Appeal number: TC/2016/01219

CAPITAL ALLOWANCES – Conversion of flight training centre into 124-room hotel – Whether entitled to Business Premises Renovation Allowances on whole or only elements of sum paid to developer – Appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

LONDON LUTON HOTEL BPRA PROPERTY FUND LLP	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE BROOKS
NICHOLAS DEE

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1 on 30 April, 1 – 4, 8 – 11, 14, 16 – 18, 21, 22 May and 2, 3 August 2018

Malcolm Gammie QC and Jonathan Bremner QC, instructed by DWF LLP, for the Appellant

Jonathan Davey QC, John Brinsmead-Stockham, Ruth Hughes, Sam Chandler, Nicholas Macklam and Hugh Cumber, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. In its 2010-11 tax return London Luton Hotel BPRA Property Fund LLP (the "LLP") claimed business premises renovation allowances ("BPRA") of £12,478,201, the sum it had paid in accordance with a contract with a property developer, for the conversion of a flight training centre near London Luton Airport into a 124-room hotel (the "Property").

2. On 5 February 2016 HM Revenue and Customs ("HMRC") issued a Closure Notice, under s 28B of the Taxes Management Act 1970, amending the LLP's 2010-11 tax return reducing the BPRA claim by £6,478,201. However, following the provision of further information by the LLP and the developer, HMRC revised the amount disallowed to £5,255,761, allowing a claim for BPRA of £7,222,439.36. The elements of the BPRA claim disallowed, which derive from a 'Schedule of Developer's Costs' provided to HMRC on 2 February 2015 at a meeting between HMRC, the developer, the promoter and the LLP, are as follows:

(1) The Interest Amount (£350,000);

(2) The Capital Account (£2,000,000);

(3) IFA fees (£372,423.40);

(4) Promoter fees (£310,000);

(5) Legal fees (£153,409.89);

(6) Franchise costs (£272,862);

(7) Fixtures, Fittings and Equipment ("FF&E") and other non-qualifying amounts (£587,556.35); and

(8) Residual amount/profit (£1,209,510).

3. HMRC, represented by Jonathan Davey QC, John Brinsmead-Stockham, Ruth Hughes, Sam Chandler, Nicholas Macklam and Hugh Cumber**,** contend that the total price paid under the contract with the developer was part of a total price paid for an "entire package" of assets and services that constituted a fully operational branded hotel business together with the cost of, amongst other things, borrowing. Although it is accepted that the sum paid to the developer did include "qualifying expenditure" of £7,222,439.36 for BPRA purposes, HMRC do not accept that this extends to the entire £12,478,201 claimed and contend that the payments, listed above, by the developer out of the sum it received from the LLP do not come within the definition of "qualifying expenditure" under Part 3A of the Capital Allowances Act 2001 for BPRA purposes:

4. Malcolm Gammie QC and Jonathan Bremner QC for the LLP contend that as all of the £12,478,201 paid by the LLP to the developer is expenditure incurred "on or in connection with the conversion, renovation or repair" of the Property, the LLP is entitled to BPRA on the entire sum claimed and that it is not appropriate to undertake an investigation into the use of the money by the developer.

5. However, if contrary to the LLP's primary case, we were to find such an investigation to be appropriate, it is argued that the LLP would still be entitled to BPRA on the full amount claimed as each item of expenditure by the developer which is disputed by HMRC is "qualifying expenditure" for BPRA purposes.

6. We should also mention at this stage that, although we have carefully considered all of the submissions of the parties, comprising almost 1,000 pages of written submissions and transcripts of two days of opening and two days of closing oral submissions together with the documents to which they refer (contained in some 55 lever arch files) and nine bundles of authorities, which has resulted in a far longer period between the last day of the hearing and the production of this decision than we would have hoped, we have not found it necessary in reaching our conclusions in this appeal to address every argument advanced on or behalf of parties or refer to all of the evidence that we were taken to.

Application to Amend Statement of Case

7. On 1 May 2018, at the commencement of the hearing (30 April 2018 being a reading day for the Tribunal), we heard an application which had been made on 26 April 2018 by HMRC to amend its statement of case to enable it to advance an argument that a particular element of the LLP's expenditure, the "Licence Fee Amount/Interest Amount in the sum of £350,00 was not expenditure "incurred" by the LLP in 2010-11 or at all. Additionally, HMRC applied, on what Mr Davey explained was a protective basis, to amend paragraph 72 of the statement of case (which is set out below) to include an argument in relation to the LLP's expenditure of £2,000,000 described as the "Capital Amount" which HMRC contends was not expenditure "incurred" by the LLP in 2010-11 or at all.

8. The application was opposed by the LLP.

9. Having heard Mr Davey for HMRC and Mr Bremner for the LLP, after the short adjournment, we announced our conclusion that an amendment to the statement of case was necessary in relation to the Capital Amount "incurred" argument and dismissed HMRC's application to amend the statement of case to include that, and the Licence Fee Amount/Interest Fee Amount "incurred" argument. Rather than risk the tight timetable for the hearing, which was originally listed for 17 days between 30 April and 23 May 2018 (with the first day being a reading day for the Tribunal), we said that we would give our reasons for dismissing the application to amend the Statement of Case within the "full" decision on the substantive appeal. These are our reasons.

10. Under Rule 25 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 HMRC "must" send or deliver a statement of case to the Tribunal and appellant. Rule 25(2) provides:

> A statement of case must–
>
> (a) in an appeal, state the legislative provision under which the decision under appeal was made; and

(b) set out the respondents’ position in relation to the case.

11. In the present case the statement of case was provided to the Tribunal and the LLP on 1 July 2016. The relevant paragraphs of the statement of case, with the amendments sought in *italics* and underlined, provide:

> “64. In the circumstances, the Licence Fee Amount, alternatively the £316,120.49, is not eligible for BPRA relief. *The Licence Fee Amount was not expenditure “incurred” by the LLP in 2010/11 (or at all). Further or alternatively, even if it was expenditure “incurred” in 2010/11*, it is not eligible for BPRA relief for the following reasons:
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> …
>
> “71. Another element of the Development Sum paid by Luton LLP is what is referred to in the Co-Op Loan Agreement as the Capital Amount which OVL is obliged to deposit in the Capital Account so as to secure the obligations of Luton LLP under the Co-Op Loan Agreement and OVL under the Guarantee Agreement. As stated in the Schedule of Costs and in the IM the figure in question is £2 million. HMRC has disallowed this figure.
>
> 72. The reason that HMRC has disallowed this figure [i.e. the £2 million deposited in the Capital Account] is because such expenditure on the part of Luton LLP does not constitute expenditure *(a) “*incurred” *(b) “*on or in connection with*”* the conversion or renovation or incidental repair of the Property. …”

12. It is accepted that the Licence Fee Amount/Interest Fee Amount “incurred” argument was not expressly articulated in the statement of case and, as such, an application to amend is necessary. However, it is contended that it was not strictly necessary for an application to be made in relation to the Capital Amount argument as this already falls within the Closure Notice and the un-amended statement of case. It is therefore necessary to first consider whether this is the case.

13. Mr Davey argued that “incurred”, as part of the statutory test, had always been in issue in relation to the Capital Amount and within the scope of the Closure Notice and correspondence between the parties and statement of case. As such, he contended, the LLP was on notice of the Capital Amount “incurred” argument. He referred to the Closure Notice which disallowed the £2,000,000 “Capital Account re Co-op Loan” and correspondence between the parties, eg a letter, dated 27 May 2016, from Ms Katherine Nash of HMRC to the LLP’s solicitors which stated:

> “We have previously discussed the position regarding this sum [the £2m Capital Account], and you have suggested that further information might be available demonstrating that the loan arrangements are fully commercial. We would be interested to consider this if it was available, and we would also like to see the Capital Account Deed, but at present our view remains that this amount cannot be considered an allowable BPRA cost, **and in addition we believe that this sum cannot be considered to have been paid as at the date of the claim**.” (emphasis added)

14. Mr Davey also referred to the burden of proof in this appeal being on the LLP and that HMRC had, in its paragraph 2, reserved the right to amend the statement of case which had been written on the understanding of the then current position and should "not be construed as an admission "either as to the facts or consequences alleged" by the LLP as to which it was "put to proof".

15. However, as Mr Bremner submitted, we do not consider that paragraph 72 of the statement of case in its original form, ie the "expenditure on the part of Luton LLP does not constitute expenditure incurred on or in connection with the conversion or renovation or incidental repair of the Property" can be read as incorporating the two issues that HMRC now seek to rely upon, ie (1) whether the expenditure was "incurred"; and (2) if so whether it was incurred on or in connection with … etc. Moreover, such an interpretation would be inconsistent with paragraph 3 of the statement of case which, under the subheading "Scheme overview", states:

> "… Those arrangements [in which the LLP was involved] included the incurring of expenditure in relation to a building near Luton airport, namely Blush House, Airport Way, Luton, Bedfordshire …"

16. Although Mr Davey did refer to the correspondence, as is clear from the Rule 25(2)(b) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 it is the statement of case and not the correspondence in which HMRC is required to set out its (final) position in relation to a case, ie to set out the case that an appellant has to meet. We did not consider that the Capital Amount "incurred" argument was clearly included in in the statement of case and therefore an application to amend was required if it were to be relied on.

17. In *Quah Su Ling v Goldman Sachs Ltd* [2015] EWHC 759 (Comm) Carr J said:

> "36. An application to amend will be refused if it is clear that the proposed amendment has no real prospect of success. The test to be applied is the same as that for summary judgment under CPR Part 24. Thus the applicant has to have a case which is better than merely arguable. The court may reject an amendment seeking to raise a version of the facts of the case which is inherently implausible, self-contradictory or is not supported by contemporaneous documentation.
>
> 37. Beyond that, the relevant principles applying to very late applications to amend are well known. I have been referred to a number of authorities: *Swain-Mason v Mills & Reeve* [2011] 1 WLR 2735 (at paras. 69 to 72, 85 and 106); *Worldwide Corporation Ltd v GPT Ltd* [CA Transcript No 1835] 2 December 1988; *Hague Plant Limited v Hague* [2014] EWCA Civ 1609 (at paras. 27 to 33); *Dany Lions Ltd v Bristol Cars Ltd* [2014] EWHC 928 (QB) (at paras. 4 to 7 and 29); *Durley House Ltd v Firmdale Hotels plc* [2014] EWHC 2608 (Ch) (at paras. 31 and 32); *Mitchell v News Group Newspapers* [2013] EWCA Civ 1537.
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> 38. Drawing these authorities together, the relevant principles can be stated simply as follows:

> a) whether to allow an amendment is a matter for the discretion of the court. In exercising that discretion, the overriding objective is of the greatest importance. Applications always involve the court striking a balance between injustice to the applicant if the amendment is refused, and injustice to the opposing party and other litigants in general, if the amendment is permitted;
>
> b) where a very late application to amend is made the correct approach is not that the amendments ought, in general, to be allowed so that the real dispute between the parties can be adjudicated upon. Rather, a heavy burden lies on a party seeking a very late amendment to show the strength of the new case and why justice to him, his opponent and other court users requires him to be able to pursue it. The risk to a trial date may mean that the lateness of the application to amend will of itself cause the balance to be loaded heavily against the grant of permission;
>
> c) a very late amendment is one made when the trial date has been fixed and where permitting the amendments would cause the trial date to be lost. Parties and the court have a legitimate expectation that trial fixtures will be kept;
>
> d) lateness is not an absolute, but a relative concept. It depends on a review of the nature of the proposed amendment, the quality of the explanation for its timing, and a fair appreciation of the consequences in terms of work wasted and consequential work to be done;
>
> e) gone are the days when it was sufficient for the amending party to argue that no prejudice had been suffered, save as to costs. In the modern era it is more readily recognised that the payment of costs may not be adequate compensation;
>
> f) it is incumbent on a party seeking the indulgence of the court to be allowed to raise a late claim to provide a good explanation for the delay;
>
> g) a much stricter view is taken nowadays of non-compliance with the Civil Procedure Rules and directions of the Court. The achievement of justice means something different now. Parties can no longer expect indulgence if they fail to comply with their procedural obligations because those obligations not only serve the purpose of ensuring that they conduct the litigation proportionately in order to ensure their own costs are kept within proportionate bounds but also the wider public interest of ensuring that other litigants can obtain justice efficiently and proportionately, and that the courts enable them to do so.

18. Applying these principles in the present case it is clear that the application, given it was made on the first day of the hearing, was very late (see Carr J's principle (c) above). Contending that we should nevertheless allow the application, Mr Davey referred to the overriding objective contained in Rule 2 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules to deal with cases "fairly and justly" which includes "avoiding unnecessary formality and seeking flexibility in the proceedings"

(see Rule 2(2)(b)). Although there may be some merit in adopting such a flexible approach in the case of an unrepresented appellant and/or when HMRC is represented by a Presenting Officer, that is not the case in an appeal such as the present where one party is represented by two QCs and the other by a QC and five junior counsel and is more akin to commercial litigation in the High Court.

19. In any event, even though the CPR does not apply to the Tribunal, as Lord Neuberger JSP observed *BPP Holdings Ltd v HMRC* [2017] STC 1655, in relation to time limits and sanctions:

> "25. … guidance to tribunals on tax cases was given by Judge Sinfield in the UT in *McCarthy & Stone*. In para 43, after referring to differences and similarities between the CPR and the tribunal rules, in that case the Tribunals Procedure (Upper Tribunal) Rules 2008 (SI 2008/2698), he accepted that "the CPR do not apply to tribunals" but added that he did not "accept that the UT should adopt a different, ie more relaxed, approach to compliance with rules, directions and orders than the courts that are subject to the CPR". The same view was expressed by Ryder LJ in paras 37 and 38 in the Court of Appeal in this case, including this: "I can detect no justification for a more relaxed approach to compliance with rules and directions in the tribunals", and added that "[i]t should not need to be said that a tribunal's orders, rules and practice directions are to be complied with in like manner to a court's".
>
> 26. It is not for this Court to interfere with the guidance given by the UT and the Court of Appeal as to the proper approach to be adopted by the Ft-T in relation to the lifting or imposing of sanctions for failure to comply with time limits (save in the very unlikely event of such guidance being wrong in law). We have twice recently affirmed a similar proposition in relation to the Court of Appeal's role in relation to the proper approach to be taken in such cases by first instance judges - see *Global Torch Ltd v Apex Global Management Ltd (No 2)* [2014] 1 WLR 4495 and *Thevarajah v Riordan* [2016] 1 WLR 76. The guidance given by Judge Sinfield in *McCarthy & Stone* was appropriate: as Mr Grodzinski QC, who appeared for BPP pointed out, it is "an important function" of the UT to develop guidance so as to achieve consistency in the Ft-T: see *R (Jones) v First-tier Tribunal (Social Entitlement Chamber)* [2013] 2 AC 48, para 41, per Lord Carnwath. And, by confirming that guidance in this case, the Senior President, with the support of Moore-Bick V-P and Richards LJ, has very substantially reinforced its authority. In a nutshell, the cases on time-limits and sanctions in the CPR do not apply directly, but the Tribunals should generally follow a similar approach."

20. Therefore, adopting such an approach, it was necessary for us to consider the explanation for the very late application (Carr J's principle (f), see paragraph 17, above)) and the effect that allowing it may have had on the hearing which had already commenced.

21. Mr Davey explained that until it received the LLP's skeleton argument on 16 April 2018, HMRC had understood that the issue of whether the Capital Amount and

Licence Fee Amount/Interest Amount Interest expenditure had been "incurred" was still at large. However, following receipt of the skeleton argument it was clear that this was not the case as paragraph 13 of the LLP's skeleton argument states that:

> "It is common ground in the present case that the [LLP] both (a) incurred the relevant expenditure and (b) had the relevant interest in the Property."

Therefore, the application by HMRC to amend the statement of case was made.

22. Additionally, Mr Davey contended, after referring to passages in the statements of witnesses for the LLP, that it would not need to adduce further evidence to deal with the issues if the application was allowed but if such evidence was required it could be dealt with in examination in chief. He also referred to the fact that closing submissions were not due for several weeks and that leading counsel for the LLP, who he described as, "the finest minds, silks at the Tax Bar", would clearly be able to deal with the issues raised and that allowing the amendments would not be prejudicial to the LLP.

23. Mr Bremner dismissed the explanation for the late application as "not a good explanation at all" and said that not only would additional evidence be required to meet the issues now raised by HMRC but that the LLP would need to prepare further submissions in relation to this "brand-new" point which would disrupt the work already underway in preparation for the hearing. He compared the position to that in *Bourke v Favre* [2015] EWHC 277 (Ch) where Nugee J said, at [19]:

> "… even if an adjournment is not required, I accept that there will be prejudice to the defendants. To permit the amendment to run the new case will require considerable work between now and trial, and by this stage the defendants ought to know what the issues are to be tried, what documents are available for that purpose, and what the witness evidence is. To require the defendants to prepare a wholly new case at the same time as to get the existing case in final shape for trial is inevitably going to cause prejudice. It puts significant pressure on the defendants and at the same time it does not put a corresponding pressure on the claimants who have already prepared their evidence with this claim in mind."

24. Accordingly, he said that there was a real danger that an already tight timetable would be disrupted and increase the risk of the hearing not concluding within the allocated time.

25. We were concerned that there was such a risk of the case going part heard, giving rise to inevitable difficulties in arranging for it to be re-listed to be concluded, especially in view of Mr Bremner's submission that further evidence would be needed if we allowed the amendments to the statement of case. We did not accept Mr Davey's argument that there was already sufficient evidence before the Tribunal to deal with the issues raised by the proposed amendments. As it bears the burden of proof it is for the LLP and its advisers to determine if further evidence is necessary to meet that burden and not for HMRC to say otherwise.

26. As the application was heard on the first morning of a 17 day hearing we considered that this alone would be sufficient reason to dismiss the application. However, in addition, we agreed with Mr Bremner that the explanation given, that HMRC were not aware that an amendment was necessary until the LLP's skeleton argument was received, cannot be a justification for the very late inclusion of additional arguments. If these were part of HMRC's case, they should have been "set out" in the statement of case. They were not and, as we considered that it was not fair or just to permit an amendment to the statement of case so late in the day, we dismissed the application.

Relevant Legislation

27. Although the Tribunal in *Senex Investments Limited v HMRC* [2015] UKFTT 107 (TC) considered whether a former church was a "qualifying building" for BPRA purposes, we understand that this appeal is the first occasion in which it has been necessary to consider the legislation relating to BPRA contained in the Capital Allowances Act 2001 (as amended by the Finance Act 2005) ("CAA") in detail. All subsequent references to legislative provisions, unless otherwise stated, are to the provisions of the CAA which, as in force at the relevant time, stated:

> **360A Business premises renovation allowances**
>
> (1) Allowances are available under this Part if a person incurs qualifying expenditure in respect of a qualifying building.
>
> (2) Allowances under this Part are made to the person who—
>
> > (a) incurred the expenditure, and
> >
> > (b) has the relevant interest in the qualifying building.
>
> **360B Meaning of "qualifying expenditure"**
>
> (1) In this Part "qualifying expenditure" means capital expenditure incurred before the expiry date on, or in connection with—
>
> > (a) the conversion of a qualifying building into qualifying business premises,
> >
> > (b) the renovation of a qualifying building if it is or will be qualifying business premises, or
> >
> > (c) repairs to a qualifying building or, where the qualifying building is part of a building, to the building of which the qualifying building forms part, to the extent that the repairs are incidental to expenditure within paragraph (a) or (b).
>
> (2) In subsection (1) "the expiry date" means—
>
> > (a) the fifth anniversary of the day appointed under section 92 of FA 2005, or
> >
> > (b) such later date as the Treasury may prescribe by regulations.
>
> (3) Expenditure is not qualifying expenditure if it is incurred on or in connection with—

(a) the acquisition of land or rights in or over land,

(b) the extension of a qualifying building (except to the extent required for the purpose of providing a means of getting to or from qualifying business premises),

(c) the development of land adjoining or adjacent to a qualifying building, or

(d) the provision of plant and machinery, other than plant or machinery which is or becomes a fixture as defined by section 173(1). 13

(4) For the purposes of this section, expenditure incurred on repairs to a building is to be treated as capital expenditure if it is not expenditure that would be allowed to be deducted in calculating the profits of a property business, or of a trade, profession or vocation, for tax purposes.

(5) The Treasury may by regulations make further provision as to expenditure which is, or is not, qualifying expenditure."

360C Meaning of "qualifying building"

(1) In this Part "qualifying building", in relation to any conversion or renovation work, means any building or structure, or part of a building or structure, which—

(a) is situated in an area which, on the date on which the conversion or renovation work began, was a disadvantaged area,

(b) was unused throughout the period of one year ending immediately before that date,

(c) on that date, had last been used—

(i) for the purposes of a trade, profession or vocation, or

(ii) as an office or offices (whether or not for the purposes of a trade, profession or vocation),

(d) on that date, had not last been used as, or as part of, a dwelling, and

(e) in the case of part of a building or structure, on that date had not last been occupied and used in common with any other part of the building or structure other than a part—

(i) as respects which the condition in paragraph (b) is met, or

(ii) which had last been used as a dwelling.

