Tax and the City Review

July 2019

The Upper Tribunal reverses the FTT's unhelpful decision in the *Development Securities* case providing comfort (at least for now) that a lot more is required than a subsidiary's acquiescence to the parent's will in order to attribute central management and control to the parent's jurisdiction. The Court of Appeal agrees with the High Court in *Minera Las Bambas* that tax is not 'payable' for tax indemnity purposes until the appeal against the tax assessment has been determined by the relevant court. The latest tax gap figures show a decrease over the past decade or so in the corporation tax gap, in part due to HMRC's approach to tax risk and cooperative compliance, as well as an abundance of measures to tackle non-compliance and aggressive tax planning. The FTT finds in favour of the taxpayer in *ANO (No.1) Limited* that the pre-entry loss rules in TCGA 1992 Sch 7A deny losses in specific circumstances only and do not have as broad a purpose as HMRC suggests.

Development Securities: corporate residence

The case of *Development Securities plc and others v HMRC* [2019] UKUT 169 (TCC) concerned a scheme to enhance capital losses through certain transactions undertaken by three companies (the JerseyCos), newly incorporated in Jersey as 100% subsidiaries of UK Plc. In order for the transactions to work as intended, it was essential that the JerseyCos were Jersey tax resident when they acquired certain assets at a price significantly in excess of their market value.

The First-tier Tribunal (FTT) concluded that the Jersey directors had abdicated their responsibility to UK Plc and that, therefore, the JerseyCos were UK tax resident at the crucial time. The FTT focussed on the uncommerciality of the acquisition undertaken in pursuance of a scheme propounded by UK Plc and the fact that the Jersey directors had essentially been hired to approve the acquisition and were replaced shortly thereafter.

The Upper Tribunal (UT), however, decided that this was incorrect as a matter of law and concluded, on the basis of the facts found by the FTT, that the JerseyCos were resident in Jersey at the relevant time. The UT criticised the FTT's basis for its decision as being untenable and wrong, resting on a fundamental misunderstanding of the nature of the transactions entered into by the JerseyCos and of the duties of the Jersey directors.

Wood v Holden [2006] STC 443 is of particular relevance to this case because *Wood v Holden* concerns the residence of 'special purpose vehicles' (SPVs) and demonstrates that the mere fact that a 100% owned subsidiary carries out the purpose for which it was set up, in accordance with the intentions, desires and instructions of its parent does not mean that central management and control vests in the parent. As Park J noted in *Wood v Holden*, SPVs are often brought into being for specific and short-term purposes. On this basis, the UT did not consider that the fact that the Jersey directors had a specific task entrusted to them by their parent, after which they were to resign, says anything about where central management and control vested.

The UT stressed that the FTT erroneously took the view (expressed on multiple occasions throughout its decision) that because the transactions were uncommercial, they had to be contrary to the interests of the Jerseycos. The UT described this as a *non sequitur* which undermines the entire decision of the FTT. The FTT focused on the uncommerciality of the transactions to the

individual Jerseycos without having regard to the actual duties the directors owed to those companies. The duties in this case principally involved consideration of the shareholders' interests (because the JerseyCos did not have any employees and the scheme did not prejudice creditors) and the transactions were beneficial to its parent, UK Plc. The Jerseycos were not themselves economically disadvantaged by acquiring assets at an overvalue, because the overpayment by the Jerseycos was not funded by them.

The welcome reversal by the UT of the FTT's decision provides comfort (at least for now) that a lot more is required than a subsidiary's acquiescence to the parent's will in order to attribute central management and control to the parent's jurisdiction.

Minera Las Bambas: interpretation of tax provisions in a share purchase agreement

The Court of Appeal in *Minera Las Bambas SA & Anor v Glencore Queensland Ltd & Ors* [2019] EWCA Civ 972, upheld the High Court's decision in all material respects. The case concerned a claim in respect of Peruvian VAT under a tax indemnity in a share purchase agreement (SPA) and covered a number of questions regarding the interpretation of tax provisions in an SPA.

An appeal had been made by the target company to the Peruvian tax court challenging the assessment to VAT. The main issue before the Court of Appeal was whether the VAT was 'payable' and the Court of Appeal agreed with the High Court that it was not 'payable' for tax indemnity purposes until the appeal against the tax assessment had been determined by the overseas court. Tax is 'payable' once the debt to the tax authority becomes 'coercively' enforceable which, in Peru, is only after the appeal is determined in favour of the tax authority.

Pre-payment of the disputed VAT could reduce penalties by 60% or 40% depending on the time of payment. The purchasers paid the VAT at a time when only the 40% reduction applied. Another issue, therefore, was whether, in the event that the VAT appeal is determined in favour of the tax authority and the VAT is payable, the sellers are able to rely on the limitation in the SPA for acts or omissions of the purchasers to reduce the sellers' liability in respect of penalties. The Court of Appeal agreed with the High Court that the sellers would not be liable for the difference between the 60% and 40% discount on the basis that the purchasers took a decision not to pay the contested VAT at the time when the greater discount was available. The extra cost accordingly represents a loss that would not have occurred but for an act or omission of the purchasers. The purchasers argued that this limitation should only apply where there is fault or culpability on the part of the purchasers. The Court of Appeal disagreed. The contract would need to spell this out expressly, it is not a qualification the court could read into a contractual clause concerned to allocate liability between 'sophisticated commercial entities advised by expert lawyers'.

