TC03808

Appeal number: TC/2013/06187

CORPORATION TAX – Loss relief – Yacht chartering business carried out on a commercial basis – Whether it was also carried out with a view to the realisation of profits of trade in the accounting periods for the years ended 31 March 2009 and 2010 (as required by s 393A (3) and (4) of the Income and Corporation Taxes Act 1988) and accounting periods for the years ended 31 March 2011 and 2012 (as required by s 44 Corporation Taxes act 2010) – Yes – Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

BEACON ESTATES (CHEPSTOW) LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN BROOKS
MRS NORAH CLARKE

Sitting in public at Caradog House, St Andrews Place, Cardiff on 2 July 2014

David Whiscombe, instructed by Guilfoyle Sage LLP Chartered Accountants, for the Appellant

Simon Foxwell, of HM Revenue and Customs, for the Respondents

DECISION

1. The principal business activities of the appellant, Beacon Estates (Chepstow) Limited (the "Company"), include construction, investing and managing industrial and commercial property. However, an invitation to travel aboard a yacht in the Mediterranean in the mid-1990s gave the director of the Company, Mr Edward Hayward who gave evidence before us, the idea that the purchase of a yacht for chartering could be a profitable diversification for the Company, especially given the then buoyant state of the UK and world economy. He therefore engaged Yacht Brokers International ("YBI"), based on the French Mediterranean coast, to locate a vessel suitable for commercial charters for the Company to acquire on the understanding that should YBI do so the yacht would subsequently be marketed and managed by them on behalf of the Company.

2. After having considered some 30 yachts in various locations throughout the Mediterranean over an 18 month period the Company purchased *Supertoy* in 1998. She is a 92 foot motor yacht with 12 guest berths and a crew of five built in 1993 by the Kha Shing Ets shipyard and crewed throughout the year with three crew retained in the off season (October to April). The yacht is based in the Port Vauban, Antibes, France.

3. The daily charter rate for *Supertoy* is approximately €8,000 with the weekly rate of approximately €35,000 with expenses such as fuel being the responsibility of the customer. Mr Hayward told us that to make a profit it is necessary for *Supertoy* to be chartered for 80 days a year and that he charters the yacht for himself and his wife for two weeks each year at the commercial rate taking two to six other people with them.

4. However, before the Company could make *Supertoy* available for charter it was necessary to upgrade her to full commercial charter status in compliance with French regulations. Therefore despite the vessel being promoted by YBI and a website developed for this purpose the Company made losses of £51,393, £45,114 and £61,059 during the first three years of its chartering activities, its accounting periods ended 31 March 1998, 1999 and 2000 respectively. However, in its subsequent accounting periods, the years ended 31 March 2001 and 2002, the Company made profits of £77,243 and £103,949.

5. In 2003 *Supertoy* suffered what Mr Hayward described as a "catastrophic engine failure" despite her engines having only been used for 500 hours. As the warranty period for engines had passed the German manufacturers refused to remedy the defect and, after further delays, it became apparent that it was necessary to purchase new engines. These cost €134,000 and were fitted by the manufacturer's French agents. However, during subsequent sea trials it became apparent that there were serious vibration problems with the new engines and it was eventually discovered that the wrong type of engines had been fitted. By this time the French agent of the German manufacturers had gone out of business and the Company therefore commenced legal action against the manufacturers through the French Courts.

6. This litigation is currently in progress and to date has cost the Company approximately €350,000. A further hearing in France is due in October 2014.

7. At about the time of the commencement of the litigation the Company was introduced to a Belgian company which was able to rebuild the engines to render them compatible with the design of the yacht. This work took place over a period of six months and was completed in 2008 at a cost of €130,000.

8. During the period between 2003 and 2008, when the engines were out of action, any chartering of *Supertoy* was limited to "static charters", ie the yacht was moored in one place throughout the charter either at Antibes or at nearby Cannes and did not go to sea. Although the Company did manage to achieve some charter income during this time it did not prevent losses amounting to £927,000 being suffered over the period. Once the repairs had been completed the process of marketing *Supertoy* for charters could resume but, given the time the yacht was unavailable for anything other than static charters, this was, as Mr Hayward explained like, "starting from scratch".

9. The Company's difficulties in promoting charters in 2008 were exacerbated by the banking crisis and subsequent global recession which had a devastating effect on the yacht charter market and as a result the Company suffered further losses totalling £1,005,000 between 2009 and 2012. This was despite the appointment of new agents, CSO Yachts, to replace YBI which had ceased trading *in 2008.*

10. Although Mr Hayward said that "all boats are always for sale" and had considered whether *Supertoy* should be sold to "cut the losses" of the Company he did not believe it to be in the bests interests of the Company to sell the yacht but is of the view that as confidence returns to the international economy demand for yacht charters will return which will enable the Company's chartering venture to return to profit. An email produced at the hearing from CSO Yachts to the Company shows that in 2014 *Supertoy* had either been chartered or booked for charter for 40 days, although 16 of these days were bookings made by Mr Hayward.

