In the Royal Court of the Island of Guernsey

The 27th day of May, 2002 before Patrick John Talbot, Q.C. sitting alone

IN THE MATTER OF

THE ADMINISTRATOR OF TAXES

("the Appellant")

v.

TREMOILLE PROPERTIES LIMITED

("the Respondent")

Whereas on 9th, 10th and 11th October and 1st November, 2001 the Lieutenant Bailiff considered an appeal under the provisions of Section 80 of the Income Tax (Guernsey) Law 1975, as amended, by the Administrator of Income Tax, from the decision of the Guernsey Tax Tribunal, as set out by the Clerk to the Tribunal on 15th February, 2001, and heard thereon Advocates R. J. McMahon and P. T. R. Ferbrache Counsel for the Appellant and Respondent respectively.

The Lieutenant Bailiff this day gave judgment in the terms attached hereto and

1) DISMISSED the appeal

2) AWARDED the Respondent costs on a recoverable basis.

Her Majesty's Deputy Greffier

Final print

OFFICIAL TRANSCRIPT ~~TaxvTremJment27.502~~

MONDAY 27TH MAY, 2002

IN LA COUR ORDINAIRE

Before

Patrick John Talbot, Esq., QC, Lieutenant Bailiff

THE ADMINISTRATOR OF TAXES

- v -

TREMOILLE PROPERTIES LIMITED
(Civil Appeal No. 507)

Judgment delivered by Patrick John Talbot, Esq., QC; sitting alone

(as approved by the Lieutenant Bailiff)

Advocate Richard J. McMahon for the Appellant, the Administrator of Taxes

Advocate Peter T.R. Ferbrache for the Respondent taxpayer, Tremoille Properties Limited

LIEUTENANT BAILIFF PATRICK JOHN TALBOT Q.C.: This is my judgment in the Administrator of Taxes v. Tremoille Properties Limited on appeal from The Taxes Tribunal of Guernsey.

Introduction

1. This is an appeal by the Administrator of Taxes ("the Administrator") from the decision of the Guernsey Taxes Tribunal ("the Tribunal"), made on about 8th February 1999 and confirmed in a letter dated 15th February 1999 from the Clerk to the Tribunal, to reduce two assessments of income tax raised by the Administrator on the Respondent to the appeal, Tremoille Properties Limited ("the Company"), in October 1998 in respect of the tax years 1996 and 1997.

2. The central question on the appeal relates to payments made by the Company under two Base Rate Cap Agreements made between the Company and National Westminster Bank Plc ("the Bank") and dated 15th December 1994, (together "the

Cap Agreements"), the material terms and effect of which were helpfully summarised by the parties for the Tribunal in paragraph 3 of the Statement of Agreed Background Facts ("the Agreed Facts"), to which I shall refer later in this judgment.

3. The appeal raises the question which has been frequently addressed in the cases in England and Wales, but not it seems in Guernsey case law, whether the expenditure in question is revenue expenditure, and therefore deductible for income tax purposes from the profits of the company in each of the two years in question, or capital expenditure, and therefore not so deductible. It is common ground that the answer to the question in this case may also be applicable at least in relation to the Cap Agreement referred to in paragraph 3(b) of the Agreed Facts to the tax affairs of the Company for the next three years after the second year of assessment relevant to this appeal, that is to say, the years 1998, 1999 and 2000. As has so often been said in the context of this question, it is, I believe, far easier to state the question than to decide it in a particular case, see for instance the speech of Lord Upjohn in the Strick v. Regent Oil Company Limited (1965) 43 TC at page 51:

> *"I suppose that no part of our law of taxation presents such almost insoluble conundrums as the decision whether a receipt or outgoing is capital or income for tax purposes. Parliament* (referring of course to the United Kingdom Parliament) *wisely has never given any general statutory guidance in this matter; it has been content to leave the determination of these difficult matters to the commonsense of the tribunals and judges before whom these matters are brought."*

4. The hearing before the Tribunal proceeded on the basis of the Agreed Facts, and oral argument was presented at the Tribunal by each of the parties: by Mr. C. Michael Ayre, of the Company's accountants, BDO Reads and Co., and by the Administrator, Mr. Forman, on his own behalf.

5. The law and procedure relating to the appeal before the Tribunal are contained in the Income Tax (Guernsey) Law 1975, as amended ("the Tax Law").

6. It appears from the informal transcript, most helpfully prepared by the Company for this appeal, that the hearing on 8th February 1999 was quite informal, as is permitted in paragraph 5(2)(e) of the Third Schedule to the Tax Law which states as follows:

> *"At the hearing of an appeal the proceedings shall be conducted:*
>
> *(2) with as little formality and with as much expedition as proper consideration of the matters before the Tribunal will permit."*
>
> .....

7. The Tribunal was asked by the Administrator to state a Case by letter dated 16th February 1999, the day after their decision had been notified to the parties; but it was not until 5th December 2000 that the final version of the Case was signed on behalf of the Tribunal, about a year after the parties had let the Clerk to the Tribunal know of their comments on the last draft of the Case. It is, of course, unfortunate that so long a time had passed after the hearing before the Tribunal that a Case was stated, and, therefore, before this appeal could be lodged.

