Slaughter and May Podcast
Tax News Highlights: September 2021

Zoe Andrews	Welcome to the September 2021 edition of our tax news highlights podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Senior Professional Support Lawyer in the Tax department. In this podcast, we will cover the draft guidance in respect of the large business notification of uncertain tax treatment and a number of recent cases: • the Court of Appeal's decision in *Ingenious Games*, a sequel to the *Ingenious Films* litigation, again concerning the question whether the relevant limited liability partnerships were trading; • the decision of the Court of Session in the employment-related securities case *Vermilion*; • the decision of the Upper Tribunal in *Centrica* concerning the question whether advisers' fees were expenses of management; and • the First-tier Tribunal decision in the latest unallowable purpose case, *Kwik-Fit*. This podcast was recorded on the 7th of September 2021 and reflects the law and guidance on that date. Let's start with the draft UTT – uncertain tax treatment – guidance. You may recall that we discussed the draft legislation for Finance Bill 2022 to which this guidance relates in our August podcast and I mentioned that we would need to wait for the guidance to find out in more detail how HMRC intends the rules to work. Zoe, you've had a look at the guidance – does it answer all our questions?
Zoe Andrews	The guidance does elaborate on some aspects of the three notification triggers but leaves some questions unresolved. As expected, it also includes the content and form of the notification which was not included in the draft legislation.
Tanja Velling	Let's look at what the guidance has to say about the second trigger - where the tax treatment relies on an interpretation or application of the law not in accordance with HMRC's "known" position. Is there any clarification of what constitutes HMRC's known position?

Zoe Andrews	HMRC’s “known” position is not limited to the taxpayer’s knowledge although it does include the businesses’ correspondence with HMRC and any dealings with HMRC. So businesses need to make sure they keep track of any HMRC views they have been given, for example in rejected clearances or in previous enquiries. The guidance provides that dealings with HMRC include discussions with a CCM or HMRC tax specialist even where those discussions are not documented. This could cause problems if the taxpayer and HMRC do not have the same understanding or recollection of those discussions. So best practice would be to ensure a written record of such discussions is agreed with HMRC. The “known” position also picks up anything apparent from guidance, statements or other HMRC material of general application, readily available and in the public domain. Paragraph UTT13200 of the guidance lists the types of publications that do or do not indicate HMRC’s known position for the purposes of this trigger. But the lists are stated to be merely illustrative and not exhaustive. So there is still some uncertainty about what publications count. It is helpful, however, that submissions HMRC makes in litigation do not have to be considered.
Tanja Velling	What about conflicting guidance?
Zoe Andrews	The guidance provides that more recently published guidance is less likely to be outdated and is expected to take precedence over older guidance where there is a potential conflict. Where it is obvious that HMRC guidance is outdated or contradictory and other notification criteria do not apply, a notification is not required. But a belief that the guidance is simply wrong will not in itself mean a notification is not required.
Tanja Velling	The third trigger is that it is reasonable to conclude that there is a “substantial possibility” that, if the matter came before a court or tribunal, it would be found that the tax treatment was incorrect in one or more material respects. We were concerned that this “substantial possibility” test, would prove difficult to apply in practice and hoped that the guidance would clarify what a “substantial possibility” means. Is there anything reassuring in the guidance on this?

Zoe Andrews	Not really. In other contexts HMRC has set a defined percentage, for example, the guidance on the substantial shareholdings exemption suggests a “substantial extent” of non-trading activities means greater than 20% of total activities. But the draft legislation and draft guidance do not define “substantial” by reference to a percentage. Instead, the draft guidance identifies factors that indicate the test has been met, including different advisers recommending different tax treatments and the decision over the correct tax treatment being “fairly balanced”. If there is a written indication from HMRC that there is no material uncertainty about the tax treatment, this is a factor suggesting the substantial possibility test is not met. But this is the only example of where the test is not met, and there is still plenty of uncertainty about when this trigger applies! Yet the guidance states HMRC does not expect it will be necessary that legal advice should be obtained in order to comply with the UTT regime. HMRC expect a level of governance proportionate to the tax risk and level of uncertainty.
Tanja Velling	What happens where more than one trigger applies? The summary of responses to the second consultation noted that there would be overlap between the first trigger (provisions in the accounts in accordance with GAAP) and the third, but explained the first trigger was being retained because it is the clearest and most straightforward trigger, and taxpayers will not need to consider the other triggers, if this one applies. Is this reflected in the guidance?
Zoe Andrews	No. According to the guidance, businesses are required to identify and notify the largest tax advantage calculated by reference to the trigger criteria.
Tanja Velling	Where at least one of the three triggers applies, notification is required only if the tax advantage is £5m or more. The amount of the tax advantage is determined by comparing the uncertain amount with the expected amount (essentially the amount that will have to be accounted for if the UTT applied is found to be incorrect). In applying the £5 million threshold, the legislation provides that related amounts have to be aggregated. Does the guidance explain how this aggregation will work in practice?
Zoe Andrews	The draft guidance does not really add any more detail to the legislation here, but it does give some practical examples. The guidance also draws attention to the effect of paragraph 15 of the draft legislation. Although national insurance contributions are not a relevant tax in scope of UTT, the effect of paragraph 15 is that national insurance contributions are to be aggregated with the uncertain income tax treatment where the relevant return is a return

