TC03485

Appeal number: TC/2012/04005, TC/2012/04006 & TC/2012/04008

INCOME TAX /CORPORATION TAX - Losses – interpretation of s118ZC ICTA 1988 limit on loss relief for members of LLPs– test for admissibility of extra-statutory materials not met - whether appellant's third share in capital of LLP was "contributed" as capital (s118ZC(3) ICTA) on basis that this was the amount appellant had exposed to risk– no - whether appellant's third share was included in amount the appellant was "liable to contribute" to the assets of the LLP in the event LLP was wound up (s118Z(4)(a) ICTA) – yes - appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

HAMILTON & KINNEIL (ARCHERFIELD) LTD **Appellant**
ARCHERFIELD ESTATES LTD
H&K ENTERPRISES LTD

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE SWAMI RAGHAVAN
MR RICHARD LAW

Sitting in public at 45 Bedford Square, London on 5 March 2013

Julian Ghosh QC and Charles Bradley for the Appellant

William Kelly, HMRC Officer, for the Respondents

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DECISION

Introduction

1. The first appellant, Hamilton & Kinneil (Archerfield) Ltd ("HKAL") claimed loss relief in relation to losses made by an LLP of which it was a member. The LLP had two members, the appellant and a Delaware incorporated limited liability corporation (which was an investment vehicle for certain US investors). The appellant was set up to develop and run a golf course. The Delaware limited liability corporation put in $8,000,000. HKAL did not put in any money but under the LLP agreement HKAL had a third share of the net capital of the LLP.

2. At issue is the interpretation of provisions in s118ZC of the Income and Corporation Taxes Act 1988 (ICTA) which limit the amount of loss relief that may be claimed to the greater of the amount the member has contributed as capital or the amount the member is liable to contribute to the assets of the LLP in the event of a winding up. HMRC reduced the loss relief claimed by HKAL to nil because of the provisions in s118ZC, which it argues limit the relief to the contribution of the appellant, as they say no contribution to capital was made by the appellant. They also argue that the appellant is not liable to contribute any assets in a winding up for the purposes of the legislation.

3. The appellant argues that the provisions of ICTA limiting loss relief did not apply to reduce the claimed losses. When properly construed (taking account of the statutory context, and extra statutory materials given the ambiguity in interpretation), the terms "contributed…as capital", and "liable to contribute to the assets…in the event of a winding up" are directed in essence at the amount which the company has at risk in the LLP.

4. The appellants' appeals are against HMRC's amendment to HKAL's corporation tax return for the period ending 28 February 2009 and assessments on the second and third appellants for the periods ending 31 October 2007 to 2009. The second and third appellants are companies in the same group as the appellant and each of them hold 50% of the shares in the first appellant.

Agreed facts

5. We were assisted by the parties having agreed facts which we set out below.

6. The first appellant HKAL is owned as to 50% by the second appellant, Archerfield Estates Ltd ("Estates") and as to 50% by the third appellant, H&K Enterprises Ltd ("Enterprises").

7. Estates is wholly owned by the trustees of the "A" fund of the 14th Duke of Hamilton's 1947 Settlement and Enterprises is wholly owned by the trustees of the "B" fund of the 14th Duke of Hamilton's 1947 Settlement.

8. Estates was formerly called Hamilton & Kinneil (1987) Ltd.

9. HKAL is a member of The Renaissance Club at Archerfield LLP ("the LLP"). The other member is Invest Archerfield LLC ("IALLC"), a Delaware limited liability corporation.

10. IALLC represents the interests of an American group of investors. HKAL and IALLC were at all material times dealing at arm's length.

11. The purpose of the LLP was to develop and run a golf course and associated hospitality business on the Archerfield Estate in East Lothian. The LLP is governed by an agreement ("the Agreement") dated 1 April 2005.

12. The relevant provisions of the Agreement were as follows.

13. Clause 3.8 provided that:

> "on the Completion Date…IALLC shall remit to the bank account of the LLP…the sum of US$8,000,000 [£4,432,134] by way of an initial cash Contribution to the LLP".

14. The Completion Date fell on 3 March 2006.

15. Clause 9.1 provided that:

> "[n]othwithstanding the amount or value of any Contributions made by each Member as at the Commencement Date or the Completion Date or any other provision of this Agreement, each of the Members shall acquire as at the Completion Date a Member's Share equal to the Relevant Proportion for that Member. The Members agree that at the Completion Date all necessary adjustments shall be made to the capital accounts of the Members so as to reflect the holding by each Member of the relevant Member's Shares according to the Relevant Proportion for that Member."

16. Clause 1.1 provided the following definitions inter alia:

> ""Contribution" meant "any money or assets paid into the accounts of the LLP by a Member…less any liabilities attaching thereto which shall be assumed by the LLP in substitution for it".
>
> "Member's Share" meant a member's interest in the net capital of the LLP; and
>
> "Relevant Proportion" meant (a) in respect of IALLC, 66.66%; and b) in respect of [HKAL], 33.34%."

