**Slaughter and May Podcast**
**Tax News: May 2024**

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| **Zoe Andrews**<br><br>**0.01-0.10s** | Welcome to the May 2024 edition of Slaughter and May's "Tax News" podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge. |
| **Tanja Velling**<br><br>**00:09-00:30** | And I am Tanja Velling, Tax PSL Counsel.<br><br>We will discuss three Court of Appeal decisions: *BlackRock*, *Kwik-Fit* and *Hargreaves Property Holdings*. We will also discuss various updates to HMRC guidance and international tax perspectives and developments.<br><br>The podcast was recorded on the 7th of May 2024 and reflects the law and guidance on that date. |
| **Zoe Andrews**<br><br>**0.12-0.46** | *BlackRock* has been much written about and discussed elsewhere so we will keep our coverage brief and highlight two practical implications of the decision. This is one of the loan relationship unallowable purpose cases currently going through the courts although this one also raised an issue about transfer pricing. The Court of Appeal decided the transfer pricing issue in favour of the taxpayer, but ultimately the taxpayer lost on unallowable purpose. Here's a recap of the facts:<br><br>A US group decided to acquire a US business. |
| **Zoe Andrews**<br><br>**1.02-1.20** | A funding structure was designed to push debt down from the US parent into the taxpayer, a Delaware incorporated but UK tax resident LLC, in order to get UK tax relief. For US regulatory reasons, the taxpayer could not acquire the US business directly. |
| **Zoe Andrews**<br><br>**1.28-1.50** | It applied the funds lent by the US parent to subscribe for preference shares in another US entity. That entity was controlled by the US parent (and not the taxpayer), and it used the subscription monies to purchase the US business. The taxpayer's debt was serviced out of dividends on the preference shares, with the taxpayer retaining a margin. |
| **Tanja Velling**<br><br>**01:22-03:46** | The first practical implication is for transfer pricing. The transfer pricing rules require a comparison of the actual situation with the arm's length situation and the issue was: what adjustments are necessary to eliminate material differences to achieve comparability?<br><br>Here, the borrower serviced debt out of a dividend flow over which it had no control. The documentation did not contain covenants (from other group members) to guarantee the dividend flow which a third-party lender would have required. Before the Upper Tribunal, this was fatal: the covenants that did not exist in the actual transaction could not be hypothesised in the arm's |

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| | length comparator; so, given that a third-party lender would not have lent without the covenants, the arm's length position was no loan.<br><br>The Court of Appeal disagreed with the Upper Tribunal's decision here.<br><br>In the actual situation, the lender was able to control the dividend flow and so knew that the taxpayer would have sufficient means to service the debt. So, there was no need for any covenants; the intra-group lender was (in effect) already in the position for which a third-party lender would have required additional covenants.<br><br>So, contrary to the Upper Tribunal, the Court of Appeal concluded that, in order to compare the actual with a hypothetical, arm's length situation, it would be necessary to hypothesise covenants to remove the risk to the hypothetical lender that did not exist in the actual situation. This is a sensible result and will be welcomed by taxpayers; it avoids having to add unnecessary terms to intra-group documentation. |
| **Zoe Andrews**<br><br>**1.51-2.10** | The second practical implication is in respect of the scope of the unallowable purpose rule. The Court of Appeal helpfully recognised that it is not enough to constitute an unallowable purpose that getting a tax relief is an inevitable and inextricable consequence of entering into a loan. |
| **Zoe Andrews**<br><br>**2.14-3.53** | As Lady Justice Falk explained (and we see her make this point again in *Kwik-Fit*): "it cannot have been Parliament's intention that the inevitable consequence of taking out a loan should engage the unallowable purpose rules, subject only to consideration of whether the value of the tax relief is sufficient to make it a 'main' purpose. Something more is needed".<br><br>On the facts, as found by the FTT, there was a main commercial purpose (borrowing to invest in the preference shares) and a main tax advantage purpose (borrowing to get loan relationship debits for interest payments which could be group-relieved to lower the UK tax paid by the group).<br><br>That brings us to the issue of how to apportion the debits between those two main purposes. The Court of Appeal criticised the FTT's approach of asking whether the transaction would have gone ahead even if the tax relief had been withdrawn at the last minute and sided with the Upper Tribunal in apportioning all debits to the unallowable purpose, having judged the commercial advantage to the taxpayer "more in the nature of a by-product". The Court did, however, also indicate that "some form of apportionment based on economic advantage [as had been proposed by the taxpayer] could be appropriate in some cases".<br><br>So, not all will necessarily be lost, if there is an unallowable purpose – and this is illustrated by another unallowable purpose case that followed hot on |