(2) In this section "disadvantaged area" means—

(a) an area designated as a disadvantaged area for the purposes of this section by regulations made by the Treasury, or

(b) if no regulations are made under paragraph (a), an area for the time being designated as a disadvantaged area for the purposes of Schedule 6 to FA 2003 (stamp duty land tax: disadvantaged areas relief).

(3) Regulations under subsection (2)(a) may—

(a) designate specified areas as disadvantaged areas, or

(b) provide for areas of a description specified in the regulations to be designated as disadvantaged areas. 14

(4) If regulations under subsection (2)(a) so provide, the designation of an area as a disadvantaged area shall have effect for such period as may be specified in or determined in accordance with the regulations.

(5) Regulations under subsection (2)(a) may—

(a) make different provision for different cases, and

(b) contain such incidental, supplementary, consequential or transitional provision as appears to the Treasury to be necessary or expedient.

(6) Where a building or structure (or part of a building or structure) which would otherwise be a qualifying building is on the date mentioned in subsection (1)(a) situated partly in a disadvantaged area and partly outside it, only so much of the expenditure incurred in accordance with section 360B as, on a just and reasonable apportionment, is attributable to the part of the building or structure located in the disadvantaged area is to be treated as qualifying expenditure.

(7) The Treasury may by regulations make further provision as to the circumstances in which a building or structure or part of a building or structure is, or is not, a qualifying building."

360D Meaning of "qualifying business premises"

(1) In this Part "qualifying business premises" means any premises in respect of which the following requirements are met—

(a) the premises must be a qualifying building,

(b) the premises must be used, or available and suitable for letting for use,—

(i) for the purposes of a trade, profession or vocation, or

(ii) as an office or offices (whether or not for the purposes of a trade, profession or vocation),

(c) the premises must not be used, or available for use as, or as part of, a dwelling.

(2) In this section "premises" means any building or structure or part of a building or structure.

(3) For the purposes of this Part, if premises are qualifying business premises immediately before a period when they are temporarily unsuitable for use for the purposes mentioned in subsection (1)(b), they are to be treated as being qualifying business premises during that period.

> (4) The Treasury may by regulations make further provision as to the circumstances in which premises are, or are not, qualifying business premises.
>
> **360E General rule as to what is the relevant interest**
>
> (1) The relevant interest in a qualifying building in relation to any qualifying expenditure is the interest in the qualifying building which the person who incurred the qualifying expenditure was entitled when it was incurred.
>
> …
>
> **360G Initial Allowance**
>
> (1) A person who has incurred qualifying expenditure in respect of any qualifying building is entitled to an initial allowance in respect of the expenditure.
>
> (2) The amount of the initial allowance is 100% of the qualifying expenditure.

28. As to how these BPRA provisions should be interpreted, Lewison LJ observed in *The Pollen Estate Trustee Company Limited v HMRC* [2013] Civ 753 at [24] that:

> "The modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. This approach applies as much to a taxing statute as any other: *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991, 999; *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51; [2005] 1 AC 684 (§ 28). In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole: *WT Ramsay Ltd v Commissioners of Inland Revenue* [1982] AC 300, 323; *Barclays Mercantile Business Finance Ltd v Mawson* (§ 29). The essence of this approach is to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found: (*Barclays Mercantile Business Finance Ltd v Mawson* (§ 32)."

29. Previously, as Lewison J, he had explained in *Berry v HMRC* [2011] STC 1057 at [31]:

> "…
>
> (iv) Although the interpreter should assume that a statutory provision has some purpose, the purpose must be found in the words of the statute itself. The court must not infer a purpose without a proper foundation for doing so (*Astall v HMRC* (§ 44)).
>
> (v) In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole (*WT Ramsay Ltd v Commissioners of Inland Revenue* (1981) 54 TC 101, 184; *Barclays Mercantile Business Finance Ltd v Mawson* (§ 29))."

30. In *RFC 2012 plc (formerly The Rangers Football Club plc) v Advocate General for Scotland* [2017] 1 WLR 2767 Lord Hodge said at [11]:

> "… the courts at the highest level have repeatedly warned of the need to focus on the words of the statute and not on judicial glosses, which may clarify or illustrate in a particular case but do not replace the statutory words."

31. Although it is permissible to have regard to extrinsic material to identify the "mischief" that the legislation was intended to remedy, as Lord Diplock said in *Fothergill v Monarch Airlines Limited* [1981] AC 251 at 281:

> "Where the Act has been preceded by a report of some official commission or committee that has been laid before Parliament and the legislation is introduced in consequence of that report, the report itself may be looked at by the court for the limited purpose of identifying the "mischief" that the Act was intended to remedy, and for such assistance as is derivable from this knowledge in giving the right purposive construction to the Act."

32. However, as Sales J (as he then was) observed at [13] in *Bogdanic v The Secretary of State for the Home Department* [2014] EWHC 2872 (QB):

> "… in construing a legislative instrument in the form of an Act of Parliament, it is a basic constitutional principle that the citizen or person subject to the relevant law should have the means of access to any material which is said to provide an aid to construction of that instrument. It is only material which is in the public domain and of clear potential relevance to the issue of interpretation of a legislative instrument which can be treated as having any bearing on the proper construction of that instrument: see *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591, 614A (Lord Reid), 638D-H (Lord Diplock) and 645C-H (Lord Simon of Glaisdale); *Fothergill v Monarch Airlines Ltd* [1981] AC 251, 279F-280B (Lord Diplock: "… the need for legal certainty demands that the rules by which a citizen is to be bound should be ascertainable by him (or, more realistically, by a competent lawyer advising him) by reference to identifiable sources that are publicly accessible …"); and *R (Public and Commercial Services Union) v Minister for the Civil Service* [2010] EWHC 1027 (Admin); [2010] ICR 1198, [53]-[55]."

33. We were invited by Mr Gammie to have regard to the then Government's intention at the time the BPRA provisions were enacted to assist in their interpretation. He referred us to several documents for this purpose.

34. One of the documents, the Consultation Document, *Capital allowances: renovation of business premises in disadvantaged areas*, issued by the Inland Revenue in December 2004, after setting out the Government's intention to introduce draft legislation, states, at paragraph 1.7:

> "We have therefore designed a scheme that will be open to individuals and companies who own or lease business property that has previously been unused for 12 months or more. The scheme will allow them to claim up-front tax relief on all their capital spending on the renovation or conversion of the property in order to bring it back into business use."

35. Annex C of the Consultation Document, which sets out "the purpose and intended effect of the measure" states:

> "C.7 Boarded-up rows of derelict shops and empty business properties are a common sight in the most deprived areas of the UK. The Government has identified that further barriers to regeneration in these areas are caused by the presence of such properties. Available data shows: (i) that there is a significantly greater proportion of long-term empty properties in the 2,000 Enterprise Areas than in other areas of the UK and (ii) that market prices can hit a floor below which the costs of maintaining/refurbishing the premises would be higher than the expected yield the owner could expect to obtain as a result of incurring such costs. This is the so-called "negative rent" effect, which acts as a barrier to regeneration.
>
> …
>
> C.9 The presence of such [empty] properties can also act as a drag on the whole neighbourhood. This is sometimes referred to as the "broken window" effect, which can deter new people and businesses from locating in these disadvantaged areas.
>
> C.10 Over time, the degree of dereliction can increase, until such time as the costs of renovation could outweigh any private returns. At this point the site will not be brought back into use without some form of public support. However, earlier intervention could have saved significant public funds and so would have led to economic efficiency gains. The BPRA scheme will encourage early remediation, thus preventing the costs of remedying dereliction from spiralling until they become unaffordable.
>
> …
>
> c.12 Finally, buildings in disadvantaged areas can often be in need of significant redevelopment and refurbishment to bring them back to standard suitable for occupation. While the price for purchase or lease may reflect this, the need for a significant up-front investment can act as a disincentive compared to the more straightforward occupation of a

> building in other areas. This can increase the risk of greenfield, rather than brownfield development, with a corresponding reduction in amenity and biodiversity."

36. However, as HMRC point out, this Consultation Document was prepared by the Inland Revenue seeking responses from the public in the proposed BPRA legislation rather than a Parliamentary document. Although it does set out the policy objectives of a Government Department it cannot be assumed that these political objectives are necessarily in accordance with the purpose of the legislation as subsequently enacted.

37. To complete the picture, we should add that on 18 July 2013, after the period with which this appeal is concerned, HMRC published a technical note launching a technical review of the BPRA legislation "against the background of recent DOTAS (Disclosure of Tax Avoidance Schemes) disclosures involving BPRA, which appear to contain some features aimed at exploiting the relief in ways that Parliament had not intended." A consultation on amendments to the legislation followed after which draft legislation was published in December 2013. Following further consultation, amendments to the BPRA legislation which restricted BPRA to specific items of expenditure incurred on after 6 April 2014 were enacted in the Finance Act 2014.

Evidence

38. We heard from the following witnesses in behalf of the LLP:

(1) Nicholas Lewis the founding partner in Downing LLP ("Downing") and a Director of Downing Corporate Finance Limited ("DCF"). Downing was incorporated in November 2008 and remained dormant until June 2011 when it acquired the assets and business of DCF which had been founded by Mr Lewis as Downing Corporate Services Limited in 1986. DCF was the promoter of the LLP in February and March 2011 and, with effect from June 2011, matters have been conducted through Downing which is authorised and regulated by the Financial Conduct Authority.

Mr Lewis was also a member of the Blakes Partnership LLP ("Blakes") which he owned with his wife. Although it is primarily an equestrian business Blakes is engaged in other services and was appointed as property adviser to the project to develop the former flight training centre into a 124-room hotel (see below). Mr Lewis explained that before 2011 his family and family interests owned approximately 80% of DCF but when the business was transferred to Downing with the intention to enable more partners to be brought into the partnership his family share of the income decreased to about 50%. Mr Lewis therefore agreed with his Downing partners that, because he had been more principally involved in developing the BPRA part of the business, he should get the "lion's share of what was being created at that time" and Blakes was accordingly appointed as property adviser to the project. This was confirmed by a Profit Sharing Agreement dated 15 November 2010 between Mr Bantoft, DCF and Blakes;

(2) Michael Tracey, a chartered surveyor, director and shareholder in the Cannock group of companies ("Cannock"). This includes Cannock Projects LLP in which he had a 20% interest which, when known as OVL

(Bankfield) LLP ("OVL") was the developer of the Property. The remaining 80% interest in OVL was held by the late Stephen Bantoft who died in 2015 and it is now held by his executors;

(3) David Matthews, who between 2006 and 2013 was employed by the Co-operative Bank (the "Co-op") as a senior business development manager in Liverpool. His role involved the establishment of a new corporate office and attracting new business to the bank. In that capacity he was involved in the loan application process to finance the project for the renovation of the Property;

(4) Richard Rawlinson, an investor in the LLP;

(5) Tim Beresford, although a director of CA4 Partnership Limited which was formed in 2011 to provide specialist advice on capital allowances, Mr Beresford did not give evidence as an expert but as a witness of fact having been engaged by the LLP to assist in the negotiation of the BPRA claim with HMRC;

(6) David Harper FRICS, who provided an "Expert Witness Valuation Report" on the Property in March 2018 and a further Report, "Supplemental Points", in April 2018. He is a director of Leisure Property Services, a company he established in 2005 with the intention of providing assistance to investors and operators buy hotels off-market in addition to providing valuation advice in relation to hotel purchases. He estimates that he has undertaken over £10 billion worth of hotel valuations over the last 20 years on a wide range of hotel types and is the author of *Hotel Valuation for Investors* a valuation text book published by Routledge in August 2016. Mr Harper has been asked to speak on numerous occasions at professional conferences on hotel valuations including the Henry Stewart Hotel Valuation Conference, Hotel Summit East Africa, Africa Hotel Investment Forum, GRi conferences and the international Hotel investment Forum; and

(7) Douglas Smith MRICS, an executive director of CBRE Limited, whose expert Report addresses the "typical approaches" to development and development funding in the non-tax and tax driven markets.

39. Although he had been due to give evidence Stephen Lundy, an investment Broker and independent adviser who recommended investing in the LLP was, due to ill-health, unable to do so. His witness statement was therefore admitted in evidence on the same (unopposed) basis applied by the Tribunal in *Rockall and Another v HMRC* [2014] UKFTT 643 (TC) at [6] where the appellant:

> "… was unable to attend the hearing for health reasons. In the circumstances HMRC did not object to her evidence or seek to exclude its admission. In any event rule 15(2)(a) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 provides that the Tribunal may "admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom". We therefore admitted Mrs Rockall's witness statement as hearsay evidence (ie a statement made otherwise than by a person while giving oral evidence

> in proceedings, which is tendered as evidence of the matters stated) but attach less weight to it than would have been the case had she given oral evidence under oath or affirmation which could have been tested under cross-examination."

40. The following witnesses gave evidence on behalf of HMRC:

(1) Malcolm Smith of HMRC who, from December 2005 to October 2013, was HMRC's Senior Technical Adviser on Capital Allowances responsible for technical issues arising from the CAA. On 5 May 2011 he attended a meeting with Mr Lewis and Pierre Clarke of Downing and Robert Jones of Adducere LLP (described in the Information Memorandum produced by the LLP for potential investors as the "Taxation Adviser") in which BPRA was discussed in relation to another development promoted by Downing;

(2) Trevor Huxley, a quantity surveyor employed by the Valuation Office Agency ("VOA") an executive agency of HMRC, who like Mr Beresford who gave evidence for the LLP, gave his evidence as a witness of fact;

(3) Katherine Nash, HMRC's Technical and Litigation Lead for BPRA arrangements who was responsible for opening the enquiry into the LLP's 2010-11 return and has continued to be involved in this matter ever since;

(4) Nicola Cochrane FRICS, FAAV of the Statutory Valuation Team at the VOA provided a Report, dated 16 March 2018, as a hotel valuation expert witness;

(5) Anthony Williams MRICS of the District Valuer Services (part of the VOA) who provided expert evidence relating to property development and associated market practices in relation to the development of the Property and whether or not these accord with industry norms/market practice.

(6) Paul Avo BSc, MRICS whose expert report addressed the reasonableness of the costs in carrying out the physical works of renovation, conversion and incidental repair undertaken for the LLP by the developer, OVL.

41. Also, as it was not disputed, the witness statement of Paul Wills of the VOA, who provided assistance to HMRC in relation to the calculation of the Closure Notice figure, was admitted in evidence.

42. Although Mr Gammie did not seek to exclude the expert reports of Ms Cochrane or Mr Williams he submitted that as neither had the requisite qualification or experience to be an expert in this case their evidence should be afforded little, if any weight. In the case of Ms Cochrane, Mr Gammie submitted that because of her reliance on, inter alia, client confidentiality not to provide further details when cross examined about her experience, such as the range of values, the type and nature of transactions, on the five to ten valuations in excess of £2 million (but less than £10 million) she had undertaken, we should, as she was unable to demonstrate her expertise as a valuer of the type of property and the particular market with which this appeal is concerned, disregard her report altogether.

43. Similarly, with regard to Mr Williams, Mr Gammie contends that because of the lack of experience and expertise, which Mr Williams accepted, in the type of property development such that in the present case and its funding structure we should disregard his report in its entirety.

44. We were also provided with a substantial quantity of documentary evidence comprising, as we have already noted, some 55 lever arch files. This evidence included, in addition to the correspondence between the parties, the Information Memorandum prepared by the LLP for potential investors, the agreement between the LLP and developer, the Sale and Purchase agreement for the acquisition of the property, the debt finance request, valuation reports, a profit sharing agreement, a TRI Hospitality Report, a "design and build" contract, fixtures and fittings and equipment supply agreement, Members' Agreement, transfer documents, Ramada International licence agreement, the developers loan agreement and a hotel management agreement as well as photographs and plans. There were, somewhat confusingly, multiple copies of many of these documents which often made it difficult to establish the final version.

45. In addition, we had the benefit of a site visit to the Property on 11 May 2018. During the visit we were shown a standard double and a standard twin room, an executive double room and an accessible double room. We also saw the kitchen, bar and reception areas and were also taken, climbing up fixed internal vertical ladders, onto the roof of the building where the air-handling units, chiller units and extract ventilation fans are situated.

Approach to the evidence

46. In *Gestmin SGPS SA v Credit Suisse (UK) Ltd & Anor* [2013] EWHC 3560 (Comm) Leggatt J observed:

> "15. An obvious difficulty which affects allegations and oral evidence based on recollection of events which occurred several years ago is the unreliability of human memory.
>
> 16. While everyone knows that memory is fallible, I do not believe that the legal system has sufficiently absorbed the lessons of a century of psychological research into the nature of memory and the unreliability of eyewitness testimony. One of the most important lessons of such research is that in everyday life we are not aware of the extent to which our own and other people's memories are unreliable and believe our memories to be more faithful than they are. Two common (and related) errors are to suppose: (1) that the stronger and more vivid is our feeling or experience of recollection, the more likely the recollection is to be accurate; and (2) that the more confident another person is in their recollection, the more likely their recollection is to be accurate.
>
> 17. Underlying both these errors is a faulty model of memory as a mental record which is fixed at the time of experience of an event and then fades (more or less slowly) over time. In fact, psychological research has demonstrated that memories are fluid and malleable, being constantly rewritten whenever they are retrieved. This is true

even of so-called 'flashbulb' memories, that is memories of experiencing or learning of a particularly shocking or traumatic event. (The very description 'flashbulb' memory is in fact misleading, reflecting as it does the misconception that memory operates like a camera or other device that makes a fixed record of an experience.) External information can intrude into a witness's memory, as can his or her own thoughts and beliefs, and both can cause dramatic changes in recollection. Events can come to be recalled as memories which did not happen at all or which happened to someone else (referred to in the literature as a failure of source memory).

18. Memory is especially unreliable when it comes to recalling past beliefs. Our memories of past beliefs are revised to make them more consistent with our present beliefs. Studies have also shown that memory is particularly vulnerable to interference and alteration when a person is presented with new information or suggestions about an event in circumstances where his or her memory of it is already weak due to the passage of time.

19. The process of civil litigation itself subjects the memories of witnesses to powerful biases. The nature of litigation is such that witnesses often have a stake in a particular version of events. This is obvious where the witness is a party or has a tie of loyalty (such as an employment relationship) to a party to the proceedings. Other, more subtle influences include allegiances created by the process of preparing a witness statement and of coming to court to give evidence for one side in the dispute. A desire to assist, or at least not to prejudice, the party who has called the witness or that party's lawyers, as well as a natural desire to give a good impression in a public forum, can be significant motivating forces.

20. Considerable interference with memory is also introduced in civil litigation by the procedure of preparing for trial. A witness is asked to make a statement, often (as in the present case) when a long time has already elapsed since the relevant events. The statement is usually drafted for the witness by a lawyer who is inevitably conscious of the significance for the issues in the case of what the witness does nor does not say. The statement is made after the witness's memory has been "refreshed" by reading documents. The documents considered often include statements of case and other argumentative material as well as documents which the witness did not see at the time or which came into existence after the events which he or she is being asked to recall. The statement may go through several iterations before it is finalised. Then, usually months later, the witness will be asked to re-read his or her statement and review documents again before giving evidence in court. The effect of this process is to establish in the mind of the witness the matters recorded in his or her own statement and other written material, whether they be true or false, and to cause the witness's memory of events to be based increasingly on this material and later interpretations of it rather than on the original experience of the events.

…

> 22. In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth.

47. Given the time that has elapsed since the transactions with which this appeal is concerned took place, over seven years by the time of the hearing, and this is, in essence, a commercial case, we have adopted such an approach to the evidence in this appeal placing greater reliance on contemporaneous documents than the recollections of the individuals concerned.

Facts

Acquisition of Property

48. Cannock had, since 1995, been involved in developments and property regeneration projects in Enterprise Zones. Following the introduction of BPRA Cannock sought development projects that would qualify for such allowances together with sponsors who could promote the project and raise the necessary equity finance from private investors and had, before the project with which this case is concerned, undertaken six BPRA projects with Downing. Having been engaged on several such projects, on 12 September 2009, Mr Michael Tracey received an email from a Mr Victor Levy of Raphael Property Investment Company Limited in relation to the Property. The email explained:

> "We have just purchased this prominent building which is next to the Ibis Hotel at Luton airport. It is 27,000 sq ft building having been constructed about 6 years ago upon a 2 acre plot.
>
> The building was used as a flight training centre by Boeing with offices at the front.
>
> The building is in an employment zone and can be used for any of the B classes but in addition, planning permission has been obtained for a 149 bedroom hotel."

49. Matters progressed and, on 19 November 2009, Mr Tracey was able to email Mr Levy attaching terms. The email stated:

> "On the basis that these [terms] are agreed I will instruct our side. The only matter outstanding is the identity of the developer – I need to

> discuss with Stephen [Bantoft] and my FD and will confirm which company we will be running this through.
>
> I will also commence discussions with the planners tomorrow with a view to meeting them early next week. Please confirm that you are happy for me to do so."

