SLAUGHTER AND MAY/

CLIENT BRIEFING

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TAX AND THE CITY REVIEW

Draft legislation to enact the EU-derived exemption from stamp taxes on the issuance and transfer of securities to a clearance service or depositary receipt issuer in certain circumstances is less generous than the current exemption. The FTT's decision in *Wilkinson* shows that the delineation of the scheme or arrangement and how the relevant exchange relates to it is crucial to the application of the purpose test in the capital gains tax reorganisation rules. The UT in *Scottish Power* looks at the payments (made following regulatory breaches) as a whole and concludes that the FTT was wrong to single out part of the package as compensatory: all of it was punitive and therefore non-deductible. HMRC launches a pilot 'Accelerated Routes Process' for eligible transfer pricing and diverted profits tax cases over 36 months old which is open for applications until 1 December 2023.

1.5% season ticket charge: effect of CJEU case law mostly preserved

Pursuant to the *HSBC* line of CJEU case law, HMRC accepted in published guidance (STSM053010) that the 1.5% stamp duty or SDRT charges on transfers to depositary receipt issuers and clearance service providers had to be disapplied where the transfer was integral to a capital raising. HMRC confirmed this would continue even after the end of the Brexit transition period because the direct effect of the Capital Duties Directive had been confirmed by the First-tier Tribunal in *HSBC and Bank of New York Mellon* [2012] UKFTT 163 (TC) before Exit Day.

There were concerns, however, that the Retained EU Law (Revocation and Reform) Act 2023 would have had the effect of re-introducing these 1.5% charges on capital raisings from the start of 2024. To address these concerns, draft legislation was published for consultation until 12 October for inclusion in the next Finance Bill to amend the relevant stamp duty and SDRT legislation to remove the charge on share issues and certain transfers with effect from 1 January 2024. For stamp duty purposes, the new legislation would apply to instruments executed on or after 1 January 2024; for SDRT purposes, it would apply to transfers or issues on or after 1 January 2024.

This timing leaves us with a tricky intermediate period between 1 January 2024 and the date of Royal Assent to the Finance Bill in which this legislation is included (assuming that is after 1 January 2024 which seems likely). During this period, the charge would technically apply, although it may subsequently be vacated with retroactive effect. It remains to be seen whether HMRC will accept non-payment in that period (and if so, on what basis), or whether the tax will have to be paid and then claimed back, and what it means for clearances and legal opinions which have to be given in the gap!

However, it looks like there will still be a change of law at the end of the year as the draft legislation does not completely maintain the status quo. As the CJEU held in *Air Berlin* Case C-573/16, the prohibitions in the Capital Duties Directive go beyond prohibiting taxing share issues and transfers for the purpose of raising new capital. They include, inter alia, prohibiting taxing the listing of shares on a stock exchange. As the CJEU held, the provisions of the Directive preclude taxing transactions 'whereby the legal title to all the shares of a company has been transferred to a clearance service for the sole purpose of listing those shares on a stock exchange, without there being any change in the beneficial ownership of those shares'.

Wilkinson: purpose test in capital gains tax reorganisation rules

Where certain conditions are met, reorganisation treatment under TCGA 1992, section 135 applies to an exchange, for example, of loan notes for shares. The effect of this is that the loan notes are treated as the same assets, acquired at the same time, and for the same amount, as the shares. Instead of a capital gains tax charge on the exchange, any latent gain in the shares is rolled over into the loan notes.

In *Wilkinson v HMRC* [2023] UKFTT 695 (TC), the First-tier Tribunal (FTT) had to consider whether the exchange of shares for loan notes formed 'part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax'. If it did, as HMRC argued, section 137 would prevent the reorganisation treatment from applying and further CGT of approximately £1.9m would be payable by the daughters.

In summary, the shareholders of a logistics company, five individuals, decided to dispose of the company to a third party for around £130 million in cash and loan notes. Two of these individuals, Mr and Mrs Wilkinson, owned 58% of the company between them. They undertook some capital gains tax planning to make use of the entrepreneurs' relief lifetime allowance (which was £10 million at the time) of each of their three daughters.

The planning involved transferring some of Mr and Mrs Wilkinson's shares in the target to their daughters before the transaction. The purchaser's cooperation was required in order to ensure that the daughters could meet the conditions for entrepreneurs' relief in respect of the loan notes to be issued to them as consideration for the sale of their target shares. Crucially, the planning could only work if reorganisation treatment applied on the exchange of their shares in the target for loan notes issued by the purchaser.

The FTT concluded that the exchange did not form part of the Wilkinson's tax planning. The exchange was clearly part of a different, larger arrangement involving some shareholders who had no part or interest in the Wilkinson's' tax planning: the disposal of the target to a third party. The FTT considered that the tax planning was bound up in that larger arrangement, so it did not exist as a separate scheme of which the exchange could form part. Alternatively, the FTT considered that, even if the tax planning was a scheme in its own right, the exchange did not form part of it because the exchange was wider than the scheme. In particular, the Tribunal cautioned against regarding an earlier case (*Snell*) as authority that, if part of an exchange forms part of a scheme, the whole exchange should be regarded as forming part of that scheme.

The FTT considered it wrong to posit part-related, subsidiary schemes where there was one clear arrangement (such as the third-party acquisition here) to which the exchange related.

