Weekly Law Reports (ICLR)/2017/Volume 1/*Bristol & West plc v Revenue and Customs Commissioners - [2017] 1 WLR 2792

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*Bristol & West plc v Revenue and Customs Commissioners

Court of Appeal

[2016] EWCA Civ 397

2016 Jan 19, 20; April 27

Black, Briggs, David Richards LJJ

Revenue — Corporation tax — Closure notice — Revenue sending closure notice to taxpayer by mistake — Revenue immediately e-mailing taxpayer to inform it of mistake — Whether notice suspended or invalidated by e-mail — Finance Act 1998 (c 36), Sch 18, para 32 (as amended by Commissioners for Revenue and Customs Act 2005 (c 11), s 50, Sch 4, para 68(a))

Revenue — Corporation tax — Derivatives — Taxpayer transferring derivatives to other company in its group — Taxpayer and other company having different accounting periods so that statutory transfer disregard provisions prima facie only applying to taxpayer — Whether transfer disregard provisions applying to taxpayer in such circumstances — Finance Act 2002 (c 23), Sch 26, para 28 (as amended by Finance Act 2003 (c 14), s 179)

The taxpayer bank transferred a portfolio of interest rate swap derivatives to another company in its corporate group for a premium of £91m. In its self-assessment corporation tax return for the relevant tax year the bank did not bring its receipt of that premium into account, on the basis that it was entitled to the disregard in paragraph 28 of Schedule 26 to the Finance Act 2002[1], which applied to transactions between group companies in which the transferee had replaced the transferor as a party to a derivative contract. Since the transferee company's accounting period was not the same as the bank's, Schedule 26 did not apply to it at all, with the consequence that, if the bank were entitled to the disregard, the £91m premium would not be brought into account for corporation tax purposes by either company. **The revenue** began an inquiry into the return, pursuant to its powers under Part IV of Schedule 18 to the Finance Act 1998[2]. Before **the revenue** had completed its inquiry, an employee of **the revenue** mistakenly instructed **the revenue**'s computer system to issue a closure notice under paragraph 32 of Schedule 18, stating that the inquiry was complete and that no amendment needed to be made to the return. Before the notice was posted a more senior employee realised the mistake and, although he was unable to prevent the system from posting the notice, e-mailed the bank before the notice was posted informing it of the mistake. Subsequently he sent a letter to the bank stating that the closure notice had been effective to mark the completion of **the revenue**'s inquiry, but that **the revenue** would in due course amend the tax return, pursuant to paragraph 34 of Schedule 18. The letter did not specify what sort of amendment would be made, but a month later **the revenue** amended the tax return so as to assess corporation tax on the basis that the disregard under paragraph 28 of Sched-

ule 26 to the 2002 Act did not apply. The First-tier Tribunal dismissed the bank's appeal against that amendment. The Upper Tribunal allowed the bank's appeal, holding that, although the transfer was not a transaction to which paragraph 28 applied, it had not been open to **the revenue** to continue its inquiry after the issue of the closure notice which, he concluded, had been put into suspension by **the revenue**'s e-mail but brought into force by the subsequent letter.

On appeal by **the revenue** and cross-appeal by the bank—

Held, (**1**) allowing the appeal, that **the revenue** had no power to issue a closure notice under paragraph 32 of Schedule 18 to the Finance Act 1998 on a suspended

basis so that it became validly issued, if at all, only upon such later date as **the revenue** chose; that, rather, a closure notice took effect when it was issued, neither earlier nor later; that a closure notice that appeared valid on its face could be invalidated by an apparently inconsistent document, provided that the inconsistent document formed part of the contextual background to the notice; that the e-mail sent by **the revenue** formed part of the factual context for the purposes of interpreting the notice and had been sufficient to invalidate it, since it invited the reader to consider both documents together and not to treat the notice, once received, as a statement that **the revenue** had completed its inquiry with the conclusions therein stated; that the letter was not a closure notice, whether read on its own or read as if the original notice were incorporated by reference as part of it, because it failed to state **the revenue**'s conclusions, nor did it purport to be a closure notice; and that, accordingly, there had been no valid closure notice precluding **the revenue** from continuing its inquiry (post, paras *29–30*, *33–36*, *39–40*, *60*).

*Barclays Bank **plc** v Bee* [2002] **1 WLR** 332, CA applied.

(2) Dismissing the cross-appeal, that, on its true construction, paragraph 28 of Schedule 26 to the Finance Act 2002 could only operate where both the transferor company and the transferee company were subject to Schedule 26, the purpose of paragraph 28 being to achieve tax neutrality in relation to intra-group transfers, rather than to ensure that no charge to tax arose as a result of such transfers; and that, accordingly, since the group company to which the bank had transferred the derivatives had not been subject to Schedule 26 at the relevant time, the transfer did not fall within paragraph 28 (post, paras *57–60*).

Quaere. Whether a valid closure notice may be constituted by two documents, where one is incorporated by reference in the other (post, para *39*).

Decision of Peter Smith J [2014] UKUT 73 (TCC); [2014] STC 1048 reversed in part.

The following cases are referred to in the judgment of the court:

*Barclays Bank **plc** v Bee*[2001] EWCA Civ 1126; [2002] 1WLR332, CA

Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd[1997] AC749; [1997] 2WLR945; [1997] 3All ER352, HL(E)

Portland Gas Storage Ltd v Revenue and Customs Comrs[2014] UKUT 270 (TCC); [2014] STC2589, UT

Saxon Weald Homes Ltd v Chadwick[2011] EWCA Civ 1202; [2012] HLR8, CA

No additional cases were cited in argument.