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| | the heels of *BlackRock*, and also featured a leading judgment by Lady Justice Falk.<br><br>What can you tell us about that the Court of Appeal's decision in *Kwik-Fit* which was handed down on the 3rd of May? |
| **Tanja Velling**<br><br>**05:49-06:13** | *Kwik-Fit* is another case where there was both a main commercial purpose and a main unallowable purpose but, in *Kwik-Fit*, an apportionment was made of some of the debits to the commercial purpose.<br><br>Speedy, a company in the *Kwik-Fit* group had carried forward non-trading loan relationship deficits (which I'll refer to as "NTDs"). It was estimated that it would take 25 years to utilise the NTDs. |
| **Tanja Velling**<br><br>**06:18-06:47** | So, upon advice from PwC, a reorganisation of intra-group loans was carried out (involving loans being assigned to Speedy, or in one case, created in place of an original loan, and the interest rate on existing loans was increased to an arm's length rate). This resulted in more interest being received by Speedy which enabled Speedy to use £48m of NTDs within three years instead of over 25 years. So quite a significant benefit. |
| **Tanja Velling**<br><br>**06:54-07:05** | There was no increase in overall group indebtedness, but a higher rate of interest was paid by the debtor companies than was paid before the reorganisation, so Speedy received greater interest payments. |
| **Tanja Velling**<br><br>**08:06-08:32** | It was agreed that accelerating the use of the NTDs was a purpose of the reorganisation (under the legislation at the relevant time, the NTDs could not be accessed directly so the reorganisation was intended to do so indirectly: Speedy's NTDs would absorb the additional interest income with matching deductions elsewhere in the group). HMRC challenged these deductions for the interest paid by the Appellants.<br><br>What did the Court of Appeal then make of this? |
| **Zoe Andrews**<br><br>**4.01-4.43** | Lady Justice Falk referred to *BlackRock* and reiterated her point that: "The mere fact that a group organises its affairs in a manner that makes use of brought forward non-trading deficits and that it expects to obtain relief for interest and other expenses of loan relationships, in each case as the legislation contemplates, cannot be enough to engage the unallowable purpose rule."<br><br>It is a question of fact for the FTT to determine whether there was an unallowable purpose and if so, whether it is a main purpose, and this finding of fact by the FTT cannot be interfered with in the absence of error of law.<br><br>But there are two points I find particularly interesting in *Kwik-Fit*. |