17. Clause 10 provided that:

> "[n]otwithstanding the amount or value of any Contribution made by each Member as at the Commencement Date or the Completion Date or any other provision of this Agreement, the profits or losses of the LLP shall, in the case of profits, be payable or, in the case of losses, be allocated, by the LLP to the Members or by the Members to the LLP (as the case may be) in or on the basis of the Relevant Proportions."

18. Clause 21.2 provided that:

> "[i]n the event of the winding up of the LLP then any surplus of assets of the LLP over its liabilities remaining at the conclusion of the winding up…shall, notwithstanding the amount or value of any Contributions made by each Member or any other provision of this Agreement…be payable by the liquidator to the Members in the Relevant Proportions."

19. The LLP made substantial trading losses during the years in issue.

20. For its accounting period ending 29 February 2008 HKAL claimed trading losses relating to the LLP of £806,058 and for its accounting period ending 28 February 2009 HKAL claimed trading losses of £835,351.

21. HKAL surrendered losses from these periods of £683,716 and £775,590 respectively to Estates and Enterprises in the amounts and for the periods set out in the following table. (Estates and Enterprises had a different accounting period to HKAL, ending 31 October, and the losses surrendered for each of HKAL's accounting periods were claimed by Estates and Enterprises over two different accounting periods.)

Total losses surrendered by HKAL per period	Losses claimed by Estates per period	Losses claimed by Enterprises per period
Feb 08: £683,716	Oct 07: £149,738 Oct 08: £131,615	Oct 07: £270,748 Oct 08: £131,615
Feb 09: £775,590	Oct 08: £280,222	Oct 08: £280,222
	Oct 09: £77,879	Oct 09: £137,267

22. The accounts and abbreviated accounts submitted with HKAL's corporation tax return for the periods ending 29 February 2008 and 28 February 2009 stated that they were prepared on the historical cost basis and recorded that HKAL was a member of and held a one-third share in the LLP and that "there was no cost to the investment".

23. On 19 May 2010 HMRC opened an enquiry into HKAL's corporation tax return for the period ending 28 February 2009.

24. On 26 October 2011 HMRC issued notices amending HKAL's return for the period ending 28 February 2009 so as to disallow the claimed trading losses and amending Estates' and Enterprises' returns for the periods ending 31 October 2007.

Law

25. At the material times the relevant provisions were contained in Part IV of ICTA.

26. Section 114 ICTA provided that where a trade, profession or business was carried on in partnership and one of the partners was a company, the profits and losses of the partnership should be calculated as if the partnership was a company and the partner company should be chargeable to corporation tax as if its share of those profits and

losses were the profits and losses of a notional trade, profession or business carried on by it alone.

27. Section 118 ICTA restricted the total loss relief claimable by corporate partners in a partnership to a maximum of "the partner company's contribution to the trade", which was defined in subsection (3):

> "(3) A partner company's contribution to a trade at any time is the aggregate of—
>
> (a) the amount which the partner company has contributed to the trade as capital and has not, directly or indirectly, drawn out or received back (other than anything which it is or may be entitled so to draw out or receive back at any time when it carries on the trade as a limited partner or which it is or may be entitled to require another person to reimburse to it), and
>
> (b) the amount of any profits of the trade to which the partner company is entitled but which it has not received in money or money's worth."

28. Section 118ZA ICTA dealt with the treatment of limited liability partnerships and provided:

> "(1) For corporation tax purposes, where a limited liability partnership carries on a trade, profession or other business with a view to profit—
>
> (a) all the activities of the partnership are treated as carried on in partnership by its members (and not by the partnership as such),
>
> (b) anything done by, to or in relation to the partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and
>
> (c) the property of the partnership is treated as held by the members as partnership property.
>
> References in this subsection to the activities of the limited liability partnership are to anything that it does, whether or not in the course of carrying on a trade, profession or other business with a view to profit."

29. Section 118ZB ICTA provided that:

> "Section 118 [*which dealt with restriction on relief in relation to limited partners*] has effect in relation to a member of a limited liability partnership as in relation to a limited partner, but subject to sections 118ZC and 118ZD."

30. Sub sections 118ZC(2) and (3) ICTA provided that:

> "(2) But, for the purposes of ...section 118, such a member's contribution to a trade at any time ("the relevant time") is the greater of–

(a) the amount subscribed by it , and

(b) the amount of its liability on a winding up.

(3) The amount subscribed by a member of a limited liability partnership is the amount which it has contributed to the limited liability partnership as capital, less so much of that amount (if any) as–

(a) it has previously, directly or indirectly, drawn out or received back,

(b) it so draws out or receives back during the period of five years beginning with the relevant time,

(c) it is or may be entitled so to draw out or receive back at any time when it is a member of the limited liability partnership, or

(d) it is or may be entitled to require another person to reimburse to it.

(4) The amount of the liability of a member of a limited liability partnership on a winding up is the amount which–

(a) it is liable to contribute to the assets of the limited liability partnership in the event of the partnership's being wound up, and

(b) it remains liable so to contribute for the period of at least five years beginning with the relevant time (or until the partnership is wound up, if that happens before the end of that period)."

