TC04170

Appeal number: TC/2011/05760 & TC/2011/05761

PROCEDURE – application to reinstate appeals that had been withdrawn - application refused

FIRST-TIER TRIBUNAL
TAX CHAMBER

TOWER MCASHBACK 3 LLP **Appellant**

- and -

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

TRIBUNAL: JUDGE GREG SINFIELD

Sitting in public in London on 2 September 2014

Tori Magill and Stephen Brown of Mazars LLP, accountants, for the Appellant

Rebecca Murray, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. This decision concerns an application by the Appellant ("TM 3 LLP") for two appeals that had been withdrawn to be reinstated. For the reasons set out below, I have decided that TM 3 LLP's application should be refused because the appeals have no reasonable prospect of succeeding.

Background

2. For the hearing, I was provided with various documents, including correspondence between the parties and an unsigned witness statement of Mr John Wright who is the current chairman of the TM 3 LLP board. I set out below various matters of fact, which I have taken from the documents, by way of background to the applications.

3. Under an agreement dated 6 July 2004 ("the TM 3 LLP Agreement"), the original founding members of TM 3 LLP were Mr Simon Smith, Mr Stephen Marsden and Mr Paul Feetum. They were the designated members for the purposes of the Limited Liability Partnership Act 2000 and members of the Board of TM 3 LLP.

4. In its partnership tax return for the year ended 5 April 2005, TM 3 LLP claimed first year allowances of £21,283,551 under section 45 of the Capital Allowances Act 2001 ("CAA") in relation to expenditure on software.

5. On 27 September 2006, HMRC opened an enquiry into the return by writing to Mr Smith as the nominated partner for the purposes of the Taxes Management Act 1970 ("TMA"). Throughout the enquiry, Mr Marsden responded to HMRC's correspondence on behalf of TM 3 LLP, always referring to himself as a designated member.

6. In May 2011, the Supreme Court gave its decision in *HMRC v Tower MCashback 1 LLP and Tower MCashback 2 LLP* [2011] UKSC 19 ("*Tower MCashback 1 and 2*"). The Supreme Court decided that only 25% of the amount claimed by those LLPs should be allowable as first year allowances for expenditure on software rights. The Supreme Court held that the balance of the expenditure that the LLPs claimed was not, in any meaningful sense, an incurring of expenditure in the acquisition of software rights.

7. Following the Supreme Court's decision in *Tower MCashback 1 and 2*, HMRC issued a closure notice, dated 28 June 2011, which amended TM 3 LLP's claim for first year allowances on software expenditure from £21,283,551 to £5,320,888, ie 25% of the amount claimed. On 27 July 2011, Mr Marsden sent a notice of appeal in the name of TM 3 LLP appealing against the closure notice to the First-tier Tribunal.

8. In November 2011, HMRC wrote to Mr Marsden proposing a settlement offer in relation to the outstanding appeals. Mr Marsden emailed the members of TM 3

LLP about HMRC's offer. Mr Marsden and Mr Feetum wanted to accept the offer. Mr Smith did not wish to accept the settlement offer and told Mr Marsden.

9. On 27 January 2012, Mr Marsden notified the Tribunal that TM 3 LLP had withdrawn the appeals. Mr Wright, who has been a member of TM 3 LLP since September 2004, states that Mr Marsden acted without the consent of the members of TM 3 LLP when he withdrew the appeals.

10. On 1 February 2012, Mr Marsden emailed Mr Wright to say that if a proposal by Mr Smith to reject the settlement offer had majority support, TM 3 LLP could apply to reinstate the appeals and he, Mr Marsden, would resign.

11. On 10 February 2012, the Tribunal wrote to HMRC to inform them that TM 3 LLP had withdrawn the appeals.

12. On 22 February 2012, the Tribunal received an application from Mr Smith to reinstate TM 3 LLP's appeals. At the time of the application, Mr Smith was a designated member, a member of the Board, and the nominated partner for the purposes of the TMA. The application stated that the reasons for applying to reinstate the appeal were that:

> "… we wish to consider further technical differences between this case and those of the decided case on Tower MCashback 2 in the Supreme Court and also to reinstate the right to access to the alternative dispute resolution process …"

13. On 10 April 2012, the Tribunal wrote to HMRC to inform them that TM 3 LLP had applied to reinstate the appeals. On 19 April, HMRC served a notice of objection to the reinstatement application.