50. The terms attached to the email provided:

TRANSACTION:	Cannock Developments Ltd proposes to acquire on behalf of the Purchaser (detailed below) the freehold interest in the Property from Chainridge Limited under the terms and conditions as set out in these Heads of Terms.
…	
DEVELOPER:	A company controlled by Cannock Developments Ltd (to be confirmed) … FAO Mike Tracey
PURCHASER:	Newly formed On-Shore LLP C/O Downing Corporate Finance

51. Chainridge Limited ("Chainridge") of which Mr Levy was a director, as is clear from a statutory declaration he made on 11 March 2011, had purchased the Property, which had been vacant, on 30 November 2009 and was its freehold owner. It agreed to sell the Property, under the terms of a conditional agreement dated 9 December 2009 between Chainridge¸ OVL (a Cannock company) and the LLP, to OVL and the LLP. Although this contract envisaged a contractual completion date on or before 31 May 2010 it was not completed. Instead the agreement went through a number of iterations between 9 December 2009 and 25 March 2011 when the freehold interest in the Property was actually transferred to the LLP. This included, in addition to the Property the surrounding access land and car parking. The purchase price was £2,880,000 plus VAT and the Developer was to pay a deposit of £29,999 plus VAT and the LLP £1.

52. Immediately after the acquisition of the Property by the LLP, also on 25 March 2011 Chainridge sold "land adjoining Blush House" to OVL for which OVL paid £250,000 (plus VAT). Additionally, on 25 March 2011, OVL entered into a Deed of Covenant in favour of the London Luton 2010 Limited, the Operating Company (see below) which OVL appointed as manager of 49 car parking spaces on the adjoining land for consideration of £35 per space per calendar month.

53. An application for planning permission was made on 18 December 2009 and registered on 30 December 2009. To meet the local planning criteria, which required the generation of sufficient employment opportunities which the hotel alone would not provide, the application included in addition to the conversion of the Property to a hotel a separate small office scheme located on the north east car park area. Initial planning permission was granted on 17 February which was conditional on the delivery of the office scheme. However, following a second application on 25 June 2010, which was granted on 19 August 2010, the office scheme requirement was

removed. By this time OVL had become Cannock Projects LLP ("Cannock") which is how we shall subsequently refer to it.

54. Cannock explored various franchise agreements for the Property by considering the hotels already operating in the vicinity and speaking to hotel operators and hospitality specialists. There was already a Holiday Inn Express near Luton airport and a "lock out" agreement with another hotel owner prevented the creation of any other IHG brand hotel nearby. Hilton were advanced negotiations for a site near to the Property and Accor traded from an adjacent site. Therefore, discussions were opened and successfully concluded with Wyndham Worldwide for a Ramada Encore franchise.

55. During March and April 2010 Cannock was in discussions with a Mr Simon Matthews-Williams of Sanguine Hospitality Management Limited ("Sanguine") in relation to the anticipated trading figures for a Ramada Encore hotel operating at Luton Airport and provision of advice on the layout, design and finishes for the completed hotel. However. Cannock subsequently identified ThenHotels Limited trading as ThenHospitality ("ThenHospitality") as suitable mangers and operators for the hotel on completion and its, rather than Sanguine's, assistance was sought throughout the design and development of the project. Mr Lewis explained that this was because of the deterioration of the personal relationship between Mr Bantoft, who Mr Lewis described as "not always the easiest person to get on with", and Mr Matthews-Williams and that although Sanguine was not appointed to that role it did receive a payment of £248,000 (net of VAT) by Cannock. Mr Tracey said that that this payment was not a Franchise cost but a sum agreed between Sanguine and Mr Bantoft as a result of the decision to use ThenHospitality and not Sanguine to advise throughout the design and development period and as a suitable for the operation of the hotel.

56. Financial projections for the development of a 124-room Ramada Encore hotel at the Property were prepared by ThenHospitality. These projections were reviewed by TRI Hospitality Consulting ("TRI"), a management consultancy specialising in data analytics for the hotel sector from which Cannock sought advice. On 20 January 2011, TRI provided Cannock with its 'final report' which concluded that the projections prepared by ThenHospitality:

> "… appear reasonable, accurately reflecting the anticipated market position of the hotel and the strength of the market opportunity."

Construction contract

57. Cannock put the construction contract out to tender with Multibuild Interiors Limited, which was acquired by Balfour Beatty plc in 2010, and Heyford Homes Limited ("Heyford"), a residential developer and contractor which is part of the Cannock group. After initial discussions in April 2010, a Design and Build Contract was entered into by Cannock and Multibuild (Construction and Interiors) Limited, ("Multibuild") a subsidiary of Balfour Beatty plc (with a guarantee given by Balfour Beatty plc), on 24 March 2011 for, "the conversion of a flight simulator facility to a 124 bed Ramada Encore Hotel at [the Property], Airport Way, Luton Airport" at an

agreed price of £5,721,914 although they subsequently agreed to increase this sum to £5,894,555.

58. The Design and Build Contract was signed before the LLP had acquired the freehold of the Property and was:

> "… conditional to the issue of a notice by [Cannock] to [Multibuild] that Financial Close has occurred and that the Agreement is not longer conditional."

However, if Financial Close had not occurred by 5 April 2011 and Cannock had not issued the notice described above, either Cannock or Multibuild was entitled any time after 5 April 2011 to:

> "… terminate this Agreement by the service of written notice to that effect in which event [Multibuild] and [Cannock] agree that the obligations of both parties under this Agreement will immediately cease and neither party shall owe the other any form of liability under the terms of this Agreement."

59. Under the Contract, "Financial Close" was defined as the date on which the Loan Agreement was entered into between the Co-op and LLP (see below) which, as Mr Tracey explained, was the usual practice as it is necessary to have a contractor in place ready to undertake work immediately after legal completion to avoid any delay in the commencement of the works and avoid a risk of a premium on the contractor's fees.

60. On 24 March 2011 Multibuild and Cannock had entered into a FF&E Supply Agreement (the "FF&E Supply Agreement") under which, although in its original tender it had allowed £817,896 for loose FF&E, Multibuild agreed to the reduced sum of £685,000 corresponding to the amount that Cannock had agreed the LLP should pay for loose FF&E. However, having agreed the reduction in price Multibuild faced difficulties with its subcontractors who had provided fixed prices but, due to the passage of time since their quotes, found themselves being squeezed. Cannock therefore entered into a Deed of Agreement with Multibuild under which Cannock agreed to meet any additional costs over £685,000 incurred in the provision of FF&E:

> "… subject to a maximum of £817,896. For the avoidance of doubt if the sums incurred for the provision of FF&E are less than £850,000 [Cannock] shall only be liable for such lessor amount plus attendances, overheads and profit."

61. Like the Design and Build Contract the FF&E Supply Agreement pre-dated the acquisition by the LLP of the freehold of the Property and was conditional on Financial Close by 5 April 2011. There were no conditions as to the commencement of works which began in May 2011, after legal completion. These were completed in June 2012.

Bank Loan

62. Following the 2008 global banking crisis, Cannock found it difficult to obtain bank finance for the development project. Indeed, as Mr Tracey confirmed in evidence, Cannock were turned down by RBS, HSBC, Lloyds and Santander before finance for the project was eventually obtained through the Co-op. Cannock was responsible for making the request for debt finance to the banks and, according to Mr Tracey, the same information was provided to all of the banks from which finance was sought.

63. On 6 December 2010 in an email to Mr David Matthews at the Co-op, Mr Tracey referred to the "outline details" for the Luton hotel scheme. The email explained that TRI was "finalising" its comments on the scheme. The details to which he referred were contained in a Debt Finance Request that had been prepared by Cannock. This explained that:

> "The developer in this instance will be [Cannock], a development company owned by Stephen Bantoft and Mike Tracey. Between Cannock Developments, Office Villages Limited and various OVL LLP's we have developed in excess of 2,000,000 sq ft of commercial accommodation funded both through tax driven vehicles and traditionally."

Other sections of the Debt Finance Request provide:

> "**3. Fund Administration**
>
> The raising of investor funds and ongoing administration of the purchasing vehicle will be carried out by Downing Corporate Finance. Downing has acted as sponsor on our past four BPRA syndicated deals.
>
> …
>
> **4. The Structure**
>
> …
>
> The purchasing entity will be an on shore LLP funded by way of Investor equity, primary bank debt and developer loan. It will simultaneously purchase the freehold in the property and enter the development agreement with the developer.
>
> The developer will have entered a fixed priced building contract for the works subject to funding prior to completion of the Development Agreement. The Development Agreement will oblige the developer to complete the building in compliance with the planning permission and brand requirements that will have been pre-approved by all parties.
>
> …
>
> **5. The Hotel Operation**

The Purchasing LLP (PropCo) will own 100% shares in the Operational Company set up to run the hotel. This OpCo will enter a 25 year lease with PropCo with the rent payable being made up of a base rent and turnover do that the total rent equates as closely as possible to EBITDA.

The hotel will be operated as a Ramada Encore, a Wyndham international hotel brand and will be managed on behalf of the OpCo by Sanguine Hospitality. The OpCo will enter into the franchise agreement and separate management contract with Sanguine. To protect the bank and investors suitable termination clauses will be built into the management contract and non disturbance agreements and step in rights will be negotiated with the Franchisor.

…

64. Having set out the envisaged development costs, which included sponsors and IFA fees (£525,000), developers, LLPs, Franchise and freeholders “legals” (£50,000, £70,000, £35,000 and £10,000 respectively), fees (including the bank arrangement fee £87,500) and “hotel set up costs” (Sanguine £248,000, Wyndham £80,000, working capital account £350,000 and FF&E £500,000) the debt request turned to “Loan Security” and the “Loan Sought”, stating:

8. Loan Security

In addition to the stature of the parties involved the bank will derive its protection and comfort from the following:

1. First charge over the property.

2. Charges over the initial deposits to include:

Construction Costs	£5,200,000
Construction Cost Overrun	£350.000
Interest Account	£243,858
FF&E Account	£500,000
OpCo Loan Account	£350,000
Developers Security Account	£2,000,000
Total Day One Secured Deposit	£8,643,858

3. Step in rights to the development agreement and building contract.

4. Warranties form the contractor and professional team.

5. Access to the developer’s Security Account in the event repayments are not made by the PropCo.

6. Non disturbance agreements with the Franchisor permitting rectification of breaches and removal of the management company.

The Developers Capital Account is provided by the developer to give additional comfort to the Bank and investors throughout the initial loan period. It may be called upon in the even that pre-agreed interest and amortisation payments (and other loan covenants) are nor met out of trading income. The benefit of the account should therefore be taken into account when calculating the loan covenants throughout the period.

> …
>
> **9. Loan Sought**
>
> We are seeking debt finance to assist the investors in their purchase of the building. The loan would ideally be for a term of between 5 and 8 years at a margin above LIBOR.
>
> …
>
> Edward Symmons have advised, based on the revised trading figures that the hotel would have an estimated value of £12,400,000.
>
> Assuming a loan of £6,500,000 this represents an LTV [loan to value] of 52.4%.
>
> After deduction of the security deposit (and this show the true day one net lend) the LTV reduces to 36.3%.
>
> Edward Symmons have also provided a valuation of the property at PC and fully fitted but prior to trading of £11.25m"

65. Mr Tracey explained the reasoning behind the £2 million Developers Security Account, which was also described as the Capital Account, as being "something in addition" to the other security offered to the bank. He said that the "genesis of the capital account" had come about in the first trading hotel transaction that Downing had undertaken following lengthy discussions with RBS as to how best to obtain finance of any level on a trading hotel. Mr Matthews said, in relation to the capital account, that he thought it worked well in terms of protecting the Co-op's interests and that he would not have encouraged the parties to consider other options which, from his past experience of development projects were inherently risky. But, as Mr Matthews accepted, the proposal for a capital account was in place before the Co-op had been approached by Cannock and it was not included as a requirement of the bank. However, Mr Matthews could not say that its inclusion had not been "driven" by another bank. As he said in evidence:

> "I wasn't naïve enough to think that we were the first bank that had been asked to look at this proposition, and I was aware that this sort of mechanism had been used at the behest of other banks. When it was introduced as a concept in this proposal, it was something I felt worked well for parties, particularly the bank, from my past experience of similar projects, and I very quickly got comfortable with that and felt it was the best way forward for the bank … and so [I] didn't really look at any variations beyond that other than the quantum of debt that the bank would be comfortable with."

66. Having considered the proposed scheme to be "interesting" and the funding requirement to be "within the banks parameters", Mr Matthews responded to Mr Tracey's email on 17 December 2010. He requested a copy of the TRI Report and any valuations following which he hoped to be able to provide "indicative terms and conditions." He also told Mr Tracey that the Co-op was currently involved in similar transactions with Downing and were also funding a number of BPRA schemes and were familiar with the proposed structure of the scheme. Mr Tracey provided the TRI

Report (which was dated 24 May 2010 and addressed to Mr Stephen Bantoft) on 22 December 2010 and suggested a meeting "early in January".

67. The proposed meeting took place on 12 January 2011. On 17 January 2011 Mr Matthews sent an email to Mr Tracey to which were attached "outline terms for the proposed loan". These terms which were "subject to formal credit approval" contained nine "conditions precedent" which included the following:

> (1) Valuation report to be undertaken by Bank appointed panel surveyor to confirm the market value and market value with special assumptions of the hotel on completion;
>
> (2) Bank appointed QS to confirm that costings are realistic and to monitor the development on an ongoing basis;
>
> (3) Fixed price contract for the refurbishment work to be obtained from a main contractor acceptable to the Bank; and
>
> (4) TRI report on the viability of the hotel to be updated and addressed to the Bank.

The terms also referred to the facilities including a "Development facility" of "£6,500,000 converting on completion of hotel to a term loan" and, under the heading "Security", included:

> "Charge over Developers Security Account balance of £2.0m – to be released on a basis to be agreed."

68. Mr Matthews explained that these terms were not a bank document but a "Dave Matthews document", something he put together himself. He explained that unlike most of his Co-op colleagues, who would have been wary of putting something into writing at such an early stage in the transaction, Mr Matthews sought to summarise the position to "flush out" any issues at the very earliest stage possible and avoid wasting time before taking the proposal to more senior people at the bank, who would be responsible for making the decision on whether to approve the loan. Mr Matthews said that if the terms were acceptable to a potential borrower it would give him the encouragement to invest further time and effort to try to move the deal forward. However, he made it clear that the terms were "far from" a formal bank offer letter and appreciated and accepted that the proposed transaction would evolve and change before reaching such a stage.

69. Mr Tracey responded to Mr Matthews by email on 17 January 2011, within hours of receiving the above terms:

> "Dave,
>
> Many thanks for the Terms. All seems fine but could you stretch this to a further £250,000 being a loan of £6.75m? It would help feed the ever growing family.
>
> Also, will you speak with Carl Ridgeley at Edward Symmons to ensure that they can be appointed as banks valuers?

Regards,

Mike"

70. It was accepted by Mr Lewis, Mr Tracey and Mr Matthews that there were no increased costs of the project that necessitated the additional £250,000 but that, notwithstanding the loan was to the LLP, the purpose of the increased facility was to improve Cannock's cashflow. With regard to the reference to Mr Tracey's "ever growing family" in the email Mr Matthews said that he regarded this not as meaning that Mr Tracey would benefit personally from the further £250,000 but, having met Mr Tracey and discussed their families and knowing that he was expecting a new addition to the family, took it "as a joke, a bit of banter" and did not read any more into it.

71. Although at this stage there had been no formal involvement by Downing, Mr Tracey explained that there would have been discussions between himself and Mr Lewis from around November 2009 to ensure that the proposal was suitable to Downing and would attract investors in the LLP. Indeed, this is confirmed by a letter of 15 November 2010 from Mr Bantoft to Mr Lewis setting out their agreement in relation to the proposed fundraising for the hotel development under which, for consideration of £1, Mr Bantoft undertook to ensure that Downing and Blakes were appointed as sponsor and property adviser (respectively) to the project.

72. On 19 January 2011 Mr Tracey sent the updated TRI Report to Mr Matthews. The Report, clearly marked "Draft", was that sent to Stephen Bantoft on 19 January 2011. Mr Tracey subsequently provided Mr Matthews with three references for ThenHospitality and asked Mr Matthews if there was anything further he required for his report by which Mr Tracey meant the report that Mr Matthews was preparing for the credit committee of the Co-op. In the meantime, on 20 January 2011 there had been a meeting in London between Mr Matthews and Mr Nick Lewis of Downing. However, Mr Matthews explained that although the London Luton project may have been discussed the purpose of the meeting was to introduce his colleague, the Bank's relationship manager who was "looking after the other Downing connections" with which the Co-op was involved, to Mr Lewis who had worked with Mr Matthews in relation to other Downing projects one of which, the Indigo Newcastle also involved a claim to BPRA.

73. Returning to the document prepared by Mr Matthews, the "Corporate Asset and Liability Asset Forum (CALM) & Preliminary Note" ("CALM"), dated 27 January 2011. This refers to the borrower as "Ramada Luton Airport BPRA and the "new money requirement" as being £6,750,000. The section headed "Rationale for proceeding" states:

> "Opportunity to support an experienced team that brings together an experienced property development company (Cannock Developments) a London based fund manager (Downing) and a major hotel brand (Ramada) to develop and operated a new Ramada Encore Hotel at Luton Airport. Total cost will be £11.5m and we are asked to fund a maximum of 58.7% of the cost with a day one market value expected

> to be minimum of £12m. The LTV will only be 56.2%. The borrowers are seeking an 8 year commitment.
>
> In addition we will have a £2m cash deposit as additional security reducing our net exposure to only 40% LTV.
>
> In summary an acceptable LTV, excellent return and deal structure that will meet all the hotel sector key credit criteria. Significant upfront cash input of minimum of £6.75m by high net worth investors. Approval is recommended."

As in the initial terms provided by Mr Matthews there was a reference, under "security", to the "charge over developer's security account of £2m" and the same "conditions precedent" (as stated above). On 1 February 2011 this was agreed by CALM.

74. Mr Matthews explained that CALM was not a credit assessment vehicle but there to manage the bank's balance sheet. He said that CALM was primarily looking on any transaction above a certain level to determine whether the bank had sufficient capacity within its sector limits. If approved by CALM the application would then be considered by a senior committee responsible for the bank's balance sheet for approval. He said that approximately 50% of the deals approved by CALM "never progressed".

75. A further submission to CALM was made by Mr Matthews increasing the "New money requirement" by £250,000 to £7,000,000. Although essentially the same as the previous submission there was an additional "synopsis" section which included the following information:

> "• Downing Corporate Finance are London based fund managers who we know well through two other deals [one of £10m and the other £14.5m]. They will be raising the equity.
>
> • Edward Symmons have valued the hotel for the investors at £12.7m when complete and trading. We propose to obtain our own valuation from a bank approved valuer and will use either Collier's or Christies."

76. However, on 2 February 2011 Mr Matthews had received an email from Carl Ridgley of Edward Symmons. This referred to "our customer" Stephen Bantoft who had asked Mr Ridgley to contact Mr Matthews to ask if he, Mr Matthews, could provide formal instructions from the Co-op to proceed with the valuation. The email also stated that Edward Symmons fee for the valuation would be "£8,000 plus expenses and VAT." Mr Matthews replied by email later that day in which he explained that:

> "While the stabilised market figure is of interest our primary focus will be on the 'day one' opening market value and the market value with special assumptions ie business closed, no licences, accounts and inventory. Our policy is to lend up to 70% of the current market value and 90% of the mvsa. The proposed loan in this case is £7m so I am sure there will be plenty of cover but if you have an indication of the likely values on these basis it would be helpful.

> I will organise an instruction letter. However, with regard to your fee my understanding was that the borrowers [ie the LLP] were to pay you directly. Is this correct?"

77. Having reviewed the proposal approved by CALM with a colleague, in an email, dated 7 February 2011, the Function Leader, Credit Underwriting, Banking Risk of the Co-op noted that he expected to be able to support it but:

> "… didn't really understand why the £2m "developers security account" cash can't be used to simply reduce the actual debt requirement, rather than just being held on a charged side account – perhaps this is something linked to BPRA rules, but not doubt the application will clarify this"

78. Mr Matthews said that he explained to his immediate superior at the bank that the rationale for the £2m security account was that it kept the developer committed to ensuring the success of the project and that if for some reason it failed there were funds available to cover the bank.

79. On 2 March 2011, having been instructed by the Co-op to do so, Edward Symmons provided the Co-op with its Report and Valuation of the Property as at 15 February 2011. The Report explains that Edward Symmons':

> "… opinions of value are based on the bases of freehold vacant possession assuming acquisition by an owner operator or franchisee not subject to the proposed management contract to [ThenHospitality]. In formulating our opinions of the value of the proposed hotel on a Day One basis and in a Stabilised Year of Operation, we have relied upon financial projections prepared by [ThenHospitality]. We have also included additional revenue in the form of a management fee, in connection with 49 additional spaced which are to be held by [Cannock]."

