Tax and the City Briefing for March

March 2017

Spring Budget

As expected, the final Spring Budget was light from a tax perspective, thus helping taxpayers and advisers to get ready for the move to Autumn as the main fiscal event. The Budget mostly confirmed measures which are already in progress, together with highlighting changes following consultation on the earlier draft legislation (albeit with little detail being provided in some areas). The good news is that in response to comments received, a number of changes will be made to the corporate interest restriction to ensure the rules do not give rise to unintended consequences or impose unnecessary compliance burdens. In particular, there was a somewhat vague statement about ensuring that certain debt guarantees do not result in interest being treated as related party interest for certain purposes. This is, hopefully, recognition that the related party debt rule should not catch intra-group guarantees, only third party guarantees which enable a company to borrow more than it would under its own credit rating. The detail of this proposed change should become clear when the Finance Bill is published on 20 March.

No Budget is complete, of course, without some anti-avoidance measures taking immediate effect and this Budget's offerings include preventing the election under TCGA 1992 s 161(3) being made for capital losses to be treated as trading losses on appropriation of assets to trading stock on or after Budget day. This will be a disappointment to many companies which have previously elected to convert not very useful capital losses to more flexible trading losses in reliance on the Court of Appeal's decision in *New Angel Court v HMRC* [2004] STC 779. How times have changed since 2004 when the Court of Appeal said that this type of transaction was "fiscal alchemy" for which Parliament had made "express provision". Now it is unacceptable tax avoidance to be closed down.

Anti-avoidance has also featured in recent tribunal decisions, most of which have been decided in HMRC's favour (see below).

GAAP-compliant accounts and "fairly represents"

There is an interesting contrast between the Upper Tribunal's judgment of 17 February in *GDF Suez Teesside v HMRC* [2017] UKUT 68 (TCC) that a transaction notified under DOTAS does not work and the decision of the First-tier Tribunal of 8 February in favour of the taxpayer in *Smith and Nephew v HMRC* [2017] UKFTT 151 (TC). In both cases, the relevant tribunal considered whether the accounting treatment adopted by the taxpayer in question was correct and whether, despite this, the (now repealed) "fairly represents" language could override the accounting treatment. Although both cases concerned loan relationships and perceived tax avoidance, it is notable that only one (*GDF*) is described in the first line of the decision as being a tax avoidance scheme. The change in functional currency in the *Smith and Nephew* case was intended to trigger a foreign exchange loss for loan relationships purposes without there being any actual economic loss, but the transactions escaped being labelled as avoidance by the FTT and this may have coloured the decision.

The Upper Tribunal in *GDF* rejected the argument that the reference to "fairly represents" in FA 1996 s 84(1) imported "some overarching requirement

of "fairness", allowing a court or tribunal to impose its own perception of the right result". This should have been the end of it, with a victory for the taxpayer, but the taxpayer still lost. The Upper Tribunal, prepared to go the extra mile to defeat the perceived tax avoidance scheme regardless of the technical merits and arguments, decided that there was an asymmetry between the accounting treatment of the taxpayer and the accounting treatment of the subsidiary which, in its view, s 84(1) was designed to correct and accordingly found that a sum representing the value of the shares allotted to the taxpayer in exchange for the assignment of the claims to its subsidiary was required to be brought into account for tax purposes.

The FTT in *Smith and Nephew* was not inclined to extend the scope of s 84(1) in this way. There was a choice of two methods of accounting for the change in currency and the taxpayers chose the "foreign operation method" which, for tax purposes, gave them significant foreign exchange losses (as it looked at the difference in rates over the year) even though, in fact, the companies only had exchange rate exposure for one day. The FTT preferred the experts for the taxpayers and, accordingly, the FTT decided the taxpayers were entitled to adopt the accounting method that they had and that nothing in s 84(1) enabled the tribunal to change that.

The FTT rejected the idea that "fairly represents" is an overarching test, a "sanity check" or "fail-safe" quoting *Greene King v HMRC* [2016] EWCA Civ 782 (paragraph 77 of the Court of Appeal judgment) and the FTT in *Union Castle v HMRC* [2016] UKFTT 526 (TC) (paragraphs 53-56 of the FTT's decision). Given the significant amount of exchange losses involved, it is likely that HMRC will seek to appeal this decision and it will be interesting to see if the Upper Tribunal follows the approach in *GDF* and takes the opportunity to use s 84(1) to tackle the asymmetry between the economic reality and the accounting treatment of the exchange losses.

Although, of course, we no longer have an equivalent of the fairly represents rule in the legislation (it having been replaced by a regime TAAR) these cases are still interesting for showing the attitude of the tribunals to avoidance cases and for illustrating the importance of good expert witnesses to explain the accounting treatment. They also illustrate HMRC's willingness to challenge the accounting treatment and/or to argue that tax should not follow the accounts in order to get what they perceive as the "right" tax result.

Unallowable purpose

In *Travel Document Service and Ladbroke Group International v HMRC* [2017] UKUT 45, the taxpayer had argued that the loan relationship debits in Ladbroke Group International (LGI) were not attributable to LGI's unallowable purpose (it being common ground that one of LGI's main purposes in entering into the loan relationship was to enable its parent, TDS, to obtain a tax advantage).

The Upper Tribunal rejected the taxpayer's arguments and found that the reason the method (of extracting LGI's reserves) was chosen was to obtain a tax advantage for TDS, not for any commercial or business purpose of LGI, thus the debits were wholly attributable to the unallowable purpose.

This serves as a useful reminder that, when considering the possible application of the unallowable purpose rule in section 441 CTA 2009, the legislation requires that the disallowance applies to "so much of any debit in respect of that relationship as on a just and reasonable apportionment is attributable to the unallowable purpose". The test is not whether it is just and reasonable to disallow the debit - a suggestion which is sometimes made in the context of UK to UK loans where the recipient does in fact pay tax on the resulting credits.

What to look out for:

- It's a bumper few weeks for tax cases in the Court of Appeal: *Hancock and Hancock* (CGT on conversion of QCBs/non-QCBs) on 14/15 March, *Blackwell* (CGT- whether payment for release from exclusivity agreement is deductible expenditure) on 28 March, *Newey (t/a Ocean Finance)* (whether offshore scheme designed to save VAT is abusive) on 28/29 March, and *Hely-Hutchinson* (judicial review) on 28/29 March

- The Supreme Court will hear the *Rangers* case on 15/16 March on whether contributions to an EBT are employment income

- The Finance Bill is to be published on 20 March and will contain some changes from the previously published draft legislation, including in the areas of SSE, reform of loss carry forward rules and the corporate interest expense restriction

- 1 April – commencement date for various Finance Bill 2017 changes including the new corporate interest restriction and loss carry forward rules and SSE reform

- 6 April – commencement date for various Finance Bill 2017 changes including the new Apprenticeship Levy, the application of disguised remuneration rules to self-employment and the extension of the double tax treaty passport scheme to all types of overseas lenders and UK borrowers

- We await the response document and draft legislation to clarify and improve aspects of partnership taxation which was not published with the Budget - the Budget did not specify when to expect these documents. It was confirmed that the changes will not be included in Finance Bill 2017 but will be included in the next finance bill.

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