the first 6 month Primary Rental calculated (inter alia) on the actual LIBOR rate.

45. This brings us to the actual legal documents.

The Acquisition Agreement

46. The document governing the expenditure for which the allowances are claimed was the Acquisition Agreement dated 18 December 1995 and made between Alpha Newco as Seller and the Appellant as Purchaser. Compared with the Lease which we consider later, the Acquisition agreement was comparatively simple, although many of its definitions were imported from the Lease. It was governed by English Law.

47. Clause 4 provided,

> "The Seller with full title guarantee (other than Permitted Liens), shall sell and the Purchaser shall purchase the Equipment in accordance with and subject to the terms of this Agreement."

The Equipment was described in Schedule 1, which schedule consisted of Valuer Inc's Valuation Schedule of assets in Buildings LL and SS and in Buildings BB and DD with a total sterling value of £165, 811, 815 at an exchange rate of £1/$1.537888. It consisted of sub-account lists for each of the four buildings with sub-totals and totals and asset listings with valuations. Some £107 million was production machinery and equipment and £3 million was tote boxes and portable storage. Although there were a large number of items with a specific accounting record such as "465528 10 ton bridge crane", an indeterminate number of items, almost certainly larger, had group designations such as "999999 Group, Cranes and Hoists."

48. By clause 5 the Purchase Price was payable in full on delivery of the Equipment. Under clause 3.1 and Schedule 4 Part 1, it was a condition precedent to the Acquisition Agreement that the conditions precedent to the Appellant's obligations under the Lease had been satisfied to the extent that they were not waived; these included a condition that the Appellant should have received a guarantee duly executed by Alpha and also an original counterpart of a Put Option agreement between ABL and the Appellant (being an Operative Document under the Acquisition Agreement). By clause 3.2 and Schedule 4 Part 2 it was a condition precedent to the Appellant's obligation to pay the Purchase Price that the Appellant should have received an invoice from the Seller (Alpha Newco) and should be "satisfied that Acceptable Security is in place as required by the Lease" or that this be waived or deferred in writing.

49. Clauses 6, 7 and 8 provided as follows:

> "6. DELIVERY
>
> 6.1 Delivery by the Seller to the Purchaser shall be at the expense of the Seller and shall take place in The State, United States of America and shall be effected by delivery of a Bill of Sale to the Purchaser in The State, United States of America, and conclusively evidenced immediately thereafter by the execution and delivery of the Confirmation of Acceptance. The signing of the Confirmation of Acceptance by a representative of the Lessee, as agent for the Purchaser and at the direction of the Purchaser, shall be conclusive evidence, as between the Purchaser and the Lessee, that the equipment is in a fit condition for Leasing to the Lessee at Delivery.
>
> 6.2 Delivery shall, unless otherwise agreed by the Purchaser and the Seller, take place on the date of notification by the Seller to the Purchaser that the Equipment is ready and available for delivery or at such other time as the parties may agree. The Seller undertakes to deliver the Equipment no later than 18th December 1995.

6.3 The Seller shall procure that at Delivery the Equipment shall be as described in Schedule 1, capable of functioning and operational.

6.4 The Purchaser shall appoint the Lessee's representative as agent of the Purchaser to accept delivery of the Equipment, documents and other items relating thereto on behalf of the Purchaser and shall authorise such person, subject to the conditions of this Agreement, to execute and deliver the Confirmation of Acceptance to the Seller upon Delivery. The Lessee shall nominate a person as the Lessee's representative for this purpose and such person shall be the Lessee's agent for the purpose of determining that the Equipment is in a fit condition for leasing to the Lessee at Delivery.

7. TITLE

Title to the Equipment shall pass to the Purchaser from the Seller by delivery of the Bill of Sale on Delivery and on payment of the Purchase Price.

8. RISK AND INSURANCE

Risk of loss of or damage to the Equipment shall pass to the Purchaser on Delivery and thereafter shall be determined in accordance with the provisions contained in the Lease."

Under the Acquisition Agreement the seller was Alpha Newco and the purchaser was the Appellant. Clauses 6, 7 and 8 also referred to the Lessee. The Acquisition Agreement provided that "The Lessee" had the meaning assigned to it under the Lease. The Lease defined the Lessee as Alpha Newco. Thus Alpha Newco was both the Seller and the Lessee.

50. Clause 10 provided inter alia, that either party could terminate the obligations in the event that,

> "the obligations of the Purchaser to acquire the Equipment and to lease the same to the Seller and the obligations of the Seller to lease the Equipment from the purchaser shall have lapsed pursuant to Clause 3.4 of the Lease."

Clause 13 provided,

> "13. ASSIGNMENT BY PURCHASER AND SELLER

> The Purchaser and the Seller may not dispose of any benefit or interest under this Agreement except as permitted by and in accordance with their rights to do so under the Lease."

51. Clause 14.9 provided that each party submitted to the non-exclusive jurisdiction of the Courts of England and of the State of New York.

52. Under Schedule 3 Part 2(F), Alpha Newco warranted that the Equipment was moveable personal property and not fixtures.

53. On 18 December, Alpha Newco notified delivery under clause 6.2. A document headed "Bill of Sale" was executed by Alpha Newco in The State under The State law; an invoice for £165,811,815 was received by the Appellant and formal confirmation was given by Alpha Newco that the conditions precedent to delivery had been satisfied. Confirmation of Acceptance of Delivery was given by attorneys acting on behalf of the Appellant.

54. Although counsel for the Revenue raised questions as to how the Equipment which continued in use by Alpha could be identified, no question was raised as to the authenticity of the Confirmation of Acceptance. The Bill of Sale had not been stamped and was not produced.

55. We return later to the security, which was a condition precedent under Schedule 4 of the Acquisition agreement (see paragraph 48 above), since the primary requirement for security was contained in the Lease.

The Lease

56. The Lease extended to 142 pages excluding the Deposit Agreement which formed Appendix 2. The definitions alone run to 21 pages and included this,

"'Operative Documents' means:-

> (a) this Agreement, the Acquisition Agreement, any Sub-Lease, the Put Option Agreement, the Security Documents, the Lessor Guarantee Letter and each and every other letter, agreement, document or instrument of even date herewith between any of the parties to the above or given by any of the parties to the above to another of them; and
>
> (b) any other letter . from time to time . which the Lessor and the other parties thereto have agreed shall be Operative Documents
>
> as from time to time amended or supplemented in compliance with the terms hereof"

57. Receipt by the Appellant of the duly executed Acquisition Agreement and Delivery of the Equipment thereunder were conditions precedent as was the provision of acceptable security. The Seller and Purchaser were defined as the Lessee and the Lessor in their capacities as seller and purchaser under the Acquisition Agreement.

58. Clauses 4 and 5.1.1.1 provided,

"4.1 The Lessor agrees to lease to the Lessee, and the Lessee agrees to lease from the Lessor, the Equipment on and subject to the terms and conditions herein contained.

4.2 Delivery of the Equipment by the Lessor to the Lessee, and acceptance thereof by the Lessee, shall take place immediately upon delivery of the Equipment by the Seller to the Purchaser (or to such person as the Purchaser may have appointed for this purpose) under the Acquisition Agreement. Simultaneously with delivery of the Equipment to the Purchaser under the Acquisition Agreement the Lessee shall deliver to the Lessor a duly executed Acceptance Certificate dated the date of such delivery. Such Acceptance Certificate shall, without further act, constitute irrevocable evidence of delivery of the Equipment to the Lessee and acceptance thereof for all purposes of this Agreement.

.

5.1.1 The Lessee acknowledges and agrees that:-

5.1.1.1 the Equipment has been designed, manufactured, assembled and constructed without reference to or involvement of the Lessor and that the Lessee alone has selected the Equipment for purchase by the Lessor and leasing by the Lessor to the Lessee hereunder."

59. Clause 6 provided that the leasing should commence on Delivery and continue until 5 January 2026 unless terminated earlier. Clause 7 provided for a rental of £350,000 for the Preliminary Period to 5 January 1996. Clause 7.2 covered rent for the period to 2026 and provided:-

"7.2 The Lessee shall pay to the Lessor, in respect of the Primary Period, a rental [each January and July] calculated in accordance with the provisions of the Financial Schedule . subject to adjustment and supplement in accordance with the provisions of the Financial Schedule."

60. Clause 8 provided that each payment by Alpha Newco to the Appellant should be by CHAPS in sterling to a specified account of Delta Finance with Delta Bank. Clause 9 required the Lessee to maintain insurance; clause 10 covered destruction and clause 11 damage less than destruction.

61. Clause 12 contained covenants by the Lessee, Alpha Newco. Under 12.1 Alpha Newco is required to procure that the Equipment is not without the Appellant's consent removed from the possession of Alpha Newco or the Sub-Lessee (earlier defined as "a sub-lessee under a Sub-Lease, its successors and assignees") or from premises in The State. Clauses 12.2.2, 12.2.4 and 12.2.5 provided,

"12.2.2 The Lessee shall not claim, and shall procure that no other party to the Operative Documents (other than the Lessor) shall

> claim, writing down allowances in the UK in respect of the Equipment or any expenditure relating thereto.
>
> .
>
> 12.2.4 The Lessee shall not, without the consent of the Lessor, cease to be resident in the United Kingdom for the purposes of Corporation Tax.
>
> 12.2.5 The Lessee shall not take any action, or permit any action to be taken, and it shall procure that no action is taken which may result in the Lessor not being entitled to claim at least annual ten per cent (10%) writing down allowances on a reducing balance basis."

62. Clause 12.3 required the Lessee to maintain the Equipment. Clause 13 provided that no part might be removed from the Equipment by the Lessee except in compliance with its maintenance, safety and environmental obligations. If any part was so removed, the Lessee was obliged to replace it by a part which was suitable and which did not materially reduce the value of the Equipment. Clause 13.2 required Alpha Newco to deliver an Equipment Report annually, showing any changes with details and Account Record numbers of any additions, and clause 13.3 required Alpha Newco to maintain or procure the maintenance of Equipment records adequate for identification. Clause 14 gave the Appellant inspection rights. Clause 16 contained the security arrangements, of which more later. Clause 17.1 prohibited subleasing without the prior written consent of the Appellant. Prior to execution of the Lease, written consent was given for the Sublease to Alpha.

63. Clause 18 governed termination. Clause 18.4.1 entitled the Appellant to terminate the Lease in the event of a default by Alpha Newco including non-payment of rent. Clause 18.4.4 empowered the Appellant to undertake a credit review in 2010 and provided that,

> "the Lessor shall be entitled in its absolute and sole discretion following the review to give not less than 3 months' notice to terminate the leasing of the Equipment . on 5 January 2011."

Clause 18.5.1 empowered Alpha Newco to give 5 days' notice of voluntary termination. Under clause 18.5.2 the leasing ceased if, without the Appellant's prior written consent, Alpha Inc ceased to be Sublessee or either Alpha Newco or ABL ceased to be a wholly-owned subsidiary of Alpha. Clause 18.6 provided that on termination (including termination under Clause 18.4.4) the Appellant was entitled to the amount calculated under Part 4 of the Financial Schedule less the net proceeds of any sale; this was designed to give the Appellant its appropriate return at the Termination Date.

64. Clause 19 provided for sale of the Equipment following termination. Under clause 20 the net proceeds of sale were to be applied as to 0.1% of the Termination Payment, together with any outstanding sums under the Lease, to the Appellant with in addition 1% of the balance, the other 99% being payable to Alpha Newco subject to a ceiling.