The Report continues:

> "In providing our opinions of value we have had regard to the Market Study of the Luton hotel market and commentary on the projections of performance of the proposed Hotel, prepared by Tri Hospitality Consulting dated February 2011."

80. Additionally, the Co-op instructed Gleeds Cost Management Limited ("Gleeds") as its quantity surveyor and monitor notwithstanding it also acted as the project surveyor for the LLP. Mr Matthews was provided with the contact details of a director of Gleeds by Mr Tracey who explained, in an email of 28 February 2011 that:

> "Gleeds have acted for RBS on our past schemes so they know the procedure and the team involved.
>
> Will you issue a draft appointment document to him?"

81. In a submission, which he subsequently prepared for the Co-op's credit department, Mr Matthews "strongly recommended" the proposal which was accepted by the bank on 16 March 2011. On 21 March 2011 Mr Matthew's received the report from Gleeds, 'Funder's Technical Due Diligence Initial Report'. Having summarised

the agreed amendments to the 'Design and Build Contract 2005 Edition incorporating Revision 2 2009 issued by Joint Contracts Tribunal (JCT) (to which we refer in greater detail below) it concluded that:

> "… the amendments in totality are considered to be comprehensive and very well thought through from an Employer who is clearly risk averse. It is worth noting that the construction contract provides for a parent company guarantee, where the Balfour Beatty Group Limited will provide a guarantee of performance for their subsidiary, Multibuild (Construction & Interiors) Limited.
>
> …
>
> Overall we consider that the amendments are very comprehensive and serve to pass a significant amount of risk onto the contractor in both terms of cost and programme delivery."

With regard to the 'Construction Costs' and the 'Main Contractor Overhead and Profit' the report observed that:

> "The Main Contractor Multibuild (Construction & Interiors) Limited has stated the allowance for Main Contractor's Overheads and Profit is included within the elemental breakdown of the Contract Sum Analysis. Multibuild (Construction & Interiors) Limited have stated the overall allowance for Main Contractor's Overheads and Profit included within the Contract Sum Analysis is 7½% for overheads and 5% for profit which is at the higher end of the range we would normally expect to find given current market conditions. However, Gleeds would note this project is a refurbishment project, with more associated risks than for example a new build development which is therefore reflected in the level of overheads and profits Multibuild (Construction & Interiors) Limited would have priced for."

82. Although in the "conditions precedent" (see paragraph 67, above) in his own document and in the CALM submission Mr Matthews had referred to "a Bank appointed" surveyor and QS to confirm the market value, market value of the hotel with special assumptions of the hotel on completion and to confirm the costings are realistic. He explained in evidence that, notwithstanding that Edward Symmons had valued the hotel for Cannock, it was "far from uncommon" when considering proposals such as this that a valuer would have valued a property "for another bank or whatever purposes" for the same valuers would also be instructed by the Co-op. This was especially the case where valuation fees could be "sometimes in the tens of thousands" and borrowers, who were responsible for the fees, "were often reluctant to bring a whole new firm in and get a fresh new valuation.

83. Mr Matthews made it clear that if he had any doubt about the integrity or accuracy he would insist on another valuation. However, in this case Edward Symmons were on the Co-op's panel of valuers and were "well known and trusted by the bank" and had the appropriate professional indemnity insurance. Mr Matthews was of the view that Edward Symmons would not risk their relationship with the Co-op by providing a "one-off" valuation for someone like Cannock which was in any way erroneous. He

explained that he had taken a similar view in respect of Gleeds and in relation to the TRI Report.

84. Therefore, because of the “very tight time frame” to approve the deal and given that any other valuer on the Co-o’s panel would “be starting from scratch with no knowledge of the building would be unable to supply the valuation we needed within the likely timescales needed”, Mr Matthews explained that he took a “purely pragmatic approach. He also explained that, because of the financial situation at that time banks were “hurriedly having to get all their property portfolios revalued” and although it might have been expected that because of the financial crisis valuers were desperate for work, that was not the case and they were, as he put it, “bombed out with valuation work to do.”

85. On 25 March 2011 the Co-op and the LLP, which had until then been dormant, entered into a loan agreement in which they were defined as the “Bank” and the “Borrower” respectively (the “Loan Agreement”). This included the following terms:

> **1 PURPOSE, DEFINITIONS AND INTERPRETATION**
>
> …
>
> **“Capital Account Deed”** means the deed in relation to the Capital Account between (1) the Developer (2) the Borrower and (3) the Bank dated the date of this Agreement;
>
> …
>
> **“Construction Amount”** means the amount of £5,721,914 (five million seven hundred and twenty one thousand nine hundred and fourteen pounds);
>
> …
>
> **“Contribution”** means the equity contribution of £7,200,000 (seven million pounds) received from the subscribers to the Information Memorandum;
>
> …
>
> **“Developer”** means OVL (Bankfield LLP) [ie Cannock] … or such other developer acceptable to the Bank;
>
> …
>
> **“Interest Period”** means each period for the calculation of interest pursuant to Clause 4 (Interest Periods);
>
> **“Loan”** means £7,000,000 (seven million pounds) or (as the context may require) the principal amount owing to the Bank under this Agreement at any relevant time;
>
> …
>
> **“Margin”** means 3% (three per cent) per annum until the Margin Change Date [ie the date of practical completion], 2.75% (two pint seven five per cent) per annum from then for a minimum of 12 months and provided …

…

“Subscribers” means the group of investors who are providing the Contribution to assist with the Total Costs;

“Subscribers Account” means the account nominated by the Bank into which the Loan is deposited on its initial drawdown along with the Contribution;

…

4 INTEREST PERIOD

4.1 The first Interest Period shall begin on the date when the Loan is drawn and each subsequent Interest Period shall begin on the expiry of he preceding Interest Period with the final Interest Period ending on the date on which the loan is repaid in full.

…

5 INTEREST

5.1 The Borrower shall, in respect of each Interest Period, pay to the Bank interest at a percentage rate per annum equal to the aggregate of:-

(a) the Margin;

(b) Bank Base rates; and

(c) Mandatory Costs. A certificate by the Bank as to the amount of such cost shall be conclusive in the absence of manifest error.

5.2 Interest shall be calculated on a day to day basis on a year of 365 days and shall be payable on the last day of each Interest Period and on final repayment of the Loan. Any interest unpaid when payable shall be compounded.

5.3 At any time after an Event of Default has occurred, which has not been waived in writing by the Bank or remedied to the satisfaction of the Bank, the Bank shall be entitled to charge interest at a rate equal to the aggregate of the Margin plus 2% per annum above Bank Base rate and Mandatory Costs. In respect of each Interest Period as determined by the Bank (or other such rate as may be determined by the Bank and notified to the Borrower from time to time) on the aggregate of the Loan and any outstanding interest up to the earlier of (i) the date on which the Bank notifies the Borrower in writing that it is satisfied that such Event of Default has been remedied or waived and (ii) the date on which the loan is repaid and any other amounts outstanding under this Agreement have been paid in full interest shall be payable at the rate both before and after demand, court decree or judgment.

…

11 EVENTS OF DEFAULT

…

Interest

11.2 Interest shall continue to be charged on the Loan until the Loan is repaid and the outstanding interest and other sums due are paid in full.

…

13 PROPERTY COVENANTS

Covenants

13.1 The Borrower undertakes that:-

Loan: Property Value

The Loan less the balance standing to the credit of the Capital Account on the relevant testing date (i) expressed as a percentage of Market Value (MV) shall not exceed 70% or (ii) expressed as a percentage of Market Value (MV) subject to Special Assumption shall not exceed 90% (whichever is the lower).

15 SECURITY

15.1 The obligation of the Borrower to the Bank under this Agreement shall be secured by:-

(a) all existing security, if any, held by the Bank for the Borrower's liabilities;

(b) security in the Bank's preferred form as follows:-

(i) a first Legal Charge over the Property and its associated assets;

(ii) a Debenture over the Borrower's whole assets and undertaking;

(iii) a limited resource Guarantee, provided by the Developer in respect of the Borrower's obligations to the Bank;

(iv) a Guarantee unlimited as to amount by London Luton Hotel in respect of the Borrower's obligations to the Bank;

(v) a Supplemental Debenture Charging the Borrower's Interest in the charges over (1) the Construction Account (2) the Construction Costs Overruns Account (3) the FF&E Account and (4) the Interest Account granted by the Developer;

(vi) a Legal Assignment of the Borrower's rights, title and interest in the Development Agreement; and

(c) all future security which the Bank may from time to time hold for the Borrower's liabilities.

15.2 The obligations of the Developer [Cannock] to the Bank under its Guarantee in favour of the Bank shall be secured by:-

(a) security in the Bank's preferred form as follows:-

(i) a first Legal Charge over the Construction Account;

(ii) a first Legal Charge over the Capital Account;

(iii) a first Legal Charge over the Interest Account;

(iv) a first Legal Charge over the Construction Overruns Account;

(v) a first Legal Charge over the FF&E Account;

(vi) a Legal Assignment of the Developer's rights, title and interest in the Building Contract;

(vii) a Legal Assignment of the Developer's rights, title and interest in the Building Contract Guarantee; and

(viii) a Legal Assignment of the Developer's rights, title and interest in the FF&E Supply Agreement; and

(b) all future security which the Bank may from time to time hold for the Developer's liabilities.

15.3 The obligations of London Luton Hotel to the Bank shall be secured by:-

(a) security in the Bank's preferred form as follows:-

(i) a first legal charge over London Luton Hotel's leasehold interest in the Property and its associated assets;

(ii) a Debenture over London Luton Hotel's whole assets and undertaking;

(iii) a Guarantee unlimited as to amount by the Borrower in respect of London Luton Hotel's obligation to the Bank;

(iv) a Legal Assignment of London Luton Hotel's rights, title and interest in the Hotel Contracts; and

(vi) a first Legal Charge over the Working Capital Account; and

(b) all future security which the Bank may from time to time hold for London Luton Hotel's liabilities.

15.4 For the avoidance of doubt the Borrower acknowledges that all security held and to be held by the Bank shall unless the security document expressly states otherwise secure all the liabilities of the Borrower to the Bank of whatsoever nature.

86. In accordance with Clause 15.2 of the Loan Agreement, on 25 March 2011 Cannock and the Co-op executed a Deed of Charge over Credit Balances clause 2 of which provides:

> "For the purposes of and to give effect to this security the Charge shall operate as a release of the Deposit to the [Co-op] until the Secured Sums have been irrevocably and unconditionally paid and discharged in full."

Intercreditor Deed

87. Also, on 25 March 2011, Cannock, the LLP and the Co-op Bank entered into an Intercreditor Deed.

88. Material clauses of that Deed include the following:

> "**16.5 [Cannock]/[LLP] Directions**
>
> Each of [Cannock] and [the LLP] directs that the balance of the Subscribers Account at the date of this Deed be utilised as follows:-
>
> 16.5.1 £2,850,000 (two million eight hundred and fifty thousand pounds) will be utilised to assist with the purchase of the Property; and
>
> 16.5.2 simultaneously therewith the balance of the Subscribers Account shall be transferred or used as follows:-
>
> (a) the Stamp Duty Amount shall be used to pay SDLT in respect of the Property;
>
> (b) the Construction Amount shall be transferred to the Construction Account;
>
> (c) the Capital Amount shall be transferred to the Capital Account;
>
> (d) the Interest Amount shall be transferred to the Interest Account;
>
> (e) the Cost Overrun Amount shall be transferred to the Construction Cost Overrun Account;
>
> (f) the Bank Fees Amount shall be used by the Bank to pay its fees and the fees of its professional advisers;
>
> (g) the FF&E Amount shall be transferred to the FF&E Account;
>
> (h) the Working Capital Amount shall be paid to the Working Capital Account; and
>
> (i) the remaining balance shall be transferred to [Cannock] or as [Cannock] shall direct in and towards the discharge of the fees and other expenses detailed in Schedule 1 (Payments).
>
> **16.6 Payments from the Construction Account**
>
> [Cannock] shall only make withdrawals of amounts standing to the credit of the Construction Account for payment to the Contractor during the Development Period and for payment of the VAT Bridge.
>
> …
>
> **16.9 Interest Account**
>
> [Cannock] may only withdraw amount relating to the credit of the Interest Account to transfer sufficient amount to permit [the LLP] to comply with payment options under clauses 4 (*Interest*) and 7 (*Payments*) of the Facility Agreement.
>
> …
>
> **Schedule 1**
>
> **Payments**

Sponsors and IFA Fees

Shakespeare Putsman Fees

Hammonds Fees

Freeholders Legals and costs

Pre contract professional fees and Reports

Project Management

Bank Monitoring fees

Valuation fee including TRI

Title insurance

Section 106 Payments

Planning Consultant fees"

Developer Loan Agreement

89. On 25 March 2011 Cannock wrote to the LLP in the following terms, subject to the Intercreditor Deed between the Cannock, the LLP and Co-op (see above):

> "Dear Sirs,
>
> **£1,985,000 Loan Facility and £2,000,000 capital account**
>
> We are pleased to confirm that [Cannock] (the "**Lender**") has agreed to provide a loan of £1,985,000 to [the LLP] (the "**Borrower**"). In the event that sums are withdrawn from the Capital Account as referred to in the deed dated with today's date and made between the Lender (1) the Borrower (2) and the [Co-op] (3) [ie the Intercreditor Deed], then such sums withdrawn shall be treated as having been added to the sums advanced pursuant to this letter and shall form part of the loan hereunder (together in aggregate the "**Loan**")."

The letter continues setting out the applicable terms and conditions which in relation to interest provides, at paragraph 4:

> "4.1 without prejudice to paragraph 12 [which provides for interest on overdue amounts], interest shall accrue on the principle (sic) amount of the loan (being £1,985,000) outstanding from time to time at a rate equal to the interest rate applicable to the loan made available by Co-op to the Borrower ("**Co-op Loan**") on or around the date of this letter ("**Co-op Interest Rate**"). For the avoidance of doubt, the agreement relating to the Co-op Loan ("**Co-op Loan Agreement**"). No interest is payable on any additional sums withdrawn from the Capital Account referred to above.
>
> 4.2 Accrued interest shall be rolled up and compounded quarterly and is payable in full at the same time as repayment of the principle (sic) amount of the Loan under paragraph 5 of this letter."

Paragraph 5 provides for the repayment of the loan at the earliest of the repayment of the Co-op Loan by the LLP using funds made available by a third party, the sale of the Property or a period of eight years from the date of the drawdown of the loan.

Information Memorandum

90. The final stage of the funding process was the raising of equity for the project. On 15 February 2011 Downing, as sponsor of the Fund responsible for raising capital for the LLP, issued an Information Memorandum (the "IM") inviting investors, for a minimum investment of £100,000:

> "… to subscribe for an investment in the refurbishment of an existing commercial building adjacent to London Luton Airport, which will be converted to a 124-bedroom Ramada Encore hotel. Qualifying expenditure should attract relief under the Business Premises Renovation Allowance, providing higher rate taxpayers with significant relief on the cost of their investment. In addition, a limited recourse Loan Facility has been agreed with a major clearing bank to part fund the acquisition of the Property and the conversion of the Property to a hotel. An amount of £2,000,000 will be place on deposit by the Developer as additional security for the Bank."

It continued:

> "The total subscription from investors is £15.5 million. This will fund the purchase of Property and all costs associated with the conversion works. Planning consent for the Works was granted by Luton Borough Council on 19 August 2010."

91. In the 'Risk Factors' section of the IM, under the heading 'Taxation', there is the following warning:

> "This Memorandum has been prepared in accordance with current legislation and HMRC practice and its interpretation by the Fund's advisers. HMRC practice and interpretation of the law may differ from that set out in this Memorandum. The allowances to be claimed are new and therefore the understanding of the regulations is based upon an interpretation rather than historical practice; as such, there may be a delay in agreeing the amount of the allowances with HMRC and/or the amount that is actually claimed may be materially lower than anticipated."

92. The IM also explained the ownership of the hotel and the Developers Capital Account as follows:

> "A feature of an investment in the Fund is that investors, through the Fund, will own the company that operates the hotel as well as the Property itself. This means that should the hotel meet its projections (which have been analysed and commented on by TRI Hospitality Consulting, a major hotel consultancy …), the overall levels of return for investors will be higher than if the Property was leased to a third party on normal commercial terms. However, there is a risk that the

hotel will fail to meet its trading projections, and consequently, that the Fund will be unable to meet its repayments to the Bank. This risk has more serious consequences in the first seven years following refurbishment, because if the Bank enforced a sale of the Property then investors would suffer a clawback of the tax reliefs. In order to mitigate this risk, the Developer has agreed to provide a cash deposit of £2 million in the Developer's Capital Account at the Bank. This cash is not an asset of the Fund; however, the Developer has agreed that this account will be charged to the Bank. The Developer's Capital Account can be accessed by the Bank should the Fund be unable to meet its payment obligations to the Bank. In the event such a drawdown occurs, the drawn funds from the Developer's Capital Account will be deemed to be lent to the Fund and will create a secondary loan (without covenant tests) which will be repaid either from the ultimate sale proceeds of the Property of following a refinancing. Significantly, an balance in the Developer's Capital Account will be taken into account in assessing the level if all financial covenant tests under the terms of the Loan Facility. This will provide a significant headroom on the agreed covenant tests."

93. The IM also explained, under the heading 'The Loan Facilities' that:

"The purchase of the Property will be financed through a combination of funds provided by Members and Loan Facilities including a Loan Facility from a major clearing bank.

Limited recourse loan facilities have been agreed in principle, subject to documentation, to provide the Fund [the LLP] with fixed term loans of approximately £8,300,00, in total being approximately 54% of the Total Purchase Price.

	Total **£**	**Minimum Subscription** **£**	**%**
Subscription into Fund	7,200,000	46,451	46.5
Loans to Fund	8,300,000	53,549	53.5
Total Property Cost	15,500,000	100,000	100.0

Loan Facilities

A major UK bank will provide a limited recourse loan to the Fund of up to £8,300,000 which will be secured by a first charge over the Property and other assets of the fund and an assignment of rental income. The loan is interest only for 18 months following the practical completion of the hotel and then is scheduled to amortise (ie capital to be repaid) over the following 13.5 years. The Developer will pay the interest during the construction period which is expected to be 15 months. The initial term of the loan is eight years. All surplus trading income will be used to amortise the outstanding loan balance on a quarterly, in arrears, basis. There are no early redemption penalties.

> Loan interest will be charged at a margin of 3.00% over Bank Base rate ("Base") during the construction period, 2.75% over Base for the first year of trading, and 2.5% over Base for the remainder of the term.
>
> If the loan provided by the Bank is less than £8,300,000 the Developer has agreed to make available a loan for the amount of the shortfall on the same terms as the Bank. Interest payable in such a developer loan will be at the same rate as the bank loan. However, the interest cannot be services from rental income, which is used to repay the bank loan, and will not therefore be rolled up and added to the developer loan and repaid following the sale of the Property or an earlier repayment of the bank loan or other refinance."

94. Three individuals with a connection to Cannock, Mr Bantoft, Mr Tracey and a Mr Gotley invested in LLP as did Mr Lewis. When asked in cross examination about the relevance of people on both sides of a contract trying to agree a price, Mr Lewis explained:

> "Well, I would say it is relevant in a positive manner in the financial services industry, which this would be part of it, investors and advisers are actually quite comfortable when individual members who are party to the transaction have actually put some money up on the same basis as they have. So I view it as a positive not a negative.

Having agreed that he had himself invested in the LLP Mr Lewis continued:

> "But let me be quite clear about how much was put in. I think this has to be put into some perspective. The investments of the four individuals I think we're talking about – four or five individuals – would have comprised no more than about 4 per cent. So these are not what I would call dominating or dominant shareholdings in the business, but they are a sign of – of, you know, being involved in the project."

95. Although, as investment in the LLP was regulated under the Financial Services and Markets Act 2000, the IM was produced by Downing, it is clear from the emails sent to the LLP by Mr Bantoft of Cannock that he took a significant interest and played a part in its production. On 3 February 2011 Mr Bantoft wrote:

> "How are you getting on with my memorandum mark-up. I'm on a train most of tomorrow son would like to make a start on my drafting. Any chance of something today?"

In an email of 4 February 2011, which was also copied to Mr Tracey, Mr Bantoft stated:

> "Attached is amended memo. Mike [Tracey] will update the financials to reflect the model on Monday.
>
> Mike – can you also fill in the section for the existing property size etc. on page 6.
>
> Pierre [Clarke of the LLP] – please insert the correct TRI graphs etc. The final version report won't be out until later in the week but it'll only have a changed P&L table. The main text won't be affected.

> Pierre – I'm attaching under separate cover a series of photos, artists impressions etc. … for inclusion with the document. I'd suggest the artists impression of the hotel is used on the front cover.
>
> Could we have a unified document with all the above items completed for circulation close of Monday."

On Monday 7 February 2011 Mr Bantoft emailed Pierre Clarke of Downing:

> "Memo with correct numbers. Could you please insert the various info as per Friday's email."

