TAX AND THE CITY REVIEW

The FTT in *Euromoney* finds in favour of the taxpayer that 'arrangements' in the context of TCGA 1992 s 137 should be interpreted widely in the context of the overall deal with the result that the tax avoidance purpose was not a main purpose. The FTT in *M Group Holdings Limited* agrees with HMRC's long-held view that the substantial shareholding exemption is not available where the transferee company is a newly acquired subsidiary of what was previously a single trading company. Finance Bill 2021 has completed its committee stage and amendments have been made, including to the hybrids rules. HMRC updates its stamp taxes guidance to confirm that the confirmation letter from HMRC is sufficient evidence that an instrument of transfer submitted electronically is duly stamped and there is no need to re-submit the physical documents for stamping post-COVID.

Euromoney: statutory purpose test

Euromoney v HMRC [2021] UKFTT 61 (TC) is the latest case on the application of a statutory purpose test to be decided in favour of the taxpayer. It involved the sale of shares in two companies, CDL and CNL, and initially the consideration was going to be a mixture of cash and ordinary shares in the purchaser. There were commercial reasons for the taxpayer wanting to own shares in the purchaser but the purchaser also wanted a material amount of cash consideration.

Whereas the sale of the CNL shares would qualify for the substantial shareholding exemption (SSE), the sale of the CDL shares would not (it appears this was because Euromoney had not been entitled to receive a dividend on the CDL shares, receiving instead a licence fee from CDL). This meant that any cash consideration for the CDL shares would be taxable. The parent company's tax director suggested that the cash element of the consideration for CDL shares should be replaced with preference shares which Euromoney could hold for 12 months and then redeem. Such redemption would then benefit from the SSE and save £2.8m of tax.

Euromoney applied for clearance under TCGA 1992 s 138 in respect of the share for share exchange to get confirmation from HMRC that s 137 would not apply to disapply the s 135 rollover treatment. But HMRC argued that the entire exchange for CDL shares failed the purpose test in s137, not just the exchange of preference shares for the CDL shares, and sought an additional £10m in corporation tax from Euromoney.

The question for the FTT was whether the share for share exchange was part of a scheme or arrangements which had a main purpose of avoiding tax on the disposal. There was disagreement between the parties as to what constituted the 'arrangements' for the purpose of s 137 with HMRC taking a narrow view looking just at the part of the arrangements concerning the preference shares. The taxpayer, on the other hand, regarded the arrangements in a wider commercial sense including the sale of the shares in both CDL and CNL and all three elements of consideration (cash, ordinary shares and preference shares). If HMRC were correct, the appeal would fail because there was clearly a main purpose of avoiding tax when looking just at the preference shares part. However, the FTT agreed with the taxpayer and said that in order to reflect the reality of the position, the arrangements must be taken as a whole. This meant that the 'bad' purpose was diluted when looked at in the context of the overall deal so the FTT found that avoiding tax was a purpose, but not a main purpose and so s 137 did not prevent s 135 from applying to the share exchange.

As ever with purpose tests, the factual evidence was key. In determining that the purpose of obtaining a tax advantage was not a main purpose of the overall deal, the FTT was influenced by the following findings of fact:

- the tax advantage was less than 5% of the total sale consideration;

- the amount of time spent on the tax analysis was not significant;
- the tax advantage from being issued preference shares was regarded as no more than a 'bonus' and 'nice to have'; and
- the deal signed before clearance from HMRC was obtained which illustrated the lack of importance of the tax saving in the context of the transaction.

With *Blackrock Holdco 5 LLC v HMRC* [2020] UKFTT 0443 (TC), that now marks two FTT decisions in relatively quick succession where the taxpayer has successfully appealed the application of a main purpose test by HMRC notwithstanding the fact that there has been clear evidence of tax planning and the court has found that the taxpayer had at least a purpose of obtaining a tax advantage. That serves as a good reminder, to both taxpayers and HMRC, that it is perfectly legitimate to take tax considerations into account when structuring commercial transactions.

M Group Holdings: SSE para 15A not satisfied as group not in existence for 12 months before disposal

The technical conditions for SSE have been tweaked many times over the years to remove irritants highlighted by business and improve the practical application of the rules. One such example is the change made in 2011 to permit SSE following a hive down of a trade into a new company (Newco) before selling the Newco. In this situation, TCGA 1992 Schedule 7AC para 15A provides that the period over which a parent is treated as holding shares in the Newco that acquires the business to be sold is extended to include the period for which the assets transferred were used by the group in a trade (so that the qualifying period condition is satisfied in respect of the Newco shares). But what if there was no group in existence before the Newco was set up because the parent was a stand-alone company? This is what happened in *M Group Holdings Limited v HMRC [2021] UKFTT 69 (TC)*.