The Court of Appeal followed the Supreme Court in *Wood v Capital Insurance Services Ltd* [2017] UKSC24 on how to interpret the relevant contractual provisions. The fact that the SPA was a detailed and professionally drafted contract meant that more emphasis is placed on textual analysis than where a contract is brief, informal and drafted without professional assistance.

It is important, therefore, to ensure that a tax indemnity contains clear, express provisions dealing with the timing of payments where payment of tax is deferred (whether automatically or by agreement with the relevant tax authority) pending resolution of a dispute and that any qualifications to limitations are expressly provided.

Tax gap and business risk review

The corporation tax gap has reduced from 12.5% in 2005 to 2006 to 8.1% in 2017 to 2018 according to the latest *Measuring tax gaps* report by HMRC. In

part, this is down to the extensive measures taken over the intervening years to tackle aggressive planning and non-compliance. It also reflects well on HMRC's approach to cooperative compliance and risk review. HMRC strives to use its resources efficiently which means identifying risk and dealing with it according to the level of risk. The Profit Diversion Compliance Facility is an example of HMRC working in new, innovative ways to deliver good outcomes for both HMRC and advisors in resolving risk areas without needing to go through lengthy investigations/enquiries.

The enhanced business risk review (BRR) pilot has been running well and will be rolled out from 1 October to all large business customers. The new BRR moves away from binary high/low risk to four categories of risk and wraps in measures such as the senior accounting officers regime and the bank code of conduct. HMRC hopes the new risk categories will influence boardroom discussions about tax risk.

ANO (No.1) Limited: purpose and scope of pre-entry loss rules

TCGA 1992 Sch 7A restricts the use of 'brought in losses' but not the use of losses against brought in gains. In *ANO (No. 1) Limited v HMRC [2019]* UKFTT 406 (TC), ANO was the head of a loss-making group. Another group, the O&H Group, had considerable chargeable gains and sought out a loss-making group to set off the losses against the gains. A series of transactions were structured as an acquisition by the loss group of the gains group with the intention that Sch 7A would not apply to restrict the pre-entry losses. The O&H shareholders, however, were worried about their group being acquired by a loss group and so the transactions involved the insertion of a new holding company, SSG, above ANO before SSG made the acquisition of O&H. SSG was wholly owned by the shareholders of the O&H group.

In order for the transactions to achieve the desired result, Sch 7A para 1(7) needed to apply to ensure that the group headed up by SSG was treated as the same as ANO's group. Otherwise the ANO group losses would be restricted by the pre-entry loss rules by para 1(6). The FTT agreed with the taxpayer that the conditions for para 1(7) to apply are satisfied.

One of the conditions to be satisfied is that immediately after becoming the new principal of the ANO group, SSG 'had assets consisting entirely, or almost entirely, of shares comprised in the issued share capital of [ANO]' (para 1(7)(b)(ii)).

HMRC had argued, on the basis of *Ramsay*, that para 1(7)(b)(ii) was not satisfied because, when looking at the assets of the new holding company, SSG, immediately after it acquired ANO, you must take into account the pre-ordained later step of the acquisition of the O&H group. The FTT concluded that 'immediately after' SSG acquired ANO, SSG had assets consisting almost entirely of the shares in ANO and nothing else. For these purposes, the FTT determined that 'immediately after' is synonymous with 'at the very moment after'. The FTT concluded that at least one purpose for the exemption from para 1(6) granted by para 1(7) is for situations where there will generally be planned and virtually certain further transactions in the shareholders and/or the assets of the new holding company after its acquisition.

This case is a good reminder of the purpose of Sch 7A and para 1(7). There is no tax avoidance test in Sch 7A and so the FTT could not do as HMRC argued and construe the legislation as having a purpose of restricting the use of losses whenever there is a scheme to use them. Sch 7A does not deny the use of A's losses against B's gains in all cases where A and B become members of the same group, but only where A is brought into B's group.

The FTT highlighted that the provisions operate at the level of the groups involved rather than at the level of their shareholders. The losses in this case were bought (in the form of ANO) by the shareholders of O&H and not by O&H. The legislation has no effect at that stage and the legislation evinces no intention to restrict the pre-

entry losses if thereafter, a loss-making group acquires a group with gains. The FTT saw no reason to regard para 1(7) as creating such a restriction because a 'clean' holding company is placed above the loss-making group prior to its acquisition of the group with gains. This is so even if that is part of a preordained series of transactions.

What to look out for:

- 11 July is the date for publication of the draft legislation for inclusion in Finance Bill 2020, together with explanatory notes, new consultations and responses to closed consultations.
- Draft regulations and guidance for the UK's implementation of EU mandatory disclosure regime were expected by the end of June but it is understood they are now expected by mid-July and may appear with the documents published on 11 July.
- The closing date for comments on the draft regulations on the offshore receipts relating to intangible property is 19 July.
- On 30 July, the Court of Appeal is due to hear the appeal in *R (on the application of Aozora GMAC Investment Ltd) v HMRC* on whether a statement made in HMRC's International Manual could constitute a 'relevant representation' in the context of an application for judicial review of a purported breach of legitimate expectation.

This article was first published in the 12 July 2019 edition of Tax Journal.

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