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The Court of Appeal in *JTI* decides that the First-tier Tribunal's finding that there was no commercial purpose cannot be overturned so all the debits are attributable to the unallowable purpose and disallowed. The Court of Appeal in *Altrad* decides that a disclosed arrangement intended to deliver capital allowances in respect of 'magical' expenditure did not survive HMRC's *Ramsay* challenge. The Upper Tribunal's decision in *Burlington* on the application of the purpose test in the UK/Ireland tax treaty is good news for the secondary debt market.

JTI: unallowable purpose rule strikes again

In *JTI Acquisition Company v HMRC* [2024] EWCA Civ 652, the Court of Appeal had to consider whether loan relationship debits were denied, in whole or in part, by the unallowable purpose rule in the Corporation Tax Act 2009 section 441. Unlike in *BlackRock* [2024] EWCA Civ 330 and *Kwik-Fit* [2024] EWCA Civ 434, where the fact-finding tribunals each had found both a tax advantage (unallowable) purpose and a commercial purpose, the First-tier Tribunal (FTT) in *JTI* had found that there was no commercial purpose and the taxpayer was unable to meet the high threshold for the Court of Appeal to overturn that finding.

By way of recap, *JTI* involved a funding scheme (known as the '9-step Skinny') for the acquisition of a US company (LTT) by a US headed group, using a UK acquisition vehicle (JTIAC). In step 6 of the plan, JTIAC issued loan notes to its US parent which had the effect of pushing debt down to the UK from the US. This resulted in approximately £40m of non-trade loan relationship interest debits being claimed as group relief. HMRC issued closure notices disallowing the interest debits pursuant to section 441 CTA 2009. The amount of corporation tax at stake is around £9m. The issue to be determined was what was the purpose for the issue of the loan notes at step 6.

Some may have expected on the facts of *JTI* (a UK company in a US-headed group borrowing to acquire directly the US target) that the taxpayer would be more likely to win an unallowable purpose challenge than in *BlackRock* (a UK company in a US-headed group borrowing to invest in another group company that then acquired the US target). So, what went wrong for the taxpayer in *JTI*?

Unallowable purpose - zooming in or zooming out?

The first problem for the taxpayer was that the Court of Appeal did not agree that in determining the taxpayer's purpose for being party to the loan relationship it should focus narrowly on JTIAC's purpose for borrowing (to acquire the US target), and not the purposes of any wider scheme of which the loan transaction formed part. On the contrary, the Court of Appeal concluded that when determining whether a company has a tax avoidance purpose, a tribunal is not required to adopt a 'tunnel-visioned' approach, zooming in on how the company was proposing to use the loan. The purposes of the wider scheme which the taxpayer was intended to advance may, depending on the facts, 'bear on the company's purposes in entering into the loan relationship'.

Lack of commercial purpose

The second problem for the taxpayer was that the lack of commercial purpose in this case is a finding of fact at the FTT. The witness evidence for the taxpayer was described by the FTT as 'vague, elusive, lacking in substance, contradictory to the factual matrix, and ultimately unconvincing'. It is not really possible to make up for that on appeal, as the Upper Tribunal (UT) and Court of Appeal decisions have shown. As the Court of Appeal noted, a differently constituted FTT might have taken a different view but that is irrelevant to the appeal. The UT and then the Court of Appeal found that the FTT was entitled to make the finding of fact they did and declined to interfere with that.

Attribution to unallowable purpose

Which leads us to the third problem for the taxpayer. Where there is an unallowable purpose for a company being party to a loan relationship, so much of the debits in respect of that loan relationship as on 'a just and reasonable apportionment is attributable to the unallowable purpose', are disallowed. So where the debits are solely attributable to a tax avoidance main purpose, all the debits are disallowed. The Court of Appeal decided that the FTT was entitled to conclude that the debits were wholly attributable to the unallowable purpose and disallowed.

But we have seen (in *BlackRock* for example) that the finding of mixed main purposes does not necessarily mean it will be just and reasonable to apportion any of the debits to the commercial purpose. And on the facts of *JTI*, the Court of Appeal concluded that even if there were a commercial main purpose, there would be no attribution to the commercial purpose because, 'but for' the scheme to secure a tax advantage which was 'bolted on' to the purchase of the target, there would have been no loan relationship and no debit.