11. On 4 March 2008 HMRC commenced an enquiry into the Company's accounts for the year ended 31 March 2006 accounts. Although a number of issues were raised the only matter outstanding is the allowability of the losses generated by the yachting activity. Following correspondence and meetings between the parties HMRC issued the following corporation tax assessments:

(1) Accounting period ended 31 March 2009 – Profit £104,923;

(2) Accounting period ended 31 March 2010 – Profit £62,444;

(3) Accounting period ended 31 March 2011 – Profit £143,271; and

(4) Accounting period ended 31 March 2012 – Profit 153,300.

The tax at stake is approximately £122,500 and although the Company had suffered losses as a result of its chartering activities in earlier years these have been accepted as allowable by HMRC.

12. The Company appealed to HMRC against the 2009, 2010 and 2011 assessments on 6 June and the 2012 assessment on 20 June 2013. Its Notice of Appeal against all assessments was sent to the Tribunal on 29 August 2013.

Law

13. Insofar as it applies to the present case, s 393A(3) and (4) of the Income and Corporation Taxes Act 1988 ("ICTA") provides:

> (3) …. a loss incurred in a trade in any accounting period shall not be relieved under [sub-s (1) of 393A)] unless–
>
> (a) …
>
> (b) for that accounting period the trade was being carried on on a commercial basis and with a view to the realisation of gain in the trade.
>
> … .
>
> …
>
> (4) For the purposes of subsection (3) above–
>
> (a) where at any time a trade is carried on so as to afford a reasonable expectation of gain, it shall be treated as being carried on at that time with a view to the realisation of gain.

14. These provisions were considered by the Tribunal (Judge Walters QC and Ms Folorunoso) in *Glapwell Football Club Ltd v HMRC* [2013] UKFTT 516 (TC) as follows:

> "66. … it was argued by HMRC that the appeals ought to be dismissed because there was no reasonable expectation of gain in the trade carried on by GFC at any relevant time, that is, at the end of GFC's February 2008 Period and in GFC's September 2008 Period and GFC's 2009 Period.
>
> 67. That argument addresses the test set out in section 393A(4)(a) ICTA, where it is stated that, for the purposes of section 393A(3), where at any time a trade is carried on so as to afford a reasonable expectation of gain, it shall be treated as being carried on at that time with a view to the realisation of gain.
>
> 68. The argument does not however address the question directly posed by section 393A(3) – if it is a different question – namely, whether the trade was being carried on with a view to the realisation of gain in the trade.
>
> 69. That would be a different question if the view was taken – as a matter of interpretation – that section 393A(4)(a) added a further test for the relief of losses to that provided by section 393A(3), namely that even if a trade was *not* being carried on with a view to the realisation of gain in the trade, losses could be relieved if it was being carried on so as to afford a reasonable expectation of gain.
>
> 70. Considering only the statutory language, we regard this as a tenable interpretation, so that there would be two routes to the relief of losses,

> the first being that a company's trade was actually being carried on with a view to the realisation of gain – which would be a matter of establishing the subjective intentions of the directors, and the second being that the trade was being carried on so as to afford a reasonable expectation of gain – which would be a matter of establishing the objective circumstances in which the trade was being carried on.
>
> 71. However, the result of such an interpretation would be that losses would be relieved if a trade was not (objectively) being carried on so as to afford a reasonable expectation of gain, provided that it was (subjectively) being carried on with a view to the realisation of gain in the trade. On the whole, we regard this as being a perverse result and probably not in accordance with the intention of Parliament when the legislation was enacted. Construing the legislation purposively, we disregard it.
>
> 72. We prefer the interpretation, effectively that addressed by HMRC's submissions, that section 393A(4)(a) applies to clarify the test in section 393A(3)(b), so that the test there stated – 'carried on with a view to the realisation of gain in the trade' – means 'carried on so as to afford a reasonable expectation of gain in the trade'.
>
> 73. ….
>
> 74. Another point which occurs to us on the statutory language, which was not addressed at any length by the parties in submissions, is the evident requirement that a gain of which there is, for the purposes of section 393A(4)(a) ICTA, a reasonable expectation, must be a gain in the same trade as the trade in which the losses, which are sought to be relieved, have been incurred."