14. On 15 May 2012, the Tribunal listed the application to reinstate for hearing on 8 June and wrote to Mr Marsden to notify TM 3 LLP of the hearing. In a letter dated 18 May 2012 to the Tribunal, Mr Marsden stated:

> "I have received your letter of 15 May 2012 giving notice of Hearing of the two appeals above. You say this follows application made by the Appellant for re-instatement of the appeals.
>
> I write to advise you that no such application for re-instatement was made."

15. On 19 June 2012, Mr Marsden and Mr Feetum were voted off the Board at an Extraordinary General Meeting ("EGM") of TM 3 LLP. On the same day, Mr Marsden and Mr Feetum notified Companies House that they had resigned as designated members of TM 3 LLP. Mr John Wright became one of the two new designated members. Mr Marsden also notified the Tribunal that Mr Smith had authority to act for TM 3 LLP.

16. At another EGM in November 2012, Mr Smith was forced to step down from his position on the Board and ceased to be a designated member of TM 3 LLP

because he was involved in separate legal proceedings taken against the persons responsible for marketing the Tower investment scheme to the members.

Discussion

17. The parties addressed me on the basis that the correct way to approach the application to reinstate the appeals was by considering four agreed issues, namely:

(1) whether Mr Stephen Marsden had standing to withdraw the appeals;

(2) whether Mr Simon Smith had standing to apply for the appeals to be reinstated;

(3) if Mr Smith did not have standing, whether Mr John Wright has such standing now and, if so, whether time should be extended to allow him to apply for the appeals to be reinstated; and

(4) if the appeals are reinstated, whether they should be struck out on the ground that there is no reasonable prospect of them succeeding.

18. I can deal with the first issue quite shortly. It appears to me that there is no doubt that the appeals were withdrawn. Whether or not Mr Marsden had authority to withdraw the appeals on behalf of TM 3 LLP, he had ostensible authority to do so. There was no doubt or ambiguity about the terms of the notification of withdrawal. The Tribunal treated the appeals as withdrawn and neither party suggested that the Tribunal was wrong to do so. In the circumstances of this application, whether Mr Marsden had actual authority to withdraw the appeals is of no consequence. The issue for the Tribunal is not were the appeals properly withdrawn by Mr Marsden but, having treated the appeals as withdrawn, should the Tribunal grant the application for them to be reinstated.

19. Rule 17 of the Tribunal Procedure (First-tier Tribunal) (General Regulatory Chamber) Rules 2009 ("the FTT Rules") deals with withdrawal and reinstatement. Relevantly, rule 17 provides:

> "(3) A party who has withdrawn their case may apply to the Tribunal for the case to be reinstated.
>
> (4) An application under paragraph (3) must be made in writing and be received by the Tribunal within 28 days after—
>
> (a) the date that the Tribunal received the notice under paragraph (1)(a); or
>
> (b) the date of the hearing at which the case was withdrawn orally under paragraph (1)(b)."

20. An application to reinstate the appeals was made by Mr Smith within the time limit in February 2012 and, after an unfortunate delay, notified to HMRC in April 2012. In the notice of objection served on 19 April, HMRC objected to the application's two grounds but did not object to the fact that it was notified by Mr Smith.

21. Ms Murray, who appeared for HMRC, submitted that Mr Smith did not have the authority to bring the appeals on behalf of TM 3 LLP by way of applying for the withdrawn appeals to be reinstated. Her submission was based on the TM 3 LLP Agreement. Clause 6.1.2 provided that a member of the Board could commit the LLP to do or undertake any act. Clause 6.5, however, provided that the LLP would not undertake any actions set out in Schedule 2 without an Extraordinary Resolution. Schedule 2 to the TM 3 LLP Agreement included:

> "8. Commence any litigation or other legal proceedings (other than actions to recover debts in the ordinary course of business)"

22. Ms Murray accepted that Mr Smith was a member of the Board of TM 3 LLP at the time of the reinstatement application but said that there was no evidence of any Extraordinary Resolution at the time of the application. Ms Murray submitted that when an appeal is withdrawn it is treated as terminated and the tax becomes a debt due to HMRC. She contended that reinstating an appeal has the same legal effect as commencing an appeal and that, without an Extraordinary Resolution, Mr Smith was not authorised to bring an appeal on behalf of LLP3 by way of applying for the withdrawn appeals to be reinstated.