On 8 February 2011 he asked Mr Clarke:

> "Any idea when I'll have the memorandum back?"

96. Mr Bantoft was also involved in attracting investors to the LLP. Mr Lewis, in evidence, agreed that Mr Bantoft was "keen to take a role beyond what was necessary." It is apparent that this was accepted by Mr Lewis who, after "being away for a bit" and wanted to "check from [Mr Bantoft's] view where he was – what he was up to" asked, in an email of 15 March 2011 which he sent at 09:52:

> "Back in the office today – how is Luton going? The cash seems a bit slow but presumably a work in progress?"

To which Mr Bantoft replied, at 09:57 the same day:

> "All fine. Know where it's all coming from with names. Just logistics."

97. Additionally, as his email of 13 January 2011 to Mr Lundy (an IFA) illustrates, Mr Bantoft, was involved in providing information to IFAs to market the project. He wrote:

> "I attach the design and planning pack for our 124 bed Ramada Encore at Luton Airport. We'll be producing the BPRA memorandum by mid-February and we anticipate closing the deal in early March. It will be sponsored by Downing but I'm handling the allocations and am only making it available to a very few IFA's who have been supportive in the past.
>
> The overall economics will be similar to Cumberland House [a previous project] with a likely net cash contribution of circa 6p. The deal will be approximately £15.5 million and I'm currently trying to gauge demand so I can provide reasonable allocations to each IFA. Could you please let me have your likely requirement at this stage with specific client names and likely amounts by early February."

98. Mr Bantoft also engaged in correspondence with IFAs, eg from an email exchange with Mr Lundy on 28 February 2011 and the following email exchange between him and an IFA, Mr David Healy of Ward Consultancy plc, who had received a copy of the IM and had raised a query, originally with Mr Clarke of Downing:

> "**From:** David Healy
> Sent: Thursday, March 10 2011 9:02 AM
> **To:** Pierre Clarke [of Downing]

Cc: Stephen Bantoft, …
Subject: RE: Luton BPRA

Hi Chaps

Can I have a breakdown of the development agreement.

Thanks

David

From: Stephen Bantoft
Sent: 10 March 2011 9:03
To: David Healy; Pierre Clarke
Cc:, …
Subject: RE: Luton BPRA

No

From: David Healy
Sent: Thursday, March 10 2011 9:04 AM
To: Stephen Bantoft, Pierre Clarke
Cc: …
Subject: RE: Luton BPRA

Why?

David A Healy

From: Stephen Bantoft
Sent: 10 March 2011 9:05
To: David Healy; Pierre Clarke
Cc: …
Subject: RE: Luton BPRA

It's my commercial IP. We don't even release it to HMRC. It's not something that an investor requires – they have the valuation report as their underpinning."

99. Although Mr Lewis initially played down Mr Bantoft's role in the preparation of the IM and fundraising as "just a bit of banter", he accepted that Mr Bantoft, who he described as, "a very dominant character" who "obviously thought he was very important", was "very keen" to take a role "beyond what was necessary."

100. Mr Tracey described Mr Bantoft as having worked as a developer and a reviewer of projects and developments for 25 years who knew all the principal IFAs and that they wanted to know what Cannock was doing as they were happy with the developments it had previously provided. In evidence he agreed that:

> "… of course, there's a crossover of people asking Stephen [Bantoft] "What are you doing?" And him saying "This", and all the time it's being promoted by Downing, but you can't away from that, and anything that Stephen could do to ensure the financial close of the transaction he would do. Whether he was treading on other people's feet or not, Stephen would just get on and do it."

Additional Transactions

101. By March 2011 a sufficient number of investors had agreed to subscribe for equity in the LLP to enable the project to proceed. Although a number of the transactions, such as the investors' subscription of £7.2 million to the LLP, the LLP's drawing down of the loans and its purchase of the freehold of the Property took place on 25 March 2011, a number of the contractual arrangements, including as we have observed above (at paragraphs 58 and 59) the Design and Build Contract between Cannock and Multibuild, were executed on 24 March 2011 to ensure they were "locked-in" for the investors.

102. Mr Tracey explained that there were between 70 and 80 documents involved in these transactions. In addition to those to which we have referred, these included:

> (1) The Development Agreement (see paragraphs 103 -105, below);
>
> (2) A 25 year lease of the Property, granted on 25 March 2011 by the LLP to the Operating Company, which, on 25 March 2011, entered into a hotel management agreement with ThenHotels LLP, for the operation of the completed hotel. Under the lease the Operating Company is liable for all maintenance and repairs in addition to insuring the Property.
>
> (3) The Capital Account Deed between the LLP, Cannock, the Co-op and Blakes (see paragraphs 106 – 107, below);
>
> (4) The Licence Fee Deposit Deed (see paragraphs 109 – 110, below); and
>
> (5) The Costs agreement (see paragraphs 111 – 112, below).

Insofar as we have not already done so, we consider the more significant of these below setting out the material parts of the documents underlying the transactions.

Development Agreement

103. The Development Agreement was executed on 25 March 2011 between the LLP, its wholly owned subsidiary London Luton Hotel 2010 Limited (the "Operating Company") and Cannock for the refurbishment of the Property. It included the following terms:

> INTRODUCTION
>
> A The [LLP] has agreed to appoint [Cannock] to procure the carrying out of the Works.
>
> B In consideration of the Works, the [LLP] will provide finance for the Works to [Cannock] in accordance with the terms of this agreement.
>
> C The Operating Company [London Luton Hotel 2010 Limited] has agreed to join in this agreement to take the Lease.
>
> 1 DEFINITIONS AND INTERPRETATION
>
> …

“Development” means the stripping out refurbishment and upgrading of the Site in accordance with the Approved Plans, the Building Contract, FF&E Contract and the Agreements.

…

“Development Sum” means twelve million, five hundred and thirteen thousand, two hundred pounds (£12,513,200.00) exclusive of VAT.

…

“Licence Fee Amount” means three hundred and fifty thousand pounds (£350,000.00).

…

“Works” means the construction of the Development as shown on the Approved Plans and all other ancillary building, engineering, road, drainage, service and landscaping works (if any) and the provision and installation of the fixtures, fittings and equipment to be carried out by [Cannock] either within the Site or on areas adjacent to the Site under the provisions of the Planning Permission and any Third Party Agreements.

…

2. DEVELOPMENT AND FUNDING

[Cannock] and the [LP] shall comply with their respective obligations in and accept the terms of:

(a) Schedule 1 (Development)

(b) Schedule 2 (Funding)

…

SCHEDULE 1

Development Obligations

1 Licence

1.1 This agreement shall not operate or be deemed to operate as a demise of the Site of any part of it but the [LLP] and/or the Operating Company grant licence to [Cannock], the Consultants, the Contractor and its and their respective employees and agents and Sub-contractors to enter upon and occupy the Site as from the date of this agreement for the sole purpose of carrying out the Works and [Cannock’s] obligations under this agreement.

1.2 In consideration of the licence granted at paragraph 1.1 and subject to paragraph 2 of Schedule 2 [Cannock] shall pay the Licence Fee Amount on the date hereof to be utilised in payment of a quarterly licence fee equal to each quarters interest charged to the [LLP] on the finance obtained from the [Co-op] to fund part of the Development Sum, incurred from

and including the date hereof until and including the date that the hotel at the site opens for trade as an operational hotel and any shortfall shall be paid by [Cannock] and/or be paid out of the Costs Overrun Account.

…

5 BUILDING CONTRACT AND WARRANTIES

…

5.3 [Cannock] shall ensure that:

(a) within 10 working days of completion of the Building Contract and in any event prior to the drawdown of any funds from the Construction Account and in any event prior to Practical Completion [Cannock] enters into and delivers a collateral warranty deed to the [LLP] and a separate warranty to the [Co-op] in the form of the drafts annexed at Annexure 1.

(b) within 10 working days prior to Practical Completion and in any event prior to drawdown of any funds from the Construction Account the Consultants (save the CDM Co-ordinator) each enter into and deliver a collateral warranty deed to the [LLP] and a separate warranty to the [Co-op] in the forms of the drafts annexed at Annexure 2.

(c) the Subcontractors each enter into and deliver a collateral warranty deed to the [LLP] and a separate warranty to the [Co-op] in the forms of the drafts annexed at Annexure 7 …

(d) the Building Survey Reports are re-addressed to the [LLP] and the Operating Company and the [Co-op] respectively (or suitable reliance letters provided) on or before the date hereof.

(e) all guarantees and warranties in respect of fixtures, fittings and equipment are assigned, addressed and delivered to the [LLP] in accordance with the terms of the FF&E Contract.

…

6 [Cannock's] OBLIGATIONS

6.1 Subject to the provisions of this agreement and in consideration of the [LLP's] agreement to pay the sums referred to in Schedule 2 [Cannock] shall:

(a) before beginning the Works:

(i) prepare such Additional Drawings as need to be prepared;

(ii) do whatever is lawfully required of a "client" as set out in the CDM Regulations;

(iii) give all notices required by statute and/or regulations which are lawfully required in connection with the Works and supply all drawings and plans required in connection with any such notice and pay any fees or charged lawfully required to be paid under any statute and/or regulations;

(iv) take such steps as may be necessary and/or reasonably required by the [LLP] and the Operating Company to prevent unauthorised persons from being admitted to the Site;

(v) insure or arrange the insurance of the Site against third party liability from the date hereof until the commencement of the Building Contract;

(b) at its own expense with all convenient speed and due diligence [Cannock] shall to the reasonable satisfaction of the [LLP] and the Operating Company in a good workmanlike manner and in accordance with good building practice and all relevant British Standards and Codes of Practice and any manufacturers instructions and free from defects ensure the Works are carried out and completed using new and good quality materials of their several kinds in accordance with the Approved Plans and the Planning Permission and any Third Party Agreement;

(c) [Cannock] shall ensure that the Works are commenced as soon as reasonably practicable and in any event by 1 May 2012 and shall use reasonable endeavours to procure the Works are practically completed by the Estimated Completion Date and best endeavours to ensure that the Works are practically completed by the Long Stop date;

(d) carry out the Works to the reasonable satisfaction of the [LLP's] Surveyor;

(e) consult with and supply the [LLP's] Surveyor with such information as they may reasonably require to perform efficiently their duties under this agreement;

(f) on Practical Completion supply to the [LLP] two complete sets of as-built drawings for the Development and two copies of any maintenance information for the mechanical, electrical and other installations and services to the Development and the Site (in completed readable form and hard copy);

(g) as soon as they become available to [Cannock] supply the [LLP's] Surveyor with one copy in every case of all the relevant copy documents and information specified in Schedule 3;

(h) generally perform and observe all the terms and conditions imposed on [Cannock] in relation to the Works or under any Third Party Agreements;

(j) carry out the Additional Works (if any) in a good and workmanlike manner with all due diligence and expedition in accordance with such Consents as are relevant and any Third Party Agreements and ensure that they are Practically Completed by Practical Completion.

…

10 [Cannock's] LIABILITY FOLLOWING PRACTICAL COMPLETION

…

10.3 Provided [Cannock] has complied with clause 5.3 of this Schedule following the issue of the Certificate of Completion of Making Good Defects in relation to the Works [OVL] will have no liability whatsoever to the [LLP] and the Operating Company under the agreement in connection with such Works and will be deemed to have performed to the full and final satisfaction of the [LLP] and the Operating Company all of its obligations under this agreement of such Works.

…

SCHEDULE 2

Funding Provisions

1. In consideration of the obligations entered into under this agreement by [Cannock] the [LLP] shall pay to [Cannock] the Development Sum on the date hereof.

2. Immediately on the date hereof the [LLP] shall pay the Licence Fee Amount into a deposit account to be drawn down in accordance with the terms of a Licence Deposit Deed entered into between [Cannock] and the [LLP].

104. On 13 July 2012 the LLP, the Operating Company and Cannock entered into a deed of rectification (the "Deed of Rectification")" The Introduction to this Deed explains that an error was identified in the description of "Development Sum" and "Works" in the Development Agreement which:

> "A. … should not and did not include the cost of supplying and installing the FF&E for which a separate payment, over and above the Development Sum was made.
>
> B. The FF&E sum was paid in addition to the Development Sum by the [LLP] to [Cannock] and such sums were invoiced to and paid by the [LLP] on completion. The parties have understood and intended (and funds were paid accordingly) that the FF&E sum was payable in addition to the Development Sum.
>
> C. The Information Memorandum which recorded the terms of the transaction prior to completion of the Development Agreement set out that the FF&E Sum was payable in addition to the Development Sum.

> The Development Agreement did not reflect the agreed position and did not reflect the payments made on completion.

105. Clause 2 of the Deed of Rectification under the heading, "Development Sum, Works and FF&E Sum" confirms the parties agreement to rectify the Development Agreement by amending the definition of the "Development Sum" and "Works" as set out in the Deed of Rectification and also that a definition of "FF&E Sum", which, as the Deed of Rectification states, "was accidently omitted from the [Development] Agreement", be included and that the Development Agreement should be construed in accordance with the Deed of Rectification. Clause 2.2 provides:

> "The [LLP] and [Cannock] agree and confirm that there should have been a payment obligation at Schedule 2 of the [Development] Agreement at paragraph 3 to provide that the [LLP] was (and did) pay the FF&E Sum on the date of the [Development] Agreement."

Capital Account

106. The material terms and conditions of the Capital Account Deed between Cannock (then OVL), the LLP, Blakes and the Co-op entered into on 25 March 2011 to which we were referred, provide:

> **1 INTERPRETATION**
>
> **1.1 Definitions**
>
> …
>
> "Calculation date" means the third anniversary of the date of this Deed and each anniversary thereafter.
>
> …
>
> **2 PURPOSE OF THIS DEED**
>
> The [Co-op], [Cannock], Blakes and the [LLP] agree to regulate withdrawals by [Cannock] from the Capital Account in the manner set out in this Deed.
>
> **3 CAPITAL ACCOUNT**
>
> **3.1 Capital Account**
>
> 3.1.1 [Cannock] designates and must maintain the Capital Account in its own name at the [Co-op].
>
> 3.1.2 The Capital Account shall be denominated in Sterling.
>
> **3.2 Interest on balance**
>
> All interest paid by the [Co-op] in respect of the Capital Account will be credited to [Cannock] in accordance with the Account Mandate or as otherwise agreed with the [Co-op], both parties acting reasonably.
>
> …

3.5 Payments from the Capital Account

3.5.1 Subject to Clause 3.5.2 [Cannock] may withdraw a maximum sum being equivalent to the amount of capital in respect of the Loan that has been repaid since the last Calculation Date, and for the purposes of the first Calculation Date, since the second anniversary of the date of this Deed, together with any monies not released on prior Calculation Date(s) due to any of the conditions set out in Clause 3.5.2 not having been met from the Capital Account on each Calculation Date.

3.5.2 Each withdrawal is subject to:-

(a) each request for a withdrawal having been made to the [Co-op];

(b) an Event of Default or a Potential Event of Default not continuing nor arising as a result of making the withdrawal;

(c) the [Co-op] being satisfied with the Budget and all other financial information in respect of the Security Providers available to the [Co-op] at the Calculation Date.

3.5.3 Upon the occurrence of an Event of Default which is continuing the [Co-op] may make withdrawals from the Capital Account for application towards the cure of such Event of Default. Each of Blakes and [Cannock] consents to such withdrawals.

3.5.4 It is agreed that the [LLP] shall be entitled to direct the [Co-op] to make withdrawals from the Capital Account where the [LLP] considers it necessary to enable the [LLP] to meet its obligations to the [Co-op] pursuant to the Finance Documents. The [Co-op] is not obliged to comply with any such direction but will act reasonably if considering whether or not to do so. In the event that such withdrawals are made pursuant to this Clause 3.5.4 then the amounts so withdrawn shall form part of the debt due by the [LLP] to [Cannock] pursuant to the Developer Borrower Facility Agreements. Blakes consents to such withdrawals."

107. In accordance with the Capital Account Deed Cannock opened the Capital Account in its name at the Co-op. On 25 March 2011 Cannock received the first tranche of the Development Sum from the LLP. Cannock then immediately deposited £2 million of that sum into the Capital Account.

Licence Fee

108. Under the terms of the Licence Deposit Deed between Cannock (as OVL) and the LLP, which was supplemental to the Development Agreement, the "Licence Fee" was defined as the sum of £350,000 "to cover interest payable on the funding advanced by the [Co-op] and payable in accordance with the terms of the Development Agreement." Under clause 3.1 the parties declared that Cannock had deposited the Licence Fee in a Deposit Account with the Co-op.

109. Cannock was, in accordance with clause 5 of the Deed, required to pay the LLP from the Deposit Account (ie the Licence Fee Amount of £350,000 payable in accordance with the Development Agreement):

> "… a sum equal to each quarter's rent to be utilised in payment of a quarterly licence fee equal to each quarters interest charged to [the LLP] on the finance obtained from the [Co-op] to fund the Development Sum (as defined in the Development Agreement), incurred from and including the date hereof until and including the date that the [Property] opens for trade as an operational hotel."

The Deed continued:

> "6 REPAYMENT OF DEPOSIT
>
> The [LLP] shall release the Deposit in accordance with clause 5, above. Any remaining sums in the Deposit Account shall be paid to the LLP upon completion of the Lease."

110. From 25 March 2011 until 10 October 2012 the LLP invoiced Cannock for "rent" requesting it be paid directly into the LLP's Co-op bank account. The total amount paid by Cannock (excluding VAT) was £316,120. The difference between that amount and £350,000 to which the Licence Fee Deed refers was retained by Cannock.

Costs Agreement

111. between Downing and Cannock (then OVL) under which it was agreed (at clause 3), 'Contribution to Downing's Costs' that:

> "[Cannock] shall be responsible for the payment of costs and expenses of those parties set out in the Schedule (whether or not incurred by or on behalf of any party acquiring a legal interest in the Property) and such other costs incurred by Downing (or by Downing on behalf of any party with an interest in the Property) incurred in the course of the negotiation, preparation of the Transaction [ie the acquisition of the Property by the LLP, grant of a lease of the Property by the LLP to the Operating Company and entering into of management and franchise agreements and related equity raising and funding for the acquisition of the Property] and any other necessary documentation required pursuant to it, all which sums shall be payable within 3 working days of the Transaction."

112. The costs set out in the Schedule to the Costs Agreement included, the Sponsors and IFA fees, all legal fees relating to the Transaction, Bank fees, Sanguine fees, TRI fees and Bank Monitoring fee.

Disputed Expenditure

113. We now turn to the remaining sums, not considered above, that Cannock paid out of funds received from the LLP which HMRC contend is not "qualifying expenditure".

114. £372,423.40 paid in respect of IFA fees. Mr Lewis explained that this figure can be broken down into £209,551.72 of IFA fees paid by Downing and reimbursed by Cannock and £162,871.68 of IFA fees paid directly by Cannock. It is not disputed that the LLP knew and intended that part of the Development Sum which it paid to Cannock would be used for this purpose.

115. Promoter fees of £310,000 – the evidence of Mr Lewis was that £50,000 was paid to Downing as a "consultancy fee" with the balance, £260,000, being paid to Blakes in accordance with the Profit Sharing Agreement of 15 November 2010 between Mr Bantoft, DCF and Blakes. As noted above (at paragraph 38(1)) it was agreed that because of the involvement of Mr Lewis in the BPRA part of the business that Blakes should get the "lions share" of these fees.