	under the PAYE regulations, and the NICs treatment is substantially the same as the income tax treatment it relates to. The explanation given of “substantially the same” is whether the uncertain tax treatments are as a result of applying the same reasoning to determine the tax treatments – thus rendering the word “substantially” redundant in the legislation.
Tanja Velling	That is interesting, and I’m sure we could talk for much longer about the UTT, but we must move on to our first case, *Ingenious Games*. The case concerned three LLPs, treated as partnerships for tax purposes. Two of them operated in the film and one in the games industry. The case was previously covered on the European Tax Blog by Mike Lane in a post entitled “Litigation on an epic scale…”
Zoe Andrews	With over £1.6 billion in claimed losses at stake once you include follower cases, this is indeed quite a significant case and may be further appealed by HMRC in respect of the two film partnerships, but I get ahead of myself. There were only two issues before the Court of Appeal (permission to appeal in respect of certain other issues having been refused): whether the partnerships were trading and, if they were, whether they were doing so with a view to profit. These sound like straightforward issues but this case illustrates the difficulty in applying to the facts the basic tests of whether there is a trade and shows that disagreements can arise on the answer, even if the tests themselves are agreed. If the partnerships were trading with a view to profit, the losses they claimed would be available to the partners for sideways loss relief.
Tanja Velling	The First-tier Tribunal had found that the two film partnerships were trading with a view to profit but the games partnership was not trading. The Upper Tribunal said the FTT was wrong to come to this conclusion and that, in fact, none of the partnerships were trading, let alone with a view to profit. The Upper Tribunal decided that the film partnerships (like the games partnership) were investing, not trading. In addition, it held that the partnerships’ activities were not conducted with ‘a view to profit’ but in order to realise losses for their partners.
Zoe Andrews	The Court of Appeal concluded that the FTT had not misunderstood or misdirected itself as to the underlying legal principles and so the UT was wrong to interfere with the FTT’s decision. This also meant that the Court of Appeal was not in a position to disturb the FTT’s finding that the games partnership was not trading, illustrating the importance – from a taxpayer’s perspective – of spending the time and effort to set the facts out before the FTT in order to win questions of fact there.

	The Court of Appeal noted that “with a view to profit” imported a wholly subjective test looking at the subjective intention or purpose of the putative partners to make profits from carrying on their trade, profession or business. This is not a question of motive. The question here was whether the partnerships were trying to make a profit (what was their purpose) not why they were trying to do so (which is their motive).
Tanja Velling	Our next case, *Vermillion*, concerned the question whether an option granted to Vermilion’s director, Mr Noble, is an employment-related securities option. The First-tier Tribunal said no, the Upper Tribunal overturned that decision and the Court of Session has now reinstated the FTT’s decision. But the Court of Session was split with a dissenting judgment from the Lord President. So, I would not be surprised if HMRC were to try and appeal the case to the Supreme Court. One issue in this case is the interaction between subsections (1) and (3) of section 471 of the employment-related securities legislation in Part 7 of the Income Tax (Earnings and Pensions) Act 2003. Section 471 defines when the Chapter in relation to securities options applies. Subsection (1) states that it applies “where a right or opportunity to acquire the securities option is available by reason of an employment”. Subsection (3) provides that, where such a right or opportunity is made available by a person’s employer, it “is to be regarded for the purposes of subsection (1) as available by reason of an employment”.
Zoe Andrews	Mr Noble owned and was a director of Quest, a consultant company. In 2006, Quest provided corporate advisory services to Vermilion in return for the grant of a share option. When Vermilion subsequently came into financial difficulty, it was crucial to the success of a rescue funding exercise that Mr Noble became a director of Vermilion and that the 2006 option in favour of Quest was replaced with a new option, the 2007 option, on amended terms and in favour of Mr Noble. HMRC’s position before the First-tier Tribunal was essentially that, as an option granted by a company to its director, the 2007 option falls squarely within the deeming provision in subsection (3) and that should be the end of the matter. The FTT, however, considered that the result of the deeming provision would be at variance with the factual circumstances: if one asked whether the 2007 option was granted by “reason of” Mr Noble’s directorship, looking purely at the wording of subsection (1), the real reason would seem to be the surrender of the 2006 option. The majority of the Court of Session agreed with the FTT’s reasoning in this respect. Subsection (1) is to be regarded as the leading provision with subsection (3) being subordinate to it. If, as a matter of fact, something is not made available by reason of an employment as per subsection (1), subsection (3) cannot operate to deem it to be for such reasons regardless of the facts.

