SLAUGHTER AND MAY/

CLIENT BRIEFING

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TAX AND THE CITY

In another case involving both commercial and unallowable purposes, the Court of Appeal in *Kwik-Fit* decides that some of the loan relationship debits can be allocated to the commercial purpose. In a blow to taxpayers, the Court of Appeal in *Hotel La Tour* decides that input tax in respect of deal fees in relation to a share sale are attributable to the exempt share sale (and therefore irrecoverable), rather than to the taxpayer's downstream taxable general economic activities. The FTT allows an application on behalf of the wider tax community for skeleton arguments to be made public in the *Osmond and Allen* case relating to the transactions in securities legislation. The Inclusive Framework announced its intention for the multilateral convention to implement Amount A of Pillar One to be open for signing by the end of June (the expiry of the interim period for the transitional approach to existing unilateral measures) but this seems unrealistic as there remains a lack of alignment of interests (and unwillingness to compromise) between India, China and the US.

Kwik-Fit: unallowable purpose

In *Kwik-Fit v HMRC* [2024] EWCA Civ 434, 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 CTA 2009, section 441 in another case involving mixed main purposes. The loan relationship debits came about as a result of a tax motivated intra-group refinancing. A company in the Kwik-Fit group, Speedy, had carried forward non-trading loan relationship deficits (NTDs). In order to accelerate the utilisation of these NTDs, a reorganisation of intra-group loans was implemented. This involved some loans being assigned to Speedy, (or, in one case, being created to replace an original loan) and the interest rate on existing loans being increased to an arm's length rate. Consequently, more interest was received by Speedy which enabled Speedy to use £48m of NTDs within three years instead of over 25 years. The creation of deductions in the Appellants where the corresponding income for Speedy did not create a tax charge would have produced a significant tax saving for the group. Accordingly, HMRC challenged the deductions for the interest paid by the Appellants.

Unallowable purpose

Lady Justice Falk gave the lead judgment and pointed out that the analysis in this case has been over-complicated by HMRC seeking to maintain that the reorganisation generated two separate tax advantages which the Appellants had a main purpose in securing (the use of the NTDs for Speedy 1, and the generation of relief in the Appellants). The Court of Appeal prompted HMRC to consider an alternative approach, which was that the generation of tax deductions, without tax on the corresponding income, was a main purpose of the reorganisation. On this analysis, there is no need for the use of Speedy's NTDs by itself to be shown to be a tax advantage intended to be secured by the reorganisation.

The Court of Appeal considered that the findings of the First-tier Tribunal (FTT) amply demonstrated that it concluded that the generation of deductions, without tax on the corresponding income, was found to be a main purpose of the reorganisation. One of the arguments for the Appellants was that HMRC had at no stage identified any tax saving achieved by the generation of the deductions in the Appellants; indeed, three of the Appellants were loss-making. The Court of Appeal agreed with HMRC that there is no requirement in the unallowable purpose test to identify either a specific quantum of tax saving or the precise identity of the beneficiaries. Identifying purpose is necessarily a forward-looking exercise, considering what is sought to be achieved, not what is ultimately achieved. The group sought and expected to make material tax savings.

'It would frustrate the obvious aim of the unallowable purpose rule if it were confined to identified amounts saved by a specified person.' (Lady Justice Falk at paragraph 97). The Court of Appeal agreed with HMRC that under the Interpretation Act 1978, section 6, (singular includes the plural unless a contrary intention appears), section 422(5) should be read as referring to the company in question and/or any other person or persons. The FTT had found that the aim was to benefit the whole group and the Court of Appeal considered this sufficient identification of persons for the purposes of section 442(5).

Attribution between purposes

Having agreed with the findings of the FTT that there was both a commercial main purpose and a tax advantage (unallowable) main purpose, the question was then how to attribute the loan relationship debits on a just and reasonable basis between the commercial and unallowable purposes. Last month, we wrote about the Court of Appeal's decision in [*BlackRock*] [2024] EWCA Civ 330 that there was no basis for apportionment of any debits to the commercial main purpose, so all the debits were allocated to the unallowable purpose and disallowed. In *Kwik-Fit*, however, the Court of Appeal agreed with the FTT's decision that there was a basis for apportionment. Lady Justice Falk referred to *BlackRock* for the correct approach to apportionment: it is an objective exercise requiring apportionment by reference to the relevant purposes. The Court of Appeal saw no legal error in the FTT's approach to apportionment in this case. Some of the loans were pre-existing loans, the interest rate on which had been increased, and the Court of Appeal agreed that the FTT was entitled to attribute all the debits arising from the increase in interest rates to the unallowable purpose but that deductions should be available for interest on the pre-existing loans up to the old rates of interest.

HMRC had agreed that once Speedy's NTDs were used up it would no longer be just and reasonable to deny relief for the debits. On the face of it, this may seem odd as it appears to find an unallowable purpose, yet not one for which there is a disallowance over a certain threshold. The Court of Appeal agreed that this was correct as it reflected the nature of the tax advantage sought to be secured.

Hotel La Tour – input tax irrecoverable in fund-raising exempt share sale

Taxpayers who had been hoping to recover input tax incurred in connection with a fund-raising sale of shares (based on the decisions of the FTT and Upper Tribunal (UT)) will be disappointed with the Court of Appeal's decision in *HMRC v Hotel La Tour Ltd* [2024] EWCA Civ 564. The question was whether input tax was recoverable on marketing costs and solicitors' and accountants' fees incurred by a holding company, HLT, on the sale of shares in a managed subsidiary (itself an exempt supply). The purpose of the share sale was to fund the building of a new hotel as part of HLT's downstream taxable activity. The case has been much written about already, so we will keep our observations brief.