APPEAL from the Upper Tribunal (Tax and Chancery Chamber)

The taxpayer bank, **Bristol** & **West plc**, appealed against (**1**) an amendment by **the Revenue and Customs Commissioners** to its self-assessment tax return for the bank's accounting period ending on 31 March 2004 so as to include as taxable the premium of £91m received by the bank for its novation of interest rate swaps to another company in the same corporate group on the basis that paragraph 28 of Schedule 26 to the Finance Act 2002 did not apply so as to disregard the premium for the purposes of the bank's corporation tax liability, and (2) that a notice issued by **the revenue** under paragraph 32 of Schedule 18 to the Finance Act 1998 in error and later withdrawn purportedly closing an inquiry into the bank's self assessment return had the effect of disabling any challenge to the application of paragraph 28 of Schedule 26 to the novation.

On 8 April 2013 the First-tier Tribunal (Tax Chamber) (First-tier Tribunal Judge Nowlan and Ms Susan Lousada) dismissed the bank's appeal holding that (**1**) paragraph 28 of Schedule 26 did not apply to the novation,

*[**2017**] **1 WLR 2792** at 2794*

and (2) **the revenue** had not issued a disabling closure notice under paragraph 32 of Schedule 18 [2013] UKFTT 216 (TC).

On 14 February 2014 the Upper Tribunal (Tax and Chancery Chamber) (Peter Smith J) allowed the bank's further appeal in part holding that paragraph 28 did not apply to the novation but that **the revenue** had issued a closure notice that disabled any challenge to immunity from corporation tax liability for the novation premium [2014] UKUT 73 (TCC).

By an appellant's notice filed on 2 May 2014 **the revenue** appealed against the Upper Tribunal's finding on the closure notice issue on the ground that the judge was wrong to have concluded that a disabling notice had been issued. By a respondent's notice the bank cross-appealed on the ground that the judge had wrongly concluded that the novation was not a transaction to which paragraph 28 of Schedule 26 applied.

The facts are stated in the judgment of the court, post, paras *12–23*, *41*.

Kevin Prosser QC and *James Rivett* (instructed by *Treasury Solicitor*) for **the revenue**.

Graham Aaronson QC and *James Henderson* (instructed by *Herbert Smith Freehills LLP*) for the bank.

The court took time for consideration.

27 April 2016. **BRIGGS LJ** handed down the following judgment of the court.

1 This is the judgment of the court, to which all its members have contributed.

2 This appeal raises two discrete issues arising from tax litigation in the First-tier Tribunal ("FtT") and the Upper Tribunal ("UT") in which the taxpayer is **Bristol** & **West plc** ("B & W"), a member of the Bank of Ireland group, concerning the appropriate corporation tax treatment of the novation of a portfolio of "in the money" interest-rate swaps ("the Novation") to another company in the same group, Bank of Ireland Business Finance Ltd ("BIBF") for a premium of £91m, on 29 August 2003.

3 The first issue is one of substantive law, namely whether the Novation was a transaction to which paragraph 28 of Schedule 26 to the Finance Act 2002 applied, for the purpose of B & W's corporation tax liability in the accounting period during which the Novation occurred. In outline, paragraph 28 provides, in relation to transactions between group companies to which it applies, a form of disregard (or rollover) for corporation tax purposes. This issue, which we will therefore call "the disregard issue", is about the interpretation of paragraph 28, in its statutory context, by reference to very simple agreed facts.

4 In its self-assessment corporation tax return for the accounting period ending on 31 March 2004, B & W claimed the benefit of that disregard by not bringing into account for corporation tax purposes its receipt of the £91m premium. **HM Revenue and Customs** ("**HMRC**") amended B & W's return so as to bring that sum into account. On B & W's appeal both the FtT (First-tier Tribunal Judge Nowlan and Ms Susan Lousada) and the UT (Peter Smith J) decided, for broadly similar reasons, that the disregard in paragraph 28 did not apply to the Novation.

*[**2017**] **1 WLR 2792** at 2795*

5 The second issue is purely procedural. The question is whether, in the course of correspondence between **HMRC** and B & W in October and November 2007, **HMRC** issued a closure notice within the meaning of paragraph 32 of Schedule 18 to the Finance Act 1998, which had the effect of disabling any challenge by **HMRC** to the application of the statutory disregard to the Novation, in B & W's self-assessment tax return. Again, since the relevant communications between the parties were all in writing, (and since it is not suggested that the subjective intentions or beliefs of the writers on each side are determinative of the question), this second issue is one of analysis, upon facts which are not in dispute. We will call it "the closure issue".

6 In its appeal to the FtT B & W maintained, unsuccessfully, that **HMRC** had indeed issued a disabling closure notice, but the FtT disagreed. In the UT, the judge came to the opposite view so that, regardless of B & W's failure in both tribunals on the disregard issue, it was none the less successful overall, in maintaining immunity from corporation tax liability in relation to the premium paid to it for the Novation.

7 The result was that **HMRC** is the appellant in this court, seeking to reverse the UT's decision on the closure issue, and B & W cross-appeals by respondent's notice on the disregard issue. Having heard the helpful submissions of Mr Kevin Prosser QC for **HMRC** and Mr Graham Aaronson QC and Mr James Henderson for B & W in that order, we propose to deal with the closure issue first.

The closure issue

8 Part IV of Schedule 18 to the Finance Act 1998 makes provision for inquiry into self-assessment tax returns by companies in relation to corporation tax. In outline, paragraph 24 provides that **HMRC** may inquire into a company tax return if they give notice to the company of their intention to do so within a specified time. Paragraph 27 gives **HMRC** power to require the company to produce such documents and to provide such information as they may reasonably require for the purposes of the inquiry. Paragraph 30 empowers **HMRC** to amend the company's self-assessment during the course of the inquiry, upon specified grounds, and paragraph 31 makes provision as to the consequence of an amendment by the company of its own tax return during the progress of an inquiry. Paragraphs 31A to 31D make provision for the reference to the special commissioners (as the procedure was then, prior to the introduction of the tribunal system for tax appeals) of questions arising in connection with the subject matter of the inquiry while the inquiry is in progress, for their determination.