8. The hearing before the Tribunal apparently took place without a bundle of agreed documents having been prepared for the Tribunal; and the Tribunal's files do not, it seems, include either copies of the income tax assessments in issue or a copy of a bank facility letter relating to the borrowings of the Company relevant to the issues before them. Indeed, it is possible that the Tribunal may not have even had any papers before them relating to the appeal which was to be heard by them until the hearing began, which might, I suppose, on a matter of the complexity of this case, have caused them some difficulty.

9. Further, it is to be noted that, despite the terms of Section 76 of the Tax Law, which provides the taxpayer with a right of appeal to the Tribunal from an assessment of the Administrator, and despite the express terms of Section 18 of the Tax Law, which places the onus of proof that any expenditure is an allowable deduction from profits or income for the purposes of that Law on the person claiming so to deduct, the Tribunal was addressed first by the Administrator, who arrived with what seems to have been a large amount of material, largely consisting of legal textbook extracts and cases relating to the relevant area of English tax law, which he described as *"a monstrous box of goodies"*, and that the Administrator presented his argument first.

10. So the representative of the Company, which was of course, the Appellant before the Tribunal, that is to say, Mr. Ayre, addressed the Tribunal after the Administrator, who was the Respondent to the appeal, with the result that the final right of reply was not exercised by the Appellant Company, as I consider it obviously should have been, but by the Respondent Administrator. This procedural irregularity was most unfortunate and was not pointed out to Mr. Ayre, either by the Tribunal itself, (which is a body comprising lay people, rather than say lawyers or accountants or tax experts of other specialisation,) or by its Clerk or by the Administrator himself, who should, I think, have appreciated the position clearly himself, but clearly did not. Nor did it seem to have been realised at the time by Mr. Ayre.

11. I have concluded after careful consideration that this serious, rather than minor, irregularity did not, in the result, adversely affect the validity of the hearing (paragraph 5.3 of the Third Schedule to the Tax Law is relevant here). In the circumstances which appear from the informal transcript of the hearing, prepared by the Company, I consider that the Company received a fair hearing and that the Tribunal itself did comply with the rules of natural justice during the hearing of the appeal before it.

12. Nevertheless, on any other appeal to the Tribunal in the future from an assessment of income tax by the Administrator, the appeal should, in my judgment, be conducted on a very different basis. Amongst other things, the parties to the appeal should provide the Tribunal with an indexed, paginated and chronological bundle of relevant documents, preferably having also produced a written summary of argument with attached legal authorities to the Tribunal in good time, say a few days before the hearing date, the Appellant taxpayer should address the Tribunal on the issues arising on the appeal first, the Administrator should address the Tribunal second and the Appellant taxpayer should have the final right of reply. I also believe it would be helpful for a written transcript to be taken during the hearing so that a Case may be stated reasonably soon after one is requested by the unsuccessful party.

13. Finally, although I have not been able to reach a clear conclusion on this question, I do nurse some doubt whether during the period in which the appeal was heard and the Case Stated was drafted, amended, and concluded, the Tribunal itself had kept a

properly managed file relating to the Company's appeal. If this concern of mine is in fact unjustified, then I would ask the Tribunal to forgive me having such a doubt.

14. Perhaps there is some inherent indication of the time which might be thought appropriate for the stating of a Case by the Tribunal in Section 80(2) of the Tax Law, where a period of 21 days after the determination of the appeal by the Tribunal is the time limit given for a party *"dissatisfied with the determination as being erroneous in point of law"* to require the Tribunal to state and sign a Case for submission to the Royal Court.

15. I now turn to consider the issues in the present appeal.

Facts relevant to the Appeal

16. The Agreed Facts contained the factual basis on which the appeal to the Tribunal should properly have proceeded, since no witness was called before the Tribunal. Nevertheless, the informal transcript shows that both the Administrator and Mr. Ayre told the Tribunal of certain other facts during their addresses. This was, in my judgment, both understandable, bearing in mind the comparative informality of the hearing before the Tribunal, and unsurprising, since the Agreed Facts were described as *"Agreed **Background** Facts"*, (my emphasis,) and not, as it were, all the agreed facts relevant to the appeal.

17. The Agreed Facts were, so far as material, as follows:

> " (1) [The Company] is an investment company within the meaning of Section 169 of the Income Tax (Guernsey) Law 1975, in that its activities consist wholly or mainly in the making of investments. Now the principal part of its income, that is to say, rental income, is derived therefrom.
>
> (2) The Company's audited financial statements disclosed details of amounts due in respect of a bank loan bearing interest at 2¼% above the bank base rate and repayable by quarterly instalments within 5 years. The notes to the relevant financial statements include details of what amounts were outstanding at the year ends and when such amounts fall due as follows:
>
> (i) as at 31st December 1995; within 1 year £290,019; between 1 and 2 years £325,364; between 2 and 5 years £1,197,280, making a total of £1,812,663 and equivalent figures for the year to 31st December 1996, making a total for that year of £1,451,711.
>
> (3) To protect itself against fluctuating interest rates the Company has effected two Base Rate Cap Agreements, dated 15th December 1994:
>
> (a) for £1,000,000 for 2 years from 1st January 1995 to 31st December 1996 at a cap rate of 9% with a single payment of £12,600 in full on agreement;
>
> (b) for £1,000,000 for 5 years from 1st January 1995 to 31st December 1999, at a cap rate of 9% for a total payment of £60,400 paid quarterly in advance.