The Court of Appeal took a narrower view of the caselaw than the FTT and UT concluding that HLT is prevented from recovering the input tax because, according to the long-settled rules of VAT, which have not been displaced by *Frank Smart* [2019] UKSC 39, *SKF* [2010] STC 419 or any other authority, the input tax had a direct and immediate link with HLT's exempt supply of shares. We are now in the position that, although the Court of Appeal confirmed that there is no longer an assumption that inputs incurred in the context of a share sale are directly attributable to that share sale (they may bear a direct and immediate link with the taxpayer's general economic activity and be recoverable in proportion to taxable outputs), it will be very difficult in practice to recover any input tax in a similar fund-raising scenario involving an exempt share sale.

The clarification that the direct and immediate link test has not been varied to a test of incorporation of costs is helpful, to a degree. The Court of Appeal concluded that, according to caselaw, deduction is not dependent on where costs are incorporated in the prices of outputs but, in case they are wrong about there being no separate test of incorporation of costs, they went on to say it would not make a difference in this case as the costs were incorporated in the share sale in any event, because they were used to make the share sale and were met from the proceeds of sale.

Osmond and Allen: disclosure of skeleton arguments of interest to the wider tax community

'Open justice' is a constitutional principle which applies to all courts and tribunals exercising the judicial power of the state, including the FTT, the overall purpose of which is to enable the public to understand and scrutinise the justice system of which the courts are the administrators. Under this principle, third parties may apply for disclosure of certain court documents, such as the parties' skeleton arguments, which describe the parties' respective positions in more detail than is set out in a decision. Such documents may be necessary for the third party to be in a position to understand the issues and the evidence adduced in support of the parties' cases. It is for the judge to carry out a fact-specific balancing exercise to consider the purpose of the open justice principle, the potential value of the information in question in advancing that purpose, and any risk of harm to the judicial process or to the legitimate interests of others.

It is common for third party applications for disclosure to be made by advisers who have clients considering challenging similar issues, or who are already involved in related litigation. The FTT's procedural decision in *Osmond and Allen v HMRC (Stewarts Law LLP Third Party)* [2024] UKFTT 414 (TC) differs from the usual third party application. In addition to arguing that the skeleton arguments were required because the substantive case raised a point about time limits for assessments under the transactions in securities legislation, which was directly relevant to three clients, Stewarts Law LLP also submitted that the skeleton arguments are of interest to the wider tax community. They submitted that there is a legitimate interest in 'enabling accurate and meaningful professional commentary on an important tax issue which is of interest to the wider tax community'.

Judge Nigel Popplewell allowed the application. He concluded that he could not see any principled reason to treat an application made in a 'representative' capacity on behalf of the wider tax community, where the requested documents would be put into the broader public domain, differently from an application on behalf of specific clients. Seeing the technical arguments in the skeletons will enable the broader tax community (and the public at large) to understand the decision reached in the

appeal and to judge the judges. It should also increase efficiency since it would reduce the need for other organisations to bring further, separate requests for disclosure of the same documents.

Whereas this is obviously good news for tax advisers interested in following the technical arguments in particular cases, taxpayers should be mindful that information that is included in skeleton arguments may be made public in this broader way with the risk that confidential or commercially sensitive information is accessed by competitors, the media and others.

Another development to bear in mind here is the consultation by the Civil Procedure Rule Committee (CPRC), to widen the current rule (CPR 5.4C), including to make a wider range of documents from court records (skeleton arguments, witness statements and experts reports) available to non-parties without permission, subject to some exceptions and unless the court orders otherwise. The consultation closed on 8 April and the CPRC is currently considering the responses and is aiming to bring the proposed changes into force as part of the October 2024 CPR updates. Although the CPR does not apply to the FTT and UT, they generally follow a similar approach, and it is likely they will follow a change to CPR 5.4C in due course.

Digital services taxes and Pillar One

A political compromise between the US, Austria, France, Italy, Spain and the UK agreed in October 2021 for a transitional approach to existing unilateral digital services tax (DST) measures during the interim period before Pillar One takes effect will, unless extended again, end on 30 June 2024. It was agreed that Austria, France, Italy, Spain and the UK will give credit for any DST or similar tax accruing to any taxpayer during the interim period. In return, the US agreed not to impose trade sanctions in respect of those taxes. Although the OECD/Inclusive Framework announced it is aiming to reach final agreement in time to have a multilateral convention open for signing by the end of June for Amount A of Pillar One (the new taxing right for market jurisdictions), the US has been quite vocal in saying it cannot support it unless India and China are on board with the US position. It will be interesting to see whether a further extension to the interim period is agreed, or if the US will simply seek to impose trade sanctions from July.

What to look out for:

- At the end of June, the UT is scheduled to hear the appeal in *Muller UK & Ireland Group LLP and others v HMRC* on the application of the intangible fixed assets regime in CTA 2009 to partnerships.
- On 3 July, the Court of Appeal is scheduled to hear the appeal in *GE Financial Investments v HMRC* on residence and permanent establishment under the UK/USA double tax treaty.
- On 9 or 10 July, the Court of Appeal is scheduled to hear the appeal in *HFFX LLP v HMRC* on deferred remuneration arrangements and profit reallocation.
- With the election on 4 July, new tax policy will inevitably follow, although an Autumn Budget is expected rather than anything more hurried. Labour has promised a business tax roadmap within the first six months of its government if elected.

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