65. Clause 22 provided for Alpha Newco to give the Appellant a general tax indemnity.

66. Clause 23 contained restrictions on assignment and clause 24 made English law applicable but provided that both parties submitted to the non-exclusive jurisdiction of the Courts of England and New York State.

67. The Financial Schedule, which by clause 7.2 governed rentals, was contained in Schedule 1 which, with annexes and tables, was 56 pages long. To describe it as complicated is an understatement.

68. By Part 1.2.2 of the Schedule the rental instalment due at each particular six monthly date,

> "shall be the amount (if any) shown in the Latest Cash Flow in the column headed 'Rental Income' as at that date."

"Latest Cash Flow" meant the most recent Revised Cash Flow produced under Part 3.1; this was to be produced on the same basis as the Initial Cash Flow but taking account of any changes in the Assumptions. The Initial Cash Flow was dealt with in Part 2 of the Financial Schedule.

69. Part 2.2 provided,

> "The Principles on which the Initial Cash Flow has been based are as follows:-
>
> > 2.2.1(a) that the sixty instalments of Primary Rental . shall be of such amount as, together with the Preliminary Rental and the Relevant Net Proceeds of Sale . ensures that the amount of the Lease Capital outstanding as at the Final Date is zero ."

The effect was to amortize the Appellant's investment and provide the agreed after tax return over the 30 year period.

70. The Preliminary Rental was £350,000 under paragraph 1.1 and the Relevant Net Proceeds of Sale were not less than £49,743,545 (Part 2.3.12). Each future instalment was assumed to be 2½% more than the preceding instalment.

71. Expressed at its simplest, it seems to us that in the Initial Cash Flow the Primary Rental for each period was obtained by subtracting £50,093,545 from the Lease Capital Outstanding, and then calculating the remaining instalments on the basis of a 2.5% compound increase every six months; because of the increases it was not possible merely to divide by the number of instalments.

72. We observe that the Primary Rentals depended on the Lease Capital Outstanding at the time of each Cash Flow calculation. Unfortunately we can find no definition as such of "Lease Capital Outstanding". It is necessary to infer its meaning from the Principles in Part 2.2, the Assumptions in Part 2.3, the Adjustments to Rentals under Part 3, from Annex B showing Initial Cash Flow and possibly other factors.

73. The main Principles were that the Appellant was assumed to borrow the Lease Capital Outstanding, or did actually borrow it, and pays interest compounded semi-annually (see Part 2.2.2); that the rate should be 9% per annum (2.2.3); and that a Net Cash Profit Take-Out was to be applied quarterly at a fixed

percentage depending on the Risk Weighting of the Acceptable Security (2.2.5 and Lease Definitions).

74. The main Assumptions were set out in Part 2.3 of the Financial Schedule and were that that the Equipment Cost was £165,811,815 and the Appellant would incur costs of £2,521,804 (2.3.1); that the Appellant would be entitled to Writing Down Allowances at not less than 10 per cent on a reducing balance basis with the costs of £2,521,804 being a trading expense for corporation tax (2.3.2); that corporation tax would remain at 33 per cent (2.3.3); that the Appellant would be entitled to surrender any tax losses arising on the acquisition and leasing of the Equipment to another group company and would receive payment for the surrendered loss at the other company's effective rate of corporation tax (2.3.5), benefit being obtained 9 months after the end of the relevant accounting period (2.3.6); that interest on borrowings or assumed borrowings to fund Lease Capital Outstanding would be tax deductible as a trading expense (2.3.8); that any balancing charge on disposal of the Equipment would not exceed Net Proceeds of Sale (2.3.11); that on 5 January 2026 the Equipment would be sold for not less than £49,743,545 and any excess would be a taxable receipt (2.3.12); and that no change would occur in law affecting writing down allowances or Revenue practice or published concessions.

75. This is most easily understood by setting out the figures for the first periods in the Initial Cash Flow set out on Annex B to the Financial Schedule, leaving out those for 31/12/95, 1/1/96, 31/12/96 and 1/1/97 which show no change from the dates immediately before.

(1)

(2)

Capital/

Expenses

(3)

Rental

Income

(4)

Lessor's

Interest

(5)

Tax

Credit

(6)

Capital

Outstand-

ing before

Profit

(7)

Net Cash

Profit

Takeout

(8)

Lease

Capital

Outstand-

ing

18/12/95

5/1/96

5/4/96

5/7/96

1/10/96

5/10/96

5/1/97

£168.334m

£350,000

£3.832m

£3.928m

£4.026m

£745,118

£7.385m

£7.485m

£6.406m

£167.984m

£164.896m

£164.896m

£168.353m

£161.947m

£161.947m

£165.406m

£ 30,706

£152,089

£152,229

£157,007

£151,459

£167.984m

£164.927m

£165,079m

£168.688m

£162.282m

£162.439m

£166.050m

Column (3) shows the rent needed to achieve zero for (8) at the Final Date in 2026. Column (4) is a debit figure, being interest or notional interest incurred by the Appellant. In column (6), the rental and any tax credit are subtracted from the previous Capital Outstanding and Lessor's interest is added to get the new figure. The cumulative column (7) figures are added to column (6) to get column (8), thus at 5.7.96 £335,024 is added to the column (6) figure to get the Lease Capital Outstanding.

76. At 5 January 2011, when the Appellant can terminate under clause 18.4.4, the figures in the Initial Cash Flow in Annex B were £8.039 million for the half yearly rental, £7.461 million for assumed Appellant's Interest at 9 per cent, Tax Credit due on 1 October 2010 was £1.326 million, Capital Outstanding Before Cash Profit was £154.169 million, Net Cash Profit Take-out for the quarter was £153,223 and Lease Capital Outstanding, £163.477 million; cumulative net cash profit was thus £9.308 million since the start. These figures were purely theoretical because there would be adjustments, every six months, if only for interest changes. Total cumulative tax credits up to January 2011 would have been £63.4 million.

77. On the Initial Cash Flow figures, Lessor's Assumed Interest exceeded Rentals until 5 July 2009. Lease Capital Outstanding would move within a relatively narrow band (£162.3 million and £169.8 million) until then before falling off each year at an accelerating rate until 2026. Tax credits would fall steadily from £7.275 million in October 1997 to become net payments in October 2014, which would be added to capital outstanding rather than subtracted. The final rental due on 5 July 2025 would be £16.450 million, Lessor's Interest to 5 January 2026 would be £1,016,650 and minus £49,743,545 was shown under Capital in column (1), being the Minimum Net Proceeds of Sale. Tax payments of £9.661 million were shown in October 2026 and of £15.032 million in 2027, reflecting the level of rental at the end and the balancing charge.

78. The following totals were shown in Annex B for the entire lease : Capital £118.6 million; Rental Income, £521.5million; Lessor's Interest, £379.4million; net Tax Payments, £7.75 million. The tax figure was close but not identical to 33 per cent of Rentals less Lessor's Interest and Capital. The net Capital figure was that to be claimed for capital allowances over the whole period after the balancing charge at the end. The expenses did not qualify for capital allowances but are deductible for corporation tax. The Capital figure was the difference between cost with expenses and assumed proceeds on disposal. The Net Cash Profit Take-Out was shown as £15,751,844, being the total rental figures less the Lessor's Interest, Capital and Tax; it was after taking account of all tax credits. All were of course assumed figures.

79. Annex B of the Financial Schedule to the Lease showed the Lessor's Margin from 18 December 1995 at a fraction of one per cent. We understood that this was the basis of the Net Cash Profit Take-Out figures, however the figures do not marry up : the figure in the definition of "Net Cash Profit Take-Out" in the Lease is not legible. Page 144 shows capital allowances at 10 per cent for the year to 31 December 1995 as £16,581,181 and other negative income as £2,829,470 making a net loss of £19,410,652, which at 33 per cent is the tax credit in the fifth column due on October 1996, namely £6,405,515 (paragraph 75 above); most of the £2,829,470 negative income was the expenses of £2,521,804. The tax figure shown for each October relates to the previous accounting year.

80. Part 3 of the Financial Schedule provided for adjustments each half year to reflect LIBOR, involving rebates of Rental where this was less than 9 per cent and a Revised Cash Flow if the tax assumptions were not borne out.

81. Part 3.5 and 3.6 of the Financial Schedule required adjustments in respect of interest rate fluctuations at each Adjustment Date, 5 January and 5 July annually. The interest on the Lease Capital Outstanding day to day for the immediate prior period was to be calculated at LIBOR and compared with interest at 9%. If LIBOR was less, a rebate was to be given for the prior period. Part 3.7 provided for adjustments by reference to Associated Costs: these were the additional costs to Barclays Bank (not the Appellant) of maintaining the investment resulting from Bank of England monetary control ratios and other similar requirements.

82. Part 3 also entitled the Appellant to prepare a Revised Cash Flow in the event of a change in any assumption and provided for the outstanding Rentals to be altered to ensure that Lease Capital Outstanding at 2026 was zero. In essence these Assumptions related to tax and capital allowances, interest rates and monetary control ratios or risk weighting requirements. This Revised Cash Flow was required, by adjusting the Rentals, to ensure that the Termination Sale Sum payable to the Lessor on termination after 15 years in 2011 was 139% of the Equipment cost or 150 per cent if the Appellant was "not entitled to any capital allowances in respect of any of the Equipment Cost" (Part 3.2.8); the Termination Sale Sum (Part 4.3) is the aggregate of the Rentals and Equipment cost less proceeds required in order to balance Lessor's Interest so bringing Lease Capital Outstanding to zero after allowing for Net Cash Profit Take-Out.

83. It is apparent from annex 3 to Mr B's statement that the Rental due before rebate for the first four six monthly periods was in fact the same as that shown in the Initial Cash Flow so that there can have been no Revised Cash Flow before January 1998. The Rental was given in advance; the rebate was in arrears and the rebate for each period was payable on the payable date for the next Rental. £4,503,032 was due on 5 January 1996, being £3,832,368 plus VAT; the rebate for the 18 days from 18 December 1995 was £237,848 payable on 5 January. The rent including VAT due at 5 July was £4,615,608 including VAT, the rebate for the prior period (£2,361,071) was payable on 5 July, and so on. The rebates for the following two periods were £3,086,941 and £2,202,756. The arithmetical relationship between these figures and the interest rates shown in Mr B's annex is not clear. Under an agreement in a separate side letter dated 18 December 1995, the Appellant was entitled to net off the rebate for the prior period against rental due.

84. We observe at this point that the Rentals were not in any sense related to a market value for the use of the Equipment but were calculated with great precision so as to give the Appellant a return on the capital committed to purchasing the Equipment and the notional interest on that capital after taking account of tax and capital allowances.

Security for Alpha Newco's obligations under the Lease

85. Clause 16.1 of the Lease required Alpha Newco's obligations and liabilities under the Lease to be secured for each Security Period by Acceptable Security of not less than the Minimum Security Value applicable from time to time.

86. Under clause 16.2, Acceptable Security was at the option of Alpha Newco, a Cash Deposit, UK or USA Government Securities or other security with similar Risk Weighting effect to the Cash Deposit. The Cash Deposit was to be a deposit

by ABL (see paragraph 25 above) with an Account Bank secured by a first legal charge in favour of the Appellant giving the Appellant rights which satisfied the Bank of England's requirements for no more than 20 per cent weighting for bank capital adequacy purposes pursuant to the Solvency Ratio Directive (87/647/EEC). The Account Bank was Delta Bank, although Clause 16.4 contained a procedure for changing the deposit to another deposit bank with AA+ rating. Any change in the form of Acceptable Security was subject to a set procedure.

