SLAUGHTER AND MAY

Farnborough - Disqualifying arrangements for loss surrenders

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Background

In *Farnborough Airport Properties Ltd and others v HMRC [2017] UKUT 394* the Upper Tribunal ("UT") upheld the decision of the First-tier Tribunal ("FTT") that the appointment of receivers in respect of a company meant that the shareholders of the relevant company ceased to control it. Some of the views expressed by the UT in arriving at this decision are noteworthy in terms of their potential impact on the interpretation of the safe harbour rules in the disqualifying arrangement provisions in CTA 2010 s155A/155B and s174A/174B.

Broadly speaking, these group relief provisions (and the related consortium relief provisions) apply to prevent the surrender of tax reliefs if "arrangements" are in place which could give rise to certain "disqualifying effects", such as changing the shareholding of a group or consortium company so that it no longer qualifies as such, or changing the control or voting rights in such a company in certain circumstances. The UT concluded one of the "disqualifying effects" in CTA 2010 s154 (known as "Effect 2") arose because, with effect from the appointment of the receivers, the company ceased to be controlled by its shareholders.

The conclusion arrived at by the UT meant that the company could no longer surrender losses by way of group relief because arrangements were in place whereby the relevant group relationship could come to an end.

The decision of UT

Meaning of "control"

One of the taxpayers' grounds of appeal was that the FTT had erred in finding that the shareholders had ceased to "control" the surrendering company (within the meaning of CTA 2010 s1124) once the receivers had been appointed.

First, the UT determined whether the receivers had obtained control of the surrendering company. Since the receivers did not own any shares, or possess any voting rights, in the surrendering company, this could have been the case only if the debenture pursuant to which the receivers had been appointed qualified as a "*constitutional document or other document regulating [the company]*" within the meaning of s1124. The UT held that this reference could not extend to include the debenture; and that the phrase "other document" when read in context must refer to a constitutional document akin to articles of association, which is binding on members and directors by virtue of their status as such (not some other document to which accession requires a separate agreement). The extent of the powers conferred on the receivers pursuant to the debenture was irrelevant in reaching this determination.

Second, the UT considered whether, notwithstanding its conclusion that the receivers did not obtain control of the surrendering company, the shareholders had nevertheless ceased to control it. The UT found that the powers

of the receivers were so extensive that the shareholders could no longer be said to have the power to secure that the affairs of the company were conducted in accordance with their wishes. The shareholders were, therefore, deprived of control of the company within the meaning of s1124, so that the appointment of the receivers constituted an arrangement which gave rise to Effect 2.

It is difficult to reconcile the UT's decision that the shareholders ceded their control of the surrendering company with the fact that the only document pursuant to which this could have occurred (i.e. the debenture) was of a type which, according to the UT, must be disregarded when interpreting the definition of control in s1124.

The UT also held that it did not matter that neither the shareholders nor the receivers alone had control of the surrendering company because the wording in Effect 2 recognises that control can be vested in more than one person together (i.e. the shareholders and the receiver, together, may have had control of the surrendering company). Again, this statement is hard to square with the UT's conclusion that, for the purposes of s1124, one should have regard only to constitutional documents or other documents akin to the articles, since this statement requires one to take account of the debenture which, by its nature, simply cannot qualify.

Safe harbour rules

The UT's narrow construction of the phrase "*other document regulating [the company]*" is potentially unhelpful in the context of other provisions in the tax legislation which use similar language.

An obvious example arises in the context of the safe harbour rules in the group relief (and related consortium relief) provisions which effectively exclude certain commercial arrangements from being treated as a disqualifying arrangement. One of the safe harbour rules in s155A excludes from being a disqualifying arrangement a provision in a constitutional document which provides for the suspension of a member's voting rights. Constitutional document is defined in s155A and it is generally considered that a similar reference in this definition to the words used in s1124 is apt to include a suspension of voting rights set out in a shareholders' agreement. The *Farnborough* decision now casts doubt on that view.

The suspension of voting rights in a joint venture are often located in the relevant shareholders' agreement and not in the articles as the parties to the joint venture generally do not want details of their commercial arrangements to be publicly filed in Companies House. As a result, this decision could impact on a considerable number of joint venture projects if, for no apparently logical reason, the suspension of those voting rights must now be relocated to the articles in order to fall within the safe harbour rules.

Arrangements

The taxpayers also contested the FTT's decision that the entering into of the debenture and / or the appointment of the receiver constituted an "arrangement" which gave rise to Effect 2.

The taxpayers argued that, on a purposive construction, the appointment of a receiver is not the type of arrangement that was envisaged by Parliament when the disqualifying arrangement provisions were enacted. In doing so, the taxpayers sought to rely on extra-statutory materials (such as *Hansard*, the explanatory notes and Budget press releases) as an aid to construing the legislative purpose underlying the provision. The UT disagreed and held that the criteria set out in *Pepper v Hart* [1993] IRLR 33 had not been satisfied, as it did not consider there to be any ambiguity, obscurity or absurdity in the statutory provisions that could justify resort being made to such extrinsic materials.

The taxpayers asserted that the purpose of the disqualifying arrangement provisions is to prevent

arrangements where a group surrenders tax losses to a third party without also passing economic ownership; and that the legislation is not intended to apply to commercial situations. The UT held that, subject to the safe harbour rules, Effect 2 of the disqualifying arrangements was intended to apply to arrangements of any kind where the control of two companies is or could be in separate hands, irrespective of the motive or purpose of those arrangements.

The UT held that neither the entering into of the debenture nor the right to appoint a receiver, in and of themselves, constituted an arrangement giving rise to a disqualifying effect. The UT reached this view because, in both of these circumstances, a further event entirely outside the control of the shareholders needed to occur. Therefore, until the receivers were appointed, the shareholders retained control of the surrendering company. This view is consistent with the Special Commissioners case *Scottish and Universal Newspapers Ltd* [1996] STC (SCD) 311 and the statements made in HMRC's published guidance (see *Company Taxation Manual* at CTM80196) that a genuine requirement for external approval before a transaction can proceed will prevent the existence of arrangements until the approval is given (or until it is clear that it will be given).

In reaching this view, the UT was forced to acknowledge that it sits somewhat uneasily with the safe harbour rules which form part of this legislation because, in many cases, these safe harbour rules purport to prevent circumstances which are outside the control of the shareholders from being disqualifying arrangements. Citing *Rangers* [2017] UKSC 45 and the fact that the tax code is not a seamless garment, the UT explained this anomaly by saying that this is one of those situations where the legislative patterns simply do not match up fully at the seams.

Notwithstanding this anomaly, the UT's interpretation on this point is helpful in light of the practical difficulties which can often arise when considering the application of the disqualifying arrangements provisions to straightforward commercial joint venture and M&A transactions.

What next?

The taxpayers have sought permission to appeal the UT's decision. If the case is heard before the Court of Appeal, it remains to be seen whether some or all of the above issues will be addressed in greater detail but it is hoped that the contradictions arising from the UT's narrow construction of the phrase "*other document regulating [the company]*"; and its ultimate conclusion that the shareholders were deprived of control of the company, will be resolved.

The disqualifying arrangement provisions can often cause practical difficulties for joint ventures and M&A transactions, where it is often necessary to rely on the safe harbour rules. In light of the potential impact of this decision on the interpretation of those rules, now would be a good time for any group or consortium that has invested in a joint venture where loss surrenders are important to review the commercial terms to see if any changes might be advisable.

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