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| **Zoe Andrews**<br><br>**4.56-7.00** | The first is that, in order to apply the unallowable purpose rule, HMRC had argued before the FTT and UT that the reorganisation generated two separate tax advantages which the Appellants had a main purpose in securing (the use of the NTDs for Speedy, and the generation of relief in the Appellants). But this made the analysis more complicated than it needed to be. The Court of Appeal pointed this out to HMRC and prompted them to consider an alternative approach – namely that the generation of tax deductions, without tax on the corresponding income, was a main purpose of the reorganisation. On this approach, there is no need for the use of Speedy's NTDs by itself to be shown to be a tax advantage intended to be secured by the reorganisation. The Court of Appeal looked back at the FTT's findings and was satisfied they amply demonstrate that it concluded that the generation of deductions, without tax on the corresponding income, was found to be a main purpose of the reorganisation.<br><br>The second point is the argument before the Court of Appeal that the FTT and UT erred in holding that the Appellants each had an unallowable purpose in becoming or remaining parties to the relevant loan relationships because HMRC had at no stage identified any tax saving achieved by the generation of the deductions in the Appellants, indeed three of the Appellants were loss-making. The Court of Appeal agreed with HMRC that there is no requirement in the unallowable purpose test to identify either a specific quantum of tax saving or the precise identity of the beneficiaries. Identifying purpose is necessarily a forward-looking exercise considering what is sought to be achieved not what is ultimately achieved. The group sought and expected to make material tax savings. |
| **Tanja Velling**<br><br>**11:59-13:24** | The Court of Appeal will soon have a third bite of the unallowable purpose cherry with the *JTI* case scheduled to be heard in mid-May. I wonder if Lady Justice Falk will also be sitting on that case to complete her hat-trick.<br><br>But let's move on from unallowable purpose to consider withholding tax on interest. The Court of Appeal's decision in *Hargreaves Property Holdings* is good news for capital markets and taxpayers generally, although not for Hargreaves Property Holdings itself. The issue was whether withholding tax should have been deducted from interest payments.<br><br>I'll start with a brief summary of the facts. Originally, Hargreaves Property Holdings paid interest to a Guernsey company which had been assigned the interest from each lender, but the group's loan finance was restructured so that the Guernsey company assigned the right to receive the interest to Houmet, a UK company which, once it received the interest, paid the Guernsey company for the assignment.<br><br>The intention was to enable tax deductions for the interest in the UK, but avoid a UK tax charge on the interest. The taxpayer argued that there was no withholding tax because the loans were of less than a year's duration (although they were routinely replaced by further loans from the same |

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| | lenders) and that, even if the interest were yearly, the payments were made to a UK company (Houmet) which was beneficially entitled to the interest and so the interest payments were within an exemption from withholding tax. |
| **Zoe Andrews**<br><br>**7.37-8.07** | The decision that the interest was "yearly" interest is of no surprise and is in line with the FTT's and UT's decisions on this point, too. The loans were in the nature of long-term funding and the lenders regarded the loans as investments forming part of the capital of their business and could not, in reality, be viewed in isolation as short-term advances.<br><br>The decision on the "beneficial entitlement" to interest point is more interesting – tell us about that. |
| **Tanja Velling**<br><br>**14:57-15:31** | Of course. Following the Upper Tribunal's decision there was some concern about whether a UK lender is beneficially entitled to interest if it uses any of it to fund, for example, management fees paid to a non-UK entity, but the Court of Appeal cleared that up nicely. The Court of Appeal did not endorse the suggestion that the mere on-payment by the UK recipient to an entity outside the UK may be enough to disapply the exemption. Lady Justice Falk stated that the fact that expenses may offset part, or even the whole, of the income will not, by itself, disapply the exemption. |
| **Zoe Andrews**<br><br>**8.11-8.15** | So does the Court of Appeal tell us what "beneficially entitled" actually means? |
| **Tanja Velling**<br><br>**15:39-15:55** | The Court of Appeal confirmed the FTT's decision that the *Indofood* case on the "international fiscal meaning" of "beneficial ownership" is not relevant here because the provision is in domestic tax legislation. So it is the UK domestic case law that is in point. |
| **Tanja Velling**<br><br>**16:22-16:38** | It still isn't all that clear to me, however, what "beneficial entitlement" actually means for another case with different facts, but on the facts of this one, Hargreaves Property Holdings failed to show that Houmet, as recipient of the interest, retained any benefit and that was its downfall. |
| **Zoe Andrews**<br><br>**8.17-8.20** | That's interesting, but time to move on from the cases now, I think. |
| **Zoe Andrews**<br><br>**8.48-9.40** | There are some recent changes to HMRC manuals which I'd like to draw to your attention. The first is the guidance in HMRC's Stamp Taxes on Shares Manual at paragraph STSM053100 which has been amended to expand the view of the meaning of "capital-raising arrangements" for the purposes of the exemption from the 1.5% charge. The guidance now lists three circumstances which will not prevent an issue of chargeable securities from being a capital-raising. These are: situations where non-cash consideration |