(4) The following sums have been charged as an expense in the Company's Profit and Loss Account, and claimed as a deduction in the respective income tax computations:

Year ended 31st December 1995 - £24,680.
Year ended 31st December 1996 - £12,080.

(5) These sums have been added back as capital expenditure and assessments have been made as follows:

Year of Charge 1995 - £ 71,061.
Year of Charge 1996 - £164,604.

The assessment for the Year of Charge 1995 detailed above incorrectly disallows ordinary bank charges amounting to £1,729, which are not the subject of this appeal. The assessment for the Year of Charge 1995 will be reduced by this sum once the appeal has been determined."

An investment company, as referred to in paragraph 1 of the Agreed Facts, is defined in Section 169 of the Tax Law in the following terms:

"investment company" means a company which is resident in Guernsey ... and whose business consists wholly or mainly in the making of investments and the principal part of whose income is derived therefrom .

18. During the hearing of the appeal to the Royal Court I asked if it might be possible to reconstruct the documents seen by the Tribunal on the hearing. I was provided with a bundle of the Company's accounts, correspondence, the Company's informal notice of appeal dated 1st October 1997, a letter from the Administrator to the Company's accountants dated 3rd April 1998, and the Company's formal Notice of Appeal against the assessments dated 8th April 1998.

19. I consider it both appropriate and necessary for me to treat the facts arising from the addresses to the Tribunal of both the Administrator and Mr. Ayre and the facts arising from the bundle of documents to which I have just referred as having been part of the factual material properly before the Tribunal in addition to the Agreed Facts, and I shall therefore do so. But I am not permitted to speculate on the reasons for the Company entering into the Cap Agreements insofar as they do not appear from the documents themselves, and I have not done so. Perhaps the most important facts arising from this source are as follows:

(a) The Company's income in the tax years in question consisted almost entirely of rental income, of about £340,000 for 1996, arising from lettings of its primary asset, which is a commercial building, Weighbridge House, in the middle of the Town of St. Peter Port, parts of which were let to various business tenants, including a bank, a bar, and a nightclub.

(b) The Cap Agreements were entered into at about the same time as there was a change of control of the Company.

(c) During the tax years in question there was a bank bond registered over the Company's freehold property to the value of £2.55 million as security for the Company's borrowings from the Bank.

(d) The Bank and the Company agreed as a term of the Company's lending to the Company to be secured on Weighbridge House that the Company and the Bank were then to enter into the Cap Agreements, which would relate to two separate sums of £1,000,000. But no facility letters or material correspondence between the Bank and the Company appear to have been shown to the Tribunal.

20. The Cap Agreements were, so far as is material, in the following terms: They were both dated 15th December 1994, and between the Bank (as seller) and the Company (as buyer). They commenced on 1st January 1995, and had the different termination dates set out in the Agreed Facts. The cap rate for the purposes of each agreement was 9% per annum. In Clause 2 it was provided as follows:

> *"The buyer represents that it wishes to reduce its exposure to adverse interest rate fluctuations in relation to its borrowings and acknowledges that in entering into this agreement it is not relying upon the Seller in relation to any forecast or estimate of future trends in relation to interest rates or otherwise, nor in relation to the fiscal consequences of this agreement. The sole obligation and liability of the Seller in relation to this agreement shall be to pay the cap payment amount or amounts (if any) due in accordance with the terms of this agreement. For the purpose of this agreement there is no commitment by either party to lend or borrow the reference amount...",*

which, it is to be recalled, was the sum of £1,000,000 under each Cap Agreement.

Pausing for a moment, it is to be noted that the commencing words in Clause 2 of the Cap Agreement are reflected in paragraph 3 of the Agreed Facts. By Clause 13 it was provided as follows:

> *"In compliance with the rules of The Securities and Investments Board, the Buyer is warned that investments in contracts for differences can carry a risk of loss, relatively small adverse movements in interest rates may result in the loss of the Buyer's original investment. The Buyer should carefully consider whether such investments are suitable in the light of its circumstances and financial resources, and should accordingly require the Seller to inform it of all relevant details."*

This is, in my judgment, a fairly standard requirement in contracts of this nature.

By Clause 19 it was provided that the Cap Agreements should be governed by and construed in accordance with English Law.

21. The only material differences between the two Cap Agreements relate to the Protected Period and the Payment Terms for the Total Cap Fee. In one Cap Agreement there was a period of 2 years and a single payment of £12,600; and in the other there was a period of 5 years and a total payment of £60,400 payable quarterly, over the whole period of 5 years, by instalments of £3,020.

The Decision of the Tribunal and the Case Stated

22. As I have said, on 8th February 1999, the Tribunal allowed the Company's appeal against the two assessments in issue, its Clerk gave notice of the decision by letter dated 15th February 1999, the Administrator required a Case to be stated by his letter dated 16th February 1999, and on 5th December 2000 the Tribunal stated a Case. It appeared from the Case Stated, in its final, signed, form, that the Tribunal reached its decision by a majority of 4 to 1.

23. On 12th December 2000, the Administrator submitted the Case Stated to the Royal Court, sitting as an Ordinary Court, under Section 80(6) of the Tax Law. By direction of the Bailiff, I, sitting as a single judge of the Royal Court, heard the appeal of the Administrator from the decision of the Tribunal on 9th, 10th and 11th October 2001, and at a further hearing, arranged at my request, on 1st November 2001.