23. I do not accept that reinstating an appeal is the same as commencing an appeal. I consider that rule 17 of the FTT Rules shows that reinstatement is intended to be a continuation of the case that was withdrawn. When commencing an appeal, the appellant must lodge a notice of appeal with the Tribunal. No such document is required for an application to reinstate. When an appeal is reinstated, the original notice of appeal and other documents that have already been served are used without having to be served again. That does not suggest to me that the reinstatement should be regarded as a new appeal. I consider that it would also be wrong to describe the application to reinstate the appeals in this case as the commencement of litigation or other legal proceedings when the evidence of Mr Wright, which I accept, indicates that the original application to withdraw the appeals did not have the support of the majority of the members. I consider that an application to reinstate an appeal that has been withdrawn is not the commencement of legal proceedings but a continuation of those proceedings. It follows that an application to reinstate would not require an Extraordinary Resolution under the TM 3 LLP Agreement and that Mr Smith, as a Board Member, had authority to make the application. In those circumstances, it seems to me that the natural description of what Mr Smith sought to do was to revoke the withdrawal and continue the appeals rather than commence new proceedings.

24. In conclusion, I hold that Mr Smith had standing to apply for the appeals to be reinstated in February 2012. That being so, I do not need to decide whether Mr Wright has legal standing to reinstate the appeals and, if so, whether I should grant an extension of time to allow the application to be made after the expiry of the 28 day time limit. I should indicate that, had I decided that Mr Smith did not have standing to make the application, I would have extended time to enable Mr Wright to make the application. In short, it seems to me that, in all the circumstances and applying the overriding objective, the prejudice to TM 3 LLP of not allowing an application to be made would outweigh any prejudice to HMRC who had been aware that some members of TM 3 LLP sought reinstatement of the appeals since April 2012.

25. Although I have decided that Mr Smith had the standing to make an application to reinstate, I must now consider whether such an application should be granted. In considering TM 3 LLP's application, I follow the approach taken by Sir Stephen Oliver QC in the Upper Tribunal in *St Annes Distributors Limited v HMRC* [2010] UKUT 458, at [40]. In that case, the Upper Tribunal held that the appellant had not given a notice of withdrawal under rule 17 of the FTT Rules and, accordingly, there was no need for an application for reinstatement as the appeals had never been withdrawn. In case he was wrong on that point and assuming that a notice of withdrawal had been given, Sir Stephen Oliver considered whether the First-tier Tribunal should have granted the application for reinstatement of the appeals. At [39]-[40], Sir Stephen observed:

> "Rule 17(3) and (4) are there to protect the Appellant who for some reason has, deliberately and in good faith, withdrawn his appeal but, for an acceptable reason … has applied to reinstate the appeal within the 28 day cooling off period. Rule 17 is not a weapon to enable the Tribunal to cull unmeritorious appeals of non-cooperative traders. That may be a subsidiary consideration in refusing the application to reinstate; but it cannot be the principal reason.
>
> The right approach to a rule 17(3) reinstatement application is to proceed on the basis that the Rules give an Appellant who has withdrawn his appeal the right to apply for reinstatement. If the Appellant is using the right to apply for an abusive purpose then the Tribunal may refuse it. It may, for example, be part of a delaying strategy on the part of an appellant to withdraw and then to apply for reinstatement."

26. At [42] of *St Annes*, Sir Stephen held that the application by the director of the appellant in that case was made in good faith and

> "… came within the spirit of rule 17 and the Tribunal's exercise of its power to allow the application to reinstate falls well within the object that rule 17(3) was designed to achieve."

27. Applying the guidance given in *St Annes*, it seems to me that there is a presumption that an application, made in good faith, to reinstate an appeal that had been withdrawn in error or because of a misunderstanding should normally be granted. However, each application must be considered on its facts and the tribunal may exercise its discretion to refuse it, even in cases of innocent error and good faith, in appropriate circumstances.

