Tax and the City Review

The UT in *Altrad Services Limited* decides that a disclosed arrangement intended to deliver capital allowances in respect of 'magical' expenditure survived HMRC's *Ramsay* challenge. The UT in *BlackRock* allows HMRC's appeal on transfer pricing and, although not necessary to determine the appeal, finds that all of the debits were attributable to the unallowable purpose and none to the commercial purpose. HMRC's appeal to the UT in the *Euromoney* case fails as the UT agrees with the decision of the FTT on the application of the purpose test in TCGA 1992 s137. Recent cases show that it is currently taking nearly a year for determination of applications to appeal to the Supreme Court.

Altrad: statutory interpretation

On the face of it, the taxpayer's victory in the case of *Altrad Services Limited v HMRC* [2022] UKUT 185 (TCC) may appear surprising. The case involves an artificial series of transactions (duly disclosed under DOTAS) which the First-tier Tribunal (FTT) found to be devoid of business purpose and which were effected just to achieve a 'magical' uplift in qualifying expenditure for capital allowances purposes. HMRC was successful before the FTT in arguing that the scheme failed based on the *Ramsay* line of cases but the Upper Tribunal (UT) allowed the taxpayers' appeal criticising both the way the FTT applied the two-step *Ramsay* approach (whether the facts, viewed realistically, answer the statutory description, interpreted purposively) and the way HMRC formulated the *Ramsay* argument.

The success of the scheme depended on a sale of assets being a disposal event under CAA 2001 s61(1)(a), even though the assets were immediately leased back and ownership was regained after a few weeks by exercise of a put option. The UT found that the FTT had viewed the facts realistically but failed to interpret the legislation purposively. The UT concluded that construed purposively, section 61(1)(a) operated by reference to a snapshot in time asking whether the taxpayer had lost legal and beneficial ownership of the assets, and on the facts, even when viewed realistically, it had.

Although the UT hinted that there was a way that HMRC could have put their *Ramsay* argument which would have resulted in them winning, it did not do the work for them. An invitation to appeal if ever there was one!

BlackRock: transfer pricing and unallowable purpose

There was much anticipation of the UT's decision in *HMRC v BlackRock Holdco 5, LLC* [2022] UKUT 199 (TCC) as the issues included both transfer pricing and the loan relationships unallowable purpose rule. The UT determined the case in HMRC's favour on the transfer pricing point but also considered the unallowable purpose issue. The structure involved LLC5, the UK resident taxpayer, effectively borrowing $4bn from its US resident parent company, LLC4, to acquire preference shares in another US resident company, LLC6. LLC6 used the proceeds from the preference share subscription to acquire BGI US. LLC4 owned most of the common stock in LLC6 and controlled it (having 90% of the vote directly and 10% indirectly via LLC5).

Transfer pricing

Before the FTT it was agreed that an independent arm's length lender would not lend $4bn to LLC5 on the terms that LLC4 did, rather it would require covenants from LLC4, LLC6 and BGI US to ensure that the anticipated flow of dividends on the preference shares would materialise. The debate before the FTT was effectively whether such covenants would be given at arm's length and the FTT concluded that they would.

HMRC had five grounds of appeal on the transfer pricing issue before the UT, but the most important of these is the first and is one that HMRC had not relied on before the FTT but no objection had been made by the taxpayer to HMRC pursuing it. This ground was that the hypothetical arm's length loan cannot take into account covenants from third parties which did not, in fact, exist.

The key risk for a lender to LLC5 was the fact that LLC5 had no control over the dividend flow. This was not a risk for LLC4, the actual lender, because it had control of LLC6 and therefore did control the dividend flow. The taxpayer argued that the covenants did not alter the substantive provision because they simply ensure that the hypothetical lender would be taking the same risks as LLC4. The UT agreed with HMRC, however, that the covenants did materially alter the relevant characteristics of the transaction and meant the FTT was essentially comparing a different transaction to the actual one. The provision of covenants went to the substance of the transaction, altering the relevant risks and economic characteristics.