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| | is provided (for example, in the form of assets), where no consideration is provided (for example, bonus issues) or where consideration is directly received from a third party such as a subsidiary of the issuing company. |
| **Tanja Velling**<br><br>**18:35-19:36** | The second HMRC manuals change is the addition of a couple of new paragraphs to the CGT manual dealing with clearance applications for share exchanges. CG52632 states that HMRC will not provide clearance under section 138 of the Taxation of Chargeable Gains Act 1992 where "a degree of avoidance of a charge is disclosed in or is apparent from an application and where based on the information provided HMRC cannot be satisfied that avoidance is not a main purpose or one of the main purposes". This emphasises the importance of making sure the application for clearance provides sufficient evidence that tax avoidance is not a main purpose.<br><br>The new guidance also comments on the issue of what is tax avoidance, referring to the Court of Appeal's decision in *Euromoney* for confirmation that non-payment of tax that would otherwise be due, rather than deferral of tax that will eventually be charged, is tax avoidance for the purposes of the share exchange and company reconstruction rule. |
| **Tanja Velling**<br><br>**19:56-20:20** | New paragraph CG52633 explains the bona fide commercial reasons part of the test. HMRC will not provide clearance to arrangements that seek to avoid a criminal, civil or regulatory risk or liability because HMRC consider that the "bona fide commercial reasons" test expressly requires genuine, "good faith" commercial reasons for undertaking the exchange or scheme of reconstruction. |
| **Zoe Andrews**<br><br>**9.52-10.12** | And while we're on the subject of guidance-related news, HMRC has published a new website – they call it a manual; I would call it a collection – which brings together links to different pieces of VAT tertiary legislation. These are directions, conditions or forms published by HMRC with force of law. |
| **Zoe Andrews**<br><br>**10.32-10.50** | This includes various VAT registration forms, details on the tour operators and other margin schemes, and prescribed methods for converting foreign currency into sterling (which can be found under valuation). I think it's rather helpful to bring together all of these materials in one place! |
| **Tanja Velling**<br><br>**22:36-23:37** | HMRC also published a Business Brief on the interpretation of VAT and excise law post-Brexit. It sets out HMRC's views on the impact of the Retained EU Law (Revocation and Reform) Act 2023 and its modified application to VAT and excise law pursuant to section 28 of the Finance Act 2024: "UK VAT and excise legislation will continue to be interpreted in the same way as it was before 1 January 2024. Drawing on rights and principles that have always applied for interpreting UK law, including the principle of abuse" and the principle of consistent interpretation. |

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| | But businesses can no longer rely on the direct effect of EU law – the Brief states that this "does not lead to any changes in HMRC policy"; HMRC engaged with potentially affected sectors and is "satisfied that…there are no adverse results", for instance, because there are corresponding domestic rules providing for the same treatment. Relevant guidance will be updated "as necessary, where further clarity is needed". |
| **Zoe Andrews**<br><br>**10.53-11.57** | Since our last podcast, we have had a Tax Administration and Maintenance Day (or TAMD) but you may not have noticed as it was a bit of an anti-climax. Which was particularly disappointing for me, as I was speaking on a panel at the UK IFA meeting that same day and had planned to talk about the exciting new developments! We had been expecting, as in previous TAMDs, updates on current consultations and perhaps the launch of some new consultations. In particular, I was hoping for an update on two major developments in the pipeline. The first is the modernisation of stamp taxes on shares the consultation for which was launched at the TAMD last spring and so we were expecting a response to that consultation setting out the proposals which will be taken forward. The consultation proposed moving to a consolidated single stamp tax, with a simplified territorial scope to be collected through self-reporting or, where applicable, CREST. There were a lot of responses submitted so it will be interesting to see how HMRC responds to the comments made. |
| **Tanja Velling**<br><br>**24:44-25:26** | The second major development in progress is the reform of transfer pricing, permanent establishment and diverted profits tax. This consultation is further advanced than the stamp taxes one: HMRC published a summary of responses in January. There's a lot of detail involved in this consultation, but a key part is the reform of DPT to bring it into the corporation tax regime (although continuing to tax diverted profits at a higher rate). The summary of responses promised a technical consultation on draft legislation in 2024 so we still have that to look forward to – perhaps at the next L-Day when draft legislation for the next Finance Bill is published. But I suppose that may all depend on the timing of the general election. |
| **Zoe Andrews**<br><br>**12.00-12.18s** | Yes, the lack of content on TAMD may have also been a result of this being an election year which makes the timing of policy announcements more political than usual.<br><br>Tanja, in your introduction, you referred to "international tax perspectives and developments" – what did you mean by perspectives? |
| **Tanja Velling**<br><br>**26:03-26:15** | Well, I was hoping you'd ask to give me an excuse to talk about our foray into tax disputes landscapes across the world. We recorded six podcasts with our tax partners and local experts; three of these have been published so far. |