87. The calculation of Minimum Security Values was governed by Part 5 of the Financial Schedule to the Lease. The values differed for each sixth month period. Initial values were specified in the Table in Appendix 3 Part 1 and started at £145,351,150 from 18 December 1995 and, broadly speaking, increased to £201.7 million for 5 July 2010 before falling to £47.6 million in July 2025 and zero in January 2026.

88. Under Part 5.1.1 the Minimum Security Value for all six monthly periods up to January 2011 was the sum of (a) the present value at the relevant dates of future rentals up to January 2011 and (b) the present value of the Lessor Option Capital Amount, based on the Termination Sale Amount at January 2011. The present values were to be determined by discounting at 8.875%. The values were subject to recalculation on a change in the Assumptions.

89. Interest was payable to ABL on the cash deposits and any excess of the money deposited over the Minimum Acceptable Security was to be released to ABL. Payment of rental by Alpha Newco, debiting of the notional interest paid by the Appellant and the receipt of tax credits all affected the Minimum Acceptable Security, which as pointed out above rose before falling. If the security was less than the minimum, Alpha Newco was obliged to procure that the current security was increased.

90. The form of the Acceptance Certificate under clause 4.2 of the Lease (see paragraph 58 above) was specified in Appendix 1 to the Lease.

91. The form of the Deposit Agreement and the Deed of Assignment to give effect to the requirement for Acceptable Security in the form of a cash deposit was specified in Appendix 2. If the Acceptable Security was in a form other than a Cash Deposit, this was to have an effect operating to put the Appellant in substantially the same position as under the form in Appendix 2.

92. On 18 December 1995 the Appellant notified Alpha Newco of the Minimum Security Value, which was that in the Lease, namely £145,351,150; that for the first period was after a release following payment of the initial rental of £350,000. The maximum security was to be £201.7 million from 5 July 2010, after which the basis of calculation altered and it was to decline to zero in 2026.

93. On the same day Alpha Newco gave notice in accordance with clause 16.3 of the Lease that the security was to be a Cash Deposit of £146,000,000 by ABL with Delta Bank. The Appellant confirmed its approval of the security. Also on 18 December, ABL, the Appellant and Delta Bank executed the Deposit Agreement and Deed of Assignment ("the Deposit Deed"), the Appellant being described as "the Lessor". Alpha Newco was not a party. Alpha provided the cash required for the deposit.

94. Under clause 2 of the Deposit Deed, ABL covenanted with the Appellant to discharge on demand the Secured Obligations, effectively any monies due but unpaid under the Lease, limited to the assigned deposit. Clause 3.1 provided,

> "In consideration of the Lessor entering into the Lease and the other Operative Documents, ABL hereby irrevocably and unconditionally assigns . to the Lessor all of its . interest in . (i) the Account and (ii) all sums of money . at any time standing to the credit of the Account together with all interest thereon . as continuing security for the payment and discharge of the Secured Obligations. ."

95. Under clause 7, ABL was prohibited from giving withdrawal instructions during the period of the security but the Appellant agreed to give written instructions for the withdrawal of sums permitted under clause 16 of the Lease, effectively any excess over the Minimum Security Value for each successive six monthly security period. Under clause 8, interest is LIBOR less 0.125 %.

Put option Agreement

96. Also on 18 December 1995, ABL entered into the Put Option Agreement with the Appellant which was a condition precedent under the Lease and thus also the Acquisition Agreement (see paragraph 48 above).

97. Under the put option, the Appellant was entitled in specified circumstances set out in clause 3 to require ABL to buy the Equipment. These circumstances involved defaults by Alpha Newco under the Lease. The price payable by ABL was the higher of the Termination Sale Amount under the Lease and the open market value of the Equipment. The effect was that, if Alpha Newco was in default in one of the ways specified in clause 18.1 of the Lease, ABL could be obliged to purchase the Equipment. In such event ABL could set-off its security deposit against the price provided always that it was with Delta Bank.

Guarantee and Indemnity

98. Again on 18 December 1995, Alpha as guarantor and the Appellant as beneficiary executed a deed of guarantee and indemnity under English law, under which Alpha guaranteed the performance of the obligations of Alpha Newco and ABL under the Operative Documents to which either of them was party, the Operative Documents being as defined in the Lease (see paragraph 56 above); under clause 9.2.3 Alpha agreed that it would in certain circumstances pledge the shares in ABL as security for those obligations.

99. Under clause 2.1, the guarantee and indemnity were given in consideration of the Appellant entering into the Acquisition Agreement, the Lease and the other Operative Documents.

The Acquisition by Alpha Newco

100. Alpha Newco could not of course enter into the transactions unless the Equipment was first transferred to it. It could not sell what it did not own. The

documents governing the acquisition by Alpha Newco from Alpha Inc were the Amended and Restated LLC Agreement of Alpha Newco, executed by Alpha and Alpha Newco and dated 14 December 1995, and a Deed of Assignment, executed by the same parties on the same day.

101. Alpha Newco was formed as a Delaware company on 31 October 1995 by Alpha and Alpha of Delaware, those two corporations being its members. The agreement of 14 December 1995 amended and restated the October LLC agreement in its entirety.

102. Article III of the LLC agreement stated the general purpose and character of the business which included acquiring, leasing and subleasing equipment of the type involved. Article IV stated that the principal office should be in England.

103. Under Article VI the members agreed to make contributions to the company in cash or in property in the proportions shown in the schedule; those proportions were 99 per cent by Alpha and 1 per cent by Alpha of Delaware. The capital of the company was to be divided into 1,000 units. Article V1.9 provided for the directors to,

> "distribute any proceeds derived from entering into any financing arrangement in accordance with the Company's purpose to the Members, in accordance with their percentage interests."

104. Under Article VIII the initial directors were JS, PY and SE. All actions were to be taken when physically present in the United Kingdom (Article VIII.3).

105. On 14 December 1995 an assignment was executed in two counterparts by a vice-president of Alpha and by SY, director of Alpha Newco. This included the following:

> "WHEREAS, Assignor is a party to an LLC Agreement ('LLC Agreement'), dated as of October 31, 1995, with Alpha of Delaware, a Delaware corporation, pursuant to which Assignor has agreed to contribute certain designated equipment located at the Buildings DD and BB and at the Buildings LL and SS (the 'Equipment') to Assignee as a capital contribution.
>
> NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged:
>
> Assignor hereby contributes, transfers, conveys, assigns and delivers to Assignee all of Assignor's right, title and interest in and to the Equipment and Assignee hereby agrees to and acknowledges such contribution, transfer, conveyance, assignment and delivery, to have and to hold the same, with the appurtenances thereof, unto Assignee, its successors and assigns, forever, to its own proper use and behalf, pursuant to the LLC Agreement."

No point was taken as to the fact that it was expressed as pursuant to the 31 October LLC Agreement. All the Operative Documents were signed on behalf of Alpha Newco by SY, apart from the Acceptance Certificate under the Headlease which was signed by JS.

106. The property assigned remained in use at Alpha's premises. The Assignment did not identify the actual equipment, referring to an agreement to contribute "certain equipment". No written agreement was in fact produced. The only evidence in the files of Alpha Newco as to what was comprised in the equipment was the Report and Valuation by Valuer Inc on 15 December 1995, the Sublease back to Alpha and the Acquisition Agreement and Lease from the Appellant.

107. The Report by Valuer Inc was to Alpha and Alpha Newco which referred to the Equipment to be transferred to Alpha Newco but to be operated by Alpha under a lease. Appendix B, listing the equipment with valuations, extended to 35 pages.

108. The Acquisition Agreement, by which Alpha Newco sold the Equipment to the Appellant, defined the Equipment as "the equipment described in Schedule 1." Schedule 1 is outlined in paragraph 47 above.

109. The Lease from the Appellant to Alpha Newco defined the Equipment as follows:

> "the equipment details of which are recorded on the computer systems maintained by [Alpha Newco] and [Alpha] and described therein by reference to 'Accounting Records', details of which Accounting Records are themselves summarised in Schedule 1 to the Acquisition Agreement and shall include all substitutions and replacements therefor, renewals thereto and . additions thereto."

The Sublease

110. The Sublease was dated 18 December 1995. A draft sublease was approved by the directors of Alpha Newco on 7 December 1995 before the restated LLC Agreement.

111. The definition of the Equipment in the Lease was repeated mutatis mutandis in the Sublease which was dated 18 December 1995.

112. Under clause 2 Alpha Newco agreed to lease the Equipment to Alpha, delivery by Alpha Newco and acceptance by Alpha to be on 18 December being irrevocably evidenced by delivery to Alpha Newco of a duly executed Acceptance Certificate by Alpha.

113. Under clause 3 the term commenced on delivery and continued until 17 December 2006 unless terminated earlier. Clause 4 and Schedule 2 provided for 22 instalments of £7,968,721 payable on 4 January and 4 July of each year.

114. Clause 5 made Alpha Newco liable for insurance. Clause 7 provided that the Equipment would not be removed from Alpha's possession or from Alpha's premises shown in a plan without Alpha Newco's consent and that it should be maintained in "excellent repair". Alpha Newco had the right to inspect. Subleasing and assignment were subject to Alpha Newco's prior consent.

115. This Sublease itself required consent under clause 17.1 of the Lease. By a letter dated 18 December and signed by the Appellant and Alpha Newco, in consideration of Alpha Newco entering into the Lease, the Appellant consented to the Sublease to Alpha in the terms which were attached thereto and by paragraph 4 agreed to further subleases with prior written consent to Alpha as follows:

"4. The Lessee may enter into further sub-leases of the Equipment ("Other Sub-Leases") from time to time after the expiration or earlier termination of the Sub-Lease if it obtains the prior written consent of the Lessor.

PROVIDED THAT the Lessor may not unreasonably withhold or delay the granting or otherwise of its consent if -

(a) the Other Sub-Lease is entered into by the Lessee as Sub-Lessor and Alpha Inc. as Sub-Lessee;

(b) .

(c) the proposed terms and conditions of the Other Sub-Lease represent the entire agreement between the relevant parties and are acceptable to the Lessor acting reasonably;

(d) .

(e) the Other Sub-Lease will not prejudice the Lessor's right to claim and receive writing down allowances at the rate of 10% per annum on a reducing balance basis pursuant to CAA 1990; and

(f) ."

It was agreed by the letter that the Sublease and the letter itself were Operative Documents under the Lease.

Witnesses

116. Three witnesses gave evidence; the first two being cross-examined on their written statements:

PP, Group Treasurer of Delta Bank Ltd from 1991 until his retirement in 2000; an economist with the International Monetary Fund 1961-65 and First Secretary (Economics) at a British Embassy in 1979-81;

Mr B, a director of Delta Finance since 1992, being responsible at the relevant time for "big ticket" leasing transactions; and

EMT, a director of Alpha Newco since 2000.

The Appellant put in evidence a written statement by ABH, an employee of Alpha Inc, who was Capital Assets Manager, Corporate Accounting Services at the relevant time.

The Regulatory Position and Weighted Risk Assets

117. PP gave evidence that the position of Delta Bank and its subsidiaries in 1995 was strongly liquid. Its ability to lend is and was, however, constrained like any bank by regulatory requirements designed to protect depositors. Apart from providing services, banks make their profits by using moneys deposited with them to earn money, whether by loans or investments.