Which leads, as the UT itself noted, to the somewhat odd outcome that 'LLC5 would not have been challenged if it had gone through the rather artificial exercise in the actual transaction of having covenants in place with LLC4 and LLC6 and BGI and so on'. The group did not do that, because they did not need to. But if they had, because covenants are not guarantees, they would not have been ignored under TIOPA 2010 s152(5) and could have been taken into account in the hypothetical transaction.

It will be interesting to see if BlackRock appeals to the Court of Appeal on this point. There is certainly an argument that a distinction should be drawn between taking into account (a) covenants or other arrangements which have not been put in place in an intra-group situation because, as the UT acknowledges, they would be artificial and unnecessary, but merely go to ensuring that the borrower's assets are worth what both the borrower and the actual lender think they are worth, in a way that could be relied on by an independent lender, and (b) an arrangement which uses assets from outside the borrowing unit to support the loan which clearly should be ignored in the hypothetical scenario.

It seems rather odd here that the UT decided not to remit the transfer pricing issue back to the FTT but to re-make the decision itself, seemingly on the basis that the arm's length provision was no loan at all. After all, the FTT had been asked whether, if the parties would not have entered into the loans on the same terms and in the same amounts if they had been independent enterprises, they would have entered into any loans at all and, if so, what amounts and at what rate of interest and on what other terms. However, the FTT did not appear to make any findings on this given its conclusion on the covenant issue.

Unallowable purpose

Although the UT's decision on the unallowable purpose issue was, in its own words, 'immaterial to the outcome' it will no doubt inform arguments in other cases, including the *Kwik-Fit* hearing before the UT later this month. The FTT had found there were two main purposes of LLC5 borrowing the $4bn: a commercial main purpose of making and managing passive investments and a tax advantage main purpose of getting interest deductions for the group. The UT agreed, but the reasoning for finding an unallowable purpose differs as does the approach to just and reasonable apportionment between purposes.

It is welcome that the UT considered that the FTT was wrong to hold LLC5 had an unconscious unallowable purpose on the basis that an 'inevitable and inextricable consequence' was a purpose. The UT confirmed that the only relevant principles were those derived from *Travel Document Service v HMRC [2018] EWCA Civ 549*, a Court of Appeal case on point. Otherwise, it would seemingly mean that anyone who borrowed money aware that interest was tax deductible would then find they had an unallowable purpose. This only got the taxpayer so far, however, as the UT was not satisfied there was any material error in the finding that LLC5 had a tax advantage purpose.

Although it was necessary to look at the subjective purposes of the directors, this went beyond their stated intentions. The UT considered there was 'ample evidence' to support the finding that securing a tax advantage for the Group (which is a tax advantage to LLC5) was a main purpose of the creation of LLC5 and thereafter, its intention and purpose in entering into the loans. These purposes were subjectively held by LLC5, even if the directors were told to disregard them in considering their approval to entering into the loans.

The UT looked at the evidence before the FTT of the group tax planning, EY's involvement and the fact that debt was pushed down to the UK because of the UK's 'generous tax regime for interest deductions'. The evidence showed that the group would not have used an acquisition structure with a UK resident LLC in the absence of the UK tax benefits of doing so. The awareness of this by LLC5 when entering into the loans is crucial to the UT's finding that the FTT did not make a material error in law in finding that LLC5 had an unallowable tax advantage purpose because, on the evidence, it was a subjective, albeit not stated, purpose of the directors to obtain the tax advantage.

The awareness means this is not a case of usurping the board, or attributing someone else's purpose to LLC5. Rather it is saying that because the directors were fully aware of the role LLC5 was being asked to play, to secure the tax deduction, that was a subjective purpose of theirs, and hence LLC5's, in being part to the loan.