9 Paragraph 32 then provides as follows, in relation to completion of the inquiry (as amended by section 50 of and paragraph 68(a) of Schedule 4 to the Commissioners for Revenue and Customs Act 2005):

> "An inquiry is completed when an officer of Revenue and Customs by notice (a 'closure notice') informs the company the officer has completed the officer's inquiry and states the officer's conclusions. The notice takes effect when it is issued."

10 Paragraph 33 makes provision for the company to apply (then) to the commissioners for a direction that **HMRC** give a closure notice within a specified period. The commissioners are obliged to give that direction unless

satisfied that **HMRC** have reasonable grounds for not giving a closure notice within a specified period.

11 Paragraph 34 makes the following provision about amendment of the return after the completion of the inquiry. First, the company is given 30 days beginning with the day on which the inquiry is completed to amend its return, so as to bring it into accord with the conclusions stated in the closure notice. Secondly, **HMRC** is empowered, during the following 30 days, to make such amendments to the company's return, by notice, as they consider necessary. Provision is then made for an appeal by the company, within a further 30 days after notification of the amendment.

The facts

12 The Novation occurred, as we have said, on 29 August 2003. It fell within B & W's accounting period ending on 31 March 2004. B & W submitted its tax return for that period on 7 April 2005. We will call it "the return".

13 **HMRC** gave notice of its intention to inquire into the return by notice dated 22 November 2005. By March 2007 **HMRC** had made it clear in correspondence that a principal issue in the inquiry was the question whether, as B & W claimed but **HMRC** disputed, the disregard in paragraph 28 of Schedule 26 to the Finance Act 2002 applied to the Novation. There was an additional issue in the inquiry, which we will label "the accrued income issue" without needing to describe it.

14 In mid-September 2007, correspondence shows that the inquiry was still an ongoing one in the sense that **HMRC** was seeking further specialist advice about the disregard issue, and also seeking clarification on certain points from B & W.

15 The correspondence about the inquiry was carried on mainly between a Mr Gavin Howard, a tax specialist in **HMRC**'s direct tax section, and a Mr Liam Boyd, the head of UK Tax for the Bank of Ireland on behalf of B & W. There were also parallel inquiries into the tax returns of two other Bank of Ireland subsidiaries.

16 On 30 October (or possibly one day earlier) Mr Howard made a written request to his colleague, a Mr Gill, to issue closure notices in relation to the inquiries relating to those two other group companies. By mistake, Mr Gill also took the requisite steps (by input into the **HMRC** computer system) to issue closure notices in relation to the inquiry into B & W's tax return for the 2004 period (i e the return), and also its return for the previous year. Those inputs by Mr Gill set in motion a process which led inexorably to the printing of a closure notice document, hundreds of miles away, by **HMRC**'s contractor Fujitsu, even though Mr Howard discovered Mr Gill's error later on 30 October, and tried, unsuccessfully, to prevent that happening.

17 Recognising that, once printed, the notice would be put into an envelope by Fujitsu and collected from its premises for postal delivery by Royal Mail, and that he was for all practicable purposes powerless to prevent its posting in due course to B & W, Mr Howard sent Mr Boyd the following e-mail, at 07.44 on the following morning (31 October):

> "Morning Liam, I wanted to pre-warn you that two closure notices were issued today in error in relation to B & W **plc** for periods ended
>
> *[**2017**] **1 WLR 2792** at 2797*
>
> 31/03/03 and 31/03/04. We will be taking action to correct the position in due course. I'll confirm the position in writing within the next few days. Best regards Gavin"

Mr Boyd, who was at home, unwell, at the time, responded at 08.16 on the same day in an e-mail sent from his Blackberry, saying: "OK Gavin. Thanks". We will refer to Mr Howard's e-mail as "the October e-mail".

18 It is possible, although not certain, that the computer-generated notice had been printed and put into an envelope by the time of the October e-mail, but it was not collected for posting from Fujitsu until **1** November, as second class post, and therefore not delivered until Saturday 3 November, or possibly the following Monday or Tuesday, 5 or 6 November. We will call it "the October notice".

19 The October notice, as printed, posted and received, described itself as having been issued on 31 October. It was in conventional and uncontentious form for the purposes of notifying the completion of the inquiry, and stating, as **HMRC**'s conclusions, that no amendment need be made to the return.

20 Mr Howard followed up the October e-mail with a further e-mail sent to Mr Boyd on the morning of 8 November, enclosing a letter which we will call "the November letter". After expressing the hope that Mr Boyd had fully recovered, Mr Howard continued:

> "Further to my e-mail on 31 October concerning the closure notices that were issued in error in relation to B & W **plc** for periods ending 31/03/03 and 31/03/04, I herewith attach a letter explaining the action we will be taking to correct the position in due course … Please accept my apology for the error and feel free to call me if you'd like to discuss further."

21 Bearing in mind the weight of submissions directed to the November letter, it is convenient to set it out in full:

"Dear Mr Boyd

"***Bristol*** *&* ***West plc***

"*Years ended 31 March 2003 and 31 March 2004*

"*Closure notices issued on 30 October 2007*

"I refer to our recent e-mail exchange regarding the closure notices issued in error for B & W **plc** for the two accounting periods noted above. First of all I apologise for the error on our part in issuing these notices and for any confusion that their issue may have caused. As promised I am now writing to explain the action I propose taking so as to enable us to ensure that the assessments can ultimately be finalised in the correct amounts and that the basis upon which they are ultimately finalised is sound in law. The present position is that, albeit in error, closure notices were issued on 30 October 2007 and those notices are effective under paragraph 32(**1**) Schedule 18 FA 1998 marking the completion of the inquiries into the returns made by B & W **plc**. The original self assessments however remain in place and have not been amended by the closure notices.