The taxpayer had been a stand-alone company until it incorporated a subsidiary and, at the time it sold the subsidiary, less than 12 months had elapsed since the group had formed. The taxpayer tried to rely on para 15A to take into account the time that the taxpayer had owned the trade assets before the transfer to the subsidiary but HMRC disallowed the claim for SSE and assessed the taxpayer to £10.6m corporation tax in respect of the disposal.

The FTT agreed with HMRC that the purpose of para 15A was to help groups, not stand-alone companies. This is consistent with HMRC's interpretation in its capital gains manual at CG53080C: 'Note that para 15A extends the holding period by reference to the previous use of trading assets by a member of the group while it was a member of a group. Therefore a capital gains group must have existed at the time. The provision cannot apply where the transferee company is a newly acquired subsidiary of what was previously a single trading company.'

The solution appears to be for stand-alone companies to incorporate a dormant subsidiary in case a hive-down may in future be required. But what is the policy reason for excluding the exemption for a stand-alone company that sets up a subsidiary, hives down its business and sells the shares, yet providing the exemption in identical circumstances except that the original trading company already happened to have a dormant subsidiary? The FTT agreed that there does not seem to be any obvious justification for this distinction and that this is an odd and arbitrary result of HMRC's construction of the legislation. But being odd or arbitrary is not enough for the FTT to intervene, HMRC's interpretation would have to produce a 'wholly unreasonable result' and the FTT could not conclude this because it is not obvious that Parliament intended stand-alone companies with newly acquired subsidiaries to benefit from SSE. The FTT concluded that the purpose of para 15A in this context is not sufficiently clear, whether from the legislation, the explanatory notes or the consultation document that led to the introduction of para 15A.

It looks like this is an issue to be picked up whenever the next consultation on SSE takes place but until such time as para 15A is amended, any stand-alone companies should take care to meet the bright line SSE rules on a hive down and not seek to rely on para 15A to extend the period of ownership.

Finance Bill 2021: changes to hybrids changes

The public bill committee stage is now complete with all the government amendments to the bill being agreed as expected. A revised version of the bill incorporating all amendments made during the committee stage was published on 28 April.

The amendments at committee stage included clarifications and changes to Finance Bill 2021 Schedule 7 (changes to the hybrids rules) to remove unintended consequences. This included deleting para 2 which would have made changes in relation to the definition of 'hybrid entity' and 'investor' in TIOPA 2010 s 259BE. This deletion follows stakeholder engagement in which it became clear that the existing draft had unintended consequences. A revised provision dealing with the underlying issue is intended to be included in the Finance Bill 2022, backdated to 2017. This makes for an interesting discussion on filing positions!

The further tweaking of changes to the hybrids rules highlights yet again the complexity of the rules but it also shows a commitment by the government and HMRC to get the rules right and make sure that fixing some identified problems does not create new ones.

The Bill is expected to complete the remaining stages and have royal assent before the parliamentary summer recess which starts 22 July.

Stamping update: HMRC confirms instrument of transfer submitted electronically is 'duly stamped'

Since 27 March 2020, new stamp duty procedures have been in place requiring electronic submission of documents for stamping rather than the impression of physical stamps on instruments of transfer, as was the practice pre-COVID. Once the duty has been paid, or a relief adjudicated, HMRC provides confirmation that the duty has been paid or the relief adjudicated. At the end of April, HMRC updated its guidance to confirm that the confirmation letter is sufficient evidence that an instrument of transfer submitted electronically is duly stamped and there is no need to re-submit the physical documents for stamping post-COVID. As the amended guidance also no longer ties the use of this process to COVID, it seems it is here to stay. Which is a good thing practically speaking, but the legal basis for HMRC concluding that stock transfer forms/instruments of transfer dealt with under the electronic stamping procedures can be viewed as 'duly stamped' is unclear.

There are also concerns about what the instrument of transfer is in these circumstances and where it is considered to be located. Such points are obviously key when considering whether an instrument of transfer of non-UK shares has been brought into the UK and whether a charge to UK stamp duty arises.

We await the response to the call for evidence on the modernisation of stamp taxes on shares framework which closed in October 2020 and which included questions on the new procedure, which was described as temporary at that time. It is hoped that the government's response will address the legal basis for non-physical stamping and address the concerns about unintended consequences in relation to what amounts to a chargeable instrument of transfer. Although an even better result would be to abolish stamp duty altogether!

What to look out for:

- **The Upper Tribunal is scheduled to begin hearing the appeal *in Centrica Overseas Holding* on 12-14 May on the subject of management expenses and in particular whether an investment company was managing its investments.**
- **28 May is the closing date for comments on the consultation on changes to the commentary on Article 9 (transactions between associated companies) of the OECD Model Tax Convention aiming to clarify the application of Article 9, especially as it relates to domestic laws on interest deductibility.**
- **1 June is the closing date for responses to a number of consultations including those on notification of uncertain tax treatment by large business, transfer pricing documentation and clamping down on promoters of tax avoidance.**
- **The consultation on reform of the taxation of securitisation companies closes on 3 June.**

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