15. In *MacDonald (Inspector of Taxes) v Dextra Accessories Ltd and others* [2005] STC 1111, the House Lords considered the interpretation of s 43(11)(a) Finance Act 1989 which extended the rule on non-deductibility to "potential emoluments" which were defined as "amounts or benefits … held … with a view to their becoming relevant emoluments". Lord Hoffman (with whom Lords Nicholls, Hope, Scott and Walker agreed) said, in relation to "with a view":

> "13. "The Special Commissioners (Dr John F Avery Jones and Edward Sadler) [2002] STC (SCD) 413 rejected the Revenue's argument. They said that funds were held "with a view to becoming relevant emoluments" only if the purpose of the contributing company was that they should be used to pay emoluments. In this case, the terms of the trust deed showed that the contributing companies had other purposes as well.
>
> 14. On appeal, Neuberger J [2003] EWHC 872 (Ch); [2003] STC 749 upheld the Special Commissioners. He did not agree that the purpose for which the companies made the payments was decisive. The question was whether they were held by the intermediary, the trustee, with a view to becoming relevant emoluments. That depended primarily upon the terms of the trust, read against the surrounding circumstances, rather than the purposes of the contributors. Nor did he agree that the exclusive purpose had to be the payment of emoluments.

> But he said that it had to be the principal or dominant intention of the trust. On the facts, the trust deed did not demonstrate such an intention.
>
> 15. The Court of Appeal (Potter and Jonathan Parker LJJ and Charles J) [2004] EWCA Civ 22; [2004] STC 339 accepted the submissions of the Revenue and allowed the appeal. Jonathan Parker LJ said, first, that if Parliament had intended that the funds should be held, as the Special Commissioners thought, *for the sole purpose* of paying emoluments, or as Neuberger J thought, *with the principal or dominant intention* of paying emoluments, Parliament would no doubt have used such expressions, which are by no means unfamiliar in tax legislation. Furthermore, the notion of the trustees having an intention, dominant or otherwise, in respect of the use of the fund in advance of an occasion to exercise their discretionary powers would be artificial and possibly unlawful. Their only intention would be to act (if at all) within the powers conferred by the deed. So the question must be answered solely by reference to the terms of the deed, construed no doubt in the light of any relevant background.
>
> 16. Secondly, Jonathan Parker LJ pointed out that the subsection is concerned with what may happen in the future, rather than (as in some other statutes which used the expression "with a view to") an examination of the reasons, motives or purposes with which some action was done in the past. That element of futurity, combined with the statutory label "potential" emoluments, suggested that Parliament was concerned simply with what might realistically happen.
>
> 17. The Court of Appeal therefore decided that the funds were held with a view to becoming relevant emoluments if they were held on terms which allowed a realistic possibility that they would become relevant emoluments.
>
> 18. I agree with the Court of Appeal, largely for the reasons given by Jonathan Parker LJ. …"

16. Following the tax law re-write project, legislation relating to corporation tax was consolidated in the Corporation Tax Act 2010 ("CTA") albeit with the replacement of what was perceived to be archaic language and impenetrable terminology with its modern equivalents. However, despite the different language, as consolidating legislation, the CTA does not change to law.

17. Section 44 CTA, which applies for accounting periods ended after 1 April 2010, provides:

> (1) Relief under section 37 [relief for trade losses against total profits] is not available for a loss made in a trade unless for the loss-making period (see section 37(3)(a)) the trade is carried on—
>
> (a) on a commercial basis, and
>
> (b) with a view to the making of a profit in the trade or so as to afford a reasonable expectation of making such a profit.

18. In the present case s 393A ICTA applies to the accounting periods ended 31 March 2009 and 2010 and s 44 CTA to the accounting periods ended 31 March 2011 and 2012.

Issue

19. HMRC accept that in this case the Company did carry on the yacht chartering business on a commercial basis between 1 April 2008 and 31 March 2012.

20. Therefore, the issue for us to determine is whether this business was undertaken with a view to making a profit or so as to afford a reasonable expectation of making such a profit so that any loss arising as a result of the chartering activities will be available for relief against profits arising from the other trading activities of the Company during this period.

Submissions

21. Mr Whiscombe, for the Company, submitted that the legislation envisaged a two part test, namely that the trade must either subjectively be carried on with a view to making a profit or objectively carried on so as to afford the reasonable expectation of making a profit.

22. Although such an approach had been described by the Tribunal in *Glapwell* as a "tenable interpretation" of s 393A ICTA it went on to reject such an interpretation, at [71], as "perverse". However, Mr Whiscombe contended that by conflating these alternative tests the Tribunal in *Glapwell* had wrongly interpreted the legislation and, as such should not be followed. He submitted that this was clear from s 44 of the CTA which, as a consolidating Act, did not change the law but provides for relief of losses where the trade is carried on "with a view to the making of a profit in the trade **or** so as to afford a reasonable expectation of making such a profit" (emphasis added) which clearly envisaged two tests, if this were not the case he submitted "and" rather than "or" would have been used in the section.