"Paragraph 34 Schedule 18 provides that:

"(**1**) The company has 30 days to amend its return in accordance with the closure notice.

"(2) If after the end of that 30-day period **HMRC** are not satisfied that the return that was the subject of the inquiry is correct and complete, they may, within the following period of 30 days, make such amendments of the return as they consider necessary.

"(3) An appeal may be brought against any such amendment of a company's return.

"In order to ensure that the assessments may ultimately be finalised in the correct figures I therefore propose making amendments to the returns of B & W **plc** under the provisions of paragraph 34(2). The relevant notices of amendment to the returns will be issued shortly after 30 November 2007 being the expiry of the period referred to in paragraph 34(**1**). Bank of Ireland will no doubt wish to appeal those amendments and we will then be in a position where the assessments can ultimately be finalised in the correct figures by agreement under section 54 of the Taxes Management Act 1970 in the light of the conclusions reached regarding the ongoing issues. Put shortly, in relation to these accounting periods for B & W **plc** the statutory position will be akin to that which generally prevailed for all corporation tax returns and accounting periods for pre-CTSA accounting periods.

"I trust the above has now clarified for you the legal basis upon which we will be moving forward. Once again I apologise for any confusion and inconvenience this situation has created.

"Yours sincerely …"

Mr Boyd replied very briefly to Mr Howard, by e-mail later that morning: "even Homer nods—don't worry about it Gavin …"

22 On 6 December 2007, **HMRC** amended the return so as to assess corporation tax recoverable on the basis that the paragraph 28 disregard did not apply to the Novation. B & W then appealed that assessment.

23 Later, although of no relevance for the purposes of the analysis of this issue, **HMRC** purported to withdraw the closure notice which it had in the previous November letter asserted as having been validly issued by the October notice. Only in February 2010 did **HMRC** assert, for the first time, that the October notice had not been a valid closure notice. This was followed by a further amendment of the return made on 16 March 2010 by **HMRC**, and an appeal by B & W on 9 April 2010.

Law and analysis

24 The following matters are common ground between the parties, and we see no reason to doubt them:

(i) There is no prescribed form for a closure notice under paragraph 32, but it is essential to the validity of such a closure notice that the document (or perhaps documents) relied upon should both state that **HMRC** has completed their inquiry, and state their conclusions. This flows naturally from the language of paragraph 32(**1**).

(ii) The only alternatives (as a matter of law) for the issue date of a closure notice sent by post are the date of posting and the date of receipt. It is unnecessary in this case to decide which is correct.

(iii) “Notice” in paragraph 32(1) means notice in writing: see section 832 of the Income and Corporation Taxes Act 1988.

(iv) A closure notice once issued cannot be withdrawn unilaterally by **HMRC**.

(v) Having issued a closure notice, **HMRC** have no power to amend the relevant tax return otherwise than to give effect to the conclusions stated in the closure notice: see paragraph 34(2)(b).

Thus it is common ground that if the October notice was validly issued as a closure notice, there was nothing which **HMRC** could do thereafter to disable B & W from relying upon the paragraph 28 disregard in relation to the Novation, even if not entitled to do so as a matter of law. Similarly, if (as found by the UT) the November letter had the effect of bringing to an end a temporary suspension of the October notice as an issued closure notice, either on 8 November or retrospectively, **HMRC** would be similarly disabled. It follows also that if the November letter was itself a closure notice, and incorporated **HMRC**’s conclusions about the inquiry as stated in the October notice, then again **HMRC** would be similarly disabled.

25 The result of that common ground is that the answer to the closure issue depends entirely upon whether the October notice or the November letter, or some combination of the two, can be said to have amounted to the issue of a closure notice in relation to the inquiry into the return, stating as **HMRC**’s conclusion that it did not need to be amended, in relation to the applicability of the paragraph 28 disregard.

26 It is both convenient and illuminating to approach that issue chronologically, starting with the alternative potential issue dates for the October notice, ignoring for that purpose the November letter. Those dates were 1 November (if posting is the relevant date) and 3 or 5–6 November if the issue date is the date of receipt. In our view the answer to the question identified in para 25 above depends upon the correct interpretation of the October notice, as it would be understood by a reasonable person in the position of its intended recipient, namely B & W, having B & W’s knowledge of any relevant context: see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749. At p 767G Lord Steyn said, in relation to a contractual notice served by a landlord under a lease:

> “The question is not how the landlord understood the notices. The construction of the notices must be approached objectively. The issue is how a reasonable recipient would have understood the notices. And in considering this question the notices must be construed taking into account the relevant objective contextual scene.”

27 In the *Mannai* case, the context was sufficient to enable a notice to be interpreted as valid where, viewed on its own, it appeared to be invalid. But context may work both ways. In *Barclays Bank plc v Bee* [2002] 1 WLR 332 the simultaneous service of two incompatible statutory notices (under Part II of the Landlord and Tenant Act 1954) had the effect of invalidating both of them, even though, viewed on its own, the relevant notice was in perfect conformity with the statutory requirements. As Wilson J put it, at para 56:

> “The covering letter dated 18 December 1997 enclosed the two documents and alleged that the one was a copy of the other. Of course, as was immediately apparent to the tenant’s agent, neither was a copy of the other. On the contrary, the kernel of the two documents was entirely

> inconsistent and the central message to the tenant was hopelessly and instantaneously confused. In those circumstances, despite appearances when each is taken out of context, neither of the documents enclosed under cover of that letter can sensibly be construed to have made the statement of intention as to opposition or otherwise, which is a prerequisite of its effectiveness set by section 25(6) of the Act."