116. Under the Profit Sharing Agreement, upon consideration of £1, Mr Bantoft would ensure DCF was appointed as sponsor and Blakes as property adviser for the project with their fees being the aggregate of 2% of the gross proceeds of the fundraising plus all third party expenditure, other than DCF's legal fees for the IM, in connection with the Project and 15% of all monies released from the Capital Account, and 15% of all payments (including interest) which Mr Bantoft or certain other entities receive in relation to various facilities which were made available to assist with the funding of the Project. In evidence Mr Lewis agreed that the sums total arising under these arrangements to which DCF and Blakes were entitled was in excess of £1 million. He also accepted that the LLP knew and intended that part of the Development Sum would be used to pay the Promoter fees

117. Legal fees of £153,409.89 – this is the balance of the total amount of legal fees paid after deduction of £34,999 which the LLP accepts is attributable to the acquisition of the Property and which therefore does not qualify for BPRA. This sum can be further broken down as follows:

(1) a payment of £8,520.36 to Shakespeare Putsman (solicitors) which was described by Mr Tracey as being in respect of an "agreement with vendor" for the Property. The invoice for the transaction, dated 21 April 2010 describes the sum as an "interim bill re purchase of [the Property]" and includes disbursements for items including HM Land Registry fees. In evidence Mr Tracey agreed that the invoice related to the purchase of the Property;

(2) a payment of £24,958.07 to Shakespeare Putsman. The invoice, dated 29 March 2011, refers to "our professional fees in connection with the purchase of [the Property]" and again includes disbursements including HM Land Registry fees. In evidence Mr Tracey described these fees as relating to "due diligence in relation to the purchase of the Property";

(3) a payment of £6,000 described by Mr Tracey as "completion legal fees of £5k+irrecoverable VAT. In evidence he agreed that this payment related to "the raising of finance and debt for the Property – for the purchase of the Property";

(4) a payment of £36,330.20 described by Mr Tracey as the Co-op's "charges of solicitors costs re sale of [the Property]." In evidence he explained that this related to the Co-op's costs of obtaining security over the Property and agreed that it was "in relation to the purchase of the Property;

(5) a payment of £71,468.76 made on 18 April 2011 to Downing in relation to the LLP's solicitors, Squire Sanders Hammonds, fees. The invoices concerned refer to the Property and Mr Tracey accepted that at least "some" of these fees related to its acquisition;

(6) a payment of £1,919 on 18 April 2011 to Downing in respect of Squire Sanders Hammonds fees described by Mr Tracey as the "recharge of Hammonds non vatable disbursements;

(7) a payment of £400 to Shakespeare Putsman dated 29 July 2017 described by Mr Tracey as "agreement of licence over car park". He agreed that these fees were in respect of a right over land;

(8) a payment of £8,812.50 which Mr Tracey said was deducted at source on 28 May 2010 and for which no invoice was available. He described the payment as being "Legal Fees [the Property]" and explained that these were the vendor's legal fees for the sale of the Property to the LLP; and

(9) a payment of £30,000 made on 31 March 2011 to "Chainridge Vendor". Although the invoice states that the fee is a "deposit on sale of [the Property] in evidence Mr Tracey described it as a "Lock Out Fee" to ensure that the LLP could acquire the Property for development in accordance with the project and prevent it being sold to a third party.

118. The Debt Finance Request provides for payment of the legal fees using funds raised by the LLP and paid to the developer, Cannock, (see paragraph 64, above). Additionally, under clause 16.5.2(i) and Schedule 1 of the Intercreditor Deed Cannock is required to pay Shakespeare Putsman Fees, Hammonds Fees and Freeholders Legals and costs" (see paragraph 88, above). Both Mr Lewis and Mr Tracey accepted that the LLP knew and intended that part of the Development Sum would be utilised in payment of legal fees.

119. Franchise costs of £272,862 – in addition to the £248,000 paid to Sanguine (for which see paragraph 55, above) this sum includes £24,862 paid to Ramada International Inc. by the Operating Company to use the Ramada brand and can be further broken down as follows:

(1) an initial fee of $15,000, paid in accordance with a Franchise Agreement in relation to a licence to use the Ramada brand; and

(2) a fee of £15,000 pursuant to a Technical Services Agreement to which the Operating Company was a party which Mr Tracey explained related to "preliminary co-operation between the brand and hotel developer from the project inception through to its opening."

120. The Debt Finance Request provides for the payment of a Sanguine Legacy Payment in the sum of £248,000 and also for payment to Wyndham (see paragraph 64, above). In addition, under clause 16.5.2(i) and Schedule 1 of the Intercreditor Deed Cannock is required to use part of the Development Sum to pay "Franchise Fees" (see paragraph 88, above).

121. FF&E and other amounts of £587,556.35 – the categories of expenditure that HMRC contend do not qualify for BPRA are in relation to the following:

> (1) work on external areas which comprise the external tarmacking for the provision of a car park, landscaping and drainage. Although all of these are outside the footprint of the Property there are, as Mr Huxley agreed when cross examined within its curtilage;
>
> (2) drainage works all of which are below ground and external to the Property;
>
> (3) roof plant, a substantial structure which houses the air-handling units, chiller units and extract ventilation fans. It is clearly attached to the Property but with no direct internal access Property other than fixed vertical ladders onto the roof.;
>
> (4) mains service connections;
>
> (5) FF&E comprising bedroom FF&E, other FF&E; and FF&E sundries. These include cupboards, headboards, mirrors, reception desk, bar counters etc. Although items such as headboards cupboards and other bedroom furniture was initially installed to comply with the Ramada Encore franchise requirements they have remained in place notwithstanding the change of brand to a Holiday Inn (see below). When we visited the Property these items appeared to us to be permanently fixed, in that they could not be removed without causing damage to the internal bedroom walls.

122. Residual amount/profit (£1,209,510) – it was accepted by Mr Lewis in evidence that Cannock would earn a profit of approximately £4 million from the project of converting the Property into an hotel.

Subsequent Events

123. On 5 May 2011 after completion of the contractual arrangements regarding the Property but before the BPRA claim had been submitted there was a meeting attended by Mr Malcolm Smith of HMRC, Mr Lewis and Mr Pierre Clarke of Downing and Mr Robert Jones of Adducere LLP in respect of a different project. Mr Lewis explained that Mr Smith had "highlighted the need to deduct any legal costs that we incurred in relation to the acquisition of the building in respect of future BPRA claims". However, Mr Smith could not recall whether he had said this as he had not been provided with a note of the meeting prepared Mr Jones.

124. Therefore, although Downing did not agree with such an approach, still considering that all of the Development Sum paid by the LLP to Cannock should

qualify for BPRA, it was decided, as Mr Lewis said, "in the spirit of compromise and in order to work constructively with HMRC to obtain early settlement of what was not, we thought at the time, considered by HMRC to be a contentious BPRA claim," to accept an adjustment to the legal fees in connection with the acquisition of the Property. Accordingly, £34,999 was deducted from the Development Sum of £12,513,200 (see paragraph 103, above) reducing the BPRA claim to £12,478,201. This was seen as a simply pragmatic decision by Downing which was intended to remove a possible objection by HMRC in the hope the BPRA claim could be concluded swiftly.

125. On 11 July 2011 the LLP filed its 2010-11 tax return containing the BPRA claim in the sum of £12,478,201. By letter, dated 1 June 2012, HMRC opened an enquiry into the return and, as noted above (at paragraph 2), on 5 February 2016 HMRC issued the Closure Notice disallowing elements of the BPRA claim.

126. In relation to the development, following its completion in July 2012, trade commenced at the Property as a Ramada Encore branded hotel with the day to day management being undertaken by Thenhotels in accordance with the management agreement, dated 25 March 2001, with the Operating Company. However, the level of trade in the hotels first two years of operation was below that anticipated in the forecasts which was due, in part, to the unanticipated competition of a 'Hampton by Hilton' hotel which opened in the vicinity. This led to a breach in the financial covenants of the loan from the Co-op in February 2013. Although the Co-op did not formally call in the loan it did draw down the £2 million in the Capital Account on 12 February 2014 increasing the LLP's indebtedness to Cannock by £2 million.

127. To address the challenges facing the business the Operating Company relieved Thenhotels of its responsibility for the management of the hotel replacing it with Interstate UK Management Limited with effect from 26 August 2014. In September 2015 the hotel brand was changed from Ramada Encore to Holiday Inn (which it was during our site visit on 11 May 2018). As a result of these changes, we understand that the LLP is now generating significant profits and cash to reduce its indebtedness and its actual financial performance is converging with the projections originally set out in the IM.

128. There has also been a refinancing of the initial principal debt provided by the Co-op through new debt provided by the National Westminster Bank plc ("NatWest") on 26 August 2014. Additionally Downing, on behalf of the LLP has negotiated with Cannock, the developer, for the repayment of the £2 million drawn down from the Capital Account which, as a result became a loan due to Cannock. The final tranche was repaid on 20 February 2017. The repayment was made possible by an increase in the NatWest facility and the utilisation of profits generated by the hotel. A valuation of the hotel, by Knight Frank LLP dated 9 September 2016, was commissioned by NatWest as a condition precedent of the increase in the LLP's loan facility. This gave a stabilised valuation of the hotel at £14 million.

Issues

129. In essence, the dispute between the parties concerns whether the LLP is entitled to BPRA on the entire £12,478,201 claimed, ie the £12,513,200 it paid to Cannock under the Development Agreement (see paragraph 103, above) less £34,999 deducted in respect of estimated legal fees incurred for the costs of acquisition of the Property paid by the LLP to Cannock (see paragraph 124, above). HMRC contend that it is therefore first necessary to consider whether it is permissible to examine what Mr Davey refers to as the constituent elements of the Development Sum, ie to consider the various payments made by Cannock and if so, to examine the following elements and ask whether they meet the definition of "qualifying expenditure" contained in the legislation:

(1) The Interest Amount (£350,000);

(2) The Capital Account (£2,000,000);

(3) IFA fees (£372,423.40);

(4) Promoter fees (£310,000);

(5) Legal fees (£135,409.89);

(6) Franchise costs (£272,862);

(7) FF&E and other non-qualifying amounts (£587,556.35); and

(8) Residual amount/profit (£1,209,510).

130. For the LLP Mr Gammie and Mr Bremner contend that not only this is the wrong approach but that it is not supported by the language of the statute or authority. Rather than examine and disqualify the expenditure of Cannock they say we should consider whether the LLP has incurred the capital expenditure and, if so, what was that expenditure incurred on or in connection with. This, they say, does not require a two stage approach as HMRC contend but merely an answer to the second, straightforward question, whether the expenditure was incurred "on or in connection" with the conversion of the Property which can be contrasted with the usual statutory language entitling particular expenditure on allowances which solely refers to expenditure "on" the construction of a building or "on" the provision of plant and machinery.

Discussion

131. Before considering the correct approach to the issues it is first necessary to address two matters which were the subject of much cross examination and submission during the hearing, first, the relationships between the various parties to the transactions, particularly the LLP and Cannock; and secondly, the valuation of the Property.

132. Although HMRC did not go quite as far as to allege collusion between the parties, particularly Cannock and the LLP, to increase the BPRA claim, the argument advanced did not stop far short of that. In closing, Mr Davey contended that it was

fundamental to recognise that the nature of the relationship between the parties was put in issue by the LLP and points to its skeleton argument in support which states:

> "The Development Agreement, like all agreements which have been entered into in relation to the Property, was negotiated at arm's length. Thus, the Development Sum was the amount which the [LLP] was required to pay in order to secure the conversion of the Property into an hotel."

133. Mr Davey contends that such an assertion is "fundamentally flawed" in that, as Mr Lewis accepted, there was no record of any negotiation between Downing, the LLP and Cannock. However, it is not disputed that prior to their transactions concerning the Property, Cannock and Downing had worked together and had an established business relationship (see paragraph 48, above). As such, it is perhaps not surprising that there were not drawn out detailed and documented negotiations between them leading to an agreement on the services to be provided by Downing and for what fee.

134. Moreover, as Mr Gammie argues, the notion of parties being "connected" is a statutory concept of which there are many examples, eg s 286 of the Taxation of Chargeable Gains Act 1992 which provides how, "the question of whether one person is connected to another" for the purposes of that Act is to be determined. Clearly, neither Cannock, Downing or the LLP are "connected" in a statutory sense and, as such, any transactions between them are to be regarded as being at "arm's length" commercial transactions.

135. HMRC have also queried the independence of the Co-op and Mr Matthews in relation to the transactions citing in particular the valuations and reports of Edward Symmons and Gleeds in the light of the emails sent to Mr Matthews on 17 January 2011 by Mr Tracey asking him to "ensure" that Edward Symmons "can be appointed as [the] banks valuers" (see paragraph 69, above) and by Carl Ridgely of Edward Symmons on 2 February 2011, referring to "our customer", Mr Bantoft seeking formal instructions from the Co-op to proceed with the valuation (see paragraph 76, above).

136. However, we fully accept the evidence of Mr Matthews (see paragraphs 83 and 84, above) that neither Edward Symmons nor Gleeds would take the risk of opening themselves up to a claim for breach of contract, professional negligence or professional misconduct or jeopardise their relationship with the bank for the sake of a "one-off" valuation and that if he had any doubt of the integrity or accuracy of the reports or their independence the Co-op would not have accepted the reports relationship between the bank notwithstanding the "very tight time frame" involved.

137. Turning then to the question of valuation, its relevance was conveniently summarised by Nugee J in *Acornwood LLP and others v HMRC* [2016] STC 2317 ("*Acornwood*") where he said, at [66]:

> "I accept Mr Davey's submission. In the example he gave a person pays £1,000, and in return he gets his car washed and a promise to pay

> him back £900 in a year's time. You could attack that by saying that nobody in their right mind would pay £1,000 to have their car washed. You could call evidence that other people would wash the car for a few tens of pounds. And you could then draw the inference that the £1,000 could not have been spent on getting it washed and must have been spent on something else. But you do not need to attack it that way. You can attack it a different way, which is to say: 'Look at the contract. As well as the car washing you get the £900 back. That £900 back is worth £900 because you also get interest in the meantime. So you cannot have spent the £900 on getting the car washed.' Now it logically follows from that that what you were paying for the service of having the car washed is only £100, but you have not attacked it on the basis that you were paying over the odds for the car wash. You have simply attacked it on the basis you are getting something additional, which is not car washing, in return for the £1,000. I accept that there is a distinction between 'we are not relying on the valuation point to prove our case' and saying 'we accept that the services were worth 95', just as there is a difference between saying 'we are calling a car wash expert to tell you how much it costs to get your car washed and it is only £100, so the £1,000 must have been spent on something else' and saying 'we are not calling a car wash expert; we are relying on what it says in the contract about getting £900 back. It does not mean we accept that £1,000 is a market price for having had your car washed'."

138. Although, for the reasons above, we consider the Edward Symmons valuation to be wholly independent it was not disputed that it established the anticipated value to the LLP of the completed conversion of the Property into a Ramada Encore hotel (ie the business) rather than value the Property as a building or particular works of renovation, conversion or repair.

139. Mr Davey contends that the consequence of this is that the Edward Symmons stabilised valuation figure does not provide the LLP with any support for its argument that the Development Sum was a reasonable sum to pay Cannock for the conversion work as it had no correlation with the costs of converting and renovating the Property. Therefore, he says that the report cannot be used to test the market value of the works undertaken or to determine the purpose for which the LLP paid the Development Sum to Cannock. Additionally, he says, relying on the expert evidence of Mrs Cochrane, that the Edwards Symmons valuation is an overvaluation.

140. Taking the overvaluation point first, given our conclusion that Edwards Symmons valuation was wholly independent and was provided for the benefit of the Co-op, we can see no reason to doubt the integrity of its valuation. Additionally, we accept Mr Gammie's criticism of Mrs Cochrane who, when cross examined, was unwilling, for perfectly understandable reasons of client confidentiality, to provide any detail, even in general terms, of her experience of undertaking valuations that could stand comparison with type of transaction with which we are concerned in this appeal. This can be contrasted with the experience of the LLP's valuation expert, Mr Harper (see paragraph 38(6), above) who was "overall" satisfied that the Edward Symmons report accurately reviewed the value of the hotel and who disagreed:

> "… with the Revenue's statement that the valuation was inaccurate in that it constitutes or includes an overvaluation"

141. As to the correlation between the Development Sum and the renovation or conversion of the Property, Mr Davey contends that given the valuation was directed at valuing an operational business rather than the value of physical premises from which it operates and having regard to the approach of Nugee J in *Acornwood*, that there is no valid basis on which the LLP can advance the Edward Symmons valuation as any reliable indication of the market value of the conversion works acquired by the LLP.

142. However, we agree with Mr Gammie who contends that HMRC have confused costs with value which is irrelevant to investors. The question with which they are concerned is what do they get for their money with the answer being the Property converted into a Ramada Encore hotel. He says that it is clear from the IM that the price paid by the investors was that which the market was prepared to pay and that, although prepared for the Co-op, Edward Symmons would also have known that their valuation would provide the basis for the IM.

143. We now turn to the approach to be adopted in relation to the issues.

144. Having set out the legislative provisions above (paragraph 27) it is clear that for BPRA to apply there must be:

> (1) a "qualifying building" (s 360C);
>
> (2) "qualifying expenditure" must be incurred "on, or in connection with" the qualifying building (s 360A and s 360B); and
>
> (3) the "qualifying building" must ultimately comprise "qualifying business premises"(s 360D).

In the present case it is not disputed that the Property is a qualifying building and that when completed it comprised qualifying business premises. The difference between the parties concerns whether the payment of the Development Sum by the LLP to Cannock was made "on or in connection" with the conversion renovation or repair to the Property.

145. HMRC submit that the focus of legislation is directed at expenditure on or in connection with physical works. This argument is based on the words used in the statute particularly "conversion", "renovation", "repair" in s 360B(1)(a)-(c), which Mr Davey contends are fundamentally physical in character. While, HMRC, in our view quite rightly, accept that qualifying expenditure is not limited solely to physical works it is nevertheless contended that the physicality of the words used is reinforced by the fact that s 360A(1) provides that allowances are only available in respect of a "qualifying building", as defined in s 360C(1), "in relation to any conversion or renovation work", with "work" being an inherently physical concept. As such, it is submitted that there must be a close connection between the expenditure and the conversion, renovation or repair of the building.

146. However, although s 360C does indeed refer to “conversion or renovation **work**” (emphasis added), there is no reference in s 360B to “work” which, had Parliament intended it to be included it could have expressly done so. We agree with Mr Gammie that the reference to “work” in s 360C is required to associate the timing of particular conversion, renovation or repair work with the date by reference to which the statutory requirements of s 360C(1)(a)-(e) must be met for a building to be a “qualifying building”. Accordingly, as indeed HMRC, accept there is nothing in the legislation to restrict the construction of “qualifying expenditure” to that incurred on or in connection with physical works. Rather it is necessary to consider the actual words used in the legislation, namely “on or in connection with”.

147. Clearly the interpretation of these words, particularly “in connection with” depends on its statutory context. In the rating case of *Coventry and Solihull Waste Disposal Company Limited v Russell (Valuation Officer)* [1999] 1 WLR 2093 Lord Hope considered the phrase in relation to the issue of whether the primary function of premises was “in connection with” the production of electricity and heat, saying at 2103:

> “It may be that in some contexts the substitution of the words “having to do with” will solve the entire problem which is created by the use of the words “in connection with”. But I am not, with respect, satisfied that it does so in this case, and [counsel for the respondent] did not rely on this solution to the difficulty. As he said the phrase is a protean one which tends to draw its meaning from the words which surround it. In this case it is the surrounding words, when taken together with the words used in the Amending Order of 1991 and its wider context which provide the best guide for a sensible solution of the problem which has been created by the ambiguity.”

148. Such an approach was adopted by the Court of Appeal in *Barclays Bank plc & Trustees of the Barclays Bank Pension Fund v HMRC* [2007] EWCA Civ 442 in which the “primary question” as identified by Arden LJ (as she then was) at [18], was “the proper meaning of the words ‘in connection with past service.’ She observed that the expression, “in connection with”, “could describe a range of links” and recognised, at [20] that “a connection may be indirect for the purpose of the definition of relevant benefits”. She continued, at [30] dismissing counsel for the appellants argument that the scope of the provision should be limited because of its context:

> “… that Parliament has used a broad expression, namely the expression "in connection with". Having cast the net widely, Parliament has drawn it in particularly by imposing a limit that there should be a connection with service. The limitations prescribed by Parliament are the limitations that the court should apply. The context of occupational pension schemes cannot be used to narrow the phrase ‘in connection with past service’ yet further.”

149. A similar approach has been taken by this Tribunal. In *Talisman Energy (UK) Limited v HMRC* [2010] SFTD 359 where, in relation to petroleum revenue tax and having referred to *Barclays Bank*, it considered, at [52], that the expression “in connection with”:

> "… should be given a broad meaning and that the only limitations should be those prescribed by Parliament"

150. In *J & A Young (Leicester) Limited v HMRC* [2015] UKFTT 638 (TC) the issue was whether certain property was held "in connection with" business premises held as an investment in the context of the taxation of a pension scheme. The Tribunal observed at [72] that:

> "There are many authorities which consider the words "in connection with" in a variety of different statutory contexts. It is a phrase commonly used by in statutes and delegated legislation, as well as in commercial contracts. The phrase is very frequently used in tax statutes. For example, the words "in connection with" occur over 30 times in the Finance Act 2015 alone. The words are often used in charging and anti-avoidance provisions to extend the scope of the charge to tax. For example, section 401 ITEPA charges to income tax payments made "in connection with" the termination of employment. Another example, in this case an anti-avoidance provision, is section 686 (3) Income Tax Act 2007 where the provision applies in circumstances where an abnormal amount by way of dividend is received "in connection with" certain transactions in securities. It is fair to say, however, that the use of the phrase "in connection with" to extend the scope of a relieving provision, as in this case, is less common. In these appeals, HMRC is in the slightly unusual position of having to argue that the words "in connection with" should be narrowly construed when more frequently HMRC is wont to urge this Tribunal and the higher courts that the same phrase should be given an expansive meaning when used in a charging provision."

151. Similarly in the present case it is the LLP rather than HMRC that is inviting us to adopt such a wide approach. At [73] of *Young* the Tribunal considered that:

> "… two propositions can be derived from the dozens of authorities which have considered those words in different contexts. First, the words "in connection with" generally have a very broad meaning. Secondly, the degree of connection – the remoteness, proximity and type of connection – required by the use of that phrase in a particular statute must be identified from the particular statutory context in which it is used."