Parties' submissions in summary

31. The appellants are all in the same group and their appeals in relation to the issue before the Tribunal stand or fall together. While we refer to appellant in the singular the arguments advanced by one appellant applied equally to the other appellants. The appellant argues that the amount which HKAL "contributed to [the LLP] as capital" under s118ZC(3) ICTA was the amount HKAL had at risk in the LLP which was its one third share of the net capital. HKAL's 33.34% entitlement was at risk because this was expressly provided for in the LLP deed.

32. HMRC highlight the reference to "it" in "it has contributed" and say HKAL has contributed nothing as capital. The capital of $8,000,000 came from the investors represented by IALLC. HKAL's contribution as distinct from its Member's Share was nil. HMRC say the appellant contributed nothing, and nothing of it was at risk.

33. The appellant further argues that the words "the amount which [HKAL was] liable to contribute to the assets of the [LLP] in event of the partnership's being wound up" in s118ZC(4)(a) also covered HKAL's one third share of the capital in the LLP. That is the share which would be required for satisfaction of the LLP's debts and/or division between members on a winding up. HMRC disagree and say the words refer only to the amount which a member is liable to contribute on a winding up in addition to its existing capital share at the date of the winding up.

34. The appellant argues that the legislation is ambiguous and that reference may therefore be made to extra-statutory aids to interpretation under the test in *Pepper v Hart.*

Discussion

35. Although the Tribunal were referred to various extra statutory materials by the appellant, it is necessary to first consider the relevant legislation and the parties' arguments in relation to its interpretation, before considering whether the relevant tests in *Pepper v Hart* [1993] AC 593 for looking at the extra statutory materials and for looking at later legislation are made out.

36. Broadly speaking the parties were agreed as to the mischief the section was aimed at. Both parties are agreed the provisions have an anti-avoidance purpose and stem from a desire to overturn a judicial decision. HMRC agree with the legislative context as summarised in the appellant's skeleton argument which we extract and set out below.

37. The parties however take a different view on the interpretation of the provisions as well as on their application to the facts. HMRC also disagree with the appellant's view that the provisions are ambiguous such that reference may be made to extra-statutory materials such as Hansard extracts.

Legislative history

38. Section 118 ICTA was an anti-avoidance provision and its predecessor in the 1970 Act was introduced by the Finance Act 1985 to reverse the effect of the Court of Appeal's decision in *Reed (HMIT) v Young* [1985] STC 25 (subsequently upheld by the House of Lords ([1986] STC 285).

39. *Reed v Young* concerned a tax avoidance scheme in which a limited partner in a limited partnership claimed relief from income tax of £41,000 being her share of the partnership's losses, notwithstanding that her maximum possible liability under the partnership agreement was only £15,000.

40. To counteract this kind of avoidance s118 ICTA limited the amount of loss relief by reference to the amount which the limited partner had "contributed…as capital".

41. Pausing there, the appellant argues the mischief which was apparent in the scheme in *Reed* and which s118 and s118ZC are aimed at, is that of a limited partner or partner of an LLP claiming more by way of loss relief than it is possible as a matter of economic reality for her to lose in participating in the business of the partnership or LLP.

42. HMRC contend however that the appellant's case here is precisely the sort of case which the mischief identified in *Reed v Young* was designed to stop. That is, an amount of loss being capable of set-off that is entirely unrelated to the taxpayer's own capital at risk.

43. According to the appellant, the expression "contributed…as capital" was based on the language of s4(2) of the Limited Partnerships Act 1907 ("LPA") which provided that a limited partnership:

> "must consist of one or more persons called general partners, who shall be liable for all debts and obligations of the firm, and one or more persons to be called limited partners, who shall at the time of entering into such partnership contribute thereto a sum or sums as capital or property valued at a stated amount, and who shall not be liable for the debts or obligations of the firm beyond the amount so contributed".

44. The appellant argues that the limited partner's "capital contribution" is more than simply a sum of money or asset paid or transferred into the partnership accounts. It is an amount which is assigned a fixed nominal value by agreement between the partners, and the fixed nominal value of which defines the extent of the risk borne by the limited partner.

45. Section 118ZC ICTA along with ss118ZA-ZB was introduced by s10 of the Limited Liability Partnerships Act 2000 ("LLPA"). Section 118ZC pertains to the same subject matter as s118 ICTA and the draftsman evidently intended the expression "contributed …as capital" to a have a similar function in both.

46. The explanatory notes to s10 LLPA state:

> "the new section 118ZB ICTA operates to extend the provisions of sections 117 and 118 ICTA to members of LLPs that carry on a trade. The new section 118ZC will establish the limit on the tax relief for interest and trading losses that members of an LLP can claim against income other than that from an LLP."

47. Both s118 and s118ZC necessarily assume that the "amount" of what has been "contributed…as capital" is straightforwardly quantifiable and that other amounts can be straightforwardly deducted from it.

48. The appellant notes that while a limited partner's capital contribution is a numerically defined amount pursuant to s4(2) LPA, the LLP legislation contains no equivalent provision. Section 5 LLPA provides in essence for the rights and duties of the members to be whatever the members determine them to be and the rest of the LLPA contains no specific provision which requires "capital contributions" or defines their nature or effect.