118. At any time the balance sheet of a bank will show market borrowing, debt issues, customers' deposits and shareholders' funds as liabilities and, as assets, buildings, fixed assets, advances or loans to customers, deposits with other banks or institutions, government securities and other securities. Broadly speaking, shareholders' funds will represent net assets.

119. The management of liquidity is critical, being primarily designed to ensure that at all times funding requirements can be met. These include replacement of maturing borrowing by the bank and additional lending requests from customers. A sufficient reserve of liquid assets such as cash must always be maintained to protect against unforeseen cashflow volatility; the cash is generally placed in the money markets to get the best return consistent with the desired maturity profile.

120. A common type of business for banks is the provision of finance by leasing transactions. The bank purchases assets for a lump sum and leases them to a customer for a rent designed to give the bank an adequate return. Sometimes the assets are new assets so that the bank finances the purchase. Frequently, however, the assets are already in use and the bank is providing finance on the security of the assets. This is known as finance leasing. Two important aspects of finance leases are the overall regulatory requirements which the bank must meet and the security held by the bank.

121. The regulatory framework complies with the Basle Agreement of 1988 between the central banks of the OECD countries. The Basle Agreement requires banks to ensure that their Risk Asset Ratio is at least 8 per cent. The Risk Asset Ratio is the Regulatory Capital as a percentage of total Weighted Risk Assets ("WRAs"). Regulatory Capital consists of shareholder's funds, general provisions and certain types of debt instruments. Each asset on the balance sheet, such as loans, advances or (as here) finance leases, must be assessed or risk-weighted to determine how great is the risk of default. An asset so assessed is a WRA according to its risk-weighting. The amount of finance which a bank can provide for a given amount of Regulatory Capital thus depends on the risk-weighting of the form of financing adopted. Individual banks carefully monitor their RAR, often setting internal guidelines limiting WRAs so as to maintain a cushion over the minimum Risk Asset Ratio. At the end of 1995 Delta Bank had a Risk Asset Ratio of 10.9 per cent, 0.5 per cent more than a year earlier, compared with the Basle minimum of 8 per cent.

122. The WRAs which a given amount of Regulatory Capital can support is therefore 100 divided by the minimum RAR multiplied by the Regulatory Capital. Put another way, the Regulatory Capital multiplied by 100 divided by the minimum RAR gives the available WRAs. The risk weighting of assets varies from NIL to 100 per cent. A loan to the UK government or a loan for which there is a complete cash collateral is weighted at NIL : it is treated as involving no risk. Lending to OECD banks is risk weighted at 20 per cent : an example might be a deposit by Barclays Bank with Lloyds TSB. Residential mortgage lending is risk weighted at 50 per cent. Finance leases and all other lending are weighted at 100 per cent.

123. A bank will increase its profits if it can lend at the same rate of interest with reduced risk weighting because less Regulatory Capital is required. The higher the risk weighting, the more Regulatory Capital is needed and the higher rate of interest must be charged. The ideal is a zero weighted asset since no Regulatory Capital is used to support it; the return obtainable on such assets is naturally lower. A lower usage of WRAs enables a bank to charge a lower interest margin

while still securing a higher return on Regulatory Capital. Low weighted transactions free up Regulatory Capital to support other business.

124. Depending on its category, a security reduces the weighting for a particular loan or asset and the required Regulatory Capital. Full cash collateral reduces the risk weighting of an asset to nil; a guarantee from an OECD bank reduces it to 20 per cent, however inter bank lending is subject to other limits. Reduced risk weighting enables the bank to charge a lower rate of interest.

125. The Risk Asset Ratio subject to Bank of England supervision applied to the Delta Bank group as a whole. WRAs employed by the various units within the group, including Delta Finance, were subject to limits reported monthly to the Group Treasury Committee.

126. The deposit by ABL of £146 million with Delta Bank as security for the obligations of Alpha Newco under the Lease from the Appellant complied with the regulatory requirements and thus reduced the WRAs employed by the group in financing the lease. We assume (although this was not spelt out) that the asset in question was the freehold subject to the lease. The security enabled the Appellant's parent to write further business within its WRA limits thus improving its return on capital.

127. PP's evidence was that the sale and lease back with Alpha was not dependent on the security deposit but that, without the deposit, the price to Alpha would have been higher because of the higher weighting of the transaction. He said that he was not personally involved in the negotiation or agreements. It was normal banking practice to ensure that the security was in place before parting with the money.

128. Counsel for the Revenue asked PP to consider a customer with £146,000 in cash, who wished to buy a house for £165,000, borrowing the whole sum and depositing the cash as security. He asked when this could be cheaper than borrowing £19,000. PP said that this depended among other things on the customer's foreseeable needs for cash : a second mortgage might be expensive. He suggested that the loan with security might be cheaper, depending on the agreed margins. He agreed that a full rate of interest would apply on the £19,000 differential. He said that from the customer's viewpoint the argument was one of liquidity and the ability to substitute another security. He said that it would probably not be cheaper. He said that it was very hard to say that £19,000 would cost as much at the margin as £165,000 with a £146,000 deposit. The revenue on the security would be relevant. There could be good reasons for leaving cash in the bank and borrowing.

129. We are not persuaded on the facts of this case that it could ever have been cheaper for the Alpha group to borrow £166 million depositing £147 million than to borrow £19 million, since the agreed rate of interest on the principal sum was less than that on the security.

Mr B's evidence

130. Mr B said that finance leasing is a form of asset financing whereby companies needing to raise finance do so on the security of the asset indirectly benefiting from the capital allowances claimed by the lessor. To the bank, a finance lease differs from a loan secured on the asset only in that certain tax consequences ensue. Capital allowances enable the assets to be written off faster

with payment of tax by the bank being deferred. The reduced funding cost to the bank is reflected in a lower rental.

131. He said that in spite of the restrictions on cross-border leasing in the Finance Act 1982, approximately £717 million of assets were acquired by UK lessors for cross-border leasing between 1993 and 1995 and £2.1 billion between 1996 and 1999.

132. Leasing companies were competing in a market in which large companies expected to borrow from banks at less than 1 per cent over LIBOR. Delta Finance was anxious to maximise its return on a limited amount of WRAs available to it within the Delta group.

133. Mr B's statement said that Alpha was expanding and seeking to raise medium to long term finance. He was keen to ensure that the leasing transaction should not be 100 per cent risk weighted so that cheaper funds could be offered. The transaction would be attractive to the Delta group and Alpha if weighted at around 20 per cent. The real choice of security for Alpha was between cash and Treasury Bills; Alpha was concerned that the security should not be limited to cash since this might be required for other business purposes. Treasury Bills would be acceptable to Delta.

134. He stated that the amount of the cash deposit was fixed by identifying the maximum sum which the Appellant would require to ensure that it would receive its full financial return if the Lease terminated after 15 years and taking the net present value of this sum together with the rentals over the term, discounting future rentals at 8.75 per cent.

135. He stated that because Alpha had the right to substitute gilts or Treasury Bills, the cash deposit was risk weighted at 10 per cent instead of nil. The end result was an overall risk weighting on the lease of 20.8 per cent (88% cash deposit at 10% plus 12% balance at 100%). Without the right of substitution, the risk weighting would have been 12 per cent and the rental would have been lower : as it was the transaction was priced at 0.5 per cent over LIBOR. The purpose of the deposit throughout the lease was to achieve reduced risk weighting for regulatory purposes. He stated that in his view the Alpha group would not have done a transaction with a rental based on 100 per cent risk weighting.

136. Mr B stated that Alpha was concerned to be able to change the account bank with which the deposit was placed in case Delta's credit rating deteriorated. This would involve increased risk weighting and thus increased rent. The possibility was real.

137. He stated that in the autumn of 1998 the cash deposit had been released for several months to provide Alpha with additional cash resources for internal balance sheet reasons. Alpha paid a fee equivalent to a proportion of one per cent on the margin being charged; this involved an advance payment of under £1 million plus VAT.

138. In cross-examination, Mr B agreed that the Equipment was being used in Alpha's factories throughout and that there was no reason to believe that Alpha wished to limit its use of the equipment to 11 years; he said that he did not know why the Sublease was limited to 11 years. He said that the Equipment was not in any way unique or special to Alpha but could be easily exchanged if necessary. There was a ready market for such Equipment.

139. He agreed that the purpose of interposing Alpha Newco was to avoid the pitfalls in section 42(3). He said that the original structure had been varied in that the security had been provided before payment of the acquisition money; this was in line with banking practice. However the cost was not funded by the deposit.

140. He said that the transactions started because Alpha wished to raise £165 million on existing plant and machinery; the reason why this did not appear on the documents was that the approach came from Alpha, via Evans Randall. The issue for Delta was how much it could accommodate.

141. Mr B did not agree that Alpha just did it for the tax benefit. Delta was not so concerned with the benefit of the transaction to Alpha; Delta was concerned that it could enter into it on terms satisfactory to itself and within section 42. It was correct that the only discussions between Alpha and Delta were on the Evans Randall structure. It was normal for multi-national companies to go through an intermediary. Evans Randall were paid an introductory fee.

142. He agreed that Alpha Newco did not need to raise funds and that Alpha did not need to enter into a finance lease in order to acquire the equipment which it already owned.

143. Mr B agreed that a finance lease with end-loaded rentals increased the return, losses being increased in the earlier years. The Initial Cash Flow (paragraph 75 et seq above) showed an escalating rental with the capital allowance in early years exceeding the tax on the rent. The tax figures were net.

144. He said that the bank never loses sight of the importance of assets it is financing, even where as here there is separate security. He accepted that the deposit was at the heart of the transaction in that without the reduced capital weighting the transaction would never have proceeded. He said that it was taken as read that the assets were the key security. He disagreed with the contrary statement in the lease proposals. He said that the additional security in cash was important (1) because of weighting, (2) in the event of exit or default and (3) as additional security to the assets. Later he said that when Delta is looking at lease finance transactions it always ignores the value of the leased assets in terms of security.

145. Mr B agreed that the quantum of the security was determined by the net present value calculation and not by regulatory requirements but said that the transaction could not have gone ahead without the risk weighting. An OECD bank guarantee would have sufficed but the calculations would have been the same. Evans Randall would have understood the issue of regulatory capital. Ultimately the transaction was governed by the strip risk which Delta was prepared to accept. At page 43 of his written statement he described the strip risk as "the residual unsecured risk, namely that part of the net present value of the lease rentals not covered by the Acceptable Security."

146. He said that Alpha were concerned that the assets were to be owned by a UK bank and the deposit was to be with the same bank, so that there was double jeopardy if Delta experienced difficulties : this was just after Baring's difficulties. Alpha therefore wished to be able to move the deposit. Although the initial security was a cash deposit, Alpha wished to be able to vary it. He agreed that if US Treasury Bills were substituted, substantial restructuring would be necessary.

147. Mr B said that although the Appellant borrowed £166.67 million from Delta Bank and £146 million was deposited with Delta Bank, the two were separate: the bank was not £19 million down as a result of the transaction, the two were not connected. The Appellant spent £165 million on the assets to be leased; the security was a deposit by ABL with Delta Bank. The transactions were separate.

148. He did not accept that the only difference between the purchase price of £165.8 million at LIBOR plus ½ per cent and £146.7 million initial security at LIBOR minus ⅛ per cent was capital allowances: he said that the dynamics were different.

149. He accepted that the Financial Schedule in the Lease was drafted to ensure that whatever variations occurred in the principles and assumptions everything came back to equilibrium in order to protect the net after tax position of the Appellant. The relationship between the rentals, the interest on the security deposit and the minimum security was to be held in equilibrium.