152. The Tribunal also cited, at [79], "the judgment of the Court of Appeal in *Ideal Life Assurance Company Ltd v H J Hirschfield and A H Hirschfield* [1943] KB 442 where du Parcq LJ, delivering the judgment of the Court, stated (at page 446) that:

> "… the phrase "in connection with" was not a term of art and had to be construed in accordance with its ordinary meaning."

153. We also note that more recently in *Khanty-Mansiyisk Recoveries Limited v Forster LLP* [2018] EWCA Civ 89 the Court of Appeal, at [36], rejected a submission by counsel for the appellant in the context of a "widely worded compromise agreement", that the phrase "in connection with" is narrower in its scope than "connected with". Lewison LJ (with whom Sir James Munby and King LJ agreed) said:

> "The former phrase requires a causal link between the compromised action and the cause of action now sought to be advanced. This a very fine linguistic distinction, and Mr Davenport did not develop the point orally. I do not consider that it is supported by either of the cases on which he relies (*Coventry and Solihull Waste Disposal Co Ltd v Russell* [1999] 1 WLR 2093 and *HMRC v Barclays Bank plc* [2007] EWCA Civ 442, [2008] STC 476). On the contrary both those cases emphasise the protean nature of the phrase which takes it meaning from the context in which it is used: see *Coventry* at 2103 B-C (Lord Hope) and *Barclays* at [18] to [19] (Arden LJ)."

154. In the light of these authorities and, as the Tribunal noted in *Young*, "dozens" of others, it must follow that, in the context of s 360B(1), the words, "on or in connection with" is to be given a wide construction. That said, we agree with Mr Davey that if the phrase "in connection with" is to be given a wide construction for the purposes of s 360B(1) to identify what is included within the statutory definition of "qualifying expenditure, it follows that the same approach must also be adopted for the purposes of s 360B(3) to determine what is not within that definition.

155. It is also clear from the legislation that for the expenditure concerned to be "qualifying expenditure" it must be incurred on or in connection with the building, ie in this case the Property and its conversion from a flight training centre into hotel premises and not given so wide a construction so as to provide an entitlement to relief on all expenditure associated with creating a fully functioning hotel business.

156. We have already noted that it is HMRC's case that to answer the question of whether the Development Sum falls within the definition of "qualifying expenditure" within s 360B(1) a close examination of what it has been spent, "on or in connection with" and what the expenditure has been incurred "in respect of" is required. In undertaking such an examination, Mr Davey says that it is necessary to consider, among other things, the purpose of the taxpayer in making the payment and cites three authorities in support, *Tower MCashback v LLP 1 and another v HMRC* [2011] 2 AC 457 ("*MCashback*"), *Acornwood* and *Marathon Oil UK, LLC v HMRC* [2017] UKFTT 822 (TC).

157. In *MCashback* Lord Walker, giving the judgment of the Supreme Court, said at [76]:

> "I respectfully consider that Moses LJ was right in deriving assistance from *Ensign* (paras 78 and 79 of his judgment, quoted in para 62 above) as to the relevance of the terms of the borrowing (here interest-free and non-recourse). But I respectfully think that he was wrong to concentrate on the terms as an indication of whether there was 'real expenditure'. That was the issue in *Ensign* (no real loan, no real expenditure). Here the issue was whether there was real expenditure *on the acquisition of software rights*. I think that Moses LJ gave the right answer to the wrong question. The transfer of ownership (or at least of rights) indicated the reality of some expenditure on acquiring those rights, but was not conclusive as to the whole of the expenditure having been for that purpose."

158. The Upper Tribunal (Nugee J) in *Acornwood* stated, at [54]:

> "… if the payer knows that the payee is going to use the money in a particular way, and intends that the payee should do so—indeed has been responsible for devising the transaction in such a way as to make it essential that the payee does use the money in that way—then it is wholly unrealistic to say that the payer does not intend the money to be used for that purpose. And if that is what the payer intends, it is very difficult to see that the payer can have had any other object in making the payment. In this way what the recipient is going to do with the money, as the payer both knows and intends, is indeed the purpose of the payer. As Millett LJ said this is a consequence which is so inevitably and inextricably involved in the payment that it must be taken to be a purpose for which the payment was made."

159. Having considered the relevant authorities, including *Tower MCashback*, and *Acornwood*, in relation to the meaning of incurred "on" for capital allowances purposes, the Tribunal (Judge Thomas Scott) in *Marathon Oil* observed, at [150], with emphasis as stated by the Tribunal:

> "… in my judgment the authorities support the proposition that in determining what expenditure is incurred "on", it is necessary to determine the **purpose or object** of that expenditure."

160. Mr Gammie, who accepts that the LLP knew and intended how the money transferred to Cannock would be used, contends that HMRC can derive no assistance from *Acornwood* which, he says, was concerned with a statutory provision that required the identification of the purpose served by particular expenditure. This can be contrasted with the present case in which the relevant statutory provision that turns on what the expenditure was incurred "on" or "in connection with". As such, the reason why the expenditure was incurred is irrelevant.

161. Mr Gammie suggests that HMRC's approach appears to be rooted in the approach taken by Park J in the High Court in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* (2002) 76 TC 446 ("*BMBF*") where he said at [57], in relation to s 24 of the Capital Allowances Act 1990, (with emphasis added):

> "Section 24 refers to incurring expenditure on the provision of machinery or plant. It is true that in a strictly legal sense one can say that BMBF incurred expenditure on the provision of the pipeline. That is what the two Acquisition Agreements said: "The Seller shall sell the Pipeline as beneficial owner, and the Lessor shall purchase the Pipeline…". Each agreement provides for "the Purchase Price for the Pipeline", and the two purchase prices aggregate to over £91 million. However, in the light of the *Ramsay* authorities I consider that I have to interpret and apply the statute in a wider way. I have to ask: looking at the matter commercially (Lord Hoffmann's term), did BMBF incur expenditure of £91 million on the provision of the pipeline, or did it incur it on something else? **I have to ask: on what did BMBF *really* incur its expenditure of £91 million? Was it really incurred on the provision of the pipeline, or was it really incurred on something else?** Businessmen are familiar with situations under which, in order to

> get some advantage which the business wants, it is necessary to achieve it indirectly by buying some other item through which the advantage, which is what the money is really paid for, can be secured."

162. However, neither the Court of Appeal nor House of Lords accepted such an approach as correct.

163. For example, in the Court of Appeal, Carnwath LJ (as he then was) noted, at [57], that:

> "The Judge thought that the pipeline transaction could be disregarded as simply "the fifth wheel of the coach". I find that difficult to follow, even if one looks at the BZW scheme as a whole. One cannot ignore the reality of the pipeline, nor can one ignore the fact that ownership was transferred to BMBF, with whom it remains, and that leases were granted to BGE and BGE (UK). On any view, those are real world transactions with lasting consequences in the real world."

Lords Lord Nicholls, giving the decision of the House of Lords observed:

> "40. These statutory requirements, as it seems to us, are in the case of a finance lease concerned entirely with the acts and purposes of the lessor. The Act says nothing about what the lessee should do with the purchase price, how he should find the money to pay the rent or how he should use the plant. …
>
> 41. … The finding of the Special Commissioners that the transaction 'had no commercial reality' depends entirely upon an examination of what happened to the purchase price after BMBF paid it to BGE. But these matters do not affect the reality of the expenditure by BMBF and its acquisition of the pipeline for the purposes of its finance leasing trade."

This was because, as Lord Nicolls continued, at [42]:

> "If the lessee chooses to make arrangements, even as a preordained part of the transaction for the sale and lease back, which result in the bulk of the purchase price being irrevocably committed to paying the rent, that is no concern of the lessor. From his point of view, the transaction is exactly the same. No one disputes that BMBF had acquired ownership of the pipeline or that it generated income for BMBF in the course of its trade in the form of rent chargeable to corporation tax. In return it paid £91m. The circularity of payments which so impressed Park J and the Special Commissioners arose because BMBF, in the ordinary course of its business, borrowed the money to buy the pipeline from Barclays Bank and Barclays happened to be the bank which provided the cash collateralised guarantee to BMBF for the payment of the rent. But these were happenstances. None of these transactions, whether circular or not, were necessary elements in creating the entitlement to the capital allowances."

164. Accordingly, Mr Gammie contends the only question to be determined is on what, or in connection with did the LLP incur expenditure in paying the Development Sum to Cannock? Posing and answering such a question is not, he says, at odds with

authority in the shape of *MCashback* relying on the decision of the Special Commissioner in that case which was ultimately accepted by the Supreme Court that, "the gross capital expenditure has not been incurred" (see [2007] STC (SCD) 1 at [138]).

165. However, we agree with Mr Davey that it is necessary to adopt a realistic view of the facts taking account of all the relevant circumstances of the case so as to identify the true legal and tax effect of the transactions avoiding affording primacy to purported form over substance notwithstanding the label utilised by the parties to describe a particular transaction. This much is clear from authorities such as, for example, *Street v Mountford* [1985] AC 809, *AG Securities v Vaughan* [1990] AC 417 and *Booth v Buckwell* [1980] STC 578.

166. In undertaking such a realistic appraisal of the facts it is necessary to consider the economic realities of the transactions and examine the extent that the Development Sum comprises qualifying expenditure. As Lord Hope observed in *MCashback* at [93]:

> "In *Barclays Mercantile Business Finance v Mawson* [2005] 1 AC 684 the House of Lords adopted a practical, commercial approach to the reality of the expenditure. Although the facts of this case lead to a different result, I would adopt the same approach here. As Lord Walker JSC's exacting analysis has shown they do not support the LLPs case that the whole of the claimed expenditure was actually used to acquire the rights in the software. I agree that, in the circumstances of this case, we can and should reach our own conclusion as to the amount that should be allowed in respect of the claimed expenditure."

167. Similarly in the present case, given that it is not disputed that the LLP knew and intended how the money it transferred to Cannock would be used, we have adopted a practical commercial approach to the reality of the expenditure and whether it was actually used on or in connection with the conversion or renovation of the Property.

168. Mr Gammie, however, contends that HMRC is wrong to equate the knowledge of the LLP with its intention of how the Development Sum should be utilised by Cannock. He gives an example of paying someone for services knowing that the person concerned intends to use the money for a Caribbean holiday. Clearly the payment is not incurred on the holiday even if it is known that it would be used for this purpose. The intention, in contrast to the knowledge, of the person making the payment is to secure the contracted services.

169. Despite being initially somewhat attracted to this argument it is clear from the Intercreditor Deed, to which the LLP was a party and which directs how the Development Sum was to be spent, that the LLP in addition to having the knowledge also intended how the Development Sum should be utilised. In the circumstances it is therefore necessary to consider what Mr Davey referred to as the "constituent elements" of the Development Sum which were paid by Cannock and whether these are "qualifying expenditure" as defined by the legislation.

170. We also consider that, by excluding £34,999 as relating to the acquisition of land from its BPRA claim, the LLP may have implicitly accepted such an approach despite its attempts to explain it away as a pragmatic compromise.

171. In respect of each of these elements it is HMRC's case that the primary purpose of the LLP in making the payment was to increase its claim for BPRA. However, and perhaps not unsurprisingly, this is not accepted by the LLP which contends that even if these items of expenditure fall to be considered, they are clearly "qualifying expenditure" as defined in the legislation.

The Interest Amount/Licence Fee (£350,000)

172. The Interest Amount is described in some of the documentation as a "Licence Fee".

173. The sum of £350,000 was paid into the Interest Account by Cannock in accordance with the above agreements (ie clause 5 of the Co-op Loan Agreement, paragraph 1.2 of schedule 1 and schedule 2 of the Development Agreement, the Licence Deposit Deed, clause 16.5.2(d) and clause 16.9 of the Intercreditor Deed). Under clause 16.9 of the Intercreditor Deed Cannock was precluded from making any withdrawal for any purpose other than complying with clause 5.1 of the Licence Deposit Deed, namely to pay a sum equal to the quarterly interest that the LLP was required to pay to the Co-op.

174. HMRC contend that the £350,000 was paid for the sole purpose of inflating the BPRA claim and that this is plain because there was no commercial reason for it to have been paid to Cannock. Indeed the LLP could have retained the sum itself using it to meet the interest payments due to the Co-op. As such, HMRC argue, the payment cannot be qualifying expenditure as the required connection between it and the items listed in s 360B CAA is absent.

175. In support reliance is placed on the decision of the First-tier Tribunal, as upheld by the Upper Tribunal, in *Acornwood* where at [261] it states:

> "However one looks at the principal exploitation agreements, and despite their wording, it is plain that what the partnerships paid for included a guaranteed income stream. Such an acquisition had nothing to do with the partnerships' trade in the exploitation of intellectual property rights but was something with an independent existence."

Similarly in the present case, HMRC say, the payment by the LLP to Cannock of the Interest Amount only for Cannock to place it on deposit and periodically repay it to the LLP had nothing to do with the renovation, conversion or incidental repair of the Property.

176. HMRC also contend that it would be contrary to the purpose of the BPRA regime to treat the LLP's borrowing costs as eligible for relief relying on the observation of Lord Hailsham in *Ben-Odeco Limited v Powlson (HM Inspector of Taxes)* [1978] STC 460 where he said, at 465:

> "I am not satisfied that the policy of the statute really conforms with the taxpayer company's contention. Granted that its main purpose was to encourage investment in new machinery and plant, I am not convinced that to include interest charges and commitment fees would serve this purpose without giving rise to abuse."

Mr Davey argues that such an abuse arises in the present case as the LLP, by paying the Interest Amount to Cannock, has in fact passed on its borrowing costs to Cannock in an artificial manner to enlarge its BPRA claim.

177. However, we do not accept HMRC's further contention that if the Interest Amount is properly characterised as the payment in return for a licence it is incurred on or in connection with an interest in land and, as such, precluded by s 360B(3) from being "qualifying expenditure" and not therefore eligible for BPRA. This is because the legislation denies relief on expenditure incurred to obtain an interest in land. In in this case it is Cannock, not the LLP, which acquired an interest in land, ie the licence.

178. For the LLP it is argued that first, the LLP did not claim the interest paid to the Co-op as qualifying expenditure; and secondly, whether consideration is given to the licence fee or the interest cost, such costs are clearly incurred "in connection with" the conversion of the Property.

179. It is accepted that the LLP knew and accepted that is granted the licence to Cannock because it was necessary to enable it and its contractors to enter the Property for the purposes of carrying out the project. Also, the LLP did not have the funds to meet it obligation to pay interest to the Co-op during the development phase of the project. We agree with Mr Gammie that this was a commercial arrangement, the effect of which was not to increase the tax deduction available to the LLP as the income it received from the licence fee was taxable.

180. We also agree with the LLP that *Ben-Odeco* does not assist HMRC's abuse argument given that the legislative provision with which the House of Lords was concerned in that case, s 41(1)(a) Finance Act 1971, referred to expenditure "**on** the provision of machinery or plant" (emphasis added) whereas the legislation with which we are concerned, s 360B, applies to expenditure incurred "on or **in connection** with" (emphasis added) the conversion, renovation etc of a qualifying building.

181. As such, we conclude that the payment of this amount was on or in connection with the conversion, renovation etc of a qualifying building

The Capital Account (£2,000,000)

182. Clause 16.5.2 of the Developer Intercreditor Deed required Cannock to pay the Capital Amount into the Capital Account over which it had created a charge in favour of the Co-op (see Clause 15.2(a)(ii) of the Co-op Loan Agreement). The withdrawal of any sums from the Capital were governed by the Capital Account Deed.

183. Under Clause 3.5.1 and 3.5.2 of the Capital Account Deed Cannock was entitled to withdraw a maximum sum equivalent to the amount of capital that had been repaid

by the LLP although no withdrawals could occur for at least three years. If an "Event of Default" or "Potential Event of Default" occurred the Co-op was entitled, under Clause 3.5.3 of the Capital Account Deed, to make withdrawals from the Capital Account "towards the cure" of such Event or Potential Event of Default.

184. Also, the LLP was entitled, under Clause 3.5.4 of the Capital Account Deed, to direct the Co-op to make withdrawals from the Capital Account where it considered it necessary to enable it to meet its obligations to the Co-op although the Co-op was not obliged to do so but was required to act reasonably in considering whether or not to comply with a direction from the LLP.

185. HMRC contend that the £2 million paid by the LLP to Cannock which Cannock immediately deposited into the Capital Account was not qualifying expenditure. Viewed realistically, it is said that the true position was that the payment of the Capital Amount by the LLP was funded by the loan from the Co-op under which the LLP had borrowed £5 million (not £7 million) in order to be in a position to incur "real expenditure" of that amount.

186. As such, the LLP was not able to incur the Capital Amount as "real expenditure" on or in connection with the items listed in s 360B(1). It is argued that the self-cancelling nature of the payment of the Capital Amount by the LLP to Cannock is demonstrated by the inability of Cannock to use or enjoy the fruits of that sum throughout the period that the Capital Amount was deposited in the Capital Account.

187. However, Mr Gammie contends that this is an "illegitimate attempt" by HMRC to raise the argument from which, having failed in its application to amend its statement of case, it has been precluded, namely that this expenditure was never "incurred" by the LLP. He says that, as HMRC accept, the LLP assumed a loan obligation to the Co-op, the LLP paid the Development Sum to Cannock which then deposited £2 million with the Co-op. This was therefore Cannock's money on which it was credited interest by the Co-op.

188. Mr Gammie compares the position of Cannock with that of BGE in *BMBF* saying that although BGE did exactly the same on day one the House of Lords found in favour of BMBF not HMRC. However, he argues that unlike in *BMBF* where the amount deposited by BGE was effectively used in due course to discharge BMBF's borrowing, in the present case it is the LLP which is responsible for discharging both the Co-op loan and the developers loan to the extent arising from the Capital Account.

189. HMRC further contend, relying on *Bupa Insurance Limited v HMRC* [2014] STC 2615 at [51] – [69], that during this period Cannock's entitlement to the Capital Amount constituted a "mere legal shell" such that Cannock was not beneficially entitled to or indeed the beneficial owner of the Capital Amount which at that time was the Co-op.

190. In *Bupa Insurance* the Upper Tribunal (Asplin J, as she then was, and Judge Ghosh QC) considered the features of 'beneficial ownership' and 'beneficial

entitlement' in the context of group/consortium relief holding that they were different concepts and that beneficial ownership, which amounted to more than a "mere legal shell", was a wider concept than beneficial entitlement. It observed, at [59]:

> "… any incidents of ownership which amount to more than a 'mere legal shell' amount, in the context of the group/consortium relief provisions, to 'beneficial ownership'. In particular, a right to dispose of an asset and enjoy its fruits confers 'beneficial ownership' of that asset, whereas a complete absence of both rights 'bereft of the rights of selling or disposing or enjoying the fruits …' (*Wood Preservation* [1969] 1 All ER 364 at 368 per Lord Donovan) deprives an owner of 'beneficial ownership'. So the seller of shares under a binding contract conditional only on the purchaser obtaining the benefit of a commercial contract for the company which was sold, which condition might only be waived by the purchaser, is deprived of beneficial ownership of the shares sold under the contract, because the seller could not, while waiting to see whether the condition was satisfied or waived, deal with the property; neither could it declare or pay a bonus on the relevant shares: 'the shares … were like a tree which the owner could not sell and could not cut down and of which he could enjoy none of the fruit' (*Wood Preservation* [1969] 1 All ER 364 at 367 and 368 per Lord Donovan and Harman LJ respectively; the seller was 'tied hand and foot' see at 368 per Harman LJ). Similarly, a parent company of a subsidiary subject to a liquidation order is deprived of beneficial ownership of the shares in the subsidiary; custody and control of all of the subsidiary's property were, under the order, transferred to the liquidator and all power to deal with the subsidiary's assets passed to the liquidator (*Ayerst* [1975] STC 345 at 348–349, [1976] AC 167 at 178–179 per Lord Diplock). Thus the parent company was '[deprived] of all possibility of enjoying the fruits of [the subsidiary's shares] or disposing of it for [its] own benefit.' (See [1975] STC 345 at 350, [1976] AC 167 at 179.)."

191. HMRC contend that Cannock is similarly deprived of enjoying the fruits of the Capital Amount as, under clause 3.5.3 of the Capital Account Deed the Co-op could withdraw the Capital Amount from the Capital Account. Were this to happen the Capital Amount would be returned to the Co-op without having been received by Cannock. As such at the time the Capital Amount was deposited in the Deposit Account there was a material risk that it would be withdrawn by the Co-op and set off against the LLP's liability under the Co-op loan.

192. Although Mr Lewis and Mr Tracy, in evidence, explained that they did not understand the Capital Account Deed to operate in such a way, given our approach to the evidence (described at paragraphs 46 -47, above) and, as the Supreme Court put it in *Wood v Capita Insurance Services Limited* [2017] AC 1173 at [10], our task is "to ascertain the objective meaning of the language the parties have chosen to express their agreement". In this case that agreement was professionally and, no doubt, carefully drafted in clear and unambiguous terms.