Earlier, Aldous LJ said, at para 23:

> "[Counsel for the bank] went on to emphasise to us that document B was a valid notice on its face, as it was in the prescribed form. He submitted that it could not be invalidated by reference to extraneous material. In principle, of course, that is right. If document B was the notice that was served and it need not be construed together with document A as part of the contextual background, then that is an end of the matter."

None the less, that principle was not applied in the *Bee* case because each of the simultaneously delivered documents was part of the contextual background to the other.

28 Mr Prosser referred us, out of his duty to the court, to *Saxon Weald Homes Ltd v Chadwick* [2012] HLR 8, in which two successive letters were sent by the landlord to its tenant, the first seeking possession and the second, a week later, confirming that the tenant had achieved the status of assured tenant. It was argued by the landlord, unsuccessfully, that the second letter was invalidated because of the prior delivery of the first since, in conjunction, they delivered a contradictory and confusing message. At paras 24–25 Davis LJ said this:

> "24. As noted by Aldous LJ, at para 23 of *Bee*, in principle an (ostensibly) valid notice cannot, as a matter of interpretation, be invalidated by reference to extraneous material. In my view, with all respect to Mr Glen's valiant arguments, that is in substance what the landlord is seeking to do here …

> "25. In my view, [counsel for the tenant] neatly summarised the essential flaw in Mr Glen's argument: that is, that he was not using the factual matrix to make the reading of the letter of 11 August 2009 clear: rather, he was using it to make it unclear."

29 At first sight it might be thought that Davis LJ was extracting, from the dictum of Aldous LJ in *Bee's* case quoted above, a general principle that context may validate that which, read on its own, is invalid, but not invalidate that which, read on its own, appears to be valid. In our view, there is no such principle, and Aldous LJ was not in *Bee's* case seeking to suggest that there was. He was merely saying that an apparently inconsistent document (document A in that case) will not invalidate a document which appears valid on its face (document B) if the inconsistent document did not form part of the contextual background to the document relied upon. In *Bee's* case, document A plainly did form part of the contextual background, because it was delivered at the same time as document B. By contrast in the *Saxon Weald* case, the earlier inconsistent letter did not form part of the relevant contextual background, since its inconsistency with the later letter was capable of being explained on the

ground that the landlord had, in the meantime, changed its mind. Far from establishing any principle that context may not invalidate a document which appears valid on its face, read in isolation, in our view *Bee's* case constitutes plain authority for the opposite conclusion for the reasons stated above.

30 Mr Aaronson did not submit for B & W that the October e-mail, forewarning B & W that it was about to receive a closure notice which had been issued in error, did not form part of the relevant factual context for the purposes of interpreting the October notice. In our view it plainly did. Although earlier in time, its terms excluded any possibility of a change of mind on the part of **HMRC** between 31 October (when the e-mail was sent) and the (later) date of issue of the October notice. On the contrary, it invited the reader to consider both documents together and, plainly, not to treat the October notice, once received, as a statement that **HMRC** had completed its inquiry with the conclusions therein stated. It is true that the October e-mail did not explain the nature of the mistake, by stating either that the inquiry was in fact continuing or that the conclusions stated were incorrect, or both. But, viewed as at either of the competing dates of issue, it was plainly sufficient to invalidate the October notice, looking at the matter on any of the competing dates between **1** and 6 November.

31 The next question is whether, as the UT concluded, the effect of the October e-mail was to put the issue of the October notice, as a valid closure notice, into suspension, by stating that **HMRC** would confirm the position in writing within the next few days. Peter Smith J's view was that the effect of the October e-mail together with Mr Boyd's short response, was to put the October notice into a form of agreed suspension. This was the springboard for his conclusion that the effect of the November letter was to bring the October notice into full effect as a valid closure notice. At para 42 of his decision he said: "In my view it would have been open to **HMRC** by that letter to have withdrawn the closure notices having put their effect into suspension by the e-mail with Mr Boyd's agreement." Referring to the November letter, he said, at para 45: "That has the effect of lifting the agreed suspension so that the closure notices become effective."

32 In our view there is no basis for a conclusion that a suspension was agreed. Earlier, at para 37, the judge had said, in relation to Mr Boyd's short response: "I do not think that his short response in the morning when he was ill at home has any significance beyond the fact that he acknowledged Mr Howard's e-mail and was simply waiting to receive the clarification." We agree. Mr Howard was not asking for anything to be agreed, and Mr Boyd was not purporting to do so.

33 We would prefer to leave until a case in which it matters the question whether **HMRC** and the taxpayer can agree to vary the provisions of the closure notice regime. In the absence of agreement it must be asked whether **HMRC** has the power to deliver a closure notice on a suspended basis, so that it becomes validly issued, if at all, only upon such later date as **HMRC** choose. The short and simple answer is that, in our view, it does not have that power. Paragraph 32(**1**) is clear. The notice takes effect when it is issued, neither earlier nor later. This interpretation accords both with the purpose of this part of the inquiry procedure, and with the procedural consequences of a closure notice. Taking the whole of paragraph 32(**1**) in its own context, the scheme requires **HMRC** first to decide to close its inquiry, so that it has been completed, to form a concluded view as to whether, and if

so what, amendments are needed to be made to the self-assessment return to which the inquiry relates, and then to communicate both the completion of the inquiry and their conclusions to the taxpayer. There is no scope therefore for sending a closure notice at a time when **HMRC** has yet to make up its mind either whether the inquiry is completed, or about its conclusions arising from it.

34 Mr Aaronson tried long and hard to persuade us that an inquiry is only one stage in an iterative process of discussion and negotiation between **HMRC** and the taxpayer, and that such processes frequently continue after the closure of the inquiry while, for example, the amendment to a return is the subject matter of an appeal. He even suggested that **HMRC** was not in practice limited to the amount of tax claimed in any conclusions to an inquiry or consequential amendment to the return, although he acknowledged that it would probably require a discovery assessment to enable **HMRC** to seek more.