Having found that LLC5 had both a main commercial purpose and a main unallowable purpose, the FTT had to allocate the debits between the two on a just and reasonable basis. The FTT, purportedly applying the obiter approach from *Oxford Instruments UK 2013 Ltd v HMRC* [2019] UKFTT 254 (TC), apportioned them all to the commercial purpose. This was on the basis that the tax avoidance purpose had not increased the debits seemingly because according to the witness evidence if the tax deduction had been withdrawn immediately before the transaction, it would still have proceeded.

The UT concluded that the FTT erred in applying a subjective test. What *Travel Document Service* shows, according to the UT, is that the question of whether a company has a tax avoidance purpose is to be determined subjectively by reference to the intentions of the directors (primarily) but once that has been done the apportionment is purely an objective exercise. The correct approach is to determine whether the reason the debits existed was in order to obtain a tax advantage on the basis of an objective consideration of all of the relevant facts and circumstances. Had the FTT had been applying the *Oxford Instruments* approach correctly, it would have asked if the loan would have existed at all if the benefit of the tax relief had never existed. The answer to that objectively is 'no'.

Euromoney: purpose test in TCGA 1992 s137

The UT found in favour of the taxpayer in *HMRC v Euromoney* [2022] UKUT 205 (TCC) on the application of the purpose test in TCGA 1992 s137. The case involved a third party acquisition where the substantial shareholding exemption ('SSE') was unavailable to the seller. After a cash and share deal had been agreed on, the tax director on the seller side advised that the cash element be replaced with a preference share issue. This was intended to prevent a tax charge on the cash element through the application of reorganisation treatment on the sale, and SSE becoming available in respect of a later redemption or disposal of the preferences shares.

HMRC challenged this under TCGA 1992 s137 on the basis that the share-for-share exchange formed part of a scheme or arrangements a main purpose of which was the avoidance of a liability to corporation tax. The parties agreed that the 'exchange' for these purposes was the whole deal: both the originally agreed share consideration and the preference share issue that replaced the cash element. So if the taxpayer had lost the case, reorganisation treatment would have been denied for the entire exchange costing Euromoney £7.7 million in tax instead of saving £2.8 million as intended.

Fortunately for Euromoney, the UT upheld the FTT's decision in its favour. Whether or not the exchange formed part of a scheme or arrangements and the identification of the purpose of such scheme or arrangements were questions of fact to be determined by the FTT. The UT affirmed the FTT's determination that the relevant arrangements for the s137 test included the whole deal rather than, as HMRC had argued, only the preference share issue. The UT also confirmed that, in determining the purpose of the arrangements, the FTT had been entitled to take into account the size of the tax saving relative to the deal, and the fact that Euromoney had not even considered the potential downside and spent comparatively little time and expense on the preference share issue element of the deal.

Delays in obtaining decisions on permission to appeal to Supreme Court

A couple of recent cases caught our eye for taking nearly a year for permission to appeal to the Supreme Court to be granted or refused. The first is the appeal from the decision in *Target Group Limited v HMRC* [2021] EWCA Civ 1043 on the VAT treatment of loan management services. The Supreme Court has now given Target permission to appeal, on every point other than the argument that, post-Brexit, the UK courts should be prepared to depart from the CJEU jurisprudence in this area. The second is the appeal from the decision in *Bostan Khan v HMRC* [2021] EWCA Civ 624 on statutory construction. The Supreme Court has refused permission to appeal so the Court of Appeal's judgment in favour of HMRC is now final.

What to look out for:

- The consultation on codifying the regime and narrowing the direct tax exemption for sovereign investors closes on 12 September.
- The public consultation meeting on Amount A of Pillar One of international tax reform takes place on 12 September.
- The consultation on the draft Finance Bill 2023 provisions closes on 14 September.
- On 15-16 September, the UT will hear the appeals from both sides against the FTT's decision in *Kwik-Fit Group Ltd v HMRC* [2021] UKFTT 283 (TC) on the loan relationships unallowable purpose rule.

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