Having decided that the exchange formed part of a scheme constituted of the third-party acquisition, the FTT went on to consider whether that 'scheme' had a main tax avoidance purpose. It is unsurprising that the Tribunal concluded that it did not. It took into account the size of the tax saving as compared to the deal value and what Mr and Mrs Wilkinson stood to receive, and the fact that there was no legal obligation on the purchaser to cooperate in obtaining the tax saving (although it had done so) and that Mr Wilkinson would not have jeopardised the deal for the tax saving.

Overall, the case serves as a reminder that the delineation of the scheme or arrangement is crucial to the application of the purpose test in the capital gains tax reorganisation rules. In this case, the FTT took a realistic view of the facts to conclude that the CGT planning was not a self-standing scheme or arrangements separable from the deal as a whole.

Scottish Power: deductibility of payments in connection with regulatory breaches

Scottish Power Ltd and others v HMRC [2023] UKUT 218 (TC) concerned the deductibility in computing trading profits of payments made in connection with four investigations by the energy regulator, Ofgem, into regulatory breaches by the taxpayers which carried on energy supply business. Each investigation resulted in a settlement comprising a number of redress payments to consumers, consumer groups and charities and a nominal £1 financial penalty. Across all the settlements the payments totalled around £28m. The FTT had concluded that had the taxpayers not made the settlement agreements, it was likely that penalties of at least the same amount would have been imposed.

The FTT had applied the principles derived from the House of Lords in *McKnight v Sheppard* [1999] STC 669 (that, as a matter of public policy, punitive payments are not deductible) to most of the payments but had concluded that payments of around £0.5m made directly to customers affected by mis-selling were compensatory, not punitive, and were wholly and exclusively for the purposes of the taxpayers' trade and so were deductible. The taxpayers appealed that more of the payments should be deductible and HMRC cross-appealed that none of the payments were deductible.

The Upper Tribunal (UT) looked at the payments as a whole and concluded that the FTT was wrong to single out part of that package as compensatory when all of it was punitive and therefore non-deductible. The overall package had been put together under the threat of a penalty and was paid in lieu of a penalty. The UT accordingly remade the FTT's decision with the result that all of the payments were non-deductible.

Deductibility for banks' compensation payments was, of course, turned off by statute (CTA 2009, s133A) in 2015. Indeed, Counsel for the taxpayers in *Scottish Power* argued that the implication of this measure being necessary is that banking consumer redress payments would otherwise be considered deductible. The UT disagreed, reasoning that the enactment of s133A does not preclude the possibility that such payments might have been non-deductible under the approach of *McKnight* anyway. It would depend on the circumstances in which they were paid. But the March 2015 HMT paper '[Restricting tax relief for banks' compensation expenditure](#)' certainly started from the premise that such redress payments were in the main deductible: 'These payments are generally treated as deductible expenses for corporation tax purposes, reflecting the fact that these payments are non-punitive and often the straightforward reimbursement of income upon which businesses have already been taxed'.

As the UT had concluded all the payments were punitive in nature, the question of whether they were wholly and exclusively for the purposes of the trade was not addressed, but HMRC has reserved the right to take this point if an appeal went further to the Supreme Court.

The question of deductibility is fact specific but payments in connection with regulatory breaches will often be part of a package and so, following this case, even if elements

are, when you drill down to them, more compensatory than punitive, the Tribunal's assessment is less granular than that. An overall characterisation of the payments as punitive, for example (as was the case here) if the payments had not been made a financial penalty would have been imposed instead, will be fatal.

Disputes: Accelerated routes pilot and new Code of Governance

Stemming from the review of administration for large business, on 29 September HMRC launched a pilot Accelerated Routes Process for eligible transfer pricing (TP) and diverted profits tax (DPT) cases over 36 months old. An application can be made in such cases to enter the pilot up to 1 December 2023. According to the article by Nicole Newbury *('HMRC's evolving approach to tax compliance for the largest businesses'* in Tax Journal, 8 September 2023), HMRC plans to expand the policy more widely if successful.

By making an application, the taxpayer (or 'customer') and its representatives must be adequately resourced to achieve the desired acceleration as this will require the customer to commit to the mutually agreed actions and acceleration deliverables within an agreed action plan.

Earlier in September, HMRC published an updated version of the Code of Governance for Resolving Tax Disputes (last updated in October 2017) 'to provide greater clarity and transparency, including a link to remits for its dispute resolution boards'. The updated code of governance outlines HMRC's approach to resolving tax disputes, including the department's litigation and settlement strategy and alternative dispute resolution.

What to look out for:

- **On 18/19 October the Court of Appeal is scheduled to hear the appeal in the *Euromoney* case on whether an exchange of shares forms part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to corporation tax for the purposes of section 137 TCGA. It will be interesting to see what the Court of Appeal makes of the *Wilkinson* decision.**
- **On 27 September, HMRC published a revised version of the draft legislation for inclusion in the next Finance Bill titled 'Multinational top-up tax: adoption of the undertaxed profits rule and other amendments', amending the multinational top-up tax and domestic top-up tax rules in the Finance (No 2) Act 2023. Comments on the revised draft legislation, which includes two new safe harbours, are invited by 25 October 2023.**
- **Between 6-8 November the Upper Tribunal is scheduled to hear the appeal in *Marlborough DP Ltd v HMRC* on a remuneration trust scheme.**
- **On 9 November the Court of Appeal is scheduled to hear the appeal in the Mr and Mrs Pickles case on the interpretation of "market value" and "new consideration" in s1020 CTA 2010 and the correct approach to determining the market value of the benefit received by the taxpayers.**

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