35 We do not doubt that the conclusion of an inquiry and the expression of **HMRC**'s conclusions in a closure notice leaves open for further debate, negotiation and settlement the final outcome as to the extent of the taxpayer's tax liability. But we reject any notion that the closure of the inquiry and the expression of **HMRC**'s conclusions arising from it can be belittled as a mere procedural pause. Closure marks an important stage at which the inquiry (with **HMRC**'s attendant powers and duties) ends, **HMRC** is required to state its case as to the amount of tax due, in the closure notice itself, following which its power to amend the assessment is limited to such amendments as will give effect to those conclusions. These provisions contain requirements of real potential value to the taxpayer, hence its right under paragraph 33 to seek a direction that **HMRC** issue a closure notice.

36 Furthermore, the closure notice marks the beginning of a series of precisely timed stages during which, first, the taxpayer is permitted to amend its own self-assessment; secondly, **HMRC** is, if not satisfied by any such amendment, empowered to amend; and thirdly, such an amendment may be challenged by the taxpayer by way of appeal. It would gravely detract from the procedural certainty intended to be created by those provisions and time limits if **HMRC** had a unilateral power to deliver a suspended closure notice intended to come into effect on some date in the future, which is itself not specified in the notice.

37 The final question is therefore whether the November letter was itself a closure notice, read on its own or read as if the October notice was incorporated by reference as part of it. Mr Aaronson submitted that we should not take an overly technical attitude to this, but apply practical common sense, relying for that purpose on dicta in *Portland Gas Storage Ltd v Revenue and Customs Comrs* [2014] STC 2589, paras 47–53. Viewed in that way he submitted that the effect of the November letter, read alone or in combination with the October notice, was unmistakeably to say that **HMRC** had completed their inquiry, and that the statement of an intention thereafter to amend the return was merely the mistaken assertion of a non-existent power to do so.

38 Applying practical common sense, we are prepared to assume that the November letter (read alone or with the October notice to which it referred) did communicate a clear message that **HMRC** had completed its

inquiry. But it left the reasonable reader in hopeless confusion, and partly in the dark, about their conclusions. The October notice purported to state a conclusion that the return needed no amendment, whereas the November letter stated that **HMRC** intended to amend the return, but without any specification of the amendment intended to be made. Even if the reasonable reader might infer from what had gone before that the threatened amendment would include a disallowance of the disregard in relation to the Novation, it left the reader completely in the dark about **HMRC**'s conclusions about the accrued income issue, which had also been live during the inquiry.

39 This analysis requires no conclusion, one way or the other, about whether a valid closure notice may be constituted by two documents, where one is incorporated by reference in the other. Even if it may, the November letter was not a valid closure notice in its own right, because of the failure to state **HMRC**'s conclusions. Nor did it purport to be a closure notice. For the reasons already given it could not re-clothe the October notice with validity.

40 The result is that **HMRC**'s appeal in relation to the closure issue must be allowed.

The disregard issue

41 The disregard issue arises, as mentioned at the start of this judgment, out of the Novation of a portfolio of interest rate swap derivative contracts by B & W to BIBF for a premium of £91m. The Novation occurred on 29 August 2003 which fell within the accounting period of B & W commencing on **1** April 2003 and in the accounting period of BIBF commencing on **1** September 2002. By virtue of section 83(3) of the Finance Act

2002, Schedule 26 to the Act, containing a comprehensive code as regards corporation tax on derivative contracts, took effect in relation to accounting periods beginning on or after **1** October 2002. The Schedule therefore applied to B & W, but not to BIBF, as regards their respective accounting periods in which the Novation took place.

42 B & W submits that, by virtue of paragraph 28 of Schedule 26, the premium of £91m paid to it on the Novation would not be entered as a credit in its accounts and would not therefore be subject to charge to corporation tax. However, BIBF was entitled to enter the novated contracts in its accounts at the cost to it of the premium of £91m, so that it is only any subsequent gain made by it on those contracts which would be chargeable to corporation tax in its hands. In effect, the premium of £91m would not be brought into account for corporation tax purposes by either company, with a resulting loss of taxation and a corresponding benefit to the companies and the group of which they formed part. While the underlying derivative contracts had been entered into for entirely commercial reasons and there had been no change in the accounting periods of the two companies for the purposes of the Novation, B & W accepts that the Novation was effected for the purpose of securing a tax advantage.

43 Schedule 26 replaced an earlier set of provisions, contained in the Finance Act 1994, for the taxation of derivative contracts. The comprehensive scope of the Schedule is made clear by Part **1** (Introduction) which provides by paragraph **1**:

> "(**1**) For the purposes of corporation tax all profits arising to a company from its derivative contracts shall be chargeable to tax as income in accordance with this Schedule.
>
> "(2) Except where otherwise indicated, the amounts to be brought into account in accordance with this Schedule in respect of any matter are the only amounts to be brought into account for the purposes of corporation tax in respect of that matter."

44 Part 2 (Derivative contracts) defines in paragraphs 2–13 the derivative contracts to which the Schedule applies. Part 3 (paragraphs 14–16) sets out the methods by which the credits and debits arising on derivative contracts are brought into account for corporation tax purposes. Paragraph 14(2) provides that the credits and debits given in respect of a derivative contract in any accounting period shall be treated as, respectively, receipts of its trade for the purpose of computing its profits or expenses of that trade deductible in computing those profits. Paragraph 15(**1**) provides that the credits and debits to be brought into account "shall be the sums which, in accordance with an authorised accounting method and when taken together, fairly represent, for the accounting period in question" all profits, losses, charges and expenses arising or incurred from or for the purposes of its derivative contracts and related transactions. There are two authorised accounting methods, the accruals basis and the mark to market basis. As regards the novated interest-rate swap contracts, B & W used the accruals basis. Part 4 of the Schedule (paragraphs 17–21) deals with these accounting methods and the circumstances in which they are to be applied.