Curious reference to Rossendale

At the end of the judgment, Lord Justice Lewison agrees with the majority judgment of Lord Justice Newey but adds a single paragraph expressing surprise that both sides argued the appeal as though *Rossendale Borough Council v Hurstwood Properties* [2021] UKSC 16, [2022] AC 690 had never been decided.

Rossendale involved a scheme to avoid business rates. Essentially, when a non-domestic property is unoccupied, business rates are charged on the 'owner', defined as the 'person entitled to possession of the property'. Under the scheme, an owner of an unoccupied property that it would otherwise suffer business rates on leased it to an SPV which had no assets, income or business and would be liquidated in due course. The success of the scheme relied on the SPV becoming the 'owner' and therefore the person liable for business rates, which it then failed to pay because it had no money. The Supreme Court applied the *Ramsay* approach (that is, apply the relevant statutory provision interpreted purposively to the facts viewed realistically) to conclude that the SPV was not the 'owner' for business rates purposes. The purpose of the charge was to incentivise owners to bring unoccupied properties back into use and 'owner' in that context was the person who had the ability to do that. Viewed realistically, the lease did not make the SPV the 'owner'.

Usually, the *Ramsay* approach is adopted where you have something which, on the face of it, appears to satisfy a statutory requirement, such as being the owner of a property or incurring expenditure for capital allowance purposes, but when you take a realistic look at the facts in the round, and take into account the purpose of the relevant statutory provision, you conclude that it does not. For example, because money has moved around in a circle, you have not really incurred expenditure. But it is difficult to see how this approach helps when the statutory exercise is determining a taxpayer's purposes for being party to a loan relationship. In the three recent unallowable purpose cases, it is clear from their judgments that Lord Justice Newey and Lady Justice Falk do take into account the relevant scheme as a whole and the company's intended role within it as part of the exercise. So we are baffled as to what Lord Justice Lewison's paragraph brings to the party as, in our view, it does no more than reiterate you need to look at the facts in the round!

Altrad: artificial scheme to boost capital allowances fails on *Ramsay* ground

Another case where *Rossendale* makes an appearance, although this time with an explanation as to how and why it is relevant, is *Altrad Services Limited and Another v HMRC* [2024] EWCA Civ 720. The Court of Appeal allowed HMRC's appeal, agreeing that the FTT reached the correct conclusion based on the *Ramsay* principle of construction and concluding that the UT should not have allowed the taxpayers' appeal. The case involves an artificial series of transactions (duly disclosed under DOTAS) which the 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 without the taxpayers incurring any real cost.

The success of the scheme depended on a sale of assets to a bank being a disposal event under CAA 2001 section 61(1)(a), even though the assets were immediately leased back and ownership was regained after three weeks by exercise of a put option. The FTT concluded that, looking at the scheme as a whole, the taxpayers never ceased to own the assets within the meaning of section 61(1)(a). They ended up in the same position as they had started, as the legal and beneficial owners of the assets having had the use of the assets in their trades throughout. The UT, on the other hand, concluded that, construed purposively, section 61(1)(a) operated by reference to a 'snapshot in time' asking whether the taxpayers had lost legal and beneficial ownership of the assets, and on the facts, even when viewed realistically, they had.

It was unsurprising that HMRC appealed the UT's decision, especially as the UT hinted that a different *Ramsay* argument might be more successful. The Court of Appeal, however, agreed with the FTT on HMRC' s original *Ramsay* argument on the construction of section 61(1)(a) and so there was no need to analyse the alternative which was based on the construction of 'qualifying expenditure'.

The Court of Appeal adopted a holistic approach to determine that, on the sale to the bank, the taxpayers did not cease to own the relevant assets within the meaning of section 61(1)(a) because section 61 is in general concerned with events that have enduring consequences in the real world and so affect the practical use of the asset made by the taxpayer in its trade. Although the taxpayers did cease for a short period (three weeks) to be the legal and beneficial owners of the assets they sold to the bank, looking at the scheme as a whole, the Court of Appeal concluded that the taxpayers did not in any practical sense cease to own the assets within the meaning of section 61(1)(a). The Court of Appeal decided that a brief interruption of the legal and beneficial ownership of the assets fell outside the scope of the statutory language and the intermediate steps could be disregarded. Sir Launcelot Henderson said this falls comfortably within the principles stated by the Supreme Court in *Rossendale*. The UT had been wrong to conclude that section 61(1)(a) must be applied by reference to a snapshot in time, and not over a period of time, as confining attention to a 'snapshot in time' is 'normally the very antithesis of what the *Ramsay* approach requires'.