193. In any event we do not accept the suggestion by Mr Lewis in his evidence and adopted Mr Gammie in his submissions for the LLP that, under the Developer Loan

Agreement (see paragraph 88, above) any sums withdrawn from the Capital Account would "be treated as having been added" to the Developer Loan. Such an interpretation, which does not recognise that both Cannock and the Co-op may make a withdrawal from the Capital Account, is inconsistent with the terms of the Capital Account Deed under which it is only under clause 3.5.4 that a withdrawal "shall form part of the debt due by the [LLP] to [Cannock] pursuant to the Developer Borrower Facility."

194. Additionally, it does not reflect commercial reality. The Co-op was a party to the Capital Account Deed but not the Developer Loan Agreement and had a clear and legitimate interest in knowing and defining the circumstances in which the LLP's indebtedness to Cannock could increase by £2 million and it would be expected that the circumstances in which this may occur are set out in an agreement to which it was a party rather than an inconsistent agreement with which it was not.

195. Additionally, and notwithstanding the construction of the Capital Account Deed, it is clear that the establishment of the Capital Account was not, as the LLP contends, something that was required by the Co-op. Rather it became part of the loan process on the initiative of Cannock as is apparent from the Debt Finance Request and evidence of Mr Tracey and Mr Matthews (see above). As to whether the £2 million acted as an incentive to the developer or, as Mr Matthews explained to his superiors at the bank (see paragraph 78, above), to keep it "committed" to the project is also, in our judgment, at best questionable. We agree with HMRC that Cannock had no need to be "incentivised" given its involvement with the project from which it stood to make a more than healthy profit.

196. We also agree with HMRC, that in reality the nature of the Capital Account was circular and self-cancelling cash-flow commencing and concluding under the Co-op and as such was not incurred on or in connection with the conversion or renovation of the Property.

IFA Fees (£372,423.40)

197. HMRC contend that Downing, the entity regulated under the Financial Services and Markets Act 2000, was *prima facie* the party responsible for engaging the IFAs and payment of their fees. Indeed it was Downing that paid the majority of these fees. In such circumstances HMRC argue that there can be no commercial reason for Downing to have arranged for the LLP to have paid a sum of money to Cannock only for Cannock to have paid part of it to Downing in reimbursement of IFA fees when Downing could simply have paid those fees or reimbursed itself out of the funds raised by the LLP.

198. Mr Davey submits that the payment of IFA fees cannot be expenditure "on or in connection with" any of the matters listed in s 360B(1)(a) to (c). Neither, he says, can it be "in respect" of a "qualifying building". It is clearly not expenditure "on" the items listed and not "in connection with" or in respect of a qualifying building but effectively a financing cost incurred to capitalise the LLP and therefore too remote to fall within the legislative definition.

199. He dismisses the argument advanced for the LLP that the development would not have happened without the required equity as having no bearing on the issue of whether the expenditure is properly allowable under the legislation and contends that had the sums been paid directly to Downing and/or the IFAs by the LLP they would clearly not have been allowable for BPRA purposes and that remains the position notwithstanding that they were paid via Cannock via the Development Sum.

200. However, as it says, the LLP did not pay these sums directly to Downing and/or the IFAs, rather these were paid to Cannock which then paid the IFA fees. Had such sums been paid directly by the LLP they would either be deductible revenue expenditure or, given the wide interpretation we have adopted of the statutory provision (see paragraphs 147 -155, above), expenditure incurred "in connection" with the conversion, renovation etc of the Property, a qualifying building for BPRA purposes.

201. As such, we find that the IFA fees do qualify for BPRA. In reaching such a conclusion we do not accept HMRC's argument that the IFA fees were, in part at least, incurred on or in connection with the acquisition of, or rights over, land. This is because the fees paid to the IFAs are for their services in raising equity finance and although, as previously stated, we have concluded that "in connection with" should not be narrowly interpreted it does not go so far, in our judgment so as to include such payments as falling within s 360B(3)(a).

Promoter fees (£310,000)

202. It is clear, from clause 16.5.2(i) and schedule 1 of the Intercreditor Deed, that it was known and intended by the LLP that the payment of Promoter fees, to Downing and Blakes (see paragraphs 115-116, above), would be made from the Development Sum. Mr Lewis also agreed that there was "no need" for the payment to be structured in such a way. In such circumstances, Mr Davey contends that the only reason that it was to be paid out of the Development Sum was to increase the LLP's BPRA claim. He also contends that. as with the IFA fees, that the Promoter fees were partly referable to the acquisition of the Property and, as expenditure incurred on or in connection with the acquisition of land, therefore cannot amount to qualifying expenditure in any event.

203. For the reasons above in relation to IFA fees we do not agree with Mr Davey that these fees are in connection with the acquisition of land. Additionally, while we do agree with him that there was no need for the payment to be structured in this way it was so structured, and it is this actual position which is to be considered. In doing so we note that this was a payment by Cannock (not the LLP) to Downing for its (Downing's) services in preparing and issuing the IM for the purpose of raising equity for the project. As such, and as with the expenditure in relation to IFA fees, we consider that the expenditure on Promoters fees was in connection with the conversion or renovation of the Property and, as such, that it is qualifying expenditure for BPRA purposes.

Legal fees (£153,409.89)

204. HMRC contend, having regard to the breakdown of the legal fees (see paragraph 117, above) that these were incurred on or in connection with the purchase of the Property and, as such, cannot be qualifying expenditure as it is excluded because of s 360B(3)(a). However, while we accept that this is to a large extent the case, it is apparent that not all of the expenditure concerned falls within this category. For example, the first item, the payment of £8,520.36 to Shakespeare Putsman (solicitors) is expenditure incurred by Cannock its purchase of the Property from Chainridge. Similarly, item 4, relates to the Co-op legal fees in relation to the grant of security which is, as Mr Gammie contends, not in connection with the purchase of land but in connection with the lending of money.

205. Further analysis of these amounts are therefore necessary and it is hoped that this is something that can be left to the parties to undertake and agree in the light of our conclusion that most of the expenditure under this heading is not in fact qualifying expenditure within the legislation. In the event that it is not possible for the parties to reach agreement either may apply to the Tribunal to resolve this matter.

Franchise costs (£272,862)

206. Mr Davey says that the £248,000 paid to Sanguine Hospitality was a gratuitous payment arising out of the disagreement and inability of Sanguine and Cannock to work together because of the clash of personalities of the individuals concerned and, as Mr Tracey accepted, not a franchise cost at all. Accordingly, it cannot be qualifying expenditure as defined by the legislation. Mr Gammie accepts that the LLP knew that Cannock would have to bear this cost to fulfil its obligations under the Development Agreement. However, he contends that the payment to Sanguine was made by Cannock out of its own resources and therefore should not be treated differently from a payment that Multibuild might chose to make to assuage a disgruntled sub-contractor whose service had been dispensed with.

207. In any event he contends that the payment was made in connection with the physical work done on the Property to meet the brand specifications to enable it to operate as a Ramada Encore hotel. We disagree. Unlike the payment to Ramada, which we consider below, the payment to is was not made for such a purpose. Rather it was made to remove Sanguine from any involvement with the project and, notwithstanding the wide construction of the expression “in connection with” cannot, in our view, be treated as qualifying expenditure.

208. With regard to the sums paid to Ramada, the initial $15,000 paid in accordance with the Franchise Agreement and £15,000 subsequently paid by the Operating Company under the Technical Services Agreement, HMRC’s case is that these fees are not allowable as they are not sufficiently connected to the conversation, or renovation of the Property as required by the legislation. Mr Davey also contends that there was no reason for the payments by the Operating Company to be routed through Cannock and that this is another reason why they should be excluded from relief.

209. However, as Mr Gammie reminds us the legislation does not refer to "sufficiently connected" but "in connection with". Also, that it is necessary to look at what happened not whether the transaction could have been undertaken differently. We consider that these payments, to ensure the Property complied with the requirements and branding to enable its operation as a Ramada Encore hotel, were made in connection with the conversion or renovation of the Property and are therefore qualifying expenditure for BPRA purposes.

FF&E and other non-qualifying amounts (£587,556.35)

210. We consider each of the categories of expenditure under this heading described above (in paragraph 121, above).

211. However, before doing so, given that much of this expenditure relates to the external areas of the Property, we first consider the argument advanced by Mr Gammie that a building includes its curtilage and that insofar as the external areas fall within the curtilage of the Property they cannot constitute land "adjoining or adjacent to" it so as to preclude any expenditure on these areas from being qualifying expenditure by virtue of s 360B(3).

212. HMRC contend that although their witness, Mr Huxley, agreed that the external areas in which the work was undertaken was within the curtilage of the Property, in the absence of any reference to "curtilage" in s 360B this cannot assist the LLP. Neither, it is contended by HMRC, can the argument advanced by the LLP that expenditure on such items is necessary for the conversion of the Property into an hotel.

213. We were referred to the August 1997 edition of VAT Notice 708 in which curtilage is defined as:

> "a reasonable amount of land, surrounding the building, which may include other buildings."

In *Methuen-Campbell v Walters* [1979] 1 QB 525 Goff LJ said, at 538:

> "The word "curtilage" is defined in the Shorter Oxford Dictionary, 3rd edition (1973) as "A small court, yard or piece of ground attached to a dwelling house and forming one enclosure with it" … What is within the curtilage is a question of fact in each case."

As Buckley LJ observed in the same case (at 543-544):

> "In my judgment, for one corporeal hereditament to fall within the curtilage of another, the former must be so intimately associated with the latter as to lead to the conclusion that the former in truth forms part and parcel of the latter. There can be very few houses indeed that do not have associated with them at least some square yards of land, constituting a yard or basement area or passageway or something of the kind, owned and enjoyed with the house, which on a reasonable view could only be regarded as part of the messuage … To the extent that it is reasonable to regard them as constituting one messuage or parcels of

> land, they will be properly regarded as all falling within one curtilage; they constitute an integral whole."

214. Although we are concerned with direct tax, as opposed to VAT, provisions and the authorities cited above involve different legislation to that in the present case, we accept Mr Gammie's argument that references to the Property must also encompass its curtilage and therefore be treated as a single parcel of land. Accordingly we find that any expenditure on items within the curtilage of the Property cannot be adjoining or adjacent to it.

215. We also note that Mr Davey was somewhat critical of the LLP's witness, Mr Beresford, who gave evidence in relation to this expenditure as he was instructed in February 2016 and not in a position to provide any first hand evidence of fact but relied upon information provided by others. However, the same criticism can be levelled at Mr Huxley who, like Mr Beresford, gave evidence as a witness of fact and not as an expert.

216. Turning to the first category of expenditure under this heading, external tarmacking, landscaping and drainage, it is not disputed that these works were outside the footprint of the Property. HMRC therefore submit that such expenditure is on or connection with the development of land adjoining or adjacent to the Property, a qualifying building, and not qualifying expenditure by virtue of s 360B(3)(c). Contending that the areas on which the expenditure was incurred is within the curtilage of the Property, Mr Gammie says that it cannot be adjoining or adjacent to it.

217. Mr Gammie further contends that for the purposes of s 360C, "meaning of qualifying building" roads and carparks are "structures" and thus within the statutory definition. In support of his argument he referred to HMRC's Capital Allowances Manual (CA31110) which states:

> "You should treat something as a structure if it has been artificially erected or constructed and is distinct from the earth surrounding it.
>
> Land that retains its character as land is not a structure, even if it has been cultivated or modified in some way. For example, grass tennis courts, grass football pitches, grass bowling greens and golf courses are not structures."

218. The Manual confirms that it is permissible to refer to rating cases in relation to the construction of the term "structure". The leading case in this context is *Inland Revenue Commissioners v Smyth* [1914] 3 KB 406 in which Scrutton J considered whether a private farm road constituted a "structure". Finding that it did he said, at 421-422:

> "In my view it is a question of fact in each case; a gravel path though from repeated gravellings it is harder than the surrounding soil would not in my opinion be a structure, while the roads one is familiar with in Switzerland, the Tyrol and Italy, in parts built up on mountain sides, in parts cut out of solid rock would I think clearly be structures, as would the elaborate compositions of concrete, wood blocks and tarmac used for heavy motor traffic at the present day. Between the two there is

> every variety. … I think a structure is something artificially erected, constructed, put together, of a certain degree of size and permanence, which is still maintained as an artificial erection, or which, though not so .maintained, has not become indistinguishable in bounds from the natural earth surrounding. What degree of size and permanence will do is a question of fact in every case."

219. The meaning of "structure" was also considered by the Court of Appeal in *Cardiff Rating Authority v Baldwin's Iron & Steel Company Limited* [1949] 1 KB 385 where Denning LJ (as he then was) said, at 396-397:

> "A structure is something which is constructed, but not everything which is constructed is a structure. A ship, for instance, is constructed, but it is not a structure. A *structure* is something of substantial size which is built up from component parts and intended to remain permanently on a permanent foundation; but it is still a structure even though some of its parts may be movable, as, for instance, about a pivot. Thus, a windmill or a turntable is a structure"

220. We do not agree with Mr Davey, who submits, contrary to HMRC's own guidance, that the term "structure" ordinarily implies a three dimensional building or assembly and therefore cannot include a car park. Under that a structure is something that is "artificially erected or constructed and is distinct from the earth surrounding" and in our view clearly can include a car park such as that constructed in the present case. Accordingly we find that it does come within the legislative definition of a "qualifying building" under s 360C(1) and that the expenditure is qualifying expenditure for BPRA purposes. It is therefore not necessary to consider whether the car park, which we consider to be a highly desirable facility for an airport hotel, is within the curtilage of the Property.

221. Given the similarity of the arguments in relation to the expenditure on drainage works (see paragraph 121(2), above) and mains service connections (see paragraph 121(4), above) we consider these items together. Mr Davey contends that these cannot be allowable on the basis that, being situated externally to the Property, they fall within s 360B(3)(c). Additionally, he submits that as these are below ground and external to the Property they are an extension to a qualifying building and not allowable by virtue of s 360B(3)(b).

222. In support of this additional submission Mr Davey relies on the definition of "building" at s 21(3). This provides:

> In this section, "building" includes an asset which—
>
> (a) is incorporated in the building,
>
> (b) although not incorporated in the building (whether because the asset is moveable or for any other reason), is in the building and is of a kind normally incorporated in a building, or
>
> (c) is in, or connected with, the building and is in list A.
>
> List A
>
> Assets treated as buildings

1. Walls, floors, ceilings, doors, gates, shutters, windows and stairs.

2. Mains services, and systems, for water, electricity and gas.

3. Waste disposal systems.

4. Sewerage and drainage systems.

223. Mr Davey says that it is clear, and demonstrated by the need for a specific deeming provision in s 21(3), that a building does not, as a matter of ordinary language encompass below ground drainage or mains services. However, if this is correct it must follow that a building does not encompass walls, floors, ceilings, doors, gates, shutters, windows and stairs either. In our judgment s 21, which precludes expenditure on a building from being expenditure on plant and machinery does not provide any assistance in the present case where we are concerned with the BPRA provisions of the CAA and not those relating to plant and machinery.

224. In our judgment the drainage works and mains services do not amount to an extension. Although considering the expression "extension" in the context of the extension of a right, Lord Elenborough said, in *Brooke v William Clarke* (1818) 1 B & Ald 396 at 148:

> "The word extension imports the continuance of an existing thing,"

The VAT and Duties Tribunal in *Macnamara v Commissioners of Customs and Excise* [1999] V&DR 171 at [13] considered that:

> "The word 'extension' in relation to an existing building refers, we think, to building work which provides an additional section or wing to that existing building; the degree of integration is one stage less than with enlargements."

225. In the present case we agree with Mr Gammie that the drainage works and mains service connections do not create an additional section or wing to the Property but serve it. In any event we consider that these works to be within the curtilage of the Property and, as such qualify for BPRA.

226. Similar arguments were raised regarding the roof plant (see paragraph 121(3), above), a substantial structure clearly attached to the Property in which the air-handling units, chiller units and extract ventilation fans are situated. Although there is no direct internal access from the Property other than fixed vertical ladders onto the roof, we find that, rather than an additional section to the Property, it is an integral part of the building serving the Property and as such find that BPRA is applicable to the expenditure incurred in relation to it.

227. FF&E, comprising bedroom FF&E, other FF&E; and FF&E sundries (see paragraph 121(5), above). These items were initially installed to comply with the Ramada Encore franchise requirements but have remained in place following the change of brand to a Holiday Inn and were permanently fixed, in that they could not be removed without causing damage to the internal bedroom walls, we. As such, we

consider expenditure on FF&E to be "qualifying expenditure" within the legislative definition.

Residual amount/profit (£1,209,510).

228. HMRC contend that the part of the Development Sum paid to provide remuneration to Cannock in the form of profit cannot be qualifying expenditure as defined in the legislation. This is on the basis of an apportionment between non-allowable and allowable items.

229. The LLP is critical of such an approach. Mr Gammie contends that the fact that Cannock made a profit on the Development Agreement does not call into question the quantum of expenditure upon which BPRA is available. Mr Gammie also attacks HMRC's approach to the profit figure as "misconceived" for the following reasons:

> (1) HMRC have taken into account the initial acquisition cost of the Property at £2.85 million despite the vendor of the land being an unconnected third party;
>
> (2) It is wrong in principle to apportion the profit over the total price paid by investors in addition to the cost of conversion as this could produce a different BPRA figure depending on whether it was a freehold or leasehold property on a ground rent;
>
> (3) If profit is to be apportioned it should be over the Development Sum and not sums in respect of land purchase which would not have proceeded if all other elements had not been in place; and
>
> (4) If we were to uphold HMRC's arguments, the apportionment is still incorrect as the LLP would have directly paid the IFA fees, the promoter's fee, the licence fee/interest and other costs reducing the Development Sum which should be used as the basis for any apportionment.

230. In response Mr Davey says that "quite plainly" if we hold, as we have, that elements of the Development Sum are not allowable and profit by the developer should be apportioned across qualifying and non-qualifying elements. This, he contends should include the acquisition cost of the freehold, because:

> (1) Cannock assembled a package for the LLP;
>
> (2) That package was "cradle to grave" and included securing the freehold of the Property from which the hotel business would operate;
>
> (3) The profit paid to Cannock was attributable to all elements of the package, including the freehold premises; and
>
> (4) The profit was calculated by reference to a stabilised valuation predicated on the assumption of freehold ownership.

Accordingly, Mr Davey submits that it necessarily follows that profit should be apportioned by reference to the total price of that package. He also dismisses the argument of the LLP that such an approach would lead to different BPRA figures in

depending whether the property concerned was freehold or leasehold as it would be necessary for a case-by-case apportionment to be undertaken. This, he says, would also answer the further criticisms levelled at the apportionment by the LLP.

231. We agree with Mr Davey, for the reasons he has outlined, that there should be an apportionment in this case. However, the apportionment sought by HMRC will have to be varied to take account of our conclusions in relation to the various "elements" of the Development Sum. As with the issue of legal costs (see paragraph, 205, above) we would hope that this is something that can be left to the parties to undertake and agree in the light of our conclusions. But, in the event that it is not possible for the parties to reach agreement either may apply to the Tribunal to resolve this matter.

Summary of Conclusions

232. Having concluded at [169] that it was necessary to consider the "constituent elements" of the Development Sum we found that the expenditure incurred in relation to the following elements (using the same numbering as at paragraph 2, above) did constitute "qualifying expenditure" within s 360B and is therefore eligible for BPRA:

(1) Interest Amount/Licence Fee (see paragraphs 172 – 181, above);

(3) IFA fees (see paragraphs 197 – 201, above);

(4) Promoter fees (see paragraphs 202 – 203, above);

(6) Franchise costs other than the payment of £248,000 to Sanguine (see paragraphs 206 – 209, above);

(7) FF&E etc (see paragraphs 216 – 227, above).

233. Payment into the Capital Account does not, in our judgment, qualify for BPRA (see paragraphs 182 – 196, above).

234. However, as we have observed in paragraph 204 above, a proportion of the expenditure on legal fees does also qualify for BPRA. We also find an apportionment of the residual amount/profit to be necessary (see paragraphs 228 – 231, above). As both require further analysis in the light of our conclusions we would hope that these are matters that the parties would be able to resolve between themselves with the option of returning to the Tribunal is they are unable to do so.

Decision

235. For the reasons above, we consider that much, but not all, of the expenditure incurred is "qualifying expenditure" and the LLP entitled to BPRA. The appeal therefore succeeds in part.

Costs

236. Although, the LLP made an applications for costs in October 2018, we directed that this issue would be considered following the release of this decision.

237. Therefore, if so advised, either party may make an application for its costs within 28 days of the release of this decision. The other party will be then have a further 28 days to respond or request an oral hearing to determine the matter to which the party that has applied for its costs will be given a further 14 days to reply. Having had an opportunity to consider the issues raised by any such application we will then come to a decision as to whether the applications are best dealt with on the papers or at an oral hearing and notify the parties accordingly.

Appeal Rights

238. 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.

JOHN BROOKS
TRIBUNAL JUDGE

RELEASE DATE: 28 MARCH 2019