45 Part 6 is headed "Special computational provisions" and, in paragraphs 23–31, contains provisions dealing with a wide variety of different topics. Some, but by no means all, of the paragraphs contain anti-avoidance provisions: see paras 23–24 and 26.

46 Paragraph 28 with which this appeal is concerned, provided at the time of the Novation (as amended by section 179 of the Finance Act 2003):

> "(**1**) This paragraph applies where, as a result of any transaction or series of transactions falling within sub-paragraph (2), one of the companies there referred to ('the transferee company') directly or indirectly replaces the other ('the transferor company') as a party to a derivative contract.
>
> "(2) The transactions or series of transactions referred to in sub-paragraph (**1**) are— (a) a related transaction between two companies that are— (i) members of the same group, and (ii) within the charge to corporation tax in respect of that transaction; (b) a series of transactions having the same effect as a related transaction between two companies each of which— (i) has been a member of the same group at any time in the course of that series of transactions, and (ii) is within the charge to corporation tax in respect of the related transaction; (c) a transfer between two companies of business consisting of the effecting or carrying out of contracts of long-term insurance which has effect under an insurance business transfer scheme; and (d) any transfer between two companies which is a qualifying overseas transfer within the meaning of paragraph 4A of Schedule 19AC to the [Income and Corporation] Taxes Act 1988 (transfer of business of overseas life insurance company).

*[**2017**] **1 WLR 2792** at 2805*

> "(3) The credits and debits to be brought into account for the purposes of this Schedule in the case of the two companies shall be determined as follows— (a) the transaction, or series of transactions, by virtue of which the replacement takes place shall be disregarded except— (i) for the purpose of determining the credits and debits to be brought into account in respect of exchange gains or losses and identifying the company which is to bring them into account, or (ii) for the purpose of identifying the company in whose case any credit or debit not relating to that transaction, or those transactions, is to be brought into account; and (b) the transferor company and the transferee company shall be deemed (except for those purposes) to be the same company.
>
> "(4) References in this paragraph to one company replacing another as party to a derivative contract shall include references to a company becoming party to any derivative contract which— (a) confers rights or imposes liabilities, or (b) both confers rights and imposes liabilities, where those rights or liabilities, or rights and liabilities, are equivalent to those of the other company under a derivative contract to which that other company has previously ceased to be party."

47 There was no equivalent provision dealing with intra-group transfers in the provisions replaced by schedule 26. Paragraph 28 was amended as regards transactions carried out on or after 16 March 2005, so that the disregard issue no longer arises in practice.

48 It is not in dispute that the Novation satisfies the conditions set out in paragraph 28(**1**) and (2). By virtue of the Novation, BIBF (the transferee company) directly replaced B & W (the transferor company) as a party to the portfolio of derivative contracts. The Novation was a transaction to which paragraph 28(2)(a) applied. "Related transaction" is defined in paragraph 15(7) as meaning any disposal or acquisition of rights or liabilities under a derivative contract. The Novation was between two companies that were members of the same group and were "within the charge to corporation tax in respect of that transaction". It is common ground that this latter phrase is a general expression, referring to the transaction being within the scope of corporation tax for both companies, rather than being a reference to corporation tax specifically under Schedule 26.

49 In these circumstances, it is B & W's case that the provisions of paragraph 28(3) apply to determine the credits and debits to be brought into its accounts, which involves disregarding the Novation (save to the extent, if any, to which sub-paragraphs (i) or (ii) of paragraph 28(3)(a) might apply). The result is that the premium of £91m paid to it is not brought into its accounts as a credit and is therefore not within the charge to corporation tax on its profits.

50 HMRC's case is that paragraph 28 applies only where paragraph 28(3) can be applied to the accounts of both the transferor and the transferee companies. This is not the case as regards BIBF because the Novation occurred in its accounting period commencing on **1** September 2002 and is not therefore an accounting period to which Schedule 26 applies.

51 HMRC's case was accepted by both the FtT and the UT.

*[**2017**] **1 WLR 2792** at 2806*

52 The core of the reasoning of the FtT is contained in paras 76–77 of their decision:

> "76. We entirely accept that so far as sub-paragraphs 28(**1**) and 28(2) are concerned, those sub-paragraphs do aptly refer to the situation of [B & W] and BIBF in relation to the Novation. [B & W]'s difficulty, however, is that it is sub-paragraph 28(3) that governs what must be done when a transaction is effected by the parties covered by the opening two sub-paragraphs. And on the literal meaning of sub-paragraph 28(3) what must happen is that both the transferor and the transferee must be taxed in the manner provided. Sub-paragraph (3) does not apply disjunctively to the transferor and the transferee. Had it provided that where sub-paragraphs (**1**) and (2) applied, the transferor was to be treated in a particular way, and the transferee in another way, it is arguable that if one (say the transferor) was capable of being treated in the manner provided for it, whilst the other was not, then the transferor should still be treated as provided. But this is not how the paragraph was worded. It required the two companies to be treated in a clearly matching manner. If we address to [B & W] and BIBF the questions of 'Is that how you have presented your respective returns?', and 'Would it even have been possible to present your returns on the basis prescribed for the two companies together?', the answers would manifestly have been 'No' and 'No'. It is quite clear to us, without remotely straining the language of paragraph 28 to achieve what was manifestly Parliament's purpose, that paragraph 28 only operates when the parties do what it directs should be done which is to bring into account 'for the two companies' the various debits and credits prescribed by the slightly complex rules and the fictitious notions laid down by paragraph 28(3).
>
> "77. We then address the follow-on question of what should be done when a transaction has been effected by the parties identified by sub-paragraphs 28(**1**) and (2) but the direction prescribed by sub-paragraph 28(3) cannot be achieved. The resultant choice is between the fol-

> lowing two possibilities. The first is to say that if the operative sub-paragraph cannot be applied and operated, then there is nothing to be done. The provision simply does not operate. The alternative is to strain the language of paragraph 28(3) and contend that even if it cannot operate in the manner that is clearly both required, and implicit (from the later notions in the sub-paragraph), it should still be treated as applicable to the one company even though that is not what is envisaged or directed. Since this is manifestly contrary to the obvious intent of Parliament, the conclusion is obvious to us. Our conclusion therefore is that, far from having to stretch the language of paragraph 28 against Mr Aaronson's contentions, and in his view 'to breaking point', such that on appeal our decision would be bound to be held to have been wrong, the reverse is the reality."