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| **Tanja Velling**<br><br>**27:00-27:11** | We've heard about positive developments in Brazil's highly litigious tax environment, the US Internal Revenue Service's approach to transfer pricing litigation and hot tubs in Australian tax disputes |
| **Tanja Velling**<br><br>**27:19-27:35** | (admittedly, that discussion was only a small part of the Australian podcast, but it amused me when our Australian expert said "We like a hot tub in Australian tax disputes" – probably my favourite sentence in the whole series).<br><br>But anyway, do you want to give a sneak preview of what's to come? |
| **Zoe Andrews**<br><br>**12.22-12.49** | Sure; we've yet to visit India, Nigeria and France to find out why the Indian tax authorities should perhaps be thought of as different rather than difficult, how a recent case caused companies to question whether they should continue to comply with Nigerian transfer pricing rules and why French taxpayers may face an increased risk of criminal proceedings. So, there's a lot to look forward to!<br><br>And in addition to that, I think there are some international developments that we should cover here. |
| **Tanja Velling**<br><br>**28:05-28:22** | Are you sure we can't talk some more about hot tubs…? I'm only joking.<br><br>So, there was some good news on Pillar 2 – the OECD published a consolidated version of the commentary on the GloBE Rules, updating the original for the Administrative Guidance issued up to December 2023. |
| **Tanja Velling**<br><br>**28:26-28:31** | Does this mean you won't have to worry any further about consulting multiple documents? |
| **Zoe Andrews**<br><br>**12.55-13.37** | Not quite, I would say. One point to bear in mind is that not everything that is in the Administrative Guidance would have been transposed into the consolidated commentary. The Administrative Guidance included additional background and explanation in respect of changes to the commentary. So, you may well find yourself consulting that alongside the consolidated commentary.<br><br>Also, like the original commentary, this consolidated version is only a snapshot in time. Further Administrative Guidance is expected and that would obviously not be reflected in the current consolidated version. But perhaps further consolidated versions will be published more quickly after new Administrative Guidance is issued.<br><br>And what has been happening at the UN? |

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| **Tanja Velling**<br><br>**29:20-29:28** | The first substantive meeting of the ad hoc committee charged with drafting the terms of reference for a framework convention on tax cooperation took place at the start of May. |
| **Tanja Velling**<br><br>**29:32-30:10** | In advance of this, the EU had published a position paper, expressing a preference for consistency with ongoing OECD work and for consensus-based decision-making. So, it is unsurprising that these points came up for discussion. A large number of countries appear to be in favour of including corporation tax in the terms of reference for the convention. Another question concerns the sequencing of work – should early protocols be negotiated alongside the convention or only after it has been agreed? What seems clear is that countries continue to be dissatisfied with the current allocation of taxing rights and there is political drive for this work. So, we'll keep an eye on it! |
| **Tanja Velling**<br><br>**30:13-30:16** | But what is there to look out for in the more immediate future? |
| **Zoe Andrews**<br><br>**13.40-14.15** | The 14th of May is the closing date for comments on the draft regulations concerning the tax treatment of the new Reserved Investor Fund (Contractual Scheme) or "RIF".<br><br>More consultations close over the course of May, including those on the UK implementation of the cryptoasset reporting framework and on raising standards in the tax advice market which close on the 29th of May.<br><br>The Spring Finance Bill would abolish multiple dwellings relief from stamp duty land tax from the 1st of June. At the time of recording, the Bill has passed the second reading; a date for the committee stage is yet to be announced. |
| **Tanja Velling**<br><br>**30:54-31:13** | And that leaves me to thank you for listening. If you have any questions, please contact Zoe or me, or your usual Slaughter and May contact. Further insights from the Slaughter and May Tax department can be found on the European Tax Blog – www.europeantax.blog. And you can also follow us on Twitter – @SlaughterMayTax. |