The Case Stated of the Tribunal

24. The Case Stated read, in its material parts, as follows:

> *"(2) The sole question for our determination was whether fees paid by the Company under the two 'Base Rate Cap Agreements' entered into by the Company for the purpose of protecting it against fluctuating interest rates on a loan advanced by the National Westminster Bank ('The Bank') comprise capital expenditure (and thus were not allowable under Section 7 of the Law,) or were revenue expenditure (and thus were so allowable)."*

The Agreed Facts were attached. Paragraph 4 read:

> *"(4) The following additional facts were admitted or proved-*
>
> *(a) The Company was a local property holding company which had, at the material time, borrowings in excess of £2.5 million from the Bank.*
> *(b) The beneficial ownership of the company was acquired by Mrs. B.M. Tompkins on 15th December 1994. Her shareholding was subsequently settled into Trust (the Mrs. B.M. Tompkins Discretionary Settlement (1995)), on 20th April 1995. The Settlement remained the beneficial owner of the company as at the date of the appeal. Whilst under the ownership of Mrs. B.M. Tompkins, the Company effected two Base Rate Cap Agreements, not only in order to protect the Company against fluctuating*

interest rates but also because it was required to do so by the Bank as a condition of making the funds available.

(c) *The effect of the Base Rate Cap Agreement was that if the base rate, which was 6.25% at the date of the agreements, rose above 9% during the term of those agreements, an amount equal to the interest payments due in respect of the percentage over 9% would be paid by the Bank to the Company.*

(5) *It was contended on behalf of the Company that the sums of £24,680 in respect of the Year of Charge 1995, and £12,080 in respect of the Year ofCharge 1996, paid under the two Base Rate Cap Agreements, were properly deductible in computing the profits of the Company for the purpose of its assessment of income tax.*

(6) *It was contended by the Administrator that the said sums were capital expenditure and therefore not admissible deductions in computing the profits of the Company."*

(In paragraph *(7)* the Tribunal listed the legal authorities referred to during the hearing.)

"(8) *We, the Tribunal which heard the appeal by a majority, (Mrs L. Crowder dissenting,) held that the sums paid under the two Base Rate Cap Agreements were properly deductible in computing the profits of the Company for the purposes of income tax. None of the authorities cited by the parties concerned the treatment of Base Rate Cap Agreements and all were therefore distinguishable from the present case. We found that the payments made in respect of the Base Rate Cap Agreements did not bring into existence any capital asset nor any advantage for the continuing benefit of the Company's trade as contended by the Administrator in reliance on Atherton v. British Insulated and Helsby Cables Limited, nor did they remove any disadvantageous conditions attached to the loan as in Whitehead v. Tubbs (Elastics) Limited. The effect of the payments was merely to protect the Company against the risk of onerous interest payments and thus enable the Company's business to be managed on a day to day basis. Nor did the payments have the effect of increasing in value any asset of the Company. We regarded the payments as being an integral part of the arrangement fees for the loan from the Bank and thus part of the cost of the borrowing. We accordingly held that the appeal succeeded.*

(9) *The Administrator has declared his dissatisfaction with the Tribunal's decision as being erroneous in point of law, and has requested the Tribunal to state and sign a case for the opinion of the Royal Court, which case, WE, the Guernsey Tax Tribunal who heard the appeal, have hereby stated and signed accordingly.*

(10) *The questions for the determination of the Court are:*

(a) *whether there was evidence upon which we could properly arrive at the findings of fact expressed in our decision; and*

(b) whether such decision was correct in law."

25. There must be some doubt whether the findings in paragraph 8 of the Case Stated were factual or legal findings, and a substantial part of the argument before me related to this issue. I was provided by Counsel for each party with their written submissions as to paragraph 8, and these were helpful in assisting me in following their submissions.

26. In summary, therefore, the Tribunal found, whether by findings of fact alone, or as mixed findings of fact and law, as follows:

    (a) The payments made by the Company under the Cap Agreements did not bring into existence any capital asset.

    (b) The payments made by the Company under the Cap Agreements did not bring into existence any advantage for the continuing benefit of the Company's trade.

    (c) The payments made by the Company under the Cap Agreements did not remove any disadvantageous conditions attached to the loan to the Company from the Bank.

    (d) The payments made by the Company under the Cap Agreements *"merely"* had the effect of protecting the Company against the risk of *"onerous"* interest payments and thus enabled the Company's business to be managed on a day-to-day basis (my emphasis).

    (e) The payments made by the Company under the Cap Agreements did not have the effect of increasing in value any asset of the Company; and

    (f) The payments made by the Company under the Cap Agreements were an integral part of the arrangement fees for the loan to the Company from the Bank (as dealt with in argument by Mr. Ayre at page 19, and by the Administrator in reply at page 22, and perhaps at page 23 of the transcript,) and thus part of the cost of the borrowing.

The Issues on the Appeal to the Royal Court

27. Before I turn to the main issue on the appeal, that is to say, the main issue as argued before the Tribunal, I need to deal with one separate issue relating to Section 162, and especially to a definition in Section 169 of the Tax Law.