Tanja Velling	Whilst there is an attractiveness to this argument, I can also see the sense in the opposing position taken by the Lord President, namely that the precise purpose of the deeming provision in subsection (3) is to short-circuit difficult questions around the real reason why the right or opportunity to acquire an option was made available. Applying the deeming provision in this case to bring the 2007 option within the scope of the employment-related securities legislation would not be applying, I quote, “a literal view. It is simply affording the wording of the deeming provision its plain and ordinary meaning in the statutory context.” End of quote. In particular given the importance and apparent difficulty of defining the relationship between the two subsections, HMRC may well seek to appeal the Court of Session’s decision to the Supreme Court.
Zoe Andrews	The *Centrica* case concerned an intermediate holding company, COHL, in the Centrica plc group of companies. COHL held shares in a Dutch entity which had four subsidiaries. In 2009, Centrica plc’s board had decided that certain European businesses, including everything sitting underneath that Dutch entity should be disposed of. In January 2011, an offer was made which resulted in the disposal of one of the Dutch entity’s subsidiaries and the assets of another two in March after the transaction had been approved in principle by Centrica plc’s board on the 22nd of February. The question arose whether certain bank, accountancy and lawyers’ fees incurred by COHL in the context of this transaction were deductible management expenses of its investment business under section 1219 of the Corporation Tax Act 2009.

Tanja Velling	Right at the start, the Upper Tribunal's decision notes that there was some disagreement between the parties on how the reasoning behind the First-tier Tribunal's decision that the relevant fees were not "expenses of management of the company's investment business" (and therefore non-deductible) should be interpreted. According to the UT, the FTT had concluded that the investment business had really been managed by Centrica plc and not by COHL. So, COHL's expenses were not those of managing anything. It appeared that the FTT had regarded the absence of evidence that COHL's directors had changed their group-wide "Head of Tax" and "General Counsel" hats for their "director of COHL" hats and formally decided to approve the transaction as fatal. If this was indeed the correct interpretation of section 1219, it should generally be possible to avoid being tripped up by formally documenting the intermediate holding company's participation in the decision-making process. But, fortunately, the UT concluded that this would be an unduly narrow reading and that the FTT's conclusions had been wrong in law. Given that COHL's directors had participated in the decision-making, Centrica plc's actions were "management of the investment business on behalf of COHL with the informal approval of its directors" – rather than taking the place of COHL. So, the first hurdle was taken, bringing into play the next hurdle in the form of the well-established distinction between deductible "make your mind up" expenditure and non-deductible implementation expenditure. Based on the FTT's findings of fact, the UT confirmed that bank and accountancy fees up to the 22nd of February when Centrica plc gave the green light fell into the former category. In relation to the legal fees, the point was remitted to the FTT. That's all I was going to say about the decision. Did you have anything else?
Zoe Andrews	There is one other useful point. HMRC had contended that, because the bank's fees were only payable if the transaction went ahead, they could not be regarded as deductible "make up your mind" expenditure. The UT upheld the FTT's dismissal of this argument. Fees which are otherwise expenses of management don't cease to be such merely because their payment is contingent on the completion of the transaction. But let's now have a look at *Kwik-Fit*. HMRC sought to apply the unallowable purpose rule in section 441 of the Corporation Tax Act 2009 to disallow tax deductions for interest on certain loans where the lender was an intermediate holding company in the Kwik-Fit group, Speedy 1, which had a £48 million carried forward non-trading loan relationship deficit.
Tanja Velling	Following its acquisition by a third party, the Kwik-Fit group undertook a reorganisation of its intra-group debt. Speedy 1 remained the lender under one pre-existing intra-group loan, became the lender in respect of seven more pre-existing intra-group loans and became the lender in respect of three new intra-