53 Peter Smith J, sitting in the UT, agreed with this analysis. He said that he could not see how paragraph 28 could operate unless both companies fell within the regime. He said, at para 106:

> "It is clearly contemplated that both companies are under consideration. It could not be made more clear in sub-paragraph (3)
>
> *[**2017**] **1 WLR 2792** at 2807*
>
> which refers to the credits and debits to be brought into account in the case of the two companies. It follows from that inexorably that the two companies were supposed to be the subject matter of the disregard. That means that both companies must be within the FA 2002 regime. This would achieve group neutrality in that the transaction would be disregarded. However it does not work when one company is not within the 2002 regime. The final point which leads to the construction favoured by the FtT is sub-paragraph (3)(b) 'the transferor company and the transferee company shall be deemed … to be the same company'."

54 Peter Smith J considered that paragraph 28(3)(b) was fatal to B & W's case. He said, at para 107:

> "BIBF cannot be the same company because its accounts are being written up on the basis that its opening figure is £91m; that is the whole purpose of the scheme. If its accounts are opened on the figure which B & W acquired the derivatives for it would then operate in the same way where both companies were under the 2002 FA regime but the purpose of the scheme would fail as the £91m would not disappear. That provision inevitably leads to the conclusion that both companies must be considered to be operating under the regime."

55 On this appeal, B & W broadly repeats the submissions made before the tribunals below. Its starting point is that the Novation fell within the terms of paragraph 28(**1**) and (2). As the Novation occurred in an accounting period of B & W to which Schedule 26 applied, it followed that paragraph 28(3) should apply to determine the credits or debits, if any, to be brought into account by it as a result of the Novation. Although paragraph 28(3) refers to the credits and debits to be brought into account for the purposes of the schedule "in the case of the two companies", it is submitted that the natural reading of the sub-paragraph is that each company, when preparing its tax return, should determine the debits and credits to be brought into account on that basis, if Schedule 26 applies to that company. On that basis, there need not be a symmetry of treatment between the transferor and the transferee company. Corporation tax is levied on a company by

company basis, and in applying paragraph 28 to the transferor or the transferee company, it does not matter that the paragraph does not apply to the other company.

56 B & W submits that the self-evident purpose of paragraph 28 is to permit the transfer of derivative contracts between group companies within the charge to UK corporation tax without triggering a charge to tax. It follows, it submits, that **HMRC**'s case does not give effect to the purpose of the provision. B & W accepts that a second purpose of the provision is to achieve tax neutrality in relation to intra-group transfers but the draftsman has failed, in the circumstances which arise in the present case, to achieve it. There is a drafting error, which could have been cured either by providing in paragraph 28(2) that the two companies must be "within the charge to corporation tax in respect of that transaction *under or by virtue of this Schedule*", adopting a formula used in the anti-avoidance provision in paragraph 26, or by including a suitable transitional provision to deal with the situation. Schedule 28 contains transitional provisions and it is pointed out that paragraph **1** contains an anti-avoidance provision to deal with the

situation in which a group company changes its accounting period in order to take advantage of paragraph 28 in circumstances where it would not otherwise apply.

57 Like the FtT and Peter Smith J, we have no hesitation in rejecting the submissions made on behalf of B & W. For the reasons given in their decisions, quoted above, it is in our view clear that paragraph 28 can only operate where both the transferor company and the transferee company are subject to Schedule 26. Both the requirement that sub-paragraph 28(3) applies to determine the credits and debits to be brought into account "in the case of the two companies" and the requirement that the transferor and transferee companies "shall be deemed … to be the same company" leave no room for any other interpretation. B & W's approach of, first, seeing whether the Novation satisfies paragraph 28(**1**) and (2) and, then, applying sub-paragraph (3) as best one can, does not give effect to the provisions of the paragraph. The paragraph must be read and applied as a whole.

58 Having regard to the terms of paragraph 28, we do not accept B & W's characterisation of the purpose of paragraph 28 as being to ensure that no charge arises as a result of an intra-group transaction. The purpose, as submitted on behalf of **HMRC**, is to achieve tax neutrality in relation to intra-group transfers. That purpose is evident from the terms of paragraph 28(3) and paragraph 28, read as a whole, is effective to achieve that purpose. We do not accept that there is any error in the drafting of paragraph 28. No doubt the addition of the formula used in paragraph 26 would have prevented B & W from pursuing its case, but in the light of the terms of paragraph 28(3) its omission was not a mistake and its inclusion would be unnecessary to confine the operation of paragraph 28 to transactions between group companies, both subject to Schedule 26.

59 For these reasons, B & W's cross-appeal fails.

Conclusion

60 For the reasons given in this judgment, we allow the appeal of **HMRC** and dismiss the cross-appeal of B & W.

Appeal allowed.

Cross-appeal dismissed.

1 Finance Act 2002, Sch 26, para 28, as amended: see post, para *46*.

2 Finance Act 1998, Sch 18, para 32, as amended: see post, para *9*.