28. Although it seems from pages 1 and 2 of the transcript that, at the beginning of his address to the Tribunal, the Administrator referred to the agreed fact that the Company was an investment company within the meaning Section 169, and referred as well to the definition of *"permissible management expenses"* in the same Section, he also told the Tribunal, in effect, that the real issue was whether or not the payments made by the Company under the Cap Agreements were a deduction of capital expenditure, and so not permitted by Section 7(1)(a) of the Tax Law. On

reading the informal transcript carefully, and hearing Counsel, it seems to me the better view that the Administrator did not really address argument to the Tribunal on either Section 7(1)(b) or the definition of "permissible management expenses".

29. By Section 162 it is provided as follows:

> *"A deduction from the income arising or accruing to an investment company for any Year of Charge may be permitted by the Administrator in respect of sums disbursed as permissible management expenses in the year of computation, if a claim for the deduction is made in writing simultaneously with the return as to income submitted in the form or manner required by the Administrator in accordance with the provisions of Section 68 of this law."*

The definition of "*permissible management expenses*" in Section 169 is that the term means, in the case of an investment company,

> *"such items of expenditure as are laid out or expended wholly and exclusively for the purpose of managing the company as would be permissible deductions in accordance with such provisions of this Law, as relate to the computation of the profits of a business if the profits of the company fall to be computed in accordance with those provisions, but does not include that:*
>
> *(a) any item of expenditure which may be deducted or taken into account under any provision of this law which does not relate specifically to expenses of management; or*
>
> *(b) any expense of management which may be taken into account for the purpose of determining the amount of any additional deduction, which may be claimable under the provisions of Section 13 of this Law."*

30. In his skeleton argument on this appeal Advocate McMahon, for the Administrator, sought to argue, (in paragraphs 1(e) and 13,) that the payments made by the Company under the Cap Agreements were not permissible management expenses within the meaning of Section 169 of the Tax Law, and, therefore, were not deductible from the Company's income in the years of assessment.

31. It is sufficiently clear to me from the Case Stated, and from the informal transcript, that this point was not raised by the Administrator before the Tribunal and so is a "new" point of law raised for the first time before the Royal Court. So the question arises whether or not the Administrator should be allowed to raise it on this appeal or whether he should be bound by what I shall term his "decision" not to run the argument below.

32. Advocate Peter Ferbrache, for the Company, in his skeleton argument (in paragraphs 3 and 4,) relied upon well-established statements from two English tax cases, Edwards and Bairstow (1956) 36 TC 207, at page 229, per Lord Radcliffe, and Attorney General v. Aramayo (1925) 9 TC 445, at page 497, per Lord Justice Atkin, in support of his argument that the Administrator should be precluded from arguing this point of law since he had the chance to do so below, but did not do so. I shall adopt the approach of the English Courts on this question, which appears to me to be in accordance with both obvious principle, commonsense and fairness.

33. Advocate Ferbrache amplified his point in his oral submissions to me at the start of the hearing. He gave some examples of the kind of evidence which he contended might have been led on behalf of the Company before the Tribunal, including evidence relating to the background to the Company's lending arrangements with the Bank, for instance, evidence from a director or the Company's accountant showing the circumstances in which the Cap Agreements came to be part of those arrangements. As he put it, such matters might have had a bearing on the Section 169 argument on permissible management expenses.

34. Advocate McMahon argued in his oral submissions that the Tribunal had erred in not going on to decide that the deductions were or were not appropriate deductions under Sections 162 and 169.

35. Although I do so with a little hesitation, I conclude that it would offend the principles of fairness to permit the Administrator to expand the issues on this appeal so as to include the point with which I have been dealing on Sections 162 and 169 of the Tax Law. I agree with Advocate Ferbrache that it would have been necessary for the Tribunal to have heard factual evidence, in however an informal a manner, relating to the issue, and to have then made findings on such evidence, for the point to be capable of being fairly, and I would add safely, dealt with by me on this appeal. Since they did not have any such evidence before them, I consider that the Administrator is precluded from arguing before me the point, which he must be held to have refrained from arguing below.

36. I shall therefore deal with this appeal on the main issue raised before the Tribunal only, that is to say, the issue which I identified in paragraphs 2 and 3 of this Judgment.

37. As both Counsel agree, there is no authority under either Guernsey law or English law directly in point as to whether payments made under agreements capping interest payments under bank lending agreements with taxpayers should properly be regarded under their respective tax codes as revenue or capital expenditure. Nor is there any Guernsey authority on the appropriate test or tests for the Royal Court, or, indeed, the Administrator and the Tribunal, to apply on such a question arising.

38. The next question for me to decide must therefore be; what is the proper test to apply under Guernsey law and, in particular, to apply to such a question arising under the Tax Law.

39. I shall adopt as the test or tests to be applied under the law of Guernsey the test or tests which now appear to be accepted in the English Courts as the proper test or tests. I am satisfied that it is helpful to do so, and proper to do so, and that there is no reason not to do so in Guernsey.

40. There is a very large amount of English legal authority on the issue of what is the proper test, or what are the proper tests to apply, but I consider that the position has now been reached under English law that a judge need do nothing more than follow the clear approach of the Court of Appeal in *Vodafone Cellular Limited v. Shaw* (1997) 69 TC 376, which does not appear to have been referred to the Tribunal by either side.