28. Considering the circumstances of the withdrawal of the appeals in this case and the fact that there is no suggestion that Mr Smith acted other than in good faith, I consider that, in the absence of any other considerations, I should grant TM 3 LLP's application to reinstate. Ms Murray submitted that there are reasons why TM 3 LLP's application should be refused, namely:

(1) the application was made to enable TM 3 LLP to enter into the alternative dispute resolution procedure ("ADR") which is not a valid purpose; and

(2) TM 3 LLP does not have an arguable case.

29. In my view, a desire to enter into ADR with HMRC would not be sufficient, on its own, to justify reinstating an appeal that had been withdrawn but nor is it a reason to refuse to reinstate an appeal. Although the term "alternative dispute" assumes the existence of a dispute to which ADR is an alternative, there is no requirement that there should be a live appeal, or even an appealable decision, before a taxpayer asks HMRC for ADR and no impediment to the parties engaging in the process. The ADR process is entirely separate from the appeal proceedings even though it can have an impact on them. I do not consider that the possibility of ADR is a relevant factor in deciding whether to reinstate an appeal. In this case, I do not regard the fact that TM 3 LLP wishes to enter into ADR with HMRC as a reason not to grant its application for reinstatement of the appeals.

30. I accept Ms Murray's submission that TM 3 LLP's appeals should not be reinstated if they would not have any reasonable prospect of success. As a matter of common sense and applying the overriding objective in the FTT Rules, it would be wrong to reinstate an appeal if there were no reasonable prospect of it succeeding. Even if the appeals had not been withdrawn and there was no need for an application to reinstate, it would be open to the Tribunal, under rule 8 of the FTT Rules on application or of its own motion, to strike out the appeal if the Tribunal considered that there is no reasonable prospect of it succeeding.

31. TM 3 LLP accepted that the facts of its case are not materially different from those in *Tower MCashback 1 and 2*. TM 3 LLP also accepted that it followed from that case that £13,190,121 of the amount originally claimed by TM 3 LLP as first year allowances was not qualifying expenditure incurred on information and communications technology ("ICT") for the purposes of the CAA. However, TM 3 LLP contended that £2,772,542 of the £15,962,663 disallowed by HMRC was qualifying expenditure on the purchase of patent rights under the provisions of Part 8 of the CAA. Ms Magill submitted that TM 3 LLP sought to rely on an argument not considered by the Supreme Court in *Tower MCashback 1 and 2*. She pointed out that *Tower MCashback 1 and 2* was concerned with whether the expenditure was incurred on the software for the purposes of first year allowances for the purposes of the CAA. TM 3 LLP's claim for patent allowances was based on a valuation accepted by the High Court in a related case that concerned an international patent application filed by MCashback Limited ("MCashback") in 2002, *Fanmailuk.com Ltd & Anor v Cooper & Ors* [2010] EWHC 2647 (Ch) ("*Fanmail*"). TM 3 LLP had acquired rights from MCashback under a Software Licence Agreement in February 2004. Ms Magill submitted that *Fanmail* provided sufficient evidence to show that the disputed amount was incurred on patented intangible assets, separate from the software licences that made up the original claim. .

32. Ms Murray submitted that TM 3 LLP had not made any claim for patent allowances in its tax return for the year ended 5 April 2005 or subsequently. She contended that TM 3 LLP could not make a claim now as the deadlines for amending the return or making additional claims following the issue of a closure notice had expired. Ms Murray also contended that TM 3 LLP's claim would be bound to fail in any event as there was no evidence that MCashback had transferred any patent rights to TM 3 LLP under the Software Licence Agreement in 2004. The Schedule to the

Software Licence Agreement showed that, as at February 2004, all patents were either pending or had been refused. Nor was there any evidence in *Fanmail* that patents had been acquired by MCashback. The evidence in *Fanmail* only referred to a patent application. Ms Murray also pointed out that the "valuation" in *Fanmail* related to the value of MCashback's shares in 2007 and was not reliable because there was some evidence (see [30] of the judgment) that the business opportunity was essentially worthless and, in any event, the value of the shares in MCashback was not necessarily the same as the value of the rights granted to TM 3 LLP and the other two LLPs in 2004.