23. Given that the legislation before the House of Lords in *Dextra*, like that before us in the present case, concerned what may happen in the future Mr Whiscombe suggested that it was appropriate for us to adopt the same approach and interpret "with a view" to mean "allow a realistic possibility" or "what might realistically happen". If so he contended that, despite its earlier losses which could be explained by the engine failure, the time taken for repairs, the ongoing litigation with the engine manufacturers not to mention the economic crisis of 2008 and subsequent global recession, the Company did have a realistic possibility of making a profit in the yacht chartering trade. Alternatively it had a reasonable expectation of making such a profit and emphasised that the legislation did not impose a time limit by which the Company was required to make the trade profitable.

24. Mr Foxwell, for HMRC, accepted that there was no time limit for the trade to return a profit but, applying the interpretation of the legislation as in in *Glapwell* which he submitted was correct, contended that in the present case the Company did

not carry out its chartering activities so as to afford a reasonable expectation of the realisation of a gain or profit in the trade.

25. In support of his submission Mr Foxwell emphasised the losses suffered by the Company as a result of its chartering activities and submitted that had this not been supported by the Company's other business interests but been operated as a stand-alone business it would have failed. In the circumstances he submitted that the Company could only have a reasonable expectation of the realisation of a gain or profit in the trade if it relied on the following unreasonable assumptions:

(1) That *Supertoy* would require no further maintenance or upgrading;

(2) That there would be a large increase in customers willing to charter the yacht in the busy market given the age of the vessel; and

(3) That there would be no further unexpected economic shocks such as the 2008 banking crisis and subsequent global recession.

Discussion and Conclusion

26. Like the Tribunal in *Glapwell* we first consider the interpretation of the legislation before analysing the evidence facts of the case and, as in *Glapwell* find the two part construction advanced by Mr Whiscombe to be a "tenable interpretation" of the statutory language. However, we share the concerns expressed at [71] of *Glapwell* that:

> "… the result of such an interpretation would be that losses would be relieved if a trade was not (objectively) being carried on so as to afford a reasonable expectation of gain, provided that it was (subjectively) being carried on with a view to the realisation of gain in the trade."

Although the Tribunal rejected this interpretation of s 393A(3) ICTA as "perverse result", the observations of the House of Lords in relation to the expression "with a view" in *Dextra*, or indeed any other authority, were not brought to its attention.

27. As Mr Whiscombe submitted the legislation considered by the House of Lords in *Dextra*, s 43(11)(a) Finance Act 1989, like s 393A(3) ICTA and s 44 CTA is concerned with something that may happen in the future and we agree with him that it is appropriate for same approach to be applied in the present case so that "with a view" should be interpreted to mean "allow a realistic possibility" or "what might realistically happen." In our judgment such an approach imports an objective element into whether the trade was carried on "with a view" to the realisation of gain or making a profit in the trade, something recognised by Mr Whiscombe who accepted that the "view" in question must be a reasonable one.

28. Therefore, although we consider that carried on "with a view" in the legislation should be construed as meaning "with a realistic possibility" to the realisation of gain (s 393A(3)(b) ICTA) or making a profit (s 44(1)(b) CTA) in the trade the result is similar to the "objective test" interpretation of s 393A(3)(b) ICTA by the Tribunal in *Glapwell*, at [72] (see above).

29. Before applying this test to the facts of the present case we note that the legislation does not impose any time limit for a profit to be achieved by the trade. Neither does the legislation require any profit to be sufficient to recover the losses made, only that there is a realistic possibility or reasonable expectation of a profit or gain being made.

30. In the present case the Company engaged agents, YBI to find a suitable vessel for chartering and, once *Supertoy* had been acquired and upgraded to full commercial charter status in compliance with French regulations, market and manage her for chartering. When YBI failed new agents, CSO Yachts, were engaged for this purpose. Given the need to comply with French regulations and the requirement to be always available and near at hand in relation to any issues that may arise as a result of a charter we consider the appointment of Mediterranean charter agents, rather than a hands-on approach by the Company, to make commercial sense. Clearly, as HMRC accept, this is a business carried on a commercial basis.

31. While there is no doubt that the chartering activities of the Company did incur significant losses both before and during the periods with which we are concerned, which may have caused a stand-alone yacht chartering business to fail, we find that there are reasonable explanations for these losses which include the re-fitting of the yacht to bring her up to the requisite standard for commercial chartering, the "catastrophic" engine failure and subsequent problems arising as a result including the ongoing litigation and the effect of the banking crisis of 2008 and worldwide recession on the Mediterranean yacht chartering market.

32. However, the issue posed by the legislation does not require us to consider previous losses but whether there is a realistic possibility or reasonable expectation of the Company making a profit or gain from its chartering activities in the future. After careful consideration, we have come to the conclusion that there is. Charters have been agreed for 2014 and the yacht, which meets the regulations for commercial motor yachts, is marketed and managed through professional charter agents.

33. For these reasons the appeal is allowed

Right to Apply for Permission to Appeal

34. 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: 16 July 2014