41. In the leading judgment Millett L.J. dealt with the issue at pages 433A to 436 F in this way:

> *"Was the payment a capital or revenue payment?*
>
> *Whether a payment is a capital or a revenue payment is a question of law, see Strick v. Regent Oil Co. Limited [1966] AC 295, per Lord Reid, Commissioners of Inland Revenue v. Carron Co. (1968) 45 TC 18, per Lord Wilberforce, Tucker v. Granada Motorway Services Limited [1979] 1 WLR 683, per Lord Wilberforce, Beauchamp v. F.W. Woolworth plc [1990] 1 AC 478 per Lord Templeman.*
> *There is no single test or infallible criterion for distinguishing between capital and revenue payments, see Van den Berghs Limited v. Clark [1935] AC 431, per Lord Macmillan, Commissioner of Taxes v. Nchanga Consolidated Copper Mines Limited [1964] AC 948, per Lord Radcliffe, Strick v. Regent Oil Co. Limited [1966] AC 295, per Lord Reid. On the contrary, there are many factors, which tend in one direction or the other, some of which are more relevant in some situations and some in others. Some factors are particularly relevant when the question arises on an acquisition, and others are of particular relevance when the question arises on a disposal, as it does in the present case.*
> *Two matters are of particular importance: the nature of the payment; and the nature of the advantage obtained by the payment. The fact that the payment is a lump sum payment is relevant but not determinative. In a case such as the present, where the payment is made in order to get rid of a liability, a useful starting point is to inquire into the nature of the liability which is brought to an end by the payment. Where a lump sum payment is made in order to commute or extinguish a contractual obligation to make recurring revenue payments then the payment is prima facie a revenue payment.*
> *In J.P. Hancock v. The General Reversionary and Investment Co. Limited the payment of a lump sum in order to commute an annual pension was held to be an income payment because it merely anticipated payments which if not commuted would have been income payments. In such a case 'the lump sum might be regarded as of the same nature as of the ingredients of which was composed' see Van der Berghs v. Clark per Lord Macmillan.*
> *In Anglo-Persian Oil Co. Limited v. Dale the payment of a lump sum in order to secure the cancellation of an agency agreement which was onerous to the principal and would otherwise have endured for a further ten years was held to be a revenue payment. It*
> *'neither enlarged the area of its operations, nor improved its goodwill, nor embarked upon a new enterprise, it merely effected a change in its business methods and internal organisation, leaving its fixed capital untouched' per Lawrence, L.J.*
> *But the principle that a payment made in order to commute or discharge a liability to make recurring revenue payments is itself a revenue payment, and is subject to an important qualification. If the liability to make recurring revenue payments is reduced or brought to an end by the modification or disposal of an identifiable capital asset, then any payment made for the modification or disposal is itself a capital payment.*

In Tucker v. Granada Motorway Services Limited Lord Wilberforce explained that the assumption that money spent on the acquisition of an asset should be regarded as capital expenditure had been extended in two ways. First, money spent on getting rid of a disadvantageous asset is normally regarded as capital, and secondly, money spent on improving the asset or making it more advantageous is also normally so regarded. In Mallett v. Staveley Coal and Iron Co. Limited a reverse premium paid by a tenant to a landlord to accept the surrender of a mining lease was held to be a capital payment. In that case the payment was made to dispose of a capital asset. In Tucker v. Granada Motorway Services Limited a payment made to commute part of the rent payable under a lease was also held to be capital. The payment was not made in order to get rid of a disadvantageous asset, but it was made in order to render the asset less disadvantageous. The lease itself was non-assignable, and so had no balance sheet value, but it was nevertheless a balance sheet item, that is to say, a capital asset the value of which(if it had had any) would have appeared in the balance sheet. It followed that a payment made to make the lease more advantageous was a capital payment even though the object in making the payment was to increase the taxpayer's profit by reducing its revenue.

In the present case the payment in question was made to get rid of the liability to pay annual fees under the fee agreement. The Crown submits that the fee agreement was a capital asset. I do not accept this submission. The fee agreement was certainly not a balance sheet item, and in my opinion it was no more a capital asset than was the agency agreement in Anglo-Persian Oil Co. Limited v. Dale.

It is obvious that not every contract under which a liability to make revenue payments arises is a capital asset for this purpose, or the general principle that payments to get rid of revenue liabilities are revenue payments would be entirely subsumed in the exception. It is only where such a contract is one the cancellation of which would effectively destroy or cripple the whole structure of the taxpayer's profit-making apparatus that it falls to be treated exceptionally as a capital asset. This was the case in Van der Berghs v. Clark, where the taxpayer received a capital sum for the cancellation of the contracts which comprised virtually the whole of the taxpayer's business. Lord Macmillan said:

"The three agreements which the Appellants consented to cancel were not ordinary commercial contracts made in the course of carrying on their trade; they were not contracts for the disposal of their products, or for the engagement of agents or other employees necessary for the conduct of their business; nor were they merely agreements as to how their trading profits when earned should be distributed as between the contracting parties. On the contrary, the cancelled agreements related to the whole structure of the appellants' profit-making apparatus. They regulated the appellants' activities, defined what they might and what they might not do, and affected the whole conduct of their business. I have difficulty in seeing how money laid out to secure, or money received for the cancellation of, so fundamental an organisation of a trader's activities can be regarded as an income disbursement or an income receipt."