49. HMRC referred to the dictionary definition of "contribution". This is:

> "a payment imposed on a body or people…something paid or given (voluntarily) to a common fund or stock; an action which helps to bring about a result."

50. The appellant points out in turn that "payment" can have a wide meaning depending on context.

51. The appellant says, given the statutory background referred to above, the application of the expression "contributed…as capital" to a member of a LLP is difficult and ambiguous. HMRC disagree and the Tribunal does too, for the reasons set out at [78]-[80] below.

52. Having set out that background it is necessary to return to the words of the legislation. The parties have structured their arguments in relation to subsection 118ZC(3) and 118ZC(4) separately. However it is to be noted that the background above speaks to the section as a whole and that under s118ZC(2) both subsections need to be looked at in order to find which is the greater amount in order to ascertain the limit to loss relief.

Starting point is to look at provisions together rather than in isolation

53. The starting point therefore, given that 118ZC(2) refers to the greater of these amounts is that the two subsections interact with each other and to look at the section as a whole.

54. When this is done the view that the majority of the Tribunal reaches is that both parties have resorted to strained interpretations which are unnecessary when the subsections are considered together.

55. It seems perfectly possible to give "contributed" and "liable to contribute to the assets" their ordinary meanings. Conversely for the reasons below it requires words to be read in and the language to be strained to see "contributed" in s118ZC(3) as meaning "put at risk" (as the appellant suggests). Equally, it is the Tribunal's view that further words would need to be read in (as HMRC effectively argue) to reach the effect that s118Z(C)4 covers only additional amounts (over and above the capital share). Furthermore as explained below taking account of the "greater of" test it is the majority of the Tribunal's view that there would be no apparent rationale for such an interpretation and on the contrary it would appear arbitrary.

HMRC's interpretation of "liable to contribute to the assets" in s118ZC(4)(a)

56. HMRC's argument that s118ZC(4)(a) refers only to amounts a member is liable to contribute in addition to its existing capital share at the date of winding up leads to some consequences which seem arbitrary and have no obvious rationale. Section 118ZC(4) uses a "greater of" test. On HMRC's interpretation, s118ZC(4) would only kick in when the additional amount exceeded the amount contributed (adjusting for any deductions made under s118ZC(3)). The amount contributed would not be recognised (eg if there were a contribution of 50, an additional liability of 100, the limit would be set at 100 as opposed to 150). Whether there is an additional liability for contribution depends on what the members agree. It would seem arbitrary 1) to take account of that additional liability to be contributed in a winding up but then ignore it when that additional liability is less than the contribution, and 2) ignore the contribution when the additional liability happened to exceed the contribution but then take account of it if the additional amount liable for contribution was less than the amount contributed. On the contrary, taking account of the whole amount (amount contributed plus additional amount liable to be contributed) in calculating the s118ZC(4)(a) amount leads to a loss relief limit which is rational. (So if the

contribution was 100 and additional amount liable to be contributed was 50 (and assets liable to contribution is therefore 150) the limit to loss relief is set at 150.

The appellant's argument on interpretation of "contributed" in s118ZC(3)

Ordinary meaning of "contribute". Context is subscription.

57. On the face of it there is no reason to give "contributed" an expanded meaning, it clearly has a function to play on its ordinary meaning. If HKAL had paid $8million instead of IALLC that would clearly be a contribution.

Distinction between "contributing" capital to a LLP and "acquiring" capital and resultant anomalies

58. HMRC place emphasis on the fact the legislation refers to "it" (a member of a limited liability partnership in s118ZC(3)) contributing. It is necessary to show that the company member as opposed to someone else contributed. The appellant says HMRC's interpretation gives rise to anomalies and criticises HMRC's interpretation of requiring cash or money's worth by way of subject matter for the contribution as being too narrow. They argue that no assignee could ever access losses because the assignee would not have transferred money or money's worth to the LLP even though their share of capital was at risk. The appellant says HMRC does not deal with this point and if HMRC were right this suggests the tax code has gone wrong, whereas on the appellant's interpretation it has not.

59. In the Tribunal's view there is no reason why the reference to "it" in the legislation should be ignored. The assignment of share scenario the appellant points to is not problematic.

Assignability problem not a problem

60. Looking at the provisions of s118Z(3) and (4) together and taking an ordinary interpretation of both deals with the assignee scenario. It is the majority of the Tribunal's view that the assignee would be liable to contribute assets representing whatever was assigned to it in the event of a winding up and would have its loss capped at that level even if the assignee could not be said to have contributed anything.

Other arguments

HMRC's argument on Lindley.

61. Lindley & Banks on Partnership (19th Edition) describes the liability of Limited Partners at 28-07 as:

> "limited to the amount contributed by them in cash or property when the partnership was originally created."

62. HMRC say this section directs the focus on what each partner contributed, not what the partners' rights to capital are.

63. The Tribunal agrees with the appellant the passage is not directly relevant as it is talking about limited partnerships.