150. Counsel for the Revenue put to Mr B that all that happened at each six monthly point, when rentals came in to Delta (sic), interest was credited to ABL by Delta and part of the deposit was released, was a self-cancelling exercise and that the only effect on Delta's net cash position or strip risk was the product of tax credits resulting from the capital allowances. He produced a new schedule which he had prepared (R1). Mr B said that, although the numbers for the Appellant's transactions were right and the numbers for ABL were right, the two transactions were not related. The transactions were not netted off in Delta's accounts and the Appellant did not look at them on this basis. He accepted that on Counsel's figures the rent was precisely balanced mathematically by the interest on the deposit plus the deposit released. The Financial Schedule (including the Minimum Security Values) was designed to protect the Appellant's after tax position.

151. Mr B produced a schedule annexed to his statement (Annex 3) showing the actual figures following interest rate adjustments. He said that the rents did not in fact balance the interest and deposit releases although the initial release on 18 December 1995 did so balance. He could not explain why the initial release was based on the unadjusted rental; he said that he is not an accountant. He said that adjustments to rentals by reason of the difference between 9 per cent and LIBOR (see paragraph 80 above) were not on a discounted basis. There was no linkage per se between the rents paid and the deposit releases.

152. Asked how anyone could know what was being valued by Valuer Inc, Mr B said that members of his team would have seen the valuation in draft before 15 December 1995 and he could not imagine that they did not raise questions with Alpha as to its composition. In order to know the detail item by item, access would be by interrogating Alpha's accounting records; these were very good.

153. He said that the Appellant relied on legal advice that Alpha Newco had good title to the assets. He had not seen the Assignment by Alpha to Alpha Newco.

154. Mr B said that the transaction was done on the basis that, at the end of Year 15, the Appellant could exit with a liquid security. It could not know whether the valuation assumptions would be borne out.

155. He said that the request for the deposit to be removed in 1998 came from Alpha , and not Alpha Newco or ABL. The initial proposal was for substitution but in fact none was substituted.

156. Re-examined, he said that at the time he had looked at the opinion of legal counsel to Alpha dated 18 December 1995 advising that Alpha had transferred its title to Alpha Newco and that the Bill of Sale was sufficient to transfer Alpha Newco's title to the Appellant. He concluded that Alpha Newco did have title and that with that opinion and the warranties the Appellant would have remedies if Alpha Newco did not have title.

157. He said that the main ingredients of the cashflow were as follows: the initial price and its timing, the date and periods of rentals, the timing of the Appellant's year-end and its tax payments, the Appellant's funding costs and its margin and the rate and value of capital allowances. The interest paid to ABL on the security deposit had nothing to do with the Appellant.

158. Mr B told the Tribunal that under clause 12 of the Lease the Appellant was entitled to information in the event of requests for information by the Revenue. Normally the equipment would have been marked, however with the industrial action Alpha did not want to publicise the sale. The Appellant agreed to suspend plating and the equipment had still not been labelled. Some of the equipment was moveable; it would not be possible to go into all the plants and know what was covered, it would be necessary to identify it from the accounting records.

EMT's evidence

159. EMT, a director of Alpha Newco since January 2000, attended pursuant to a summons granted to the Respondents to give evidence and produce documents.

160. He produced a bundle of documents relating to the transactions which were all those available to him. He said that these were all the documents in the file. There was a copy of the assignment and counterpart faxed this June, before the hearing. He did not know whether a copy was in the file before then; he did not normally go through the files. The Equipment was covered in the appraisal but this was not attached to the assignment.

161. He said that he had never seen Valuer Incs's valuation of 15 December 1995. He had never had occasion as a director to consider the contents and identity of the equipment in the assignment. He was not aware of Alpha Newco having any other record of the equipment.

162. EMT said that he had never before seen a copy of the lease from Alpha Newco to Alpha. He had never read the lease from the Appellant to Alpha Newco either. The money for the rent to the Appellant came from Alpha Newco's income from Alpha. There were also other back to back leases with Alpha. He said that Alpha had paid the rent to Alpha Newco but the surplus was left on inter-company loan account. He said that he was a director but did not operate the books. Leasing to Alpha companies was Alpha Newco's only business.

163. He was then asked whether Alpha Newco would be able to pay the Termination Payments under clause 18 of the Lease. He said that it depended on the notice. Alpha Newco did not have the cash itself. He did not know how much would be available to it. He did not know how much Alpha Newco had in the bank.

164. He said that there was no one on the board now who was a director in 1995. The ongoing leases were not the particular responsibility of any one director. He said that he thought that the inter-company account bore interest but did not know.

Submissions

165. The parties served and exchanged extensive skeleton arguments in advance of the hearing. Although it is taxpayer's appeal, it is convenient to set out the Revenue's submissions first since the taxpayer's case is largely a response thereto.

Revenue Submissions

166. It may be helpful if we summarise the various heads of submissions before setting them out in more detail. (A) to (C) were based on the wording of section 42(3), (D) was based on section 24(1) and (E) (1) concerned the stamp duty legislation and (2) was based on sections 75 and 76. They were as follows:

> (A) The "lease" whose terms fall to be tested under section 42(3) was the Headlease, which was admittedly caught by that subsection, as opposed to the Sublease.
>
> (B) Alternatively, the relevant "lease" for section 42(3) was the conjoined Headlease and Sublease under which the Appellant leased to Alpha on the terms of the Headlease; this argument depends on construing "lease" and "leasing" in a commercial sense following *Macniven v Westmoreland Investments Ltd* [2001] 2 WLR 377.
>
> (C) If, contrary to the above submissions, the Sublease alone was the relevant lease within subsection (3), the Sublease did not meet the requirements of (3)(e) or (d) or (c).
>
> (D) The expenditure "incurred" for the purposes of section 24(1) was limited to the difference between the Acquisition Price and the Cash Deposit, some £19 million. *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655 applies.
>
> (E)(1) The Appellant must prove that the Equipment belonged to it within section 24(1)(b) and cannot do so without producing a stamped Bill of Sale which it has not done.
>
> (2) The excess of the Appellant's expenditure over the "disposal value" by Alpha Newco was to be disregarded under section 75(1). If Alpha Newco had no disposal value, section 76(2) applied. There was no evidence of the capital expenditure incurred either by Alpha Newco or Alpha.

In the event Counsel addressed us on (A) and (C) before (B) and after hearing the evidence did not pursue (E)(2). His skeleton argument was supplemented by written submissions.

<u>Submission A - that the "lease" under section 42(3) was the Headlease</u>

167. Counsel for the Revenue said that section 42, which originated in the Finance Act 1982, was intended to restrict capital allowances on foreign leasing to 10 per cent, instead of the 25 per cent on domestic leasing which exceeds commercial depreciation. Section 42(3) specified circumstances in which no allowance at all was available; those were certain sale and leaseback situations.

It was the lessor who incurred the capital expenditure who got the allowance; where there was a chain it would normally be the headlessor: a sublessor would not normally incur capital expenditure. The circumstances in subsection (3) were typically those in a finance lease and were directed at the lessor who incurred the capital expenditure: Counsel referred to Chapter 17 of *Equipment Leasing* (1999) published by Sweet and Maxwell. He said that if a headlease did not fall within section 42(3), there was no reason why the terms of sub-leases should affect the head lessor's entitlement apart from bringing about the reduction to 10 per cent under section 42(2) because of the words "used for the purpose of being leased": subleasing was "using" within those words. Section 42(3)(a) to (e) were directed at distortions to a finance lease to which the person claiming the allowance is a party.

168. Counsel said that the expression "used for the purpose of being leased" in section 42(1) was separate from "used otherwise than for a qualifying purpose" in section 42(3); the latter reflected the words "used for a qualifying purpose" at the end of section 42(1) and was unconnected with the circumstances in section 42(3)(a) to (e), being spent before those words were reached. He said that here "the lease" in paragraphs (a) to (e) was the Headlease and not the Sublease giving rise to the foreign use; the definite article was significant. Section 50(1), which provided that references to a lease included references to a sublease did not state that references to "the lease" in section 42(3) were to any sublease. He said that the terms of a sublease might not be known to a head lessor. He submitted that paragraphs (a) to (c) were not aimed at arrangements made in the United States by subleases.

Submission C - Applicability of section 42(3)(c)(d) and (e)

169. Before turning to the possible application of the *Ramsay* approach to the construction of "lease" and "leasing", we outline Counsel for the Revenue's submissions as to the detailed application of section 42(3) on the footing that the Sublease was the relevant lease.

170. Counsel relied on section 42(3)(c)(d) and (e) but in reverse order.

171. He said that on the footing that the relevant lease was the Sublease, the "lessor" in paragraph (e) was Alpha Newco and the Appellant was "any other person". The reference to "an amount determined before the expiry of the lease" must be to a formula since the amount had to be referable to a value at or after expiry.

172. He submitted that if the Headlease was or is determined during the term of the Sublease, the Sublease must determine also. On a termination under clause 18 of the Headlease, for example on non-payment of rent by Alpha Newco, the Appellant could determine the Sublease in which event Alpha Newco could become entitled to the balance of the proceeds of sale under clauses 19 and 20. The formula had already been determined by the Headlease and the amount would be referable to the value of the Equipment at or after expiry of the Sublease which would occur at the same time.

173. Counsel submitted that paragraph (e) did not require the payment to be limited to payments under the relevant lease, here the Sublease. Provision for payments by "any other person" would not normally be found in a lease. The provision depended on the possibility of "entitlement", that is legal entitlement, so that there was no need to refer to collateral agreements.

174. Counsel distinguished *The Pioneer Container* [1994] 2 AC 324, on which Counsel for the Appellant relied, saying that it was not there said that the sub-bailment continued to exist as a sub-bailment; it was only authority for the proposition that the sub-bailee with consent could rely on the terms of the sub-bailment against the head bailor.

175. Counsel's submission as to section 42(3)(d) depended on the sub-leasing letter dated 18 December 1995 (see paragraph 115 above). Paragraph 4 of that letter was a provision in a separate agreement which conferred on Alpha Newco a right to renew the Sublease in favour of Alpha subject to any reasonable grounds for the Appellant to withhold consent. Since Alpha Newco was a wholly-owned subsidiary of Alpha, the effect was to give Alpha a right to require a renewal. He emphasised the words "provision" and "could" in section 42(3)(d). The letter was a provision for renewing the Sublease or granting a new lease. Counsel said that paragraph 4(e) of the letter does not answer his point because it was the existence of the letter which prejudiced the right to tax allowances not the renewal of the Sublease.

176. Counsel's submission under section 42(3)(c) rested on the argument that the Headlease was an agreement which "might reasonably be construed as being collateral" to the Sublease as was the Guarantee and Indemnity Agreement (see paragraph 98 above). He accepted that the Headlease was not in fact collateral to the Sublease but said that the language imported from paragraph (b) of section 42(3) was deliberately flexible and covered it.

Submission D - Applying the approach in *Macniven* and *Ensign Tankers*, the Appellant only incurred capital expenditure of £19 million, being the difference between the acquisition price and the cash deposit.

177. We cover the application of the *Ramsay* approach to the acquisition and security under Submission D before returning to Submission B which was directed at its application to the Headlease and Sublease conjoined within section 42(3).

178. Counsel for the Revenue contended that the expenditure which the Appellant incurred was limited to the difference between the £165,811,815 paid by it on 18 December 1995 and the £146,701,150 cash deposited by ABL with Delta Bank on the same day. The respective sums were paid to and deposited by wholly-owned subsidiaries of Alpha, namely Alpha Newco and ABL. Alpha funded the deposit and had received an equivalent sum on the same day from Alpha Newco out of the purchase moneys received by the Appellant. He said that they should be netted off as if both transactions had been between Alpha and the Appellant.

