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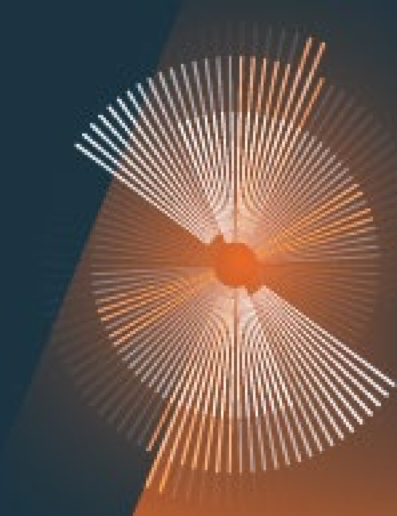

TAX AND THE CITY

CLIENT BRIEFING

JANUARY 2025

Taxpayers and advisers question the value of APAs after the Upper Tribunal's decision in *Refinitiv* on the interaction of DPT and APAs. In *Syngenta*, the First-tier Tribunal concludes on the facts that the unallowable purpose rule prevents deductions for debt financing as there was no commercial purpose of the arrangements. HMRC update their guidance on when TCGA 1992 s 135 applies, including a new statement that a court approved scheme of arrangement may be capable of being a 'general offer'. The Supreme Court in the *Cobalt* case takes another opportunity to clarify how purposive construction applies.

Refinitiv: JR challenge to DPT notice

The Court of Appeal in *Refinitiv Ltd and others v HMRC* [2024] EWCA Civ 1412 dismissed the taxpayer's judicial review claim seeking to quash or declare unlawful a diverted profits tax (DPT) notice. Refinitiv, a UK resident company in the Thomson Reuters group, had argued that the DPT notice issued by HMRC in 2018 was incompatible with an advance pricing agreement (APA) entered into for the period from 2008 to 2014. The keen-eyed reader will spot that this APA had been agreed before DPT was enacted and indeed at the time of negotiating the APA it was not even contemplated.

The purpose of an APA is to determine a method for resolving transfer pricing issues in advance of a tax return being made. It is intended to give the taxpayer certainty in respect of the transfer pricing issues covered by the APA for a specified period. Such certainty is a key factor in the UK's attractiveness as a location for inward investment and is crucial to the success of the government's growth agenda.

Refinitiv's APA with HMRC agreed that the appropriate arm's length remuneration for services provided by Refinitiv in the UK in relation to IP held by TRGR (a Swiss resident company and owner of the Thomson Reuters group's main IP assets) was to be calculated on a 'cost-plus basis' whereby a specified percentage mark-up was added to the costs of providing the relevant services during the specified period. In 2018, TRGR sold the IP to a third party and HMRC issued a notice charging Refinitiv to £167m of DPT. HMRC argued that, on an arm's length basis, on the sale of the IP Refinitiv should have received a share of the profits because the services it had provided to TRGR contributed significantly to the value of that IP.

The key question in the case was whether accounting periods from 1 January 2015 onwards (i.e. after the expiry of the APA) lay outside the temporal scope of the APA. The Court of Appeal determined that the answer lay in the true construction of both TIOPA s 220(1) and the APA to determine whether the 2018 accounting period is a chargeable period to which the APA 'relates' and if so whether the APA has the effect that the issue of the DPT notice for the 2018 period was unlawful in public law. The Court of Appeal came to the 'simple and obvious' conclusion that the APA made provision relating to the chargeable periods during the specified period ending 31 December 2014. Given the annual taxation framework in which the APA was concluded, the Court of Appeal found it cannot be intended by Parliament that the APA should relate also to 'unspecified future chargeable periods, however remote in time, in which an issue settled by the APA for the chargeable periods specified therein might again become relevant in some way to the determination of [the taxpayer's] future taxation liabilities.'

From the perspective of the Court of Appeal, if the taxpayer's arguments were correct, there would be no point renewing an APA as the agreed mechanism for the transfer pricing would continue to apply even after expiry of the APA. In the words of Sir Launcelot Henderson this would mean the transfer pricing treatment agreed in the APA would enjoy a 'potentially indefinite afterlife'. The issue here is more complex than this, however, because HMRC did not just seek a profit-share in respect of the services provided in 2015-2018 but in respect of services from 2008. HMRC's application of the profit-share method to allocate profit in respect of the IP sale in the 2018 chargeable period to Refinitiv effectively enabled HMRC to override the agreed costs-plus treatment during the periods within the scope of the APA. This case, therefore, calls into question whether an APA can deliver certainty in transfer pricing cases involving IP rights such as this if

HMRC is able to revisit in a later chargeable period the APA-agreed pricing of services provided during a period within scope of the APA.

This case was determined on the basis of the scope of the APA and in this case HMRC had conceded that if the relevant chargeable period were within scope of the APA, the DPT notice would be inconsistent with the APA and therefore would be unlawful. The obiter comment in paragraph 77 that ‘in different factual circumstances’ HMRC could successfully raise arguments not to be bound by an APA even where the issue of a DPT notice is found to be inconsistent with an APA is further cause for concern.

Given the ever-growing importance of transfer pricing services relating to IP, it is hoped that, if Refinitiv applies to the Supreme Court for permission to appeal (which, given the amounts at stake, must be likely), the Supreme Court accepts (as it did in *R v Wilkinson* [2005] UKHL 30 on extra-statutory concessions) that the proper scope of HMRC's powers is a matter of general public importance (and value to the UK as a whole) and so agrees to hear it. But even if this decision is the end of the road for the judicial review claim of the lawfulness of the DPT notice, there will be more to come because Refinitiv has also brought FTT proceedings challenging the DPT notices under FA 2015 s 102.