64. Similarly any argument that in construing the relevant provisions the desire to remedy the avoidance perceived by the scenario in *Reed v Young* ought to be borne in mind is not on point. Such an argument may indicate that, in the case of limited partnerships, loss relief was to be restricted to the maximum amount stated for limited partnerships. Even if the purpose of the legislation is taken as being that the loss relief limit should not be higher than the members' contribution this does not necessarily support the proposition that the loss relief limit ought to be pinned to a higher peg based on what the member has at risk and that therefore a broad meaning of contribution ought to be taken. In other words while any anti-avoidance purpose behind the provision could indicate the level of loss relief Parliament wanted as a minimum to counter the perceived avoidance it would not necessarily establish what the underlying purpose of the limit was so as to indicate what level of loss relief Parliament wanted to allow for as a maximum.

Argument that no valuation mechanism in s118ZC ICTA

65. The appellant argues that if HMRC were right there would be a choice as to when to value risk: either the time of contribution or the time at which the contributor wants to access losses and that cannot have been intended. In contrast to other provisions the legislation does not specify when the time to value is to occur. The appellant also drew attention to the fact that s118 defined "the appropriate time" (being the end of the relevant accounting period in which the loss is incurred).

66. In contrast the appellant says that if its interpretation of looking at the amount exposed is adopted then the time is that at which the losses are accessed and the question is how much is at risk at that point in time.

67. The appellant argues that its approach which focuses on the members' rights under the relevant LLP agreement allows the legislation to operate in a straightforward and workable way.

68. The Tribunal notes that there are two aspects to consider here: first quantification of value, and second the time at which that quantification is made.

69. Dealing first with quantification the question which arises is how the rights are to be valued. The appellant argues that in order to arrive at a numerical amount which could form the basis of the member's entitlement to loss relief it would be necessary to read a valuation rule into s118ZC ICTA (for example that non-cash contributions should be deemed equivalent to the then market value of the asset).

70. The Tribunal notes however that the same issue could equally arise on the appellant's argument in that the way the rights are defined in the LLP could well give rise to tricky valuation issues. The fact that the question posed is what is at risk does not get away from any difficulty there is around how to value. By definition there will be valuation issues in determining what is at risk.

71. Second there is the issue of the time at which to value. The appellant says HMRC's interpretation that a contribution has to be of money or money's worth gives rise to matters of choice that cannot have been intended: i.e. do you value the

contribution at the time of transfer or the time at which the contributor wants to access losses?

72. Again it is not clear to the Tribunal that this takes the matter further. That issue could apply equally to whatever rights are specified under the LLP agreement. Do you value those rights at the time of the "contribution" (which might - and probably would - be at inception of the agreement) or at the time of the loss relief?

The explanatory notes to LLPA 2000

73. The Tribunal considered the explanatory notes to s118ZC (these were put before for us by way of support for the proposition that s118ZC pertained to the same subject matter as s118) but the notes have been considered by the Tribunal more broadly following on from the proposition deriving from Lord Steyn's statement in *R (oao Westminster City Council) v National Asylum Support Service* [2002] 1 WLR 2956 at [1] –[6] that they can be used as an aid to statutory interpretation (see [81]).

> "The new section 118ZC will establish the limit on the tax relief for interest and trading losses that members of an LLP can claim against income other than from the LLP. The limit for relief claimed by members of LLPs would be the amount they have subscribed to the LLP together with any further amount that they have undertaken to contribute in the event that the LLP is wound up. Subject to the further provisions of the new section 118ZC(3) the amount subscribed will normally be the amount of the partner's investment in a conventional partnership that becomes an LLP or the amount that he has invested in the LLP when he became a member or founded the LLP. The further provisions set out in this new provision ensure that the capital invested remains in the LLP and that there are no other arrangements for extracting value from the LLP in some other way. For example, there is a requirement that the investment in the LLP must endure for a given period so that members cannot make capital contributions to give them access to the tax relief and then, after having the relief, withdraw them."

74. In relation to HMRC's argument in relation to the amount liable to be contributed on winding up it is to be noted that the reference to the limit to relief being the amount subscribed "together with any further amount [the members] have undertaken to contribute" does not match up to the words of the statute which use a "greater of" test. Given this, the reference in the explanatory note to a "further amount" cannot be read across to the "liable to contribute" amount in s118ZC(4).

75. In fact to the extent the explanatory notes provide context to the legislative provisions they suggest the opposite conclusion namely that the effect of the legislative words is that if the member is liable for an additional amount it will be this amount put "together with" the subscription amount which will act as the cap on the loss relief not just the additional amount in excess of capital contributed.

76. The explanatory note is consistent with and supportive of the interpretation taken by the majority of the Tribunal above at [55].

Admissibility of Hansard

Extra-statutory material

77. There was no disagreement between the parties as to the relevant test in respect of extra-statutory material. In *Pepper (Inspector of Taxes) v Hart* [1993] AC 593 the House of Lords held that reference to Parliamentary material such as Hansard is admissible as an aid to statutory interpretation where (per Lord Browne-Wilkinson at 634C-E) :

> (1) the legislation in question is ambiguous or obscure, or its literal meaning would lead to absurdity,
>
> (2) the material referred to clearly discloses the mischief aimed at, or the legislative intention behind the ambiguous or obscure words, and
>
> (3) the material comprises statements made by the minister or other promoter of the relevant Bill.