Missing out now part of the judgment and resuming the quotation at page 435 at letter G:

"Just as the agency agreement in Anglo-Persian Oil Co. Limited v. Dale was an ordinary commercial contract and not a capital asset (see Tucker v. Granada Motorway Services Limited per Lord Fraser) so too was the fee agreement in the present case whether it is considered as in 1983 or as in 1986. Just as in the one case the taxpayer could choose to carry on its business itself or through outside agents; so in the present case the taxpayer could obtain the necessary know-how by buying it in or by establishing its own research department. It chose to buy it in.
The initial know-how was admittedly a capital asset, and the payment by which it was obtained was admittedly a capital payment. We are not concerned with that. We are concerned solely with the agreement by which the taxpayer obtained the supply of future know-how, which was an agreement for future services and a very different thing."

Picking up the quotation again at page 436 just below letter C:

"It is now settled that a trade advantage is not a capital asset unless it is 'for the enduring advantage of the trade' and by this is meant 'enduring in the way that fixed capital endures': see Anglo-Persian Oil Co. Limited v. Dale per Romer, L.J."

Again, at letter E:

"The principles derived from the foregoing survey of the authorities are sufficient to satisfy me that the fee agreement was not a capital asset, that it was a liability but only because it was likely to entail a heavy drain on the annual income of the taxpayer, in that by cancelling it the taxpayer did not obtain 'an enduring benefit' for its trade in the sense in which that expression is used in this context. It obtained a reduction of its annual revenue expenditure but nothing more. It follows in my opinion that the payment of $30m by which it obtained that reduction was a revenue payment."

Two further citations are, in my judgment, helpful in leading the reader to a comparatively reliable guide in this tricky area of the law; but no more than that can, as I see it, be achieved by citation of cases, and the criteria which appear to be stressed by the judges who gave judgment in them. The first is described in *Whiteman on Income Tax*, 3rd Edition (1988), as *"[a] general guide"*, and is as follows, at paragraph 7-06:

"After taking the above authorities into account the authors are of the opinion that as valuable a guide as any in distinguishing between capital and revenue expenditure is to be found in the classic judgment of Dixon J. in Sun Newspapers Limited v. Federal Commissioner of Taxation."

"There are ... three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b)the manner in which it is to be used, relied upon, or enjoyed, and in this and under the former head recurrence may play its part; and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment."

That approach was adopted and approved by Lord Pearce in delivering the judgment of the Privy Council in B.P. Australia Limited v. Commissioner of Taxation, and he indicated further that the solution to the problem:

> *"has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other... It is a common-sense appreciation of all the guiding features which must provide the ultimate answer".*

That answer:

"depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured employed or exhausted in the process": per Dixon J., in Hallstroms Proprietary Limited v. Federal Commissioner of Taxation".

And secondly, I have found paragraph B3.1241 of *Simon's Direct Tax Service* of help. It is in these terms:

"General Principles:

Although it is a principle that has been eroded in a number of respects, the general rule remains that no deduction may be claimed in respect of expenditure which is capital rather than revenue in nature. The distinction between the two categories of expenditure is one, however, that is difficult to ascertain in many cases. Of the many cases on the subject it has been said that "although each individual case may be readily understood in the light of the judgment or judgments therein, the overall principle scarcely emerges with clarity from any of them." In endeavouring to find the correct answer in any particular case Lord Wilberforce noted,"

and this is in Tucker v. Granada Motorway Services Limited (1979) STC 393, at page 396:

"It is common in cases which raise the question whether a payment should be treated as a revenue or a capital payment for indicia to point different ways. In the end the courts can do little better than form an opinion as to where the balance lies. There are a number of tests which have been stated in reported cases which it is useful to apply, but we have been warned more than once not to seek automatically to apply to one case words or formulae which have been found useful in another, see Commissioners of Taxes v. Nchanga Consolidated Copper Mines Limited. Nevertheless, reported cases are the best tools that we have, even if they may sometimes be blunt instruments."

Then, still quoting from *Simon*:

"While the determination of the various factors on the basis of which a court will reach its balanced opinion is a question of fact for the Commissioners, whether the item is on the basis of those factors a revenue or a capital item is a question of law. The nature of the payment made is not to be judged by the subjective test of the intentions of those who actually made the payment but by the nature and effect of the payment made and the benefits which are obtained in return for it."

42. Accordingly, I reach the point in this Judgment when I must decide whether the payments in question go into the revenue box, as Mr. Justice Jacob said in Vodafone Cellular v. Shaw at first instance, or into the capital box. I am bound, of course, by the actual findings of fact made by the Tribunal, which I have attempted to list in paragraph 26 above. But the question of law remains for me to decide, namely, whether the payments made by the Company under the Cap Agreements were revenue or capital expenditure. Counsel's argument in both their written submissions and their oral submissions demonstrated what a delicate, borderline question it is, or may be, in this case; and, as Lord Wilberforce said in Tucker v. Granada Motorway Services Limited, I can do little better, in my judgment, than form an opinion which way the balance lies.

43. For the Appellant Administrator Advocate McMahon argued, first, that the loan by the Bank to the Company was a capital asset; whereas Advocate Peter Ferbrache for the Company taxpayer argued that, whereas the product of the loan, that is to say, the £2.55m, was a capital asset since it had been raised from the Bank in order to enable the Company to refinance Weighbridge House, its principal capital asset, the loan itself, meaning I think the package of rights and obligations in the loan facility arrangements between the Bank and the Company, (which document(s) were not before the Tribunal,) was a liability and not an asset. I doubt whether this distinction stands up to proper examination, and I hold as a matter of law that the loan under which the Company borrowed £2.55m from the Bank, or refinanced existing borrowing in the same sum, was so tied up with the retention of the primary capital asset that it should properly be regarded as a capital asset of the Company.