179. He relied on the decision of the House of Lords in *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655 read in the light of *Macniven*. In *Macniven* there was no escape from the interpretation that "payment" has only a legal meaning. Here it was necessary to construe the words "incurred capital expenditure on the provision of plant or machinery" in section 24(1).

180. In *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991; [1997] STC 908, HL it was said that capital is a commercial concept. If capital was a commercial concept in that context, it must be for section 24 also. That being so, the words around it in section 24 must, he said, be directed to a commercial concept. The whole phrase "incurred capital expenditure on the provision of plant and machinery" has a resonance for a businessman.

181. Here, in contrast with *Craven v White* [1989] AC 398 [1988] STC 476, there was no lapse of time. The documents were executed and the money moved on one day, 18 December 1985.

182. Counsel for the Revenue said counsel in *Ensign Tankers* had argued that incurring expenditure in relation to capital allowances must be a legal concept because of section 159(3). He said that this contention succeeded before Millett J but was rejected by the House of Lords. Although at paragraph 96 of *Macniven*, Lord Hutton cited Millett J's observation in *Ensign Tankers* [1989] 1 WLR at page 1241 concluding, "Expenditure is incurred by the taxpayer whatever the source of the finance with which he intends to meet it", Lord Hutton was there concerned with the meaning of "payment" in section 338 and not with section 24 of the Capital Allowances Act.

183. He said that *Macniven* shows that the Revenue do not need to prove a tax avoidance scheme in order to invoke the *Ramsay* principle. The court must however be tax aware.

184. Counsel said that, if the test under section 41 of the Finance Act 1971 had been a purely legal test, the taxpayer would have succeeded in *Ensign Tankers*; the House of Lords had however rejected a pure legal analysis when interpreting section 41 and applied a commercial test. He said that in *Ensign Tankers* as a matter of legal analysis Victory Partnership had paid $14 million to LPI of which $9.75 million had been lent by LPI. The non-recourse nature of the loan was in reality no different to the situation in *Macniven*. The House of Lords had looked at the 17 documents as a single transaction and looked at all the documents in order to determine all the consequences. Lord Templeman looked for the real expenditure, see [1992] 1 AC at pages 673 G-H and 674 C-D. Counsel pointed to the time lapse before the loan would be repaid from profits. He said that the ratio of *Ensign Tankers* was not restricted to page 667 D-E where Lord Templeman said that the true legal effect was a capital investment in return for a share of profits. *Ensign Tankers* was clear authority that the construction of section 41 involved a commercial test. The wording was substantially the same as that in section 24 here.

185. Counsel said that section 159(3) of the 1990 Act was a timing provision and did not govern how much expenditure has been incurred. An argument based on this provision was contradictory to the decision in *Ensign*. The quantum was a commercial question.

186. He said that section 153 was solely directed at grants, subsidies and the like. It did not affect the construction of section 24.

187. Counsel said that the construction and application of section 24 did not affect the tax treatment of the Headlease and other arrangements such as the Security Deposit. It did not involve any revision of the identity of the parties. The Acquisition Agreement, the Head Lease and Security Deposit were inextricably linked under the contractual arrangements of 18 December, as was the Guarantee and Indemnity. On the terms of the Operative Documents, the Cash Deposit constituted a pre-financing of 146/165ths of the totality of obligations under the Head Lease. In substance, the Cash Deposit covered all that the Appellant needed for its full return under the Headlease apart from the strip risk. If a termination event occurred on the following day, the Appellant had the cash deposit.

188. The transactions were essentially between the Alpha group and the Delta group. Delta provided the Appellant with the Acquisition price and the deposit was made with Delta on the same day. £146 million went round in a circle. It was immaterial that the security might be varied : on 18 December 1995 there was a cash deposit and under the Headlease any substituted security had to place the Appellant in substantially the same position. There was a contractual straight jacket. The variation in 1998 was not relevant. It made no sense for the Cash Deposit to be at any other bank than Delta. Counsel said that the transaction as structured would not involve any increase in the Appellant's strip risk until long after the point in 2010 when the Appellant could extricate itself.

189. He said that the net cash invested in plant and machinery was £20,110,665. In substance the strip risk was eliminated by the exclusive means of the tax credits. Evans Randall brought Alpha and Delta Finance together. The whole deal was negotiated with Alpha, Alpha Newco with ABL coming in at the end. There was no difference in substance between the final scheme and Evans Randall's original proposal.

190. Counsel said that although the Cash Security had Regulatory Capital and Weighted Risk Asset effects relevant to the price, the emphasis placed on the purpose of the deposit was not supported by the contemporary documents. The Cash Deposit was the prime security,, the Equipment being secondary. The assignment by Alpha to Alpha Newco did not even contain a schedule.

Submission B - Applying *Macniven*, "lease" in section 42(3) was a commercial concept and the lease here was the Headlease and Sublease conjoined by which the Appellant leased the Equipment to Alpha.

191. Counsel said that "lease" in section 42 was not used in its technical legal sense of an estate in land. Contractual bailment would be the legal term for a lease of chattels. The use of the expression "lease" in connection with chattels was commercial describing a wide variety of asset financing packages.

192. Treating leasing as a commercial concept in section 42, he posed the question : "who was the Appellant allowing to have the use of the Equipment in the present case, and on what terms?" This admitted of only one answer : Alpha on the terms of the Headlease Alpha had the use of the Equipment throughout : it was an integral part of its capacity. The Headlease and Sublease should be read as one. On that basis the lease did not satisfy section 42(3). The argument in *Barclays Mercantile v Melluish* [1990] STC 314 was not the same : *Ramsay* was not considered.

Submission E - Without the Bill of Sale which has not been stamped the Appellant cannot establish that "in consequence of his incurring the expenditure, the [Equipment] . belonged to him" within section 24.

193. Counsel for the Revenue submitted that the Appellant could not prove legal title to the Equipment without the Bill of Sale, see clauses 6.1 and 7 of the Acquisition Agreement (paragraph 49 above). He said that the Bill of Sale was an instrument relating to something done in the UK, namely payment between two companies in the UK, and section 14(4) of the Stamp Act 1891 provided that such an instrument,

> "shall not . be given in evidence, or available for any purpose whatever, unless it is duly stamped in accordance with the law in force at the time when it was executed."

He said that the Appellant could not prove an unstamped document by secondary evidence, see *Re Brown & Root McDermott Fabricators Ltd's Application* [1996] STC 483 and *Parinv (Hatfield) Ltd v Inland Revenue Commissioners* [1998] STC 305 per Millett LJ at page 310b. In the former case oral evidence of execution was not accepted. The Acceptance Certificate here was secondary evidence.

194. Counsel said that, although proof of equitable ownership would suffice (see *Melluish v BMI (No.3) Ltd* [1995] STC 964), the Appellant would have to show that the Acquisition Agreement would be specifically enforceable, see *Oughtred v Inland Revenue Commissioners* [1960] AC 206 per Lord Radcliffe at page 227. A contract for the sale of chattels was only specifically enforceable if damages would not be an adequate remedy to do justice, see *Chitty on Contracts* at paragraph 28-005.

195. He submitted that the Acquisition Agreement would not be specifically enforceable. Here the transaction was in substance a loan and damages would be a sufficient remedy. The last thing the Appellant needed was the Equipment at the premises. It was not sufficient that the Appellant needed the Equipment in order to get capital allowances. He said that if the subject matter was the Equipment, rather than a loan, on the evidence the Equipment was not unique but on Mr B's evidence (see paragraph 138 above) could readily be obtained on the open market

Appellant's Submissions

196. For convenience we identify these by the same lettering as for the Revenue's submissions, although they were of course not made in the same order.

Submission A -that "the Lease" in section 42(3) is the Sublease.

197. Counsel for the Appellant submitted that in section 42(3) "the lease" referred throughout to the lease which gave rise to the application of the sub-section as falling within 42(1) by reason of being to a non-resident. The definite article indicated that it referred back to a lease already mentioned. Section 50(1) provided that references to a lease include a sublease. It might be a lease or a sub-lease, here it was the Sublease to Alpha. The words "used for the purpose of being leased" covered any sublease, however remote. They did not apply to a lease to a resident, only to a non-resident. The lease which was the subject-matter of section 42(3) must be the offending lease to a non-resident.

198. He said that the mischief at which section 42 was directed was expenditure on machinery or plant for leasing where within 10 years it was leased to a non-resident. Such expenditure only got 10 per cent allowances and, if section 42(3) applied, got none. There must first be expenditure for leasing and, second, use in fact within 10 years for leasing or subleasing to a non-resident outside the charge to UK tax; section 42 did not apply to short-term leasing or to certain leasing for ships etc used for a qualifying purpose. The use for leasing to a non-resident did not have to be by the person incurring the capital expenditure, here the Appellant. That was why only 10 per cent allowances were claimed here.

199. Counsel said that the reference to "used" in section 42(3) replicated the first reference to "used" in section 42(1). The circumstances specified in section 42(3)(a) to (e) only came in when the use was not for a qualifying purpose. It would be otiose for the reference to "expenditure falling within subsection (1) above" to include ships etc not used for a qualifying purpose by virtue of section

39(6) to (9). The reference to "use otherwise than for a qualifying purpose" in section 42(3) was a reference to exactly the same use as that excluded by the closing lines of section 42(1), because the only assets within section 42 which could be used otherwise than for a qualifying purpose were those covered by section 39(6) to (9) which were those referred to in section 42(1).

200. He said that it was difficult to identify any policy requiring section 42(3) to apply to a headlease between two residents and not to a sublease to a non-resident. It would be illogical to apply the section 42(3) restrictions to the non-offending lease to the resident.

201. He said that Counsel for the Revenue had admitted that the drafting was not good. He submitted that on this basis it was ambiguous and that *Pepper v Hart* [1993] AC 593 allowed reference to be made to Hansard. He said that it was plain from Hansard for 22 June 1982 that the leases referred to in section 42(3) were foreign leases. At column 830 the Minister of State, Mr Nicholas Ridley said,

> "It is already clear that schemes are being developed to arrange the terms of foreign leases in such a way that they continue to incorporate a significant element of tax subsidy."

Mr Ridley had said that an amendment would be tabled at the Report Stage. There was no further explanation at Report Stage.

202. Counsel for the Revenue stated that he did not object to the citation of Hansard but pointed out that the Minister's statement was directed at the need to introduce what became section 42(3) and not to the wording of a draft clause to take effect from that day. We observe at this point that what is now section 42(3) took effect from the following day, 23 June 1982, see Finance Act 1982, s.70(11).

203. Counsel for the Appellant said that the fact that it was the purchaser of the equipment who lost his allowance under section 42(3) was irrelevant. It did not follow that, because the head lessor's allowance was barred, it was the headlease which must comply with section 42(3). The allowances were lost whoever used the equipment for leasing to a non-resident regardless of whether the headlessor entered into a section 42(3) compliant lease.

204. He said that on the Revenue's argument there could be an initial lease to a resident outside the circumstances in section 42(3), followed by a sublease to a non-resident within those circumstances, but section 42(3) would not apply.