78. In the Tribunal's view condition (1) is key as if it is not satisfied (2) and (3) do not come into play. The appellant says (1) is satisfied because of the absurdity of drawing a distinction between contribution and acquisition if contribution is interpreted literally. Whereas the LPA capital contribution is a numerically defined amount pursuant to s4(2) LPA, the LLP legislation contains no equivalent provision. The Tribunal is however unanimous in its view that the literal meaning does not lead to absurdity. Nor are those provisions ambiguous. The majority view of the Tribunal is that the assignment scenario the appellant depicts is not problematic because it is dealt with by giving the words "liable to contribute… in the event of a winding up" their ordinary meaning. But in any event interpreting the provision in such a way that an acquisition of capital is not taken account of, whereas a contribution of capital is, would not, in the Tribunal's opinion, lead to absurdity.

79. The appellant's arguments as to the lack of a valuation mechanism are relevant to whether their interpretation is to be preferred. As explained above those arguments do not take the matter further. Furthermore the absence of such provisions does not mean the legislation is ambiguous or obscure.

80. The provisions can be given their ordinary meaning without difficulty and the Tribunal is unanimous in its view that neither 118ZC(3) or (4) is ambiguous. It is not therefore necessary to refer to extra-statutory material. The fact that the Tribunal has expressed different views through the majority view expressed in this decision and the dissenting view set out in the appendix on the interpretation of the legislative provisions does not of itself mean that the provisions are ambiguous. The majority view and the dissenting view on interpretation are each held on the basis that the legislation is not ambiguous and that the respective interpretation set out in those views is the better one. (As an aside, if the position were otherwise, it might be expected that the decisions of the higher courts would include consideration of the issue of whether Hansard was admissible as a matter of routine whenever those courts decided appeals on points of statutory interpretation from the lower courts where dissenting judgments on interpretation had been given.)

Can the Tribunal look at later legislation?

81. The appellant argues that further support for the appellant's interpretation comes from the explanatory notes to ss59 and 60 of the Corporation Tax Act 2010 ("CTA 2010") which make it explicit that the purpose of the legislation is to tie loss relief for corporate members to "the amount the company has at risk" in the LLP at Annex 1 Change 8. The changes detailed under Change 8 did not alter the aspect of s118ZC under consideration in this appeal and so ss59 and 60 CTA 2010 were not intended to effect a change in the legislation in this respect. In support of this the appellant cited ***R (oao Westminster City Council) v National Asylum Support Service*** [2002] 1 WLR 2956 per Lord Steyn at [1] to [6].

82. The Tribunal was also referred by the appellant to the House of Lords case of *Kirkness (Inspector of Taxes) v John Hudson & Co Ltd* [1955] AC 696 and the statements of Viscount Simonds at 712 and Lord Tucker at 739 for the proposition that later legislation pertaining to the same subject matter may be used to interpret earlier legislation where that earlier legislation is ambiguous.

83. In line with *Westminster City Council* while it is permissible to refer to the explanatory note to CTA 2010 if those provisions were in issue, the Tribunal notes that the provisions before it are those in s118ZC. The provisions of CTA 2010 would themselves only be admissible as an aid to statutory interpretation of an earlier act where that earlier act is ambiguous.

84. What is required for there to be ambiguity? Their Lordships referred to discussion of this issue in the *Ormond* case which was also a House of Lords case. Viscount Simonds referred to the exposition given by Lord Buckmaster in the *Ormond* case of "fairly and equally open to divers meanings". On the point Lord Morton interpreted Lord Buckmaster's test as "…so ambiguous that it was open to two perfectly clear and plain constructions…" (which Lord Tucker also referred to) as meaning that it must be perfectly clear what are the two possible constructions. Lord Reid in addition to referring to this formulation of Lord Buckmaster's test referred to the following passages: "there is no reason on the face of the Act why one construction should be more right than the other" (Lord Sumner) or whether the act is "readily capable of more than one interpretation."

85. Whichever formulation is adopted we are not persuaded that there is such ambiguity. On the majority view the meaning of "contributed" has to be construed in context not in isolation. On that view an interpretation whereby the amount "contributed" means something less than the amount which the appellant has at risk does not give rise to the concerns the appellant raises because the loss relief cap could be set at the cumulative amount under the "liable to contribute...in the event of winding up" head in s118ZC(4). As explained at [80] above, the fact the Tribunal is not unanimous in this interpretation does not of itself mean that the legislation is ambiguous.

