SLAUGHTER AND MAY/

CLIENT BRIEFING

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TAX AND THE CITY REVIEW

HMRC revises and expands its guidance on the loan relationships unallowable purpose test, noting that it is subject to change as some of the case law it references is still being litigated. The Advocate General opines in the *Engie* case that State aid cannot be used to challenge tax rulings unless they are manifestly discriminatory. The Upper Tribunal in *Shinelock* decides the relevant payment was a distribution and was prevented from giving rise to a debit under the loan relationships rules, contrary to the reasoning of the First-tier Tribunal. *Shinelock* also raises some interesting procedural points including when a judge can decide a case on an argument raised by neither party.

HMRC's updated and expanded unallowable purpose guidance

The loan relationships unallowable purpose rule (CTA 2009 ss. 441-442) continues to be a complex area where case law is developing. HMRC has recently published expanded and updated guidance in CFM38110 to CFM38200. It is helpful to have HMRC's views on unallowable purpose comprehensively expressed, although taxpayers and advisers may not necessarily agree with it and, at the end of the day, as the guidance flags, it is important to remember that the application of the rule depends on the particular facts and circumstances of the arrangements being considered. There is a lot to digest in this guidance but we have shared below some points which stood out on an initial read.

Whose purpose?

HMRC's view of whose purpose is relevant and consideration of the wider purposes of the group are set out in CFM38125 which notes that this is a complex area and that questions of whose purposes are to be considered, and how they are assessed generally, are being discussed in cases under litigation including *HMRC v Blackrock Holdco 5, LLC* (to be heard by the Court of Appeal in October 2023) and *JTI Acquisition Company v HMRC* (the Upper Tribunal (UT) decision for which is awaited after the hearing in March). HMRC has been arguing (in *Blackrock* for example) for a company's subjective purpose to take into account the wider group's purpose. This broadens the test and is one area taxpayers and advisers are watching out for in these appeals. A proposal to extend the unallowable purpose rule to loan relationships which are part of arrangements which have a tax avoidance purpose was consulted on in 2007/2008, in the form of a new s. 442A, but was never enacted. It appears HMRC are now trying to achieve the same effect through case law.

Tax advantage (CFM38140)

HMRC's view is that all that is required for there to be a tax advantage is for the taxpayer to have improved its tax position as a result of a transaction 'for instance by deductible loan relationships debits' as confirmed by Judge Beare in *Oxford Instruments v HMRC* [2019] UKFTT 0245. HMRC notes that the question of what constitutes a tax advantage has also arisen in other cases currently being litigated including in *Kwik-Fit* [2022] UKUT 314 (TCC) (due to be heard by the Court of Appeal by June 2024).

Securing tax advantage as a main purpose - tax-related factors (CTM38170)

HMRC has provided a list, based on HMRC's experience and case law, of potentially relevant tax-related factors that may be helpful in assessing whether or not securing a tax advantage is a main purpose. These factors are: the size of the tax advantages compared with the size of the commercial benefits; the existence, or lack of, net UK tax benefits in financing arrangements; the existence, or lack of, net global tax benefits in cross-border financing arrangements; the degree of attention paid to securing the tax advantages; whether the arrangement would not have happened at all, or would have happened in a different way, 'but for' the tax advantage; and where the borrowing funds activities or investments which are not expected to generate UK tax, either immediately or at all.

Just and reasonable apportionment (CFM38150)

Where there are mixed allowable and unallowable purposes, the guidance notes there is a 'wide latitude in judgement' as the apportionment is an objective test which depends on the facts and circumstances. HMRC notes that although case law decisions which were final at the time of writing the guidance have so far resulted in 'all or nothing' apportionments, there are cases currently under litigation where partial apportionment of debits is

being considered. *BlackRock* and *Kwik-Fit* are examples of cases currently being litigated which discuss just and reasonable apportionment. The guidance refers to different approaches to apportionment including on the basis of a clear causal link (e.g. in respect of debits arising from a change in arrangements) or by looking at the extent to which the debit is different than it would have been 'but for' the identified unallowable purpose.

Status of Economic Secretary comments recorded in Hansard (CFM38180)

The guidance preserves the comments of the Economic Secretary on the predecessor of ss. 441-442 as recorded in Hansard. It is stated that these comments, and HMRC's summary of them, are consistent with HMRC's understanding of the law, then and now. This includes that ss. 441-442 will not normally apply if a company chooses the course of arranging its commercial affairs which gives a favourable tax outcome, provided that tax avoidance is not the object, or one of the main objects, of the arrangements.

Examples (CFM38190)

HMRC sets out 17 examples based on illustrative underlying fact patterns indicating HMRC's views on the types of situations where the unallowable purpose does, or does not, apply. There are ten examples where ss. 441-442 will not normally apply and seven where ss. 441-442 will apply and where the likely basis of apportionment is indicated. These examples are based on a list of assumptions that are unlikely to reflect the complexity of real-world examples and, as the guidance notes, the test has to be applied to specific facts of a case established by careful examination of the evidence available. So if there are other significant features present, or the arrangements form part of wider arrangements, the examples may not provide as much assistance in predicting HMRC's view as a taxpayer or tax adviser might hope.

HMRC's approach to enquiries (CFM38200)

HMRC sets out its approach to enquiries and the contemporaneous documentary evidence that HMRC will expect to see to establish purpose including: board papers and supporting papers such as step plans and slide packs, and emails and communications between those having input into the arrangements (including external persons). Based on HMRC's experience, the guidance lists a number of key areas to explore to understand purpose which include what the tax consequences of the arrangements are and which documents they are reflected in, and whether there is a specific tax issue the arrangements are intended to solve/ work around, if so, where this is reflected in the contemporaneous documents. HMRC will expect to see 'all drafts' of relevant documents in order to see how a proposed transaction developed and any changes from inception through to implementation.

Engie: AG's opinion on State aid challenge to tax rulings

Assuming that the CJEU in *Engie v European Commission* (Case C-451/21 P) follows the recently published Advocate General's opinion, it will be a further significant restriction on the Commission's power to launch tax State aid challenges. According to AG Kokott, the Commission and the General Court were wrong to find that Luxembourg granted unlawful State aid to the Engie group in connection with the fiscal treatment of the restructuring of the group of companies in Luxembourg. National law alone is the reference framework and only manifestly incorrect tax rulings under that framework may constitute a selective advantage.

In recent case law, the CJEU subjects general taxation decisions to scrutiny for compliance with State aid law only if they have been designed in a manifestly discriminatory manner with the aim of circumventing the requirements of EU law on State aid. AG Kokott suggests that there is no reason not to transpose that case law to situations where the law is misapplied in favour of the taxpayer. So in her opinion, only those rulings manifestly erroneous in favour of the taxpayer constitute a selective advantage and the Luxembourg tax rulings do not fit into this category.

Shinelock: distribution or non-trading loan relationship deficit

The Upper Tribunal (UT) in *Shinelock Ltd v HMRC* [2023] UKUT 00107 (TCC) dismissed the appeal in HMRC's favour but on different grounds to the First-tier Tribunal (FTT). Although the result is the same for the taxpayer (corporation tax of around £19k due on a chargeable gain), the UT's decision contains some interesting points on analysis of the distributions rules and about procedural fairness.

Shinelock purchased a residential property for £725,000 and sold it some 5 years later for £1,030,000. It paid the difference, £305,000, to Mr Ahmed, a non-UK resident who was sole director and owner of all but one of the shares. HMRC sought to tax Shinelock on the chargeable gain arising (which after deducting expenses and indexation allowance was around £94k).

The taxpayer argued that the £305,000 payment to Mr Ahmed was deductible as a non-trading loan relationship deficit (NTLRD) on the basis that Shinelock had agreed it would pay any gain on the property to Mr Ahmed in return for him providing some finance by way of loan and/or guaranteeing Shinelock bank debt. The FTT had decided that this payment was not a distribution because it was not 'paid out of the assets of the company' as it was a payment to discharge a contractual obligation. As it was not a distribution, CTA 2009, s. 465 did not kick in to prevent a NTRLD from arising. The taxpayer still lost before the FTT, however, as in order for there to have been an NTLRD, there needed to be a debit in the amount of the payment recognised in its accounts and the FTT decided that no such debit had been recognised. The receipt of the consideration and the payment had been netted and entirely excluded from the accounts (as opposed to being netted to result in an entry of 'nil' in which case it could have been said that both gross amounts had been recognised in the accounts by way of the net figure).

Although the UT decided the payment was a distribution and did not therefore need to consider the NTLRD point, the UT agreed with the FTT that this was a case where it was concluded in preparing the accounts that no entry needed to be made so nothing was recorded as required by s. 308(2) (as drafted at the time). Shinelock had accordingly not established that a NTLRD was due. A key practical point to takeaway from this case is the importance of making sure something is included in the accounts in order to satisfy the requirement in s. 308, the current drafting of which requires amounts to be 'recognised in the company's accounts for the period as an item of profit or loss'.

Distribution analysis

There was no discussion before the UT of whether the payment was made 'out of the assets of the company' because Shinelock had conceded this point by the time of the UT hearing. The UT concluded that the conditions for the payment being a distribution within paragraph F of CTA 2009, s 1000(1) were satisfied. The UT described the broad purpose of paragraph F as being 'to deny treatment as a deductible borrowing cost for payments which are in substance a distribution of profit. It is to that extent, an example of a dividing line between returns on debt and returns on equity' (paragraph 89).

Looking at the conditions for the payment to be a distribution within paragraph F the UT concluded that firstly, there was a deemed security (pursuant to s 1114(3) because consideration was given by a company for use of money advanced without a security). Second, the payment was made 'in respect of' the security because it was put into the hands of Mr Ahmed in his capacity as holder of the security (following *Clipperton* [2022] UKUT 351 TCC). Third, the consideration given by Shinelock for the use of the principal secured depended on the results of Shinelock's business as set out in Condition C of s 1015. Condition C is broadly drafted and would apply unless the disposal was not part of Shinelock's business in the broadest sense of any commercial activity capable of generating a profit. The UT concluded that the gain on the disposal of the property formed part of the 'results of' Shinelock's business, or a part of that business, which included the acquisition, holding and disposal of the property.

Procedural fairness

A number of useful general points on the scope of an appeal and procedural fairness can be taken from this decision and we have highlighted three. The first relates to how to determine the scope and subject matter of the appeal. According to the UT, this will be defined by the conclusions stated, or amendments made, in a closure notice and this must be determined at the time the closure notice was issued 'on the basis of the understanding of a reasonable recipient standing in the shoes of the taxpayer' (paragraph 64). The subsequent review process cannot retrospectively extend the scope of the matter in question, although subsequent discussions between the parties might shed light on the nature of the understanding at that time. The subject matter of the appeal is to be construed broadly as the UT explained quoting from paragraph 72 of *Investec* [2020] EWCA Civ 579: 'A narrow confinement of the subject matter of the appeal is not intended to be one of the protections conferred on the taxpayer.'

The second point is about the implications of new arguments being raised. If a party invokes new arguments in the FTT hearing that were not in the skeleton argument, the FTT must consider how to ensure procedural fairness to both parties. A new argument should not be considered by the FTT without first giving the other party the opportunity to object, or to make submissions, granting an adjournment or permitting submissions to be made after the hearing as appropriate, or permitting further evidence to be adduced in response to the new argument.

The third is where the judge thinks of an argument not raised by the parties themselves. In the Tribunals, including the FTT, there is room for a more inquisitorial approach but judges should exercise restraint. Although there is a 'venerable principle of tax law' that taxpayers should pay the correct amount of tax and that proceedings before the FTT are not simply a dispute between two private parties, there are limits on what judges can decide a case on. It is procedurally unfair for a party to learn that it has lost its case for a reason identified for the first time in the FTT's decision when that party has not had a fair opportunity to address the new argument. It will not generally be acceptable for the FTT to identify a new argument for the first time in its decision and to base the decision on that new argument without having given the parties opportunity to make further submissions.

So what should a judge do if they come up with better arguments when writing the decision? The *Altrad* case [2022] UKUT 00185 (TCC) is a good example. The UT effectively said that HMRC had not run the right *Ramsay* argument (HMRC had confined its *Ramsay* argument to CAA 2001 section 61(1)(a) attacking the scheme at the point of purported disposal of the assets by the taxpayers). The UT inferred that there was a way in which HMRC could have put its Ramsay argument which meant HMRC would have won but as it had not been argued Judge Sarah Falk said 'We stress that we have reached our conclusion based on the *Ramsay* argument that HMRC chose to put forward ... it is not for us to comment on other ways in which the *Ramsay* argument could have been advanced, or the conclusions we might have reached if different arguments had been put forward' (paragraph 94). HMRC has now been granted leave to appeal by the Court of Appeal on two grounds, one of which is a new argument not made before either of the tribunals focussing *Ramsay* on s 11(4)(a) to attack the scheme at the point the taxpayers purported to reacquire the assets pursuant to the option on the basis that the option price did not constitute 'qualifying expenditure' (see *Altrad v HMRC* [2023] EWCA Civ 474).

What to look out for:

- The closing date for comments on the consultation on the Reserved Investor Fund is 9 June.
- The Upper Tribunal is scheduled to hear the appeal in *Hotel LaTour* (VAT on professional services connected to a share sale) on 12-14 June.
- 22 June is the closing date for comments on cryptoassets and decentralised finance.
- The Supreme Court hearing in *Skatteforvaltningen v Solo Capital Partners LLP* on the applicability of the rule against enforcement of foreign revenue laws to the claim by the Danish tax authority for restitution of tax refunds is expected 5-6 July.
- The Supreme Court hearing of the appeal in *Professional Game Match Officials Ltd v HMRC* (on whether referees are employees of their representative body) is scheduled for 26 and 27 June.
- 'L Day' when draft legislation for the next Finance Bill will be published is expected 'this summer'.

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CONTACT

Mike Lane
PARTNER
T: +44 (0)20 7090 5358
E: mike.lane@slaughterandmay.com

Zoe Andrews
PSL COUNSEL & HEAD OF TAX KNOWLEDGE
T: +44 (0)20 7090 5017
E: zoe.andrews@slaughterandmay.com

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650

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