<u>Submission C - The circumstances specified in section 42(3)(c)(d) and (e) did not apply</u>

205. Counsel for the Appellant submitted that the payment under section 42(3)(e) must be a payment under the lease in question, here the Sublease. The references to "lessor" and "lessee" were here to Alpha Newco and Alpha. The entitlement must be under the terms of the Sublease. That was the logical limitation. He said that subsection (3)(e) could not possibly apply to a payment made under another interest which did not have anything to do with the Sublease, its terms or its expiry. Section 42(3)(e) did not apply to a payment under the Headlease. This was supported by reading section 42(3) as a whole.

206. He said that the side letter did not amount to any agreement to renew, extend or grant a new lease. It merely related to the possible grant of a new sublease. It was only directed at consent.

207. Counsel said that neither on its terms nor as a matter of law did the Sublease terminate in the event of termination of the Headlease. The Sublease was a bailment of chattels to the terms of which the Appellant had consented. The Sublease would continue on its terms notwithstanding termination of the Headlease. He relied on the decision of the Privy Council in *The Pioneer Container* [1994] 2 AC 324 which concerned a sub-bailment of goods to which the owner had consented; it was held that the owner of the goods was bound by an exclusive jurisdiction clause in the Bill of Lading.

208. Turning to section 42(3)(d), Counsel submitted that the side-letter was not a provision for extending or renewing the Sublease or granting a new Sublease. Its effect was that the Appellant could not unreasonably withhold its consent, it was not itself a provision for extension or renewal. The Sub-Lease would be replaced by something different.

209. He said that if section 42(3)(d) was to apply, there must be an agreement for the extension or renewal of the Sublease or the grant of a new Sublease : something binding in law which provided for the grant of a new lease. The word "could" covered an option. The side letter gave no right to anybody for the grant of a new lease. It conferred no right on Alpha.

210. As to section 42(3)(c) Counsel said that the Headlease could not reasonably be construed as collateral to the Sublease. Something was "collateral" to something else when it stood alongside it, see *Termes de la Ley* 1641 ("that which cometh or adhereth to the side of anything") and the Shorter Oxford English Dictionary ("situated or running side by side, parallel"). The Headlease, he said, was not something which was collateral to the Sublease at all; it was an entirely different and superior interest. In order to be collateral it must be parallel to it not linear. There must be something common to the two. To be collateral to a contract, the one must add to the terms of the other.

Submission D - *Ramsay, Macniven* and *Ensign Tankers* did not have the effect that the Appellant only incurred capital expenditure of the net sum of £20 million.

211. Counsel for the Appellant said that in section 24(1) the words "incurs capital expenditure . on the provision of plant and machinery" bore a legal meaning and did not bear a commercial construction to which the *Ramsay* approach could be applied. He relied on the speeches of Lord Nicholls and Lord Hoffman in *Macniven*, in particular at paragraphs 8 and 48. He argued that "incurs", "capital" and "expenditure" all had legal as opposed to commercial meanings.

212. He relied on section 159(3) as indicating that "incurring capital expenditure" was used in a legal sense; the reference to an obligation becoming unconditional could only be to a legal obligation. In the light of section 159(3), section 24(1) could not be construed as bearing a commercial meaning other than its legal sense. He said that section 153 also pointed to the obligation being legal; it predicated a person incurring expenditure although it was to be met by the government or some other person.

213. Counsel said that, since the crucial words in section 24(1) did not bear a commercial construction distinct from their legal meaning, there was no scope for the *Ramsay* approach to apply.

214. He referred to *Ramsay* [1982] AC 300 at 322E-F, 326 B-F and 337 and to *Furniss v Dawson* at 526g-527g, saying that neither suggested that ongoing rights extending forward for years could be treated as rights and obligations of persons who were not parties. He referred to *Customs and Excise Commissioners v Faith Construction Ltd* [1990] 1 QB 905 at 921, a case where there was an advance payment on terms that the moneys had to be lent back immediately, in which it was held that the tax point was nevertheless accelerated. He then referred to *Charter Re-Insurance Co Ltd v Fagan* [1997] AC 313.

215. Counsel relied on the judgment of Millett J in *Ensign Tankers (Leasing) Ltd v Customs and Excise Commissioners* [1989] 1 WLR 1222 at 769g-770h which was cited by Lord Hutton in *Macniven* at paragraph [96]. He submitted that that passage was not affected by the ultimate decision in the House of Lords [1992] 1 AC 655. He submitted that the ratio of the House of Lords was to be found in the speeches of Lord Templeman at page 667B-E and Lord Goff at page 682F-683G and was that on a true legal analysis Victory Productions did not borrow $10.75 million from LPI and so had no such sum to spend or incur; the $10.75 million was incurred by LPI under the joint venture. He submitted that *Ensign Tankers* did not decide that "incurred" had a commercial meaning. He pointed out that in *Macniven* Lord Hoffman made no reference to *Ensign Tankers*.

216. Counsel further submitted that even if the expression "incurred capital expenditure" did bear a commercial meaning going beyond its juristic meaning the Revenue needed to identify the commercial sense relied on. It had failed to do this. He said that the cash deposit did have a commercial purpose. It was not legitimate to characterise the expenditure as the sum net of the cash deposit made by a different legal entity : the deposit was an asset of ABL and a liability of Delta Bank. The presence, form or value of security for a loan could not reduce the amount loaned : the same was true where a person incurred expenditure on an acquisition and took security for other obligations of the vendor.

217. Counsel said that persons should be taxed according to the transactions which they entered into in fact and not on transactions which they did not enter into, see *Inland Revenue Commissioners v Wesleyan and General Insurance Society*(1948) 30 TC 11 per Lord Greene at page 16, who was cited in *Macniven.*

218. He said that in *Furniss v Dawson* there was always going to be a disposal between A and C and the question was whether B was interposed. Here there was never any question of a direct transaction between the Appellant and Alpha.

Submission C - The Lease and Sublease should not be read together

219. Counsel for the Appellant said that the word "lease" in section 42 was not used in a commercial sense so that *Ramsay* could be applied. It had long been accepted that chattels could be leased, see Insolvency Act 1986 s.10(4), *Bristol Airport v Powdrill* [1990] Ch. 744 and *Barclays Mercantile Finance v Melluish* [1990] STC 314. He said that even if "lease" was a commercial concept, section 42(3) clearly specified the agreements to which the statute was to apply. The Courts could not rewrite the statute by applying it to different agreements.

Submission E - the Appellant did not need to rely on the unstamped Bill of Sale as evidence

220. Counsel for Appellant accepted that something had been done in the United Kingdom within section 14 of the 1891 Act and that the unstamped Bill of Sale could not be given in evidence.

221. He said that the Equipment belonged to the Appellant since it was the beneficial owner, see *Melluish* [1995] STC 964 per Lord Browne-Wilkinson at 974d. He said that Mr B's evidence that the Appellant was owner was unchallenged. He said that there was ample evidence of ownership without relying on the Bill of Sale.

222. Counsel submitted that the Acquisition Agreement concerned specific and ascertained chattels rather than a loan. The Appellant needed the Equipment in order to discharge its obligations to Alpha Newco. The Equipment was special to the Appellant. In any event being a contract to acquire specific goods it was specifically enforceable, see *Chitty*, paragraphs 28-013 to 28-016.

Conclusions

The relevant lease for section 42(3)

223. The fact that the definite article appeared before the word "lease" each time that word appeared in section 42(3) indicates, as a matter of syntax, firstly that it referred to a specific lease and secondly that it referred to a lease or an equivalent concept already mentioned in section 42.

224. Section 42(2) made no express mention of "lease", therefore it is necessary to look to section 42(1). The word "lease" did not in fact appear in section 42(1); if it did this particular argument might not have arisen. The word "leasing" appeared four times and the expression "being leased" appeared once. The obvious use "for the purpose of being leased" was in fact leasing. It was common ground that the use "for the purpose of being leased" need not be the specific leasing for which the expenditure was incurred. The use for being leased to a non-resident was at any time within the requisite period, which under section 40(4)(a) was 10 years after the asset was brought into use. "Brought into use" must mean leased or at least made available for leasing. In the present case the use within section 42(1) was not the initial lease.

225. Grammatically, the references in section 42(1) to "the leasing" after the initial reference were to the earlier word "leasing". However the relative clause at the end of section 42(1) concerned the actual use; this indicates that the leasing of a ship etc referred to the leasing which constituted the use "for the purpose of being leased". That clause must logically apply to the ship or aircraft, notwithstanding the lack of a comma after "container".

226. It seems clear therefore that the word leasing, where it appeared after paragraphs (a) and (b) in section 42(1), referred to the leasing which constituted the use for the purpose of being leased to a non-resident and not, if different, to the initial lease. We say, if different, because there might of course be only the one lease, to a non-resident.

227. Section 42(3) was directed at situations where the assets were "used otherwise than for a qualifying purpose" and where in addition one of the five

circumstances at (a) to (e) were present. Again the use must ex hypothesi be leasing. Logically the word "lease" in paragraphs (a) to (e) must refer to the use by leasing to a non-resident, here the Sublease.

228. We recognise the force of the Revenue's submission that since it was the lessor incurring the expenditure whose allowances were at risk it was the lease granted by him which was relevant. The problem with his submission, however, is that the use might change. It would be anomalous if section 42(3) only applied to the initial use or lease which might be granted at a time when no lease to a non-resident was in fact intended. This might easily happen in relation to the airline industry in the present economic situation.

229. Section 42(4) expressly contemplated a subsequent event "at any time in the requisite period" and specifically referred to the loss of allowances "by virtue of subsection (3)". If a subsequent lease by the head lessor was covered, we do not see why a sub-lease should not also be covered.

230. It is not difficult to envisage a case where there was an initial Headlease to a resident, which fell within one or more of the circumstances in section 42(3), but where no leasing to a non-resident was contemplated. After a period of time, perhaps years, there might follow a sublease to a non-resident which did not itself breach section 42(3). It would be surprising if such subleasing had the effect of depriving the Headlessor of all allowances.

231. While the drafting is not wholly clear, on balance, we conclude that the lease to which section 42(3) must be applied in this case was the Sublease to the non-resident.

Section 42(3)(e)

232. We find as a fact that Alpha Newco might in the event of termination of the Headlease become entitled to receive from the Appellant a payment under the termination provisions referable to a value of the Equipment (see paragraphs 63 and 64).

233. We accept the Revenue's submission that the amount would be determined before the expiry of the Sublease since it would be determined by the formula in the Headlease. The words "determined before the expiry of the lease" must refer to the basis of determination since ex hypothesi the actual value at "or after expiry" (and therefore the amount) could not be known and thus determined before expiry of the lease.

234. We do not accept the Appellant's submission that the payment must be under the terms of the Sublease. Such a limitation did not appear in the statute. The very fact that it might be paid by another person to a person connected with the lessor (here the Sublessee) showed the width of the provision; it would not be normal for a lease to provide for payments by a third party.

235. We have considered *The Pioneer Container* [1994] 2 AC 324 with care. A sublease of real property determines if the lease determines, subject to statutory relief from forfeiture. *The Pioneer Container* of course concerned a bailment of goods, as does the present case. The cargo, which was the subject of the bailment, was lost at sea when the vessel sank. The original bills of lading entitled the carriers to sub-contract on any terms. This they did on bills of lading which contained an exclusive jurisdiction clause. The ship owners were the sub-bailees and it was held that, because the owners of the cargo had consented to sub-

contracting "on any terms", the cargo owners were bound by the jurisdiction clause. The Privy Council did not decide that the sub-bailment continued notwithstanding the loss or destruction of the subject-matter. What it decided was that the original bailor, having consented to the terms of the sub-bailment, was bound by them. In fact it was held that the sub-bailee having taken the bailor's goods into his possession voluntarily held them as bailee of the original bailor, see page 342A. Earlier, Lord Goff approved a passage from *Pollock and Wright*, *Possession in the Common Law* (1888), where it was said that both owner and bailee have concurrently the rights of bailor against the sub-bailee. It seems to us that the rationale was not that the sub-bailment continued with the owner standing in the shoes of the carrier, but that the owner's consent to the terms gave rise to independent rights.