Applying the legal interpretation to the facts

86. Having discussed the Tribunal's view on statutory interpretation it falls then to apply this to the facts.

Amount "contributed"

87. The appellant says exposing its share to risk amounts to "contribution". The Appellant argues capital means acceptance of use. HAKL's $2.7 million is at risk. HAKL's share of capital is exposed to creditors. It does not matter that cash was injected by IALLC (the other member of the LLP). It is HAKL's entitlement which is exposed to creditors. The appellant poses the question of whether HAKL's exposure establishes sufficient economic connection and says the answer to this is yes. The exposure is legally enforceable, HAKL cannot stop its slice of $8million being called upon by creditors. It is true IALLC paid in $8million, but this is irrelevant. Economically, the same result is achieved as if HACL had paid in $2.7million. There is no double counting of losses being used more than once.

88. The Tribunal has set out above its views as why it does not accept the appellant's view that "contribution" should be read in such a way as to refer to an amount which has been put at risk and also as to why the reference to "it" in the legislation cannot be ignored in the way the appellant suggests.

89. It is not necessary to expand the meaning of "contribute" in order for the legislation to work as intended. Economically the one third share of the $8million is what HKAL has at risk, but this does not mean that that amount has been contributed. That losses are not being used more than once does not mean the loss relief ceiling must be raised to the amount the appellant argues for.

What is HKAL's contribution to capital?

90. HMRC refer to the fact that under the agreement the appellant has not made any "contribution". The appellant say this is clearly not determinative. It is no more than a defined term; a convenient shorthand for "money or assets paid into the accounts of the LLP" and the agreement expressly provided that the members' rights to capital and profit shares bore no relation to the value of the "Contributions". The Tribunal agrees with the appellant that the definition of "Contribution" in the LLP agreement cannot be determinative of what is contribution for the purposes of the legislation.

91. HMRC ask the Tribunal to note that the abbreviated accounts submitted with HKAL's return for the period ended 29 February 2008 state: "There was no cost to this investment". HMRC say this is unequivocal support for their contention that their contribution was nil. The Tribunal agrees with the appellant that this does not take the matter further. The fact that from the viewpoint of HKAL's accounts there was no "cost" (the meaning of that being unclear) does not rule out something nevertheless having been contributed by HKAL as a matter of objective fact.

92. Returning to the question of what the nature of HKAL's contribution is HMRC say that what HKAL has is a member's share and this they say is not the same as capital. The Tribunal notes the appellant has something of value. Its Members Share is transferable under clause 16 of the LLP agreement. It is defined to be the member's share and interest in the capital which is itself defined as the net capital shown on the balance sheet "as belonging to the members" and being the excess of assets of the LLP over its liabilities. Under clause 21.1 the surplus after payment of creditors goes back to the Members.

93. The Tribunal's difficulty with the appellant's argument is not so much that HKAL did not have capital but whether it is correct to say it has made a contribution to capital.

94. It must also be taken into account that the notion of "contribution" sits under the term of "subscription" and that the explanatory note at [73] also refers to the amount subscribed. Effectively the appellant's argument amounts to it saying that it has contributed to capital because having received something of value rather than choosing to take it out of the LLP it chose to keep it in.

95. In the Tribunal's view, acquiring a share through operation of the LLP agreement and maintaining it in the LLP is a situation that is far removed from saying that HKAL has contributed anything to the capital of the LLP.

96. The issue is not so much to do with the nature of what has been contributed and whether it has to be money or money's worth but whether anything has been "contributed" in the first place.

Liability to contribute assets in the event of a winding up?

97. HMRC referred to clause 21.1 of the LLP agreement which states:

> "For the avoidance of doubt, no Member has agreed with the other Members or with the LLP that it shall in the event of the winding up of the LLP contribute in any way to the assets of the LLP in accordance with Section 74 of the Insolvency Act."

98. Section 74 of the Insolvency Act as applied to LLPs (as opposed to companies) (by virtue of the modifications pursuant to regulation 5 and Schedule 3 of the Limited Liability Partnerships Regulations 2001/1090) reads as follows:

> "Section 74
>
> When a limited liability partnership is wound up every present and past member of the limited liability partnership who has agreed with the other members or with the limited liability partnership that he will, in circumstances which have arisen, be liable to contribute to the assets of the limited liability partnership in the event the limited liability partnership goes into liquidation is liable, to the extent that he has so agreed to contribute to its assets to any amount sufficient for payment of its debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves.
>
> However, a past member shall only be liable if the obligation arising from such agreement survived his ceasing to be a member of the limited liability partnership."

99. In the view of the majority of the Tribunal HMRC's interpretation as discussed above is too narrow. The absence of a s74 agreement does not mean there is no amount which arises under s118ZC(4).

100. The assets of the LLP are greater than those which would have been available if the LLP had agreed its share of capital could not be used. The appellant says the

agreement could have stipulated that the appellant's entitlement was not to be used but did not do so.

101. The appellant says that if the LLP had say incurred debts in excess of $8 million causing it to be wound up, then HKAL would have been obliged to contribute its one third capital share to the assets of the LLP in the sense that it (along with IALLC's two-thirds share) would be required to satisfy the LLP's debts. Alternatively if the LLP had been wound up voluntarily then HKAL would still have been liable to "contribute" its one-third share in the sense that this would have formed part of the net capital of the LLP to be divided between the members.