Burlington: treaty purpose test not satisfied by withholding tax arbitrage alone

HMRC v Burlington Loan Management DAC [2024] UKUT 152 TCC is another case about purpose, but this time the relevant purpose test is in the UK/Ireland double tax treaty (DTT). The purpose test is contained in an anti-abuse provision in Article 12(5) of the UK/Ireland DTT which prevents treaty exemption from withholding tax on interest where 'it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment.'

Claims against Lehman Brothers International (Europe), a UK company, are traded in the secondary market. SICL, a Cayman company, sold one such claim to a broker for £82.4m and the broker sold it on to an Irish resident company, Burlington Loan Management (BLM), for £83.55m.

Although SICL would suffer 20% UK withholding tax (WHT) on UK interest payments made directly to it, BLM would not (because of the UK/Ireland DTT). Both parties realised this and the pricing effectively split the benefit of the gross payment (after deducting the broker's turn). Importantly, there was no mechanism to adjust the price if BLM suffered UK WHT on the interest.

SICL wanted to get the best price it could for the sale and, as BLM was competing with other bidders who were also likely exempt from UK WHT for one reason or another, BLM was willing to pay more for the assignment than the debt was worth to SICL. HMRC submitted that the case should fall within Article 12(5) because, in economic terms, SICL was taking advantage of Article 12(1) by selling to BLM for a greater sum than it could have realised itself.

Interpretation of Article 12(5)

The UT construed the provision in the light of the purpose of the treaty, which needed to be considered from the perspective of both treaty partners and not just the UK. On that basis, the UT found that the purpose of Article 12 of the treaty was to determine which of the UK and Ireland should have taxing rights over interest with a source in one of the States (here the UK) where it is beneficially owned by a resident of the other (in this case Ireland). The UT determined that the correct starting point is that unless there is an abusive arrangement falling within Article 12(5), BLM, as an Irish tax resident and beneficial owner of the interest, is to be taxed only in Ireland on the interest.

The UT decided that it is for the FTT to determine the subjective purposes of both the seller and the purchaser of the debt claim, considering all the circumstances of the case. The UT concluded that the FTT had not made an error of law in making the determination they did and that HMRC's construction of Article 12(5) would turn it into a provision directed at the avoidance of UK WHT by the seller, applicable whether or not the seller actually knew the basis on which the purchaser did not suffer a UK tax charge, so long as the mechanism for the UK WHT avoidance was the treaty. The decision shows that, despite HMRC's arguments to the contrary, such WHT arbitrage is insufficient, without more, to constitute treaty abuse.

The UT took a different view from the FTT on the significance of knowledge of reliance on Article 12(1). The FTT concluded that in order for Article 12(5) to apply, SICL had to know that the purchaser of the claim would be relying on Article 12(1) specifically. The UT described this as an 'unjustified gloss on the actual words chosen by the contracting States in concluding the treaty.' This unjustified gloss was not material to the FTT's decision, however.

The UT also agreed with the FTT that although the artificial use of a conduit company is an example of improper use of the treaty at which Article 12(5) is targeted, the provision is not confined to cases involving artificiality.

Impact on secondary debt markets and outside the UK

This case is an important one for the smooth running of secondary debt markets as it confirms that, in general, the treaty purpose test ought not to apply to an outright sale of a debt, by a person who is not entitled to treaty benefits, to an unconnected person who is so entitled even where that is reflected in the pricing of the sale.

The principal purpose test in Article 7 of the OECD's Multilateral Instrument has been widely imported in tax treaties and so tax authorities, taxpayers and tax advisers may also find this case a useful precedent when determining whether an arrangement or transaction might be considered to have a principal purpose of obtaining a treaty benefit.

What to look out for:

- With Labour expected to hit the ground running and wanting to give greater certainty to business, it may not be long after the election before consultations on new policies start doing the rounds, so enjoy the calm before then!

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