236. We conclude that, if the Headlease is terminated during the term of the Sublease, whatever the rights of Alpha against the Appellant arising out of the Appellant's consent to the terms of the Sublease, the Sublease itself expires, its performance being frustrated by Alpha Newco's loss of any title.

237. We hold that the section 42(3)(e) did apply by reason of the termination provisions in the HeadLease.

Section 42(3)(d)

238. We have no hesitation in holding that the side-letter of 18 December 1995 was a legal document which conferred legal rights on Alpha Newco. It was expressed to be in consideration of Alpha Newco entering into the lease and it contained a provision in paragraph 4 entitling Alpha Newco to enter into further subleases subject to written consent not to be unreasonably withheld (see paragraph 115 above). It was a separate agreement collateral to the Headlease.

239. Section 42(3)(d) did not require there to be a provision granting a new lease; the words were:

> "there is, in the lease or in a separate agreement, provision for . the grant of a new lease so that, by virtue of that provision, the machinery or plant could be leased for a period which exceeds 13 years;"

It seems to us that it is incontrovertible that the effect of clause 17 of the Sublease with the side letter was that the Equipment "could" be leased by Alpha Newco for a further period. Counsel for the Appellant did not suggest that for section 42(3)(d) to apply a new lease itself had to be for a period exceeding 13 years : it was enough if when added to the existing lease it exceeded 13 years. There was no indefinite article before "provision". The words were simply "provision . for the grant of a new lease". As a matter of English, we consider that the side letter which entitled Alpha Newco to enter into further subleases was "provision" for a new lease. It does not seem to us that the words "the grant of" had any magic. Nor does it seem to us that it was necessary that the provision should confer any right on the Sublessee.

240. Although this was not argued, in fact it appears to us that the side-letter might well confer rights on Alpha. It was expressed by paragraph 8 to be an Operative Document for the purposes of the Headlease. It fell within the definitions of "Operative Document" in the Lease and the Guarantee and therefore it formed part of the consideration for Alpha entering into the Guarantee and Indemnity (see paragraph 98 above).

241. We conclude that section 42(3)(d) applied by reason of clause 17 of the Sublease and the side letter.

Section 42(3)(c)

242. The argument as to section 42(3)(c) focussed on whether the Headlease was collateral to the Sublease. We do not accept the submission of Counsel for the Appellant that for one contract to be collateral to another they must be between the same parties. A contract is often said to be collateral to another, when the one agreement is entered into in consideration of the other. The parties need not be the same; indeed a collateral contract can be used to avoid the doctrine of privity of contract.

243. Counsel for the Revenue contended that although the Headlease was not collateral to the Sublease, it might reasonably construed as being collateral. This is a question of impression. We do not agree with this contention.

Whether the Appellant only incurred capital expenditure of the net sum of £19 million

244. This issue raises far-reaching and fundamental questions as to the application of section 24(1) in the light of the decisions of the House of Lords *Macniven v Westmorland Investments Ltd* [2001] 2 WLR 377 and *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655.

245. If we were construing that provision without *Ensign Tankers* one at least of us would have real difficulty in regarding the expression "incurred capital expenditure" as having anything other than a juristic legal meaning in the light of *Macniven*. The provisions of section 159(3) referring to an obligation becoming unconditional made no sense otherwise than in a legal context. Counsel for the Revenue said that they only apply to timing and not to quantum, but this is not tenable given the reference to "amount of capital expenditure". An obligation to pay an amount cannot logically exist in a vacuum from the amount.

246. Counsel for the Revenue said that an argument based on the predecessor of section 159(3) failed in *Ensign Tankers,* however there was no mention of the predecessor of section 159(3) in the speeches of the Law Lords in *Ensign Tankers*. His submission in fact emphasises that there was no argument in *Ensign Tankers* as to whether "incurred capital expenditure" had a commercial as opposed to a juristic meaning.

247. The problem which faced counsel for the Appellant was that in *Ensign Tankers* the seventeen documents or transactions all of which were dated 14 July 1980 were analysed as a single composite transaction. The Headnote in the official Law Reports, which would have been approved by the judges reads,

> "**Held**, allowing the appeal in part, that, analysing the transactions entered into as a single composite transaction regarded as a whole the legal effect was a trading transaction whereby the partnership expended $3.25m (but not $14m) towards the production and commercial exploitation of the film in which they had a 25 per cent interest and generated a first-year allowance of $3.25m within section 41(1) of the Act of 1971 ."

There was apparently no argument as to whether or not there was a single composite agreement, see page 665D where it was stated that this was agreed. There as here there were a series of interdependent transactions entered into as a single scheme.

248. Although in Lord Hoffman's speech in *Macniven* there was extensive consideration of the *Ramsay* line of authorities, he made no mention of *Ensign Tankers*. Counsel for the Revenue appeared to recognise that there may be a tension between *Ensign Tankers* and *Macniven*.

249. Whatever *Ensign Tankers* did or did not decide in relation to the *Ramsay* approach, it must be authority binding on this Tribunal that where there are a series of interdependent transactions their legal effect must be considered as a whole when determining whether a taxpayer has "incurred capital expenditure" for capital allowance purposes and how much.

250. That does not however entitle the Revenue to recharacterise the transaction as having been between different parties with different results. Apart from arguing that because of the discrete stamp duty point that the Appellant could not prove the acquisition, Counsel for the Revenue did not suggest that the Appellant incurred no expenditure. If it is assumed that all the terms of the different agreements were rolled into one agreement, Counsel gave no real explanation as to how the legal effect would be that it only covered an acquisition by the Appellant at the price net of the deposit. He did not suggest that the Appellant was only obliged to pay Alpha Newco the net sum or that the deposit became the Appellant's property. Nor did he suggest that the deposit pro tanto discharged the Appellant's debt to Delta Bank. His argument was apparently the broad brush approach that this was the overall effect for the Delta Group vis-à-vis Alpha. Nor did he point to specific steps which should be disregarded as in *Furniss v Dawson*, a type of red pencil approach.

251. We have no difficulty in concluding that for the Alpha group the reason for inserting Alpha Newco was fiscal, particularly given its hybrid residential status. We also readily infer that Alpha's reason for entering into a sale and leaseback of assets for £165 million in order to raise £19 million finance net was to take advantage of UK capital allowances. Alpha was the primary beneficiary of the capital allowances and there was no reason why evidence should not have been given if there had been another reason.

252. The fact is however that the transactions between the Alpha group and the Delta group were arms' length transactions which did have a commercial basis albeit based on capital allowances. From the viewpoint of the Appellant and the Delta group it was a means of obtaining lucrative financing business in a competitive market which was strictly regulated. Furthermore the primary beneficiary of the allowances was Alpha Newco, the Lessee. Delta Finance's internal documents in the early part of 1995 which they cannot have expected to be subject to outside scrutiny do not in any way support the proposition that it was entering into the transaction to obtain a tax benefit for itself or the Delta

group, see for example paragraph 35. Finance leasing is clearly accepted as legitimate for domestic transactions and presumably for transactions within the European Union. Counsel for the Revenue said that the purpose of section 42 was to deny unduly favourable allowances where there is overseas leasing. Section 42 clearly contains substantial restrictions on allowances where there is overseas leasing. The very width of section 42 argues against the wide construction of section 24 for which he contends. The *Ramsay* approach does not entitle the tribunal to treat the expenditure as incurred by Delta Bank plc, as opposed to the Appellant, or the deposit as the property of the Appellant. In the event because of our conclusion on the stamp duty issue, this is academic.

Whether the Lease for section 42 applied to both Lease and Sub-Lease together

253. We take this quite shortly. In relation to real property lease is clearly a technical term. Its meaning cannot be the same in relation to chattels but its use in a legal context is established and growing. It clearly involves exclusive possession of goods for an agreed term in return for a consideration.

254. In the present case Counsel would substitute Alpha for Alpha Newco in the Headlease and disregard the Sublease entirely. If that is legitimate on the *Ramsay* approach, it seems to us that most if not all of the provisions in section 42 would have been unnecessary. We do not consider that this is legitimate.

The stamp duty point

255. Counsel for the Appellant accepted that section 14 of the 1891 Act prevented him from relying on the Bill of Sale in establishing that as a result of the disputed expenditure the Equipment belonged to the Appellant. His case was that it was sufficient if the Appellant could show that it was the beneficial owner, see *Melluish*, it was beneficial owner if it could have obtained specific performance, see *Oughtred,* and it would on the facts have been entitled to specific performance under section 52 of the Sale of Goods Act 1979. We accept that it is sufficient if the Appellant would have been able to obtain specific performances, see *Oughtred* [1960] AC 206 per Lord Radcliffe at page 227 and Lord Jenkins at page 240.

256. Although Counsel for the Revenue emphasised the difficulty of identifying exactly what was and what was not covered by the Acquisition Agreement, that would in reality be a problem of evidence on which the Bill of Sale would not assist. There was a detailed report by Valuer Inc and any dispute as to what was or was not covered would have to be resolved by that report coupled with the accounting records. A similar problem could arise in respect of new plant and machinery bought on a sale and leaseback basis. We accept that the contract was to deliver specific or ascertained goods whatever the practical difficulties of identifying them : it was certainly not a contract for generic or unascertained goods.

257. It follows therefore that the court could have ordered specific performance if an action was to be brought by the Appellant. However the availability of the remedy is discretionary. No case was cited to us where a problem has arisen on a sale of chattels subject to a leaseback or bailment back. Counsel for the Revenue said that damages would be an adequate remedy for any breach. There is much force in this. The Appellant only needed the Equipment in order to discharge its obligations to Alpha Newco. It was protected by the Security if Alpha Newco failed to discharge its obligations under the Headlease.

258. There was however the difference between the sum paid by the Appellant and the security deposited. If Alpha Newco had disputed the Appellant's title and refused to pay the rental or other sums due under the Headlease, the Appellant could have sued for damages. It is not clear that Alpha Newco would have had the resources to pay : however Alpha had given a guarantee. On the evidence there is no doubt that Alpha was good for the sum guaranteed.

259. On balance we conclude that although in legal form the contract was for sale and leaseback, its commercial essence was financial and that the court would have concluded that damages would have been an adequate remedy for Alpha Newco's failure to deliver. The situation is of course hypothetical and indeed artificial. The breach would however have occurred on 18 December 1995 and presumably posits either an advance payment in error by the Appellant or the tendering of payment on immediately after signature of the Acquisition Agreement and refusal by Alpha Newco of delivery. We conclude, without great confidence, that the Appellant would not have obtained specific performance and did not obtain a beneficial title without the Bill of Sale.

Final conclusion

260. The result is that the Inland Revenue succeed and the appeal fails. Having failed to produce a duly stamped Bill of Sale, the Appellant has not established that in consequence of incurring expenditure the Equipment belonged to it. Furthermore section 42(3)(d) and (e) of the Capital Allowances Act 1990 applied so that in any event no writing-down allowances were available.

THEODORE WALLACE

NUALA BRICE

SPECIAL COMMISSIONERS

SC 3125/2000