44. This finding on my part appears to me to be consistent, in particular, with the finding, if it was a true finding of fact alone rather than a mixed question of fact and law, in the penultimate sentence of paragraph 8 of the Case Stated, that the payments by the Company under the Cap Agreements were:

> *"an integral part of the arrangement fees for the loan from the bank, and thus part of the cost of the borrowing."*

It seems to me to be the better view that this finding was a mixed finding of fact and law, and I shall treat it as such. In this regard I remind myself once more of paragraph 4(b) of the Case Stated, where it is stated, amongst the additional facts admitted or proved, that whilst under the ownership of Mrs. Tompkins, the Company had effected the Cap Agreements:

> *"not only in order to protect the Company against fluctuating interest rates but also because it was required to do so by the Bank as a condition of making the funds available."*

In my judgment, whilst it was common ground between the parties and included in paragraph 3 of the Agreed Facts that the Company entered the Cap Agreements in order to protect it against fluctuating interest rates, on the other hand there was no evidence before the Tribunal which entitled it to conclude that the Company was *"required"* to make the Cap Agreements by the Bank *"as a condition of making the funds available."* There were no documents before the Tribunal and no witness gave oral evidence to that effect. In my judgment, insofar as it is necessary for me to find, I find that in this regard the Tribunal misdirected itself. However, it also seems to me to be likely that the Tribunal had in mind, when reaching their finding, a comment by

Mr. Ayre, page 19 of the informal transcript, rather than any evidence, however informally led. The comment was in these words:

> *"The Cap Agreement is part and parcel of the cost of securing the loan, no, but not just securing the financing, it's a financing cost which is part of a procurement of financing."*

45. I have found nothing to support the argument run below by Advocate McMahon,(page 23 of the informal transcript,) and further argued by him in this Court, to the effect that the Bank *"insisted"* that the Company entered into the Cap Agreements as part of the banking or refinancing deal. Rather, to my mind, the suggestion is that the Company decided to do so and was not required to do so. In other words, there was an element of choice on the part of the Company. So the arguments on behalf of the Administrator to the effect that the Bank made such a requirement as part of the terms of the refinancing, are not supported, in my view, by any evidence before the Tribunal, by which I am of course bound.

46. Against this background I return to the Cap Agreements themselves and I refer again to the first part of Clause 2 and to Clause 13. In a strict legal sense, under English law, (which governs the Cap Agreements under Clause 19,) the Cap Agreements are contracts for difference in which, according to the wording in Clause 13, the Company made an investment. This wording may lean towards a finding of capital expenditure. But, on the other hand, it might be thought that the wording of the first part of Clause 2, namely, *"The Buyer represents that it wishes to reduce its exposure to adverse interest rate fluctuations in relation to its borrowings"*, suggests revenue expenditure.

47. Advocate McMahon also contends that, in contrast with the fee agreement in Vodafone, which was found to have been an ordinary commercial contract, the Cap Agreements included what should properly be regarded as once and for all payments, rather than recurring periodic instalments, which ensured an enduring benefit for the Company. This was suggested as having the flavour of a capital expense, and not of a revenue expense, an example of a revenue expense being the payment of interest by the Company to the Bank under the loan arrangements.

48. Advocate Peter Ferbrache argued that even if the loan was a capital asset, the payments under the Cap Agreements were revenue payments, to be treated on the same basis as interest payments to the Bank, and so were properly deductible from income for income tax purposes. He relied especially on the judgment of Lawrence L.J. in Anglo-Persian Oil Co. Limited v. Dale and on the judgment of Mr. Justice Rowlatt in the same case, at page 262, where Mr. Justice Rowlatt said as follows:

> *"[What Lord Cave is quite clearly speaking of is a benefit which endures in the way that fixed capital endures; not a benefit that endures in the sense that for a good number of years it relieves you of a revenue payment. It means a thing which endures in the way that fixed capital endures. It is not always an actual asset, but it endures in the way that getting rid of a lease or getting rid of onerous capital assets ... endures."*

49. Mr. Ferbrache argues that this extract fits well with the findings of fact in the Tribunal in this case contained in paragraph 8 of the Case Stated. He says that the payments would amount, in the event that the Cap Agreements "bite", to commutation of a revenue expense, that is to say, the interest payments under the

loan, and that this factor should lead to the payments being properly treated as revenue expenditure. He adds, in my view, probably rightly, that no fundamental change was made to the loan agreement itself by the Cap Agreements, and so that is a further reason why the payments made under them have the flavour of revenue rather than capital expenditure. I accept this argument and this reasoning as being correct.

50. As I said earlier in this judgment, the question in this case is a delicate borderline question. In these circumstances, as Lord Wilberforce said in Tucker v. Granada Motorway Services Limited, I can do little better in my judgment than form an opinion which way the balance lies. I conclude that the balance lies in favour of the payments under the Cap Agreements being revenue expenditure, and I so hold.

51. As I have reached the conclusion that the Tribunal's decision to allow the Company's appeal from the assessments of the Administrator was correct, the appeal is dismissed.