	group loans. In respect of the new loans, the interest rate was set at, and in respect of the pre-existing loans, the interest rate was increased to, LIBOR plus 5%. Following the reorganisation, Speedy 1's carried forward non-trading loan relationship deficit was used over less than three years rather than over around 25 years, as previously estimated by the group tax manager. The questions before the FTT were whether one of the main purposes for which the borrowers were party to the relevant intra-group loans was to secure a tax advantage and, if so, to what extent tax deductions should be attributed to that purpose and, therefore, disallowed.
Zoe Andrews	The FTT concluded that Speedy 1's use of the carried forward deficit was a tax advantage and that obtaining this tax advantage was "the key driver", and therefore a main purpose, of the reorganisation, and that the group purpose behind the reorganisation, being a tax avoidance purpose, had become a main purpose for the borrowers to be party to the loans. For the pre-existing loans this meant that, whilst they retained their original commercial purpose (and this continued to be a main purpose), they had acquired an additional tax avoidance main purpose following the reorganisation. The FTT considered that the increase in the rate of interest charged on the pre-existing loans impacted by the reorganisation - but not on other pre-existing intra-group debt - was "strong evidence" of this change in purpose. For two of the new loans (the appeal in respect of disallowances relating to interest debits in respect of the third loan had been withdrawn), tax avoidance was the main purpose. But to what extent should the interest debits should be attributed to the tax avoidance purpose and disallowed?
Tanja Velling	It is here where the FTT parted company with HMRC. Like HMRC, the FTT drew a distinction between the pre-existing and the new loans and concluded that, in respect of the new loans, the debits should be wholly attributed to the unallowable purpose. HMRC had then sought to draw a further distinction between the pre-existing loans transferred to Speedy 1 as part of the reorganisation which were to be treated in the same way as the new loans and the pre-existing loan in respect of which Speedy 1 had always been the lender where HMRC had attributed only the additional debits referable to the increased interest rate to the unallowable purpose. The FTT disagreed with this further distinction and attributed only the additional debits to the unallowable purpose for all pre-existing loans, given that this better reflected the continuation of the original commercial main purpose of the borrowing. The FTT then again agreed with HMRC's position of limiting the total disallowances to the amount of carried forward deficits used by Speedy 1. Whilst this may look like the right outcome, it seems at odds with the previous

	conclusion that all of the interest debits in respect of the new loans fall to be attributed to an unallowable purpose, meaning that they should be disallowed. On what basis are they then, effectively, re-allowed to the extent they exceed the carried forward deficit? Mike Lane puzzles over this question in a European Tax Blog post entitled "What's unallowable, but not disallowed?"
Zoe Andrews	Overall, this case serves to show, again, that taxpayers will find it hard to win arguments centred on the absence of a tax avoidance main purpose. The crucial battleground seems to be at the attribution stage. But there is one other point that I thought interesting. There was a brief (and obiter) discussion of the taxpayer's attempt to describe the reorganisation as having been approved by HMRC. The statement which struck me was in paragraph 139 that "this Tribunal does not have jurisdiction to hear an application for judicial review of decisions of HMRC". Whilst superficially correct, it could also be said that the FTT might have slightly understated its powers here. In the recent case of *KSM Henryk Zeman*, the Upper Tribunal decided that, in relation to an appeal under section 83(1)(p) of the Value Added Tax Act 1994, the FTT would have jurisdiction to hear a public law defence based on legitimate expectations which would generally be regarded as within the purview of judicial review. Whilst *Henryk Zeman* cannot, without more, be read across to other contexts – the Upper Tribunal stressed that the scope of the FTT's appellate jurisdiction depends in each case on the "proper construction, in the context of the statutory provisions to which it relates, of the statutory provision by which it is given" – it is not inconceivable that there could be other instances where the FTT could have jurisdiction to hear judicial review type arguments (even if it can't hear judicial review applications as such). But now, what is there to look out for?

Tanja Velling	• Well, there is still time to apply to join the working group to develop proposals for the modernisation of stamp taxes on shares and provide comments on the draft legislation for Finance Bill 2022 which was published on the 20th of July. The deadline for the former is the 10th of September and, for the latter, the 14th of September. • On the 20th of September, the EU's General Court will hear the appeal against the European Commission's decision that group financing exemption in the UK's controlled foreign company rules constitutes unlawful State aid. • The 30th of September marks the end of the temporary increase in the SDLT nil-rate band for residential property transactions. From the 1st of October, the nil-rate band will revert to being £125,000. • And an honourable mention of something which does not take place during the next month, but we found out about today and which will be of interest: the Chancellor has launched the Spending Review 2021 which is to be presented on the 27th of October alongside an autumn Budget. So, it looks as if we are finally back on track to returning to the normal legislative cycle.
Zoe Andrews	That leaves me to thank you for listening. If you have any questions, please contact Tanja 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.