102. The majority of the Tribunal disagrees with HMRC's suggestion that the amount that HKAL is liable to contribute in the event of a winding up is zero. As mentioned above the Members Share is transferable under clause 16 of the LLP agreement. It is defined to be the member's share and interest in the capital which is itself defined as the net capital shown on the balance sheet "as belonging to the members" and being the excess of assets of the LLP over its liabilities. Under clause 21.1 the surplus after payment of creditors goes back to the Members. The share is something of value. The assets representing this share (which would otherwise belong to HKAL) will be used to satisfy creditors in a winding up. They are assets which contribute to the assets of the LLP which are available in a winding up.

103. The appellant says that at the time of a notional winding up its slice of $8m was at risk. Following from the above the majority of the Tribunal agrees that this slice (its third-share amounting to approximately $2.7million) is the amount which is to be regarded as liable to be contributed at the time of the winding up.

Conclusion of Tribunal

104. The decision of the Tribunal was reached by the casting vote of the Judge (Article 8 of the First-tier Tribunal and Upper Tribunal (Composition of Tribunal) Order 2008)). The dissenting view of Mr Law is set out in the appendix to this decision.

105. The Tribunal concludes that the amount of HKAL's contribution to capital under s118ZC(3) was zero. The Tribunal were unanimous in this conclusion but were not unanimous on the reasons for that conclusion.

106. The Tribunal concludes that the amount HKAL was liable to contribute upon a winding up was its one third share. Mr Law's dissenting view on the meaning of "liable to contribute" and his view that HKAL was not "liable to contribute" anything on a winding up and that the appeal should therefore fail is set out in the appendix to this decision.

107. The conclusion of the Tribunal following the casting vote of the Judge is that:

> (1) The appeal against HMRC's amendment to HKAL's corporation tax return for the period ending 28 February 2009 is allowed.

(2) The appeals by Estates (the second appellant) and Enterprises (the third appellant) against assessments for the periods ending 31 October 2007 to 2009 are allowed.

108. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 10 April 2014

Appendix

Reasons for dissent by Richard Law

1. I have read the decision of my learned colleague, with which I agree in many respects, but I am not able to agree with him as regards two specific matters: the meaning of "contributed", within the context of s118ZC(3), and, consequently, of "liable to contribute" within the context of s118ZC(4).

2. I agree with my learned colleague that both expressions should take their ordinary meaning. In the case of "contributed", in my opinion, the ordinary meaning of that word requires the passing of some thing or asset from the ownership of one physical or legal person to the ownership of another. This view seems to me to be entirely natural and consistent with the extract from Lindley & Banks on Partnership quoted at [61] in the decision (albeit in relation to a different form of partnership). As such, I do not find any element of ambiguity about the words in the section; they are clear.

3. Consequently, in the context of this case, for HKAL to be regarded as having contributed anything by way of capital to the LLP, it would have to have passed money or other property from its ownership into the ownership of the LLP. As no such thing had happened in the periods with which we are concerned, HKAL cannot be said to have "contributed to the limited liability partnership as capital" within the context of s118ZC(3).

4. Similarly, in the absence of an agreement, whether in the LLP agreement or otherwise, such as that contemplated by s74 of the Insolvency Act (see [98] above), that imposes an obligation upon HKAL to pay something into the LLP in the course of the LLP being wound up, it cannot be said that HKAL has any liability to contribute anything to the LLP in the course of it being wound up.

5. The appellants have argued that, by potentially giving up, on a winding up, their share of the capital attributed to them from the capital contributed originally by IALLC, they would be contributing something to the LLP on a winding up. However, that would require no further action by them, as their share of the capital would still be just as available to creditors of the LLP as it had been since IALLC introduced it.

6. In the light of my above comments, HKAL cannot be regarded as satisfying either subsection (a) or (b) of s118ZC(2) to any extent and so it cannot claim loss relief. The appellants have tried hard to stretch the meaning of the provisions of s118ZC to fit their case, but, in my opinion, the provisions are not capable of being stretched as they wish, so that their appeal must fail.

7. I have been asked by my learned colleague to comment on the fact that the result may be considered arbitrary (in the sense described at [55]-[56] of the decision) and the fact that an assignee of an interest in an LLP (or capital contribution) could not access loss relief (see [58]-[60] of the decision). In my experience, tax legislation

often produces apparently arbitrary results; to the extent that someone may consider the result of my analysis to be arbitrary, it does not mean it is wrong. Equally, the absence of loss relief for an assignee of an interest in an LLP, while a consequence of my analysis, does not mean it is wrong.

8. As an aside, it is curious that the paragraph from the explanatory note set out at [73] in the decision clearly implies that, in assessing the extent to which a member of an LLP can claim losses from the LLP, it is the *sum* of the member's contribution to capital and its liability to contribute on a winding up that is to be taken into account. By contrast, in my opinion, the legislation equally clearly sets out that, rather than the *sum* of the two elements, it is the *greater* of the two. It is not clear from the materials provided to us what led to this difference, but it is possible to see that the version contemplated by the explanatory note could have led to arrangements that might be considered abusive. The actual provision may well give rise to arbitrary results, but it is clear and unambiguous.