33. At the relevant time, section 3 of the CAA provided that a claim for an allowance under the Act must be made in a tax return. It was not disputed that TM 3 LLP made a claim for capital allowances of £21,283,551 in its partnership tax return for the year ended 5 April 2005. At the time of submitting the return, TM 3 LLP made its claim on the basis that it was entitled to first year allowances for expenditure incurred on ICT. The CAA did not require TM 3 LLP to distinguish between different types of capital allowances claimed. In my view, TM 3 LLP's claim of £21 million in its tax return for the year ended 5 April 2005 was a claim for capital allowances and not a claim for a specific type of capital allowance. Of course, HMRC could (and did) require TM 3 LLP to provide details to justify its claim.

34. TM 3 LLP subsequently conceded that, following the decision of the Supreme Court in *Tower MCashback 1 and 2*, it was not entitled to treat the full amount claimed as first year allowances as expenditure incurred on ICT qualifying as a capital allowance. TM 3 LLP now seeks to claim part of the amount, which it had conceded was not allowable as expenditure incurred on ICT, as a patent allowance. TM 3 LLP submits that it was entitled to a patent allowance as part of its appeal against HMRC's decision to amend its return for the year ended 5 April 2005 to reduce TM 3 LLP's claim for capital allowances. I do not consider that, by submitting that it is entitled to capital allowances on a different basis from that first put forward, TM 3 LLP is making a new claim. If each type of capital allowance had to be the subject of a separate claim then I would expect the CAA to provide that each allowance must be separately identified in the tax return in which it is made. At the relevant time, the CAA only provided, in section 3(2A), that claims for business premises renovation allowances had to be separately identified as such in the return. I conclude that TM 3 LLP is not required to make a new claim specifically for patent allowances but can rely on the claim made in its tax return for the year ended 5 April 2005 for capital allowances generally. It seems to me that, having made a claim for capital allowances on one basis, TM 3 LLP is free to put forward an alternative basis for the claim if it is challenged.

35. A claim for patent allowances could only have a reasonable prospect of success if there were some evidence to support it. Ms Murray submitted that there was no evidence that TM 3 LLP acquired any patent rights under the Software Licence Agreement in 2004 or subsequently. Ms Magill acknowledged that TM 3 LLP could not provide evidence of the existence of the patents. She submitted that the Software Licence Agreement was evidence that TM 3 LLP did not just acquire software but also acquired the right to patents. Section 465(2)(b) CAA provides that expenditure

incurred on obtaining a right to acquire future patent rights (ie a right in relation to a patent that has not been granted) can be treated as expenditure on the purchase of those rights if the person acquires the patent rights subsequently. I was not shown any evidence that TM 3 LLP had acquired any patent rights at any point. The Schedule to the Software Licence Agreement referred to patents that had been either pending or refused, which strongly suggests that there were no patents in existence at that time. Nothing in the *Fanmail* case supported the existence of patents in 2007. Nor was there any evidence that TM 3 LLP had acquired any patent rights subsequently. In the absence of any evidence that it had acquired patent rights under the Software Licence Agreement or subsequently, TM 3 LLP could not establish that it had incurred any expenditure on the purchase of patent rights which would entitle it to claim capital allowances. On the basis of the evidence presented to me, I am not satisfied that TM 3 LLP acquired any patent rights during the tax year 2004-05 or subsequently. Accordingly, I conclude that TM 3 LLP's claim for capital allowances in respect of expenditure on the purchase of patent rights would not have any reasonable prospect of success.

36. In the absence of any evidence that TM 3 LLP ever acquired the patent rights, the question of the valuation of the patent rights does not arise. If the issue had arisen, it seems to me that the *Fanmail* case relied on by TM 3 LLP is, at best, evidence of the value of MCashback and its assets, including the software, rather than the value of any patent rights in the software. Had it been necessary, I would have found that TM 3 LLP's claim that the patent rights had a specific value calculated by reference to the *Fanmail* case would not have any reasonable prospect of success.

Decision

37. For the reasons given above, I have decided that TM 3 LLP's application for its appeals to be reinstated should be refused.

Right to apply for permission to appeal

38. 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.

GREG SINFIELD
TRIBUNAL JUDGE

RELEASE DATE: 5 December 2014