Syngenta: unallowable purpose

The principles recently laid down by the Court of Appeal last year were applied by the FTT in the latest unallowable purpose case of *Syngenta Holdings Limited v HMRC* [2024] UKFTT 998 (TC). The FTT concluded that the only purpose for the loan relationship was the obtaining of the UK interest deductions and that HMRC was right to disallow all the debits.

In brief, prior to a reorganisation in 2011 the Swiss-parented Syngenta AG group had two UK sister companies (SHL and SL) held by a Dutch holding company. SHL held a number of UK subsidiaries and SL held a mix of UK and non-UK subsidiaries. In the reorganisation, SHL acquired SL in consideration for the cash payment of $950m and the issue of $1.258bn of shares to its Dutch parent. The cash element was funded by a loan from a Dutch treasury company for which an advance thin capitalisation agreement was obtained. The deductions for interest payments in respect of this loan were denied by HMRC under the unallowable purpose rule in s 441.

The FTT found on the evidence that the reorganisation was tax driven at group level. The purpose was to obtain the UK interest deductions. Although the board minutes had referred to ‘anticipated growth’ in SL making it a ‘good investment’, the fact that the minutes had been reviewed by the accountants meant the FTT viewed them with caution ‘as we have found they were checked by tax professionals with an eye to avoiding a challenge by HMRC’. The FTT also considered that the board minutes did not reflect the SL valuation report which the directors had also seen which identified risks as well as opportunities for growth. The FTT concluded that the legal entity simplification purpose was being used as a ‘cover’ to minimise perception that the transaction was entered into for tax purposes. The FTT concluded based on overwhelming contemporaneous evidence that the purpose of the SHL directors in entering into the loan was to play their part in what they understood to be the group project of obtaining the tax deductions.

As an unallowable purpose case where evidence of commercial purpose is crucial, the odds of success seem so stacked against the taxpayer that it is difficult to see why the taxpayer brought this case. Although the taxpayer argued there was a commercial purpose of making a good investment, entity simplification or dividend planning, the evidence did not support this and the FTT concluded the transaction was tax driven at group level. This case highlights the need for the commercial purposes of a transaction to be clearly articulated and evidenced.

On the positive side, however, the FTT did dismiss HMRC’s suggestion that the circular cash flow could be used to infer tax motivation. The FTT noted that many multinationals have a group treasury company and it is not unusual for an internal transaction to have cash flows that are circular.

HMRC’s updated guidance on conditions for share exchanges

HMRC updated their guidance in the *Capital Gains Manual* at *CG52523* on the qualifying conditions for rollover treatment on share exchanges in TCGA 1992 s 135. Subject to the anti-avoidance provision in s 137, s 135 applies in three scenarios, or ‘cases’ as the legislation refers to them. The second case is where a share for share exchange is the result of a general offer made to shareholders of the target conditional at the outset on the acquirer gaining control. The changes made in November 2024 include new guidance on the meaning of ‘general offer’, clarification that the second case will also apply where the offer is subsequently made unconditional, and clarification that case 2 can be met in the case of an indirect acquisition (e.g. where company B issues shares to the target’s shareholders, but the target is not acquired directly by B, but by B’s wholly owned subsidiary).

Prior to the new guidance, it was considered that a scheme of arrangement could not be a ‘general offer’ but the new guidance states that HMRC accepts that an arrangement such as a Court approved scheme, provided it applies to all members holding a particular class of security in company A and requires their consent, may be capable of being a general offer.

Cobalt Data Centre: purposive construction

In *R (on the application of Cobalt Data Centre 2 LLP and another) (Appellants) v HMRC* [2024] UKSC 40, the Supreme Court had to consider the correct construction of CAA 2001, s 298 to determine whether the relevant expenditure was incurred (i) within the specified 10-year

time period of the designation of the area as an enterprise zone; or (ii) within 20 years of the enterprise zone designation and incurred under a contract entered into within the 10-year expiry period. The relevant contract was entered into two days before the end of the 10-year expiry of the enterprise zone, but it was amended after the end of that period by another contract, and the expenditure fell within the scope of the amendment rather than the original contract. The Supreme Court denied the claim for 100% capital allowances on the construction of two data centre buildings in the enterprise zone.

Although the enterprise zone regime has now expired, the case is of more general interest as a case on purposive construction. The Supreme Court applied *Rossendale*, the most recent Supreme Court decision on purposive construction often referred to as the *Ramsay* principle. It is a reminder that there is more to statutory construction than just the words in the statute. The legislation will be interpreted purposively and applied to the facts viewed realistically and the courts will look to materials beyond the legislation itself.

In this case, the key document used to ascertain the purpose of the legislation was the Treasury statement which had accompanied the 1980 budget announcing the enterprise zone regime. It was clear from this statement that the 10-year time limit in s 298(1)(b) was intended to secure a contractual commitment from the taxpayer by the end of that period to incur relevant expenditure which would eventually qualify for a capital allowances claim in order to ensure the impact of the enterprise zone would be achieved within a reasonable timescale. The Court of Appeal considered that treating variations to the contract after the 10-year time limit as giving rise to expenditure incurred under the original contract would undermine this purpose.

What to look out for:

- 22 January is the closing date for comments on the Tax Administration Framework Review: new ways to tackle non-compliance consultation which includes the proposal to permit a partial enquiry power.
- 31 January is the closing date for the consultation on the revised regime for carried interest.
- On 4 February, the Court of Appeal is scheduled to hear the appeal in *Gunfleet Sands* on capital allowances in respect of expenditure on windfarms.
- Various consultations referred to the in Corporate Tax Roadmap are promised for ‘Spring’, including a second round of consultation on reforms to transfer pricing